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Speech by Guillaume Eliet, AMF Managing Director - AFME/FAMA Conference MiFID II Seminar - 27 April 2017

Check against delivery

Ladies and gentlemen,

I am delighted to be with you this morning and would like to thank AFME & FAMA for inviting me to speak on this most important subject/topic of the funding of financial research.. I would also like to thank them for including the very important matter of the funding of financial research on the agenda for this morning's meeting.

This matter is key in the short term because, as you are aware, the new conditions for the funding of research imposed by MiFID II will come into force in January 2018.

It means that asset management companies that want to pass the research costs on to clients have only a few months left to implement the new system - which is, it has to be said, fairly complex - that the European legislation imposes.

It is also a long-term matter because research is crucial to the development of financing by the markets. We cannot afford to ignore the constant decline in research in recent years, especially lacking in the SME/mid-tier sector, and the potentially restrictive effects of the new regulations.

Let's start by looking at the short-term effect.

From January 2018 onwards, managers of individual portfolios that receive research will have 2 options: either pay for it out of their own pockets or invoice their discretionary management clients by putting in place a system described in article 13 of the delegated directive of 7 April 2016, which is intended to ensure transparency and fairness and to prevent conflicts of interest.

As we know, equity research is at present usually paid for somewhat unwittingly and unawares by the client, as a percentage of brokerage fees.

Generally the client does not actually/really know how much he is paying. The client may in fact be subsidising research that is used for/by other clients rather than for managing his portfolio.
Lastly, more often than not, he pays on the basis of the orders placed with the research provider, potentially resulting in conflicts of interest that are incompatible with the principles of best execution.

MiFID II sets out to close these loopholes.

- replaces opacity with transparency by requiring managers to agree upon a research budget with their clients from the outstart.
- it addresses the cross-subsidisation issue with the principle of fairness: clients should only pay for research deemed relevant to the management of their assets.
- last of all, MiFID II will put an end to potential conflicts of interest resulting from 'bundling', whereby a portion of the brokerage fee is earmarked for research, by separating the amount paid for research from brokerage fees, with a clear decorrelation and distinction between the two, notably in terms of transaction volume.

The reform is therefore soundly based on transparency, fairness and the absence of conflicts of interest. We agree wholeheartedly with these principles, of course. These are the very foundations of the trust that the regulations set out to protect.

By 3 January, asset management companies that manage individual investment mandates will therefore have to have made the basic initial choice: whether to pass research costs on to their clients or to pay for it themselves.

If they decide to pay for research out of their own pockets, the matter is settled.

Without inducements, research will no longer be a benefit likely to result in a conflict of interests. It will become a service like any other, provided to and paid for by the manager. Of course, research providers will have to charge the right price,

Many players will probably pay research costs themselves, partly for reasons of convenience but also because they regard it as normal that the manager pays all the costs related to the services that it provides to its clients.

On the other hand, if a management company does decide to pass research costs on to its clients, it will have to implement the system stipulated/required by the European text.

This system is described in detail in the Directive, but nevertheless required/ called for a number of clarifications from the regulators.
This is what we have set out to do, by way of promptly launching a public consultation and subsequently publishing a summary to clarify a number of issues raised by professionals.

For example, in our consultation we set out to identify the scope of the reform:

- What sort of research are we talking about?
- At what point should a research paper that has been received, be considered to be a benefit that will have to be assessed and paid for?

Starting from the definition given by the Directive, we felt that some non-specific or very widely-circulated research papers could fall into the category of minor non-pecuniary benefits that would not be subject to specific restrictions, since they would be unlikely to result in a benefit that generates a conflict of interests.

We also feel that corporate access, a practice consisting in brokers organising meetings between issuers and managers, should not result in charges for clients if this merely involves straightforward networking and setting up of meetings, sometimes referred to as "conciergerie" (caretaking).

However, value-added services of an intellectual nature obtained through corporate access, such as a summary of the items discussed at the meeting if the analyst was able to attend, may, of course be covered by the Directive, and hence be invoiced to the client within the research budget.

As on other matters, commentators considered that the AMF and the UK's FCA were proposing different approaches, with the AMF being more flexible whereas the FCA

proposed stricter guidelines.

In fact, after a thorough review of the documents produced by both authorities respectively, I frankly see no reason for claiming that they are taking radically different approaches. On the contrary, our proposals are similar and in any event, our main aim and object is to have a single interpretation and practice throughout Europe.

It is also with this in mind that we are actively participating in the work with the ESMA, which has already been published in the form of (questions and answers) Q & As, explaining the implementation of the texts.

Nevertheless, let's take a look at two points, on which it was felt that there may be a divergence between the FCA's and the AMF's interpretations.

In terms of scope, the FCA wants the system introduced by the Directive to cover both collective and individual investment management. The AMF does not require these measures to apply to collective investment management, as the Directive does not apply to this type of management. But we do not prohibit management companies that manage both individual discretionary investment mandates and investment funds from implementing the system for both types of activity. And this is certainly what most managers in this situation will do anyway, for the sake of convenience.

With regard to the use of a CSA, whereby payment for research is delegated to brokers, we explained that the reform does not prohibit the use of CSA since both brokerage and research fees can be included in the same payment. This practice is subject to two conditions. Firstly, these payments must remain within the research budget accepted by the client. Secondly, this payment method must not seek to reinstate the correlation between the amount assigned to a particular broker and the volume of transactions placed through it. The Directive is quite clear on this, so there is no reason to believe that the FCA and the AMF interpret it differently.

So in the short term, these are important organisational decisions that must be taken by the parties involved if they are to be ready by January 2018, irrespective of the system adopted.

In the longer term, the reform of the funding of research that has been adopted with MiFID II requires an analysis of both its method and content.

With regard to method, it is regrettable that this reform, which is of fundamental importance to the financing of the economy, was not the object of a political and overall debate, and was only revealed at level II during a technical reading of the texts on

inducements. The result is complex legislation with an outdated scope of application (as we have seen, legally it applies only to discretionary investment management and not to collective investment management), and has above all been adopted without any assessment of its potential impact.

Essentially, the European goal of creating a genuine Capital Markets Union, i.e., developing market financing that targets growth and jobs, must certainly entail a renewed, dogma-free review of research, with the aim of putting in place a system that both protects investors and encourages research. This is because, in a Europe with 27 countries that is looking to stimulate growth and to finance its SMEs and mid-tier companies, the conditions under which financial analysis is conducted are certainly important, but we need to organise ourselves to ensure that these conditions favour its growth.

Unfortunately, the figures we have indicate that research is on the decline and is becoming increasingly concentrated. It is our wish for markets to be driven by an abundant supply of research from multiple sources, covering the widest range of stocks possible.

This is a stern challenge, which inevitably leads us once again to addressing questions of principle. For example:

- How can we ensure that research into small-cap stocks will survive and thrive if we are unable to accept that research is funded by cross-subsidisation in some form or other?

We would like this question, and in general that of the development of financial analysis as a key component of the smooth functioning of the market, for which we are the guarantor, to be raised as part of a new review initiated by the Commission with a view to creating a genuine Capital Markets Union.

Thank you.

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