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MiFID II

Time to Prepare

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Ten Things You Should Know About MiFID II: A Quick Primer

By JOHN MORTON, financial regulation specialist, Bloomberg LP

The European Union's attempt at creating a single rulebook covering financial-market activities and services is slated to take effect on Jan. 3, 2018. The legislation replaces the decade-old Markets in Financial Instruments Directive, or MiFID. The new version combines the commitment by G-20 leaders to move derivatives trading on to electronic platforms with strengthened requirements for market probity and investor protection. What do you need to know? Here's a quick primer.

1 There are no boundaries, at least for securities. If a financial instrument is transacted on an EU trading venue, then its trading within the EU is governed by MiFID II – even U.S. Treasuries, if they're listed by a trading venue.

2 So what exactly is meant by a trading venue? Simple: It's a multilateral system where third-party buyers and sellers can trade. That includes regulated markets (RMs or, to most of us, exchanges), multilateral trading facilities (MTFs or nonexchange, nondiscretionary, rules-based execution platforms), and organized trading facilities (OTFs or discretionary venues).

3 Get familiar with "pretrade transparency." Firm prices in liquid securities have to be made public prior to execution if trade size is below a certain level. No other jurisdiction has tried this on such a scale before.

4 But what is liquid? Take bonds, for example. A bond that trades at least 15 times per day, at 100,000 euros ($106,000) or more per trade, on at least 80 percent of trading days is liquid.

5 Post-trade transparency. Every trade except those for the foreign exchange reserves portfolios of the European System of Central Banks will be made public. Think Trace, the U.S.'s bond-price reporting system, on steroids.

6 But is it fair? Before MiFID II, it was just possible that "fairness" may not have been the most important consideration when making a price to a customer in an over-the-counter or bespoke product. MiFID II now imposes an explicit requirement to consider the "fairness" of a proposed price using external market data on an ex-ante basis. Investment firms will also need to have sufficient records and documentation of this data as evidence of their monitoring of the performance of their best execution policy.

7 Speaking of which, MiFID II takes the original MiFID's requirement of performing all "reasonable steps" to provide best execution and changes it to all "sufficient steps." As we can see from No. 6, this isn't a matter of semantics. Firms will have to be far more systematic in obtaining the best-possible results for customers.

8 How much do regulators know about your trading? After MiFID II, a lot more. Record-keeping requirements will be strengthened. All trading and discussions will have to be undertaken via recordable means. The records have to be unalterable ("durable" in MiFID-speak) and produced at the request of a regulator for at least five years, sometimes seven.

9 Single authorization is key. Authorization by one of the national competent authorities (NCAs or EU member state regulators) enables a company or an authorized element of market infrastructure, such as Bloomberg's MTF, to operate throughout the 28 member states, a concept commonly referred to as "passporting." Ironically given Brexit, this brings Europe closer than ever to the U.K.'s vision of a single market for financial services.

10 If you think that MiFID II is over-the-top, then take a look at the original commission proposal and compare it with the outcome. Now consider that for MiFID III, the U.K. won't be playing a part in the negotiations.

This story was written by a Bloomberg LP employee involved in the selling of the Bloomberg Professional Service and then edited by the News Department. To suggest ideas or provide feedback, contact this story's editor: Ayesha Javed at ajaved10@bloomberg.net

Journey to Implementation

Oct. 1, 2011	MiFID II proposal
June 12, 2014	MiFID II/ MiFIR published in the Official Journal
July 2, 2014	MiFID II and MiFIR entered into force
Jan. 3, 2016	ESMA published and sent second set of technical standards to the European Commission
April 7, 2016	Commission adopts delegated act
January 3, 2017	Consultation on draft Regulatory Technical Standard ends
January 5, 2017	Consultation on product governance requirements ends
Feb. 20, 2017	Commodity derivatives data collection ends
March 31, 2017	ESMA issues consolidated tape scope standards; FCA publishes first policy statement
June 30, 2017	U.K. FCA to publish second policy paper
July 3, 2017	MiFID II transposed into national law of member states
Jan. 3, 2018	MiFID II and MiFIR apply within member states

Sources: Bloomberg, ESMA, FCA, Bovill

A Quick Word With David Geale, Director of Policy, FCA

Ayesha Javed interviewed David Geale of the U.K. Financial Conduct Authority by email on Feb. 27. The FCA must finalize changes to the MiFID II rules by July 3, 2017. The FCA published a policy paper in March and will publish an additional one in June. His comments have been edited and condensed.

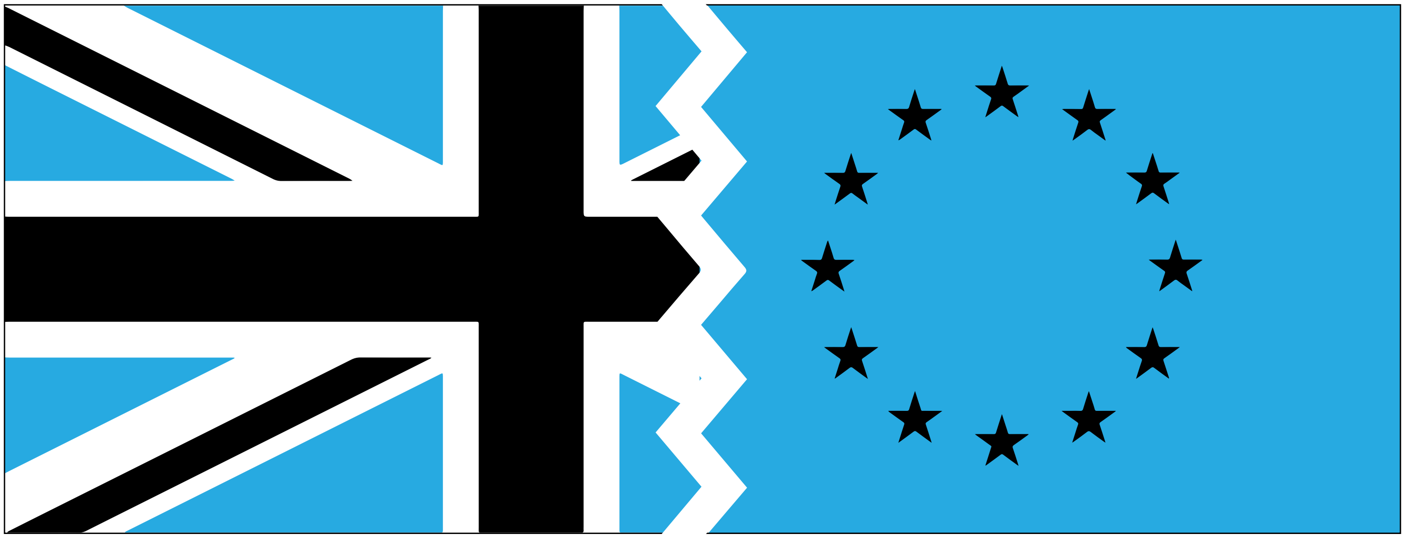
Q: How should U.K. firms be preparing for MiFID II?
A: Firms need to do two key things. First, ensure that they have the necessary permission and passports to conduct the business they want to conduct under MiFID II.

We published on Jan. 13 an application and notification guide to assist firms with this and have now opened our authorization gateway so that firms can apply for authorization or variations of permission linked to MiFID II. As set out in the guide, we are keen for firms to make applications on a timely basis so that we can process the applications and the firms are able to do the business they want to do from Jan. 3, 2018. Second, firms need to assess their current business, organization and systems against the new requirements in MiFID II.

On the basis of their analysis they are likely to have to make decisions about revising their business strategy, compliance procedures and IT systems in order to ensure that they are able to meet the commercial and compliance challenges that MiFID II presents. We would expect that firms already have this work well under way.

Q: Should their preparations be altered in anticipation of the U.K. leaving the European Union?
A: We have made clear that whilst the U.K. remains an EU member we will continue to implement EU legislation. The issue of what firms may do in response to the U.K.'s prospective exit from the EU is therefore separate from their need to comply with the MiFID II rules that will take effect here and in other EU member states from Jan. 3, 2018.

Q: Can U.K.-based firms expect the U.K. to have an equivalent regime once it leaves the EU?
A: This is for the government to answer.



The Unfinished Business of MiFID II: What to Watch in 2017

By JOE MCHALE, Bloomberg regulatory affairs specialist, EMEA

As firms try to chart a successful path out the other side of the MiFID II go-live date of Jan. 3, 2018, they should watch out for a number of key milestones in the coming months. There are still critical areas of uncertainty for which firms won't know what regulators really expect of them until later this year. Nonetheless, they should not expect any relief from regulators on the implementation timeline of MiFID II. We take a look at the issues that still need clarifying.

OTC Derivatives Trading

One of the key priorities of the European Securities and Markets Authority is to finalize the Regulatory Technical Standard to determine which over-the-counter derivatives should be subject to mandatory platform trading. Focus here will be on how consistent the U.S. and EU rules will be, and how liquidity and trans-Atlantic platform equivalence will be affected as a result. ESMA is expected to consult in the next few months and to finalize the RTS in the second half of 2017. The exact timing for implementation is still unclear as ESMA may take on-board calls for some phasing-in, and if it the final RTS is not determined sufficiently in advance of Jan. 3, 2018, firms might be requesting some extra leeway on this front.

Research

National regulators are also on the hook as member states have to put in place national implementing rules by July 3. Some of the best-known rules that European member states will interpret individually are those related to unbundling of research from execution. The rules will require investment managers to either pay for research out of their own pocket or via an identifiable charge to their clients. Of all national regulators, the U.K. Financial Conduct Authority has so far provided the most details on how it intends to frame its national rules on research and other areas. The remaining member states are now following suit as July quickly approaches. Firms should, in particular, watch out for the decisions of French and German regulators, which could diverge from the U.K. FCA's.

Guidance and Q&As

Even when ESMA and member states have finalized the rules they are mandated to develop, a lot more clarification and trouble-shooting is necessary. Realistically, the crucial task of giving firms more granular and concrete implementation guidance falls to ESMA. The volume of scenarios needing to be addressed is massive. While some clarifications have already been provided, ESMA is thought to be working on many other issues, including when an instrument is considered to trade on a trading venue – significant for the trading obligation, instrument identifiers, algorithmic trading and multilateral versus bilateral trading.

The Long Arm of MiFID II

On top of all of this, there is considerable uncertainty on the impact of MiFID II outside of Europe. Many non-EU firms are likely to find that they are asked to do business differently, and asked to provide new and additional information when facing an EU counterparty. Another crucial question is whether the EU will grant equivalence status to certain jurisdictions, and which ones. Absent this, EU firms won't be able to trade shares and derivatives covered by the trading obligation on venues outside the EU. It's also not clear which transparency rules if any will apply when the branch of an EU bank in a third country does business with a local client outside European working hours. Manifestly, the answers to many of these cross-border questions have key competitive implications for EU firms.

Even with these expected clarifications, firms should expect there will still be a significant level of uncertainty prior to the go-live date. It's probable that some voices in the market will call for a delay or some forbearance for certain requirements. But it would be unwise to bet on regulators pushing back the compliance date further.

If the recent example of the deadline for the requirements on variation margining for uncleared OTC derivatives trades is anything to go by, European regulators will correctly point out that they lack the legal powers to delay MiFID II. It remains to be seen whether and to what extent they will take a pragmatic and risk-based view when applying their supervisory powers post-implementation date, until things settle in. But it's safe to assume that they will take a very dim view of situations where firms cannot prove they genuinely undertook best efforts to comply.

This story was written by a Bloomberg LP employee involved in the selling of the Bloomberg Professional Service and then edited by the News Department. To suggest ideas or provide feedback, contact this story's editor: Ayesha Javed at ajaved10@bloomberg.net

Banks and Clients Tussle Over What It Will Cost to Read Analysts

By STEPHEN MORRIS, STEFANIA SPEZZATI and SILLA BRUSH

Just months before banks stop giving trading clients market research for free, they're still locked in discussions about how much to charge. As a European ban on bundling research with brokerage services looms, banks are sounding out asset managers and hedge funds on what they'd be prepared to pay. Money managers say they're getting quoted $50,000 for a basic package from JPMorgan Chase & Co.'s fixed-income analysts. But no firm is allowing itself to be pinned down quite yet. Deutsche Bank AG and Commerzbank AG are pitching a metered, "pay as you go" approach for smaller investors less able to swallow large, up-front subscriptions, according to three people familiar with the matter. For the largest hedge funds, all-inclusive packages are on offer, with perks such as VIP analyst access, conference discounts and unlimited research notes. "We are still waiting for banks to say definitively how much and what you get for certain prices," said Richard Benson, a London-based managing director and co-head of portfolio investment at Millennium Global Investments Ltd., which oversees $14 billion. Quotes "range from very low to the hundreds of thousands, but I doubt we'll have clarity this side of the summer break." He declined to comment on pricing from specific institutions.

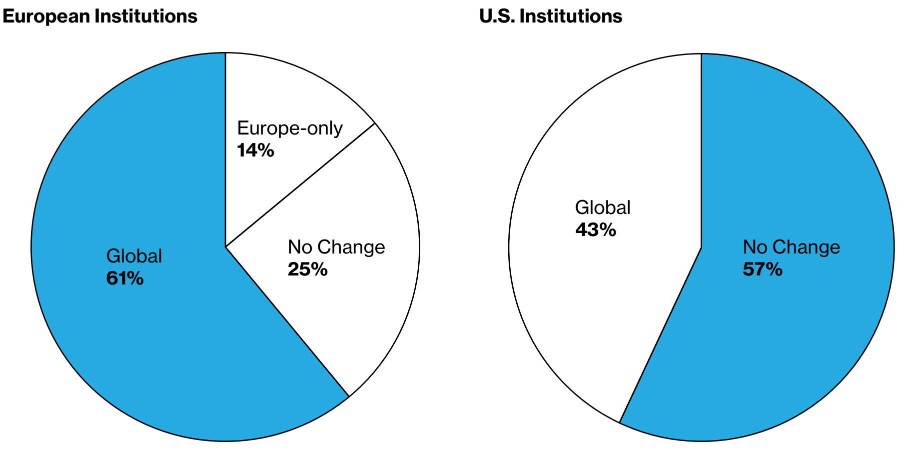
Cost Scrutiny

Charge too little and regulators might accuse you of gaming the system, while getting the pricing wrong could alienate key customers and drive their trading business elsewhere. The squeeze in margins has been so severe in stock and bond dealing that it's already led to the loss of about 11,500 sales, trading and research jobs over the past six years, according to data from Coalition Development Ltd. Active asset managers, in their struggle to compete against cheaper passive strategies, are paring back on costs including research.

The European Union's MiFID II regulations, enforced from Jan. 3, aim to tackle conflicts of interest by requiring asset managers to separate the trading commissions they pay from investment-research fees. Regulators are concerned investors that generate huge commissions may route business to traders at their favorite analysts' firms in exchange for privileged access to the best ideas, even if they aren't getting the best deal for their funds' clients. The U.K. Financial Conduct Authority and the European Securities and Markets Authority also say a lack of transparency means investors can overspend on research with impunity.

Integrity Research, a U.S. consultancy, estimates investment banks currently effectively charge clients $75,000 a year on average for access to their analysts' publications, based on its own extrapolations from banks' pricing systems and a poll of about 70 firms. Among boutique research-only houses, U.S.-based Moffett Nathanson LLC, which focuses on telecom and media, commands annual subscriptions of $100,000, and more for phone access to analysts, according to three people with knowledge of its pricing structure.

Planning Changes to Research Evaluation Process



Note: Based on 57 U.S.-based respondents and 42 European-based respondents;
Source: Greenwich Associates 2016 MiFID II Unbundling and Research Budgeting Study

That's the kind of expense investors may balk at paying. The introduction of MiFID-related fees means asset managers in Europe and the U.S. will cut more than $300 million in spending on external research, consulting firm Greenwich Associates estimated in a recent survey.

"MiFID II is supposed to level the playing field and help the smaller investors, but it's having the opposite effect, because we can't afford to pay as much as the larger firms," said Mark Holman, chief executive officer at TwentyFour Asset Management LLP in London, which oversees about 5 billion pounds ($6.4 billion) of fixed-income assets.

While MiFID II rules apply to just the 28-nation bloc, U.S. asset managers with substantial business in the U.K. and Europe are also preparing for the changes and are choosing to adopt global standards. About 43 percent of U.S. respondents to the Greenwich survey plan to make global changes to their research practices, while the rest will wait to determine the effect of the EU regulations.

The survey also found that firms will be slow to switch how they pay for research. The law allows asset managers to pay for research either by hard payments from their own profits or losses, or through separate client research payment accounts, according to Greenwich. Most European managers said they expect over five years to pay for research primarily with hard payments, which would be a significant shift from current practice.

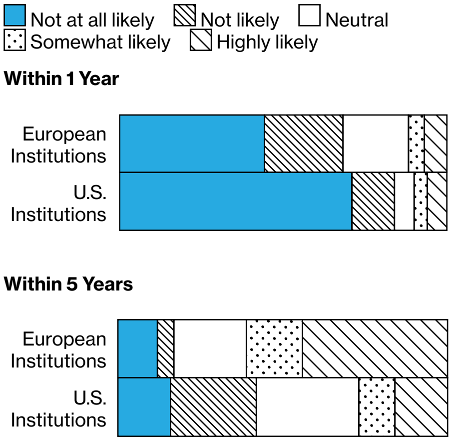
U.S. Divergence

Still, the U.S. has no plans to introduce a similar fee-based system. Some traders and investors have said this could lead to firms moving some operations across the Atlantic in order to circumvent the EU rules.

A spokesman for the U.K. FCA said the agency hasn't put any guidance out on pricing research, nor has ESMA. Banks' research teams and large investors in talks with these regulators concur, saying they've received no indication of acceptable prices.

Given the wide divergence of preliminary quotes, money managers are finding it difficult to budget for next year, one manager at a hedge fund said. This person has been pitched prices for equity research ranging from $50,000 a year to more than $100,000.

Likelihood of a Switch to Hard Payments



Note: Based on 57 U.S.-based respondents and 42 European-based respondents;
Source: Greenwich Associates 2016 MiFID II Unbundling and Research Budgeting Study

German Banks

Among the differing approaches to pricing, Deutsche Bank has long had a monitoring system tracking how many people from a client firm are logging in and how much they are reading. As it refines this system, the bank is coming up with a base user charge and is meeting clients to hammer out pricing. One medium-sized London-based investor said they were quoted 60,000 euros ($64,400) for a year's entry-level fixed-income services from the German lender, but was told this price is not set in stone.

Most clients will pay more than this, according to a separate person familiar with the bank's strategy.

Commerzbank isn't proposing a price yet, but is outlining what a tiered system might look like, according to marketing documents seen by Bloomberg News. Fixed-income, currency, commodity and macro subscriptions will come in "pay as you go," "select" and "all-in" levels, the document shows. The select option allows clients to pay for specific asset classes, such as emerging markets; the "all-in" option charges a flat fee for unlimited research as well as access to any analyst.

For equity research, the German lender will introduce silver, gold and platinum memberships with language similar to mobile-phone contracts, describing them as, respectively, pay-as-you-go, prepaid-card and flat-rate, the presentation shows. Platinum includes "VIP" and analyst access, and discounts on conferences and the bank's measure of its time spent on clients, known as "research service units."

Almost all banks are stressing they'd prefer to continue charging nothing and are leaving all fees open to negotiation, while keeping a close eye on their competitors, investors say.

JPMorgan

JPMorgan, the biggest U.S. bank, has been floating $50,000 for a basic fixed-income research option, with prices increasing for more tailored packages and better access to analysts, according to two people who spoke in condition of anonymity. Both banks have stressed prices are yet to be finalized.

One senior manager at one of the largest European asset managers said JPMorgan's move to price at the cheaper end of the scale was an attempt to win market share from rivals. The executive said the big investment banks were pricing fixed-income research packages around $250,000, but one European bank had proposed charging nothing for two years as an introductory offer, only to be batted down by EU regulators. Another asset manager has been quoted about $600,000 for credit research.

JPMorgan, Commerzbank and Deutsche Bank spokesmen declined to comment.

Firms pitching lower prices include Berenberg, the Hamburg-based broker traditionally known for its research. Managers there have been asking their fixed-income clients what they think of paying about 20,000 euros a year, one of the people said. "All the banks are speaking to clients about MiFID at the moment," Berenberg spokesman Karsten Wehmeier said. "We can't comment on any figures."

Ben Kumar of Seven Investment Management lamented the end of free analysis, saying it was useful to compare the big banks' take on a company with the boutique research his firm paid for.

"Access on demand is great," said Kumar, a London-based money manager whose firm oversees about 10 billion pounds. "I might not need it one month, then spend the next devouring whatever I can find on Vietnam as an investment opportunity. It's tough for a bank to price that."

COMMENTARY

MiFID II Will Have Far-Reaching Consequences

By MARK CROXON, head of regulatory and market structure strategy for EMEA, and GARY STONE, market structure strategist, Bloomberg LP

Across the globe, buy side and sell side firms that do business with European counterparties affected by MiFID II are beginning to realize that the directive will impact them too — and, in some cases, dramatically.

While European regulators don't have direct influence on firms domiciled outside of the EU, the new rules will put indirect pressure on non-EU domiciled firms.

European firms may, in order to be MiFID II compliant, demand additional disclosures and reports from their non-EU counterparts. In some cases, they may even require changes in the way non-EU firms conduct their business. In essence, EU regulations will require that EU firms exert influence over non-EU firms.

EU firms must grapple with approximately 11 areas of change, from transparency reporting to demonstrating best execution to archiving communications. Some obligations could extend beyond EU shores: for example, the use of dealing commissions for research payments, the trading mandate for shares and derivatives, transaction reporting, best execution and surveillance.

If we take the example of the U.S., asset managers typically either invest money from, or with, an EU-based asset manager or send orders to an EU broker. Conversely, U.S. brokers execute trades on behalf EU asset managers. Understanding the perspectives of their EU counterparts will be essential for U.S. firms to make sure they can meet the requirements of their clients and continue to do business with them when MiFID II comes into force.

Meanwhile, non-EU brokers will face two particularly complex cases, one relates to the unbundling of research payments from dealing commissions, the other to the trading mandate.

Although the final shape of the research requirements remains very fluid, their impact could be dramatic. The U.K. Financial Conduct Authority's proposed implementation of the research payment account mechanism may pose a compliance challenge for firms subject to U.S. regulations.

U.S. brokers, for example, can only provide research as a service associated with execution. In order to comply with the Research Payment Account and take a direct payment for research, they could register as investment advisers. But that isn't a no-brainer. Registered investment adviser status would change their business models by precluding much of their trading activity. So the U.S. manager unbundling isn't possible. Brokers who provide research to asset managers in the U.K. will be impacted. The French AMF, on the other hand, took a more permissive approach in its equity market guidance, and suggested MiFID II compliance could be achieved through an enhanced commission-sharing agreements regime. That appears to be similar to today's current practices and more compatible with U.S. regulation.

> The new rules will put indirect pressure on non-EU domiciled firms.

It also gets a little complicated if you're a non-EU broker and you receive orders from your EU customers in stocks with international securities identification numbers (ISINs) that have been listed or traded in the EU.

Under Article 23 of Markets in Financial Instruments Regulation, the EU client must then execute on an EU trading venue, a systematic internalizer or an equivalent non-EU venue.

Unless the EU regulators recognize the U.S. as a MiFID II-equivalent market, an EU-based client can only trade the stock on an EU trading venue. EU-based customers will not be able to send such orders to their U.S. broker for execution. In any case, if the EU market is illiquid, the trade might not comply with EU best execution and investor protection requirements, placing the counterparts in an impossible situation.

For stocks that can only trade in the U.S., there is no change to the EU buy side's workflow. However, under MiFID II, an EU asset manager may ask its U.S. broker to obtain a legal entity identifier so that it can be identified on its transaction reports.

Non-EU asset managers will face a series of other challenges too. When an EU firm invests in a U.S. asset manager for example, MiFID II's investor protection and best execution rules will probably lead the EU firm to monitor the quality of execution of the U.S. manager. Consequently, the EU-based firm may ask the U.S. manager to have an order execution policy describing how it takes what the European Securities and Markets Authority calls "all sufficient steps" to obtain the best possible result for its clients. The broker may also have to produce reports to prove it is following this order execution policy. Our interpretation of "all sufficient steps" includes conducting systematic, automated analysis of transaction costs.

There are numerous other scenarios in which non-EU firms will have to change their practices when doing business with their EU clients. We call it the long arm of MiFID II.

This story was written by a Bloomberg LP employee involved in the selling of the Bloomberg Professional Service and then edited by the News Department. To suggest ideas or provide feedback, contact this story's editor: Ayesha Javed at ajaved10@bloomberg.net

U.K. Firms Considering Moving Operations Should 'Think Carefully'

Ayesha Javed interviewed Michael Thomas, a London-based partner at international law firm Hogan Lovells, on Feb. 1. Comments have been edited and condensed.

Q: How should non-EU domiciled firms be preparing for MiFID II?
A: Generally, there's a need to keep an eye on the documentation coming out of ESMA in relation to level- three guidance on interpretation of the MiFID requirements. And on the policies of individual member states as to how they're going to apply, for example, their own regulatory perimeter. MiFID II does create some new mechanisms for permitting third-country access to EU markets, but firms still need to take account of the local regulatory perimeter in each jurisdiction which isn't restricted by MiFID II.

Q: Can you give any examples?
A: Some types of firms – like market infrastructure or trading platforms – may need to regard some of the requirements under MiFID II that impose restrictions on EU investment firms as to where they can execute their transactions, so requiring execution on an EU market or an equivalent third-country market. If a third-country market isn't assessed as equivalent, then that has an impact on the EU firms' ability to use them.

Q: What potential costs are involved?
A: The main costs for third countries is going to be assessing what is and is not permissible for their particular activities in order to provide services into Europe. For some types of firms, there may well be changes to the products that they can offer.

If a firm is providing investment research bundled with investment services, then MiFID is going to impose restrictions against how those services can be charged for, splitting up the payments for the research from the other dealing services. If a firm is currently accessing the EU markets, they need to look at what activities they are undertaking. Is it going to change the way in which the firms, or platforms with which they are dealing, are required to operate within the EU? If so, then that may have knock-on costs and operational changes for them. Secondly, if local regulators decide to take a different policy in terms of access provided to third-party firms, whether narrowing or expanding, for example overseas persons exemptions, then they'll need to consider that.

Also, if there's a possibility that the new third-country regimes under MiFID II might expand the potential to perform services in the EU, that actually presents an opportunity for them. But that is really dependent on what approach the EU takes to implementing those third country regimes and conducting those equivalence assessments.

Q: Is there potential for regulatory arbitrage for firms that choose less onerous but equivalent regimes?
A: We don't yet know how ESMA and the commission are going to approach the assessment of equivalence for the purposes of MiFID II. They haven't expressly stated how they're going to go about doing that.

You also have to bear in mind that even under the European Market Infrastructure Regulation regime, there have been rumblings from ESMA that they may have been a bit too generous in relation to the framing of the equivalence regime and a change of policy may be required going forward. That could be a concern that ESMA carries forward to the implementation of the MiFID II equivalence regimes. If there is this hardening of policy about equivalence then you might see a more robust, harder line about ensuring – not just outcomes – but also substantial requirements that are equivalent to those that are applied in the EU. That might reduce the scope for regulatory arbitrage but in the absence of that, there is theoretically a potential for third-country arbitrage.

Q: Is Brexit affecting U.K. firms' plans?
A: It does affect how firms plan for the future. The expectation would be that when we leave the EU that we would continue to apply the MiFID II rules, presumably incorporating them by reference into our law or just rewriting them in our law but that hasn't been confirmed for certain yet. The regulators have said there's going to be no bonfire of regulations. I expect that over time we [the U.K.] could diverge, particularly if the EU diverges to a different regulatory philosophy than has been the case whilst we've been party to the EU. Of course, we've had a very significant influence over the framing of EU law and financial service field. If they start to take a more prescriptive or perhaps protectionist policy then it's possible that the U.K. may not update its own laws to take account of that.

Firms still have to get ready for MiFID II. You can't get away from that. It's coming into force before Brexit occurs and we're likely to apply it after Brexit.

Firms that have passports into Europe and want to service European clients need to think about structural options. If it really is going to be a two-year negotiation period, then that doesn't give a lot of comfort that any structural changes can be put in place in that period time. Some firms are actively thinking about implementing the initial stages of their restructuring plans imminently.

Q: What contingency plans are in place?
A: Firms are looking at different jurisdictions and whether they may need to set up operations there, set up new regulated entities in order to preserve their ability to access clients or markets in the EU, within the single market. But firms do need to think carefully about what is appropriate and whether a wholesale move is necessarily appropriate, given that it may well be possible to move some operations to a new EU-regulated entity or an existing EU-based operation that they may have and outsource back to London for a large part of the staff.

Bank Research Rules Open Door to Match.com for Investors, CEOs

By SILLA BRUSH and TRISTA KELLEY

A group of upstarts is seizing on new European Union rules to shake up banks' matchmaking role between investors and corporate executives. As investors prepare for EU regulations that will force them to pay for research products a la carte, one of the most valuable services is corporate access — the conferences, roadshows and face time with executives that can provide an information edge.

New Opportunities

Investors globally spend more than $2 billion a year for corporate access, according to consulting firm Greenwich Associates. That spending was typically baked in to trading commissions paid to a bank.

Making it a separately priced service provides a big opportunity for people like Adrian Rusling, founder of a site that counts executives at BlackRock Inc., Credit Suisse Group AG and FedEx Corp. among its users.

"It's like Match.com," said Rusling, who started CorporateAccessNetwork in 2013 as an offshoot of a investor-relations firm based near Brussels. "Instead of boys meeting girls, it's companies trying to meet investors. We thought, 'Let's democratize this industry a bit and open it up a bit more.'"

Planning for Europe's MiFID II rules, which take effect in January, has driven a 50 percent surge in daily user requests so far this year, Rusling said. The firm isn't alone. WeConvene and ingage are also among independent players vying for a bigger slice of the fees. The scale is tiny – Rusling says banks probably dominate about 95 percent of the market – but competition is heating up as funds move to slash costs and as bank research desks shrink.

While corporate access has long been the subject of scrutiny over whether it gives some investors an unfair edge, it's seen as a useful way for executives to explain their strategy and for asset managers to get a better sense of a company than filings can provide. The stakes are high: Rusling estimates that a one-on-one meeting with a big name CEO could be worth as much as $20,000.

Active Traders

The startups are seizing on the potential conflicts of interest in setting up meetings that have led regulators to change the rules. Because it was funded by trading fees, banks often provided the best corporate access to clients that were the most active, rather than those who might be the best long-term investors for a company, regulators have said.

That critique has rung true with some corporations. Jeff Smith, who works in investor relations at FedEx, said that while he often taps Wall Street research desks to reach investors, there can be a downside.

"There's certain buy-siders they do business with and some they don't, and at times they're reticent to invite people they don't already have a customer agreement with," Smith said. He said that's one of the reasons he's a client of CorporateAccessNetwork.

"More and more buy-side firms are going to approach corporates directly," said says Michael Hufton, managing director of access ingage. "We'll see this activity morph away from sell side to other channels."

2017 Surge

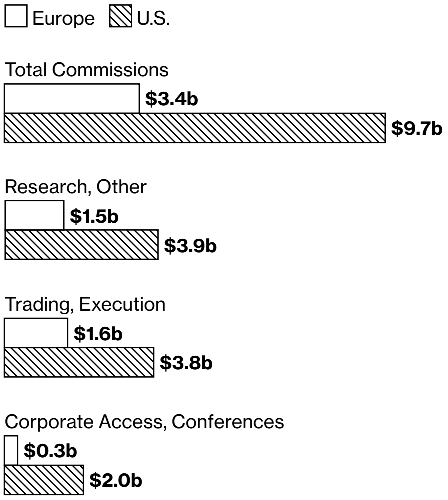
Hufton says MiFID II is a big driver for business and that ingage has had more sales so far in 2017 than it did all last year. It charges a subscription to access the system, which offers direct contact between companies and investors. CorporateAccessNetwork says it charges companies 100 euros ($108) a month to use a premium version of its web-based platform to set up meetings. WeConvene, which owns broker ranking service Extel Surveys, also offers a product that uses technology to help make the process of corporate access and analyst events more efficient. WeConvene has a partnership with Bloomberg LP, the parent company of Bloomberg News.

The new rules will allow the startups a fresh chance to make their pitch: that they can provide the investors who companies want to meet.

"I can trust that he's going to reach out to not only the fast-money hedge funds, which typically pay a lot of commissions, but also the holders FedEx would prefer: long-term holders," Smith said. "We have always used a mix of methods to get our message out to investors. There's more than one way to skin a cat."

Access to Executives

Equity trading commissions*



*One-year data as of 2016; Source: Greenwich Associates

FCA and AMF at Loggerheads on Investment Research as U.S. Firms Face Conflict

By SARAH JANE MAHMUD, Bloomberg Intelligence analyst

INVESTMENT FIRMS IN the EU should soon gain clarity on how the MiFID II research rule will work. The EU securities regulator is due to issue level 3 guidance, which should iron out the dispute that's arisen between the U.K.'s Financial Conduct Authority and France's Autorite des Marches.

The EU's MiFID II reform will require investment research to be paid for in one of two ways: from a fund manager's own account, which may be recoverable by raising fees, or via a client research-payment account.

The FCA and AMF have interpreted the EU rule differently and will likely implement contradictory rules, increasing divergence across the EU, undermining MiFID II and raising the risk of regulatory arbitrage.

While regulators will permit research charges to be collected with transaction commissions, subject to stringent conditions, there should be no link to transaction value or volume. The move to an unbundled model will limit the long-held use of commissions, and may disrupt the industry globally.

The U.K. and 27 other EU nations must integrate MiFID II by July 3. The AMF is now working with ESMA to develop EU-wide guidance and it will issue a local guide to help the French market.

Meanwhile, the commission is assessing the impact on SME research as part of its Capital Markets Union agenda.

French investment firms are likely to end up subject to less stringent research-unbundling restrictions than their U.K. peers. The AMF, the first national regulator to give guidance, interprets the EU MiFID II rule with leniency. It views commission-sharing models broadly compatible with MiFID II, subject to some changes, and indicates brokers may provide basic corporate access on a bundled basis. German regulator BaFin is expected to support the AMF's view, in line with prior negotiations.

The AMF won't embellish the rule, and wants it copied into EU countries' national law to prevent non-literal integration. This may sway other EU countries to adopt the AMF's approach, putting pressure on the U.K. FCA to follow suit. Without EU securities regulator ESMA intervening, this is unlikely.

Investment firms in the U.K. can expect stricter research-commission rules than their peers on the continent as the Financial Conduct Authority gears up to go further than the EU MiFID II rule.

While France views commission-sharing models as generally compatible, the U.K. specifies many more process and legal enhancements. The FCA also expects managers to have mechanisms in place to block unsolicited research and would continue to ban brokers from providing corporate access as part of a bundled service.

Companies can expect sanctions for non-compliance. In its March 3 review of dealing-commission expenditure, the FCA concludes many firms don't meet expectations – they're not compliant with rules in force since 2006 – and indicates it will increase focus in this area, taking action where appropriate.

Third Countries

Regulators outside the EU haven't yet issued proposals to separate research payments from dealing commissions.

Without international convergence, EU companies may become less competitive than overseas peers. Global companies could roll out an EU-compliant system on a worldwide basis, subject to local laws, to minimize operational strain, especially as non-EU brokers will be bound by MiFID II when providing execution and research services to EU managers. This may encourage non-EU regulators to adopt the EU approach.

The rule won't apply to investment managers that don't have a presence in the EU. The delegated directive would permit U.S. managers to continue paying brokers, including those in the EU, for research on a bundled basis, subject to compliance with local rules.

U.S. broker-dealers may also be subject to onerous new obligations if they invoice EU asset managers for research because they would be categorized as investment advisers. This means their fiduciary duty to clients would clash with their duty to act as executing broker. Under U.S. law, broker research is part of the transaction-execution service. Non-commissioned sell-side research – known as hard-dollar research – is tantamount to investment advice. The law implies they can't be both broker-dealer and investment adviser to an asset manager.

The U.K FCA's "omnibus" account idea breaks the commission-research link, compared with France's AMF, which seeks to preserve the commission-sharing model.

Global managers that might want to pay for research directly (in hard dollars) are in discussions with U.S regulators to resolve the conflict.

Bloomberg LP competes in the financial industry by providing research and broker-dealer services.

MiFID II to Impact Research Beyond EU, May Halve Manager's Margins, Studies Show

By AYESHA JAVED and TRISTA KELLEY

Eighty-two percent of asset managers plan to fully unbundle their brokers globally ahead of MiFID II, a survey of more than 100 funds in the U.S. and Canada, published Jan. 5, found. The poll, conducted by broking firm Investment Technology Group Inc. found that only 43 percent of North American asset managers expect the rules will directly affect them. Still, most are adapting to the coming regulations, the company said in a statement. Under the European law, asset managers will be required to separate, or "unbundle," trading commissions from investment-research payments. Some 59 percent of those surveyed said they plan to continue paying for research using commission-sharing arrangements (CSA), while 33 percent expect to use a combination of both commission-sharing and research-payment accounts (RPA). The poll found 8 percent plan to set up a new research payment account ahead of the MiFID II start date.

Operating Costs

A separate research report looked at the impact MiFID II could have on fund managers' margins. MiFID II is expected to drive further contraction in investment research coverage, according to white paper "The Future of Equity Research" from Bloomberg Intelligence, research company Edison and research procurement consultancy Frost Consulting.

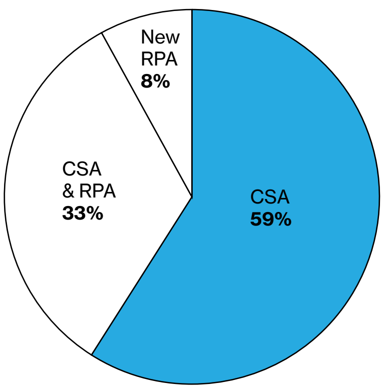
Under MiFID II rules, due to be implemented in 2018, asset managers must fund external research from their own profit and loss accounts or by using research payment accounts in an effort to separate research costs from dealing commissions. Many fund managers previously received the research from banks' analyst desks as part of a bundled service.

Consolidation in buy-side research is expected to continue as firms shift toward producing research inputs in house, due to investor pressure to bring research spending onto the balance sheet rather than charging clients, according to the report, which was published on Oct. 10. Still, asset managers' margins would almost halve if they absorbed the cost of investment research, from 30 percent to 16 percent, according to estimates by Frost Consulting.

Wealth Managers Unprepared

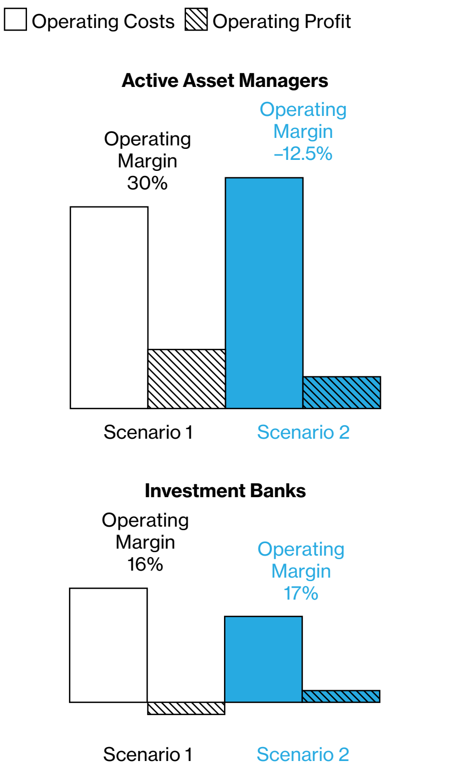
Meanwhile, research by consultancy Bovill published on March 30 found that wealth managers face five years worth of work to comply with MiFID II. On average, wealth management firms surveyed by Bovill expected they would need 1,363 days, or 10,904 working hours, to meet each requirement of MiFID II – five times the number of available working hours in a year.

Most North American Firms Plan to Unbundle



Source: ITG Survey

Margins Could Be Squeezed



Note: Scenario 1: Current estimate; Scenario 2: Asset managers absorb $5 billion of investment bank research costs;
Source: Frost Consulting Estimates

Derivatives Relief Could Be on the Horizon for Banks

By SILLA BRUSH

BANKS AND ASSET managers have pushed for more than a year to have many of their derivatives exempted from new European Union trading rules the industry says would send costs spiraling. Now they're on the verge of success.

The European Securities and Markets Authority has relaxed its proposal for determining when many common types of transactions must occur on trading platforms under new pre-trade transparency requirements that are expected to increase competition among dealers. ESMA, the EU's chief markets regulator, adopted a "more cautious approach" after industry groups said an earlier proposal was too far-reaching.

In draft rules published on Feb. 28, ESMA narrowed the criteria for when so-called package transactions, which could account for more than half of the market in interest-rate swaps and other types of derivatives, are considered liquid enough that they must meet the MiFID II rules that take effect on Jan. 3.

The draft standards "include some important improvements" and will allow the trades to continue to be an "efficient and cost-effective way of managing risk," Roger Cogan, head of European public policy at the International Swaps and Derivatives Association, said on March 1. "If the pre-trade transparency regime is applied to illiquid packages, it would result in greater execution risk and higher costs."

ISDA represents JPMorgan Chase & Co., Barclays Plc, Pacific Investment Management Co. and other major traders in the $544 trillion swaps market.

The move shows how regulators and the industry continue to debate intricate details in the regulatory rule book that will go a long way toward determining the power of restrictions written in response to the 2008 financial crisis. The law was originally intended to close loopholes that policy makers said allowed many trades to escape regulatory scrutiny.

The law increases pre-trade transparency by requiring trading platforms to make public bids and offers for many stocks, bonds and derivatives. That level of information about package trades could increase competition between banks and affect prices, ESMA said. However, it could also discourage banks from participating on platforms because the extra transparency could affect their own ability to hedge risks they take on by doing the deals, according to the regulator.

Lawmakers amended the law last year to grant an exemption for certain package transactions, which include two or more linked contracts that firms use to hedge or speculate on the price of an interest rate or other asset. ESMA's regulation further defines which packages will get the waiver. Package trades can take various forms, and can include swaps, futures, bonds and other contracts.

The new standard is a "welcoming and noticeable change" and responded to industry concerns that there was scant time to develop the rules and little comprehensive data about the market, said Dan Marcus, global head of strategy and business development at Cie. Financiere Tradition SA.

"Overall, a balance has been achieved between agreeing a set of rules and standards that are both comprehensive and practically applicable," Marcus said. Tradition is one of the world's largest inter-dealer brokers and operates trading platforms for derivatives and other assets.

In its final draft, ESMA said the revised standard "narrows down considerably the universe of package orders that qualify as having a liquid market as a whole."

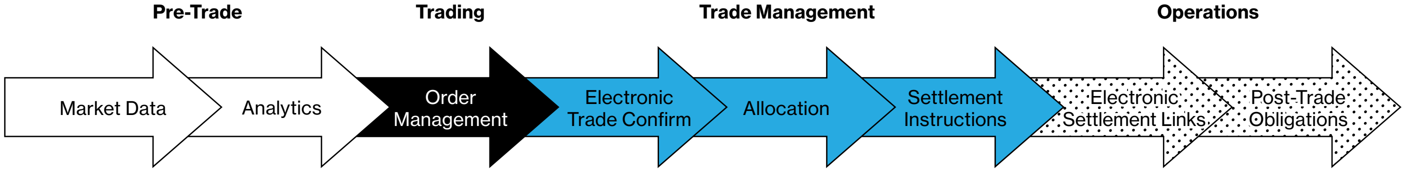
As a result, major portions of the derivatives market may not need to meet the pre-trade requirements. While ESMA gave no estimate of its own, one large broker said that almost 80 percent of volume in interest-rate derivatives is executed through package orders. A trading venue said 34 percent of its volume in interest rate trades and 48 percent in equity derivatives are executed as packages. ESMA didn't name the firms.

The Wholesale Market Brokers' Association, which represents inter-dealer brokers and trading platforms including BGC Partners and Tullett Prebon Ltd., said its members arrange about two-thirds of their business in the form of packages of trades.

Under the proposal, packages that have more than four components aren't considered liquid. The transactions can sometimes have as many as 20 components. In addition, invoice spreads, a common type of trade, would be exempted. While ESMA said some cross-asset trades – such as packages with an interest rate and a sovereign bond – are probably liquid, the regulator excluded them at the moment in favor of a cautious approach to the question.

ESMA sent its proposals to the European Commission, the EU's executive arm, for endorsement. A commission spokeswoman declined to comment on the draft.

The Life Cycle of an Investment



Source: Bloomberg

Litany of Limits on Tap for High-Frequency Traders With MiFID II

By SARAH JANE MAHMUD, Bloomberg Intelligence analyst

ALGORITHMIC AND HIGH-FREQUENCY traders face a wave of new rules under the incoming MiFID II regulation. Traders, and the venues they trade in, face stringent and costly risk controls starting Jan. 3, 2018. MiFID II may make markets more safe, especially for traditional investors. But the cost of meeting new obligations could lead to a growth in vanilla algorithms, cause smaller companies to withdraw, and limit trading volume in the short-term.

With Brexit on the horizon, the U.K. must follow EU law until it leaves the bloc, which is unlikely until the first quarter of 2019. The U.K.'s Prudential Regulation Authority and Financial Conduct Authority, along with other national securities regulators in the bloc, must integrate the new rules into local law by July 3, 2017.

After five years of deliberation, EU lawmakers have confirmed their MiFID II definition of high-frequency trading. The European Commission's April 25 delegated regulation, approved by the EU Council and Parliament, sets out a three-step test to deduce if a firm engages in high frequency trading, a subset of algorithmic trading. Those using algorithms that don't meet the criteria will still need to abide by MiFID II rules for algo traders, but these are less burdensome.

Algorithmic and high-frequency trading rules will include order-to-trade ratios, minimum tick sizes as well as disclosure and testing of trading algorithms. EU regulators don't want to prohibit or restrict such trading – MiFID II notes the virtues of trading technology such as boosting liquidity. They want to regulate the raft of potential risks that may lead to disorderly markets, and clamp down on abuses.

Rules on algorithmic and high-frequency trading will take final shape in the first half of 2017 as each EU country integrates the overarching MiFID II Directive into local law. The U.K. Prudential Regulation Authority published final rules on Oct. 24, embellishing the basics by, for example, requiring greater record-keeping granularity. EU regulatory technical standards known as RTS 6 and 7 were agreed upon in the fourth quarter of 2016 in the form of a regulation – so they will apply directly and concurrently in all EU countries when MiFID II takes effect.

Impact on Trading Activities

Fewer algorithmic traders will fall subject to MiFID II's mandatory market-making obligation than initially anticipated. Those trading on their own account, carrying out market-making activities for at least 50 percent of the trading day versus 30 percent under prior proposals, will need to enter into a market-making agreement with venues where they trade. Among other things, they must continue quoting for at least half the daily trading hours. This would ensure they remain in the market during periods of volatility. Mid- to small-sized traders may limit their activities to fall under the threshold, impairing liquidity.

The volume of change MiFID II demands presents challenges for many companies, especially smaller ones and those not yet registered, and those with a client base who would need to comply with extra investor-protection rules. Companies also risk losing their competitive edge if they're forced to disclose proprietary data, which may lead to a growth in vanilla algorithms. Yet, the rules aren't likely to threaten established electronic market-making firms already compliant with multi-jurisdictional rules.

Traditional investors, such as asset managers, insurers and pension funds, may find it easier to trade large orders as a result of MiFID II controls over algorithmic and high-frequency traders. The growth in such trading, they has led to them becoming vulnerable to predatory behavior-seeking algorithms that front-run their market orders. This has swayed them to trade in dark pools, though these too are alleged to have been infiltrated by high-frequency traders and are set to be curtailed by MiFID II rules.

24%

The portion of trading, by value, that is high-frequency in Europe, based on an a direct approach measure, according to an ESMA report published in 2014.

How MiFID II Defines High-Frequency Trading

Infrastructure to minimize latencies including:		No human intervention in:		High message intraday rates:*
Co-location OR Proximity OR High-speed direct electronic access	+	Inititation OR Generation OR Routing or execution	+	2+ messages per second per instrument traded on a trading venue OR 4+ messages per second for all financial instruments traded on a trading venue

*Which constitutes orders, quotes or cancellations;
Source: European Commission (Art. 4(1)(4) MiFID and Art. 19 Delegated Regulation)

Client Relationships Under Scrutiny in Unbundling Environment

Compiled by AINSLIE CHANDLER

The implications of the research unbundling on asset managers and their clients are far reaching and remain unclear as the deadline for the commencement of MiFID II requirements approaches. Here is a selection of comments from advisers and others involved in the sector from an event held at Bloomberg LP's New York headquarters on April 6. Comments have been edited and condensed.

Jay Bennett Jr., Managing Director at Greenwich Associates

"From a U.S. perspective, there are a couple of quick elements to note. When we talk to the traders out there, they say 55 to 60 percent of the spend is to pay for research advisory. So it's a big deal. The portfolio manager and analysts value it. It's not an incidental expense. Number two, we tend to use the mining analogy to define what research is. You know there is something precious out there; you've got to dig to find it. It's not always certain and the value changes over time. That's really hard on a value-based model to come down to unit costs transactions. This whole price discovery is really challenging; it's never been done before."

"We have always felt that the buy side doesn't set pricing, it's the sell side. And excess competition has meant rates have gone down, not just on electronic trading but on high touch, even as the research dollars have shrunk. The sell side, through the past five years, has had a tough run. And certainly on the cash equities side, it's to the point where they are looking at the cost to serve and they are looking at the revenue alternatives are and they are looking at, particularly in the European theater of operations, what is going to be a shrinkage of the pool. They are going to look at a tiered, threshold pricing model [and ask] 'who are we willing to partner with and who is willing to partner with us?' There is going to be a lot of firing of clients, to be blunt about it."

Neil Shah, Edison Investment Research

"There's a recognition that not every sell-side firm has a strategy around this and that is a mistake. There is a set of rules; you now need to play to that set of rules. These are the pricing strategies that we are seeing: There is a bulge bracket pricing strategy of saying 'you can have access to all of our global research content, 4,500 securities of coverage; you can have access to our European research team, for this number of hours; you can have access to our models, corporate access, sales coverage etc. And last year you paid x, this year we want x-plus.' There is the aspirational pricing approach which is that 'we believe our research is worth $100,000, we will start at $25,000 and evolve towards that price'; and there is the price taking model. A lot of independents said they found that not putting a price out there, they are actually getting paid better. Because they probably didn't have the same account management flex and muscle of some of the large banks. So there are people starting to put prices out there. We are starting to see some gradual evolution towards some understanding. But the main point is that research is seen as a service rather than a document."

"Banks make money buy raising money for corporates. They need the relationships to the buy side to do that. The buy side should recognize they are in a very strong position, having those relationships. I personally think that the biggest banks will use this as a market-share exercise. They will flex their muscles. Very few people can compete with the level of coverage they provide."

Neil Scarth, Principal, Frost Consulting

"You are going to see a two-tier asset management market. Those asset managers that manage to convince their clients to continue funding their research spending, will be able to spend more money, they will get higher service levels, their performance will be better, they will have higher structural levels of profitability. Those managers who either elect to pay for it through their P&L or are forced to because their clients to accept their research budgets will find themselves in a very uncomfortable position because it sets up a conflict of interest between buying the research I need in the best interest of my clients and the profitability of my firm."