



## **MiFID II – Risks and Opportunities: Beyond the Short-Term Headlines**

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# RESEARCH VALUATION / BUDGETING

It's not about compliance. It's about Alpha.



## Key Objectives:

- Increase asset manager research spending transparency.
- Protect/increase returns for asset owners.

## Outcomes/Impact:

- Widespread move to P&L in Europe *actually reduces research transparency* as P&L managers have no regulatory requirement to disclose spending.
- Large research budget cuts at managers may pose a risk to asset owner returns.



## Level Playing Field?



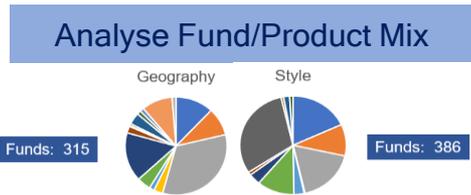
US managers - even those paying via P&L for MiFID II clients - will fund ~90% of their research budgets via commissions from US asset owners.



EU managers paying via P&L will fund >90% of their research budgets from their own resources.

Structural Disadvantage?

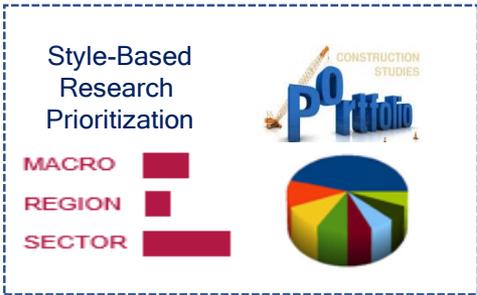
**Step One:**  
Create Strategy Budgets



**Step Two:**  
Quantify Strategy Top-Line Budgets based on "Research Intensity"



**Step Three:**  
Reflect Investment Process/Portfolio Construction in research valuation process.



**Step Four:**  
Investment teams select and prioritize research services



**Step Five:**  
Strategy Budgets Value Selected Research Services

Research service valuation based on contribution to expected return at the portfolio level .

**Net Result?**





# Multi-Tiered Asset Management Outcome: Research Budget Scenarios:



**The Unconstrained**



**Mega "First Call"**

*May raise research spending!*

**Managers with MiFID II Research Budgets Approved**

- Higher Research Spending Flexibility
- Higher service levels
- Higher returns??
- Higher structural profitability??

Research price discovery will take time. Flexibility is key.

**Managers Choosing P&L**

- **Conflict: research supply/profitability?**
- Lower research spending?
- Lower service levels?
- Lower returns??
- Lower structural profitability??

**CREDIT SUISSE**

- P&L managers will cut research spending by 50%
- Impact on clients/returns?

**Managers Using P&L On An Involuntary Basis**  
(Research Budgets rejected or sudden change in research funding strategy)

- **Sudden re-negotiation:**  
**Internal** – between Investment Dept./CFO on size of research budget.  
**Internal** – between investment teams/products for research budget allocation.  
**External** – with banks on research supply

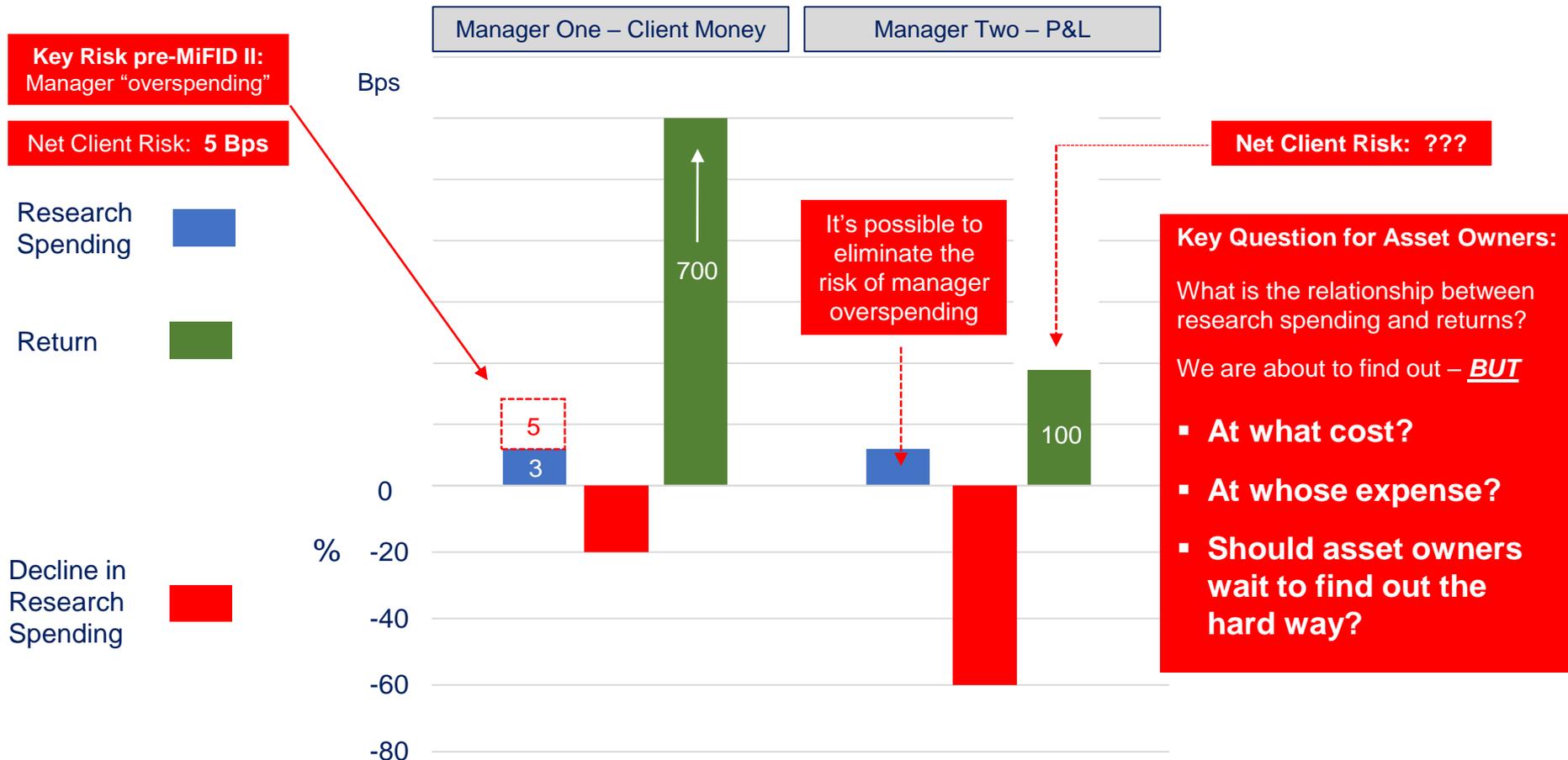
**How much performance risk are asset owners willing to take?**

# Do Risks to Asset Owners Disappear?

If Managers Buy Research via P&L?

Is the Lowest Possible Cost for Research...

... always in the best interest of the client???



What if asset owners were only willing to invest in managers using P&L for research?



## Asset Owner Impact

- Narrows asset manager universe (possibly significantly) – particularly in smaller managers/niche strategies (which tend to be higher alpha).
- Concentrates portfolio with managers that may have less information (if their research budgets have been reduced).
- Actually eliminates research transparency. Does that matter? *Only if strategies aren't getting sufficient research. How will investors know?*
- What happens if the manager's AUM falls? Pressure on research budget?
- **Objective?** To avoid paying ~5 Bps against 70 Bps Management fee on products generating ~ 700 Bps of return (**risk/reward?**)

## Industry Impact

- Possibly very bad for smaller managers.
- May reduce competition/consumer choice, stifle innovation.
- May put European managers at a structural disadvantage globally.

**Alternative View:** Paying 5 Bps in research versus additional ~100 Bps of alpha is a (very) low performance fee  
An inexpensive premium to pay to get access to managers with superior information?

*But surely, paying via P&L will spread globally.....*

# Why the SEC/Congress is Very Cautious..... About Changing Research Funding in the US

Largest companies by Market Cap.

	Year Founded		Year Founded*
 <b>Apple</b> <sup>®</sup>	1976	 <b>Shell</b>	1894
	1998		1876
	1975		1865
	1994		1847
	2004		1896
<b>Average:</b>	<b>1989</b>	→	<b>1876</b>
Average Market Cap. <i>(Billions)</i>	<b>\$ 670.2</b>	→	<b>\$ 234.4</b>

\* Including predecessor companies.

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