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Cut to the Chase

MiFID II

Markets in Financial Instruments Directive

WHAT is MiFID II and what are its requirements for research?

- The Markets in Financial Instruments Directive (MiFID) is the EU legislation that regulates firms who provide services to clients linked to financial instruments such as shares, bonds, units in collective investment schemes and derivatives, and the venues (Regulated Markets, Multi-lateral Trade Facilities and Organized Trade Facilities) where these instruments are traded.

The requirements fall on both buy and sell side investment firms.

SELL Side	BUY Side
Firms must not induce clients to trade by bundling research within their execution services	Firms have to make explicit payments for research, and demonstrate that research contributes to better investment decisions and is therefore not an inducement
Firms are required to review and identify services provided that could be categorized as research and therefore for which payment would be required.	Investment firms need to provide better reporting to facilitate payments being made for research and to help demonstrate the value that research is providing
Firms need to provide clients unbundled costs of trading, separately identifying and charging for execution, research and other advisory services	

WHEN is it going to be implemented?

- MiFID was initially applied in the UK from November 2007, which is now being revised with the new legislation known as MiFID II that includes a new Markets in Financial Instruments Regulation (MiFIR). The changes are currently set to take effect from 3 January 2018.

WHO is going to be affected?

As the investment environment have become global, MiFID II implementation will impact firms around the world that deal either directly or indirectly with Europe.

Specifically, non-European entities that:

- Are either beneficial (ultimate) owners of European-based companies, or beneficiaries of funds or portfolios of European investments; or
- Have “exposures” by the holding, investing, trading of MiFID II-mandated European assets that are held, bought or sold on European regulated exchanges and platforms.

The biggest impact will be experienced by banks, broker dealers and trading venues, while investment managers, insurance firms, independent financial advisors (IFAs), custodian banks and other asset servicing entities will also need to undertake a substantial effort.

WHY is research being segregated?

- The clear separation of research and trading costs is to inject more transparency into the fees that asset managers charge customers.
- Prior to the regulations research was arguably used to induce trade by sell side firms and entice investors.

HOW will payment for research take place?

- Buy side investment firms can pay for investment research directly from their own account or via a Research Payment Account (RPA) supported by Commission Sharing Agreement which segregates execution costs and research costs and codifies how commissions are to be shared amongst research providers.
- With the new requirements buy side firms must not link the amount paid for research to the volume or value of transactions, instead they must agree a budget to be paid for research up front and pay an amount that correlates to the quality and value that it would provide to the end investor.
- Sell side investment firms will need to unbundle their costs for research from the cost of execution, such that buy side firms can make explicit payments for research received. They will then need to be able to process direct payments or commission based payments and attribute those payments appropriately.

References

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