



Capital Markets Union

Developing Investment Research

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The AMF considers that preserving and developing investment research is a key issue in discussions surrounding a Capital Markets Union (CMU). Investment research indeed plays an essential role in providing businesses with access to sources of funding and in building investor confidence. Its funding model is currently being debated as part of the implementing measures of the Markets in Financial Instruments Directive (MiFID 2). The AMF believes that this specific issue must be addressed in light of the crucial need to develop investment research coverage in Europe, particularly for SMEs wishing to access market financing. The CMU initiative offers an ideal opportunity to address all of the issues and challenges raised by investment research.

Investment research is necessary to ensure businesses have access to sources of funding

Investment research is essential to the financing of businesses. The existence of a third party analysis on the activities, the financial health and the prospects of companies is indeed required in order to build investor appetite to provide funding, be it equity or debt funding. Any erosion in the available investment research coverage would lead to an increase in funding costs for companies, or even cause funding to dry up, by narrowing the base of potential investors. This would be especially true for SMEs and intermediate-sized enterprises¹. Conversely, a vibrant investment research can generate more robust financing flows, supporting thereby a better development of businesses and the economy.

Investors need reliable – meaning high quality – investment research

The effectiveness of investment research depends on the trust that users place in it. This trust flows from the quality of the research and the diversity of viewpoints. The financial crisis indeed showed that investor reliance on a limited number of information providers that were essentially remunerated by product issuers could generate conflicts of interest and major systemic risks. Such events can only undermine investor confidence, significantly cutting their appetite for investing in markets on which they lack reliable information.

In 2006, the AMF became one of the first European authorities to regulate potential conflicts of interest relating to the payment for investment research by establishing requirements on separate invoicing for execution fees and investment research fees. Some of these requirements only apply as from a minimum volume of research to avoid adding unnecessarily to the obligations of small providers (which play an important and absolutely necessary role in high quality investment research) in respect of minor amounts. In the last decade, the arrangements in place have not revealed any shortcomings that would necessitate a revision.

¹ *The Real Effects of Financial Shocks: Evidence from Exogenous Changes in Analyst Coverage*, Derrien and Kecskes, *Journal of Finance* 68, 4 (2013).

High quality investment research cannot exist without a robust funding scheme limiting conflicts of interest and enabling small firms to be economically viable

The existence of small firms requires limiting the factors driving excessive sector concentration and ensuring the long-term survival of a viable business model. While conflicts of interest must of course be closely monitored, this should not lead to the introduction of administrative systems that would be operationally difficult to implement. An inappropriate increase in administrative costs would indeed force research firms to pool these costs over larger volumes, which would unduly favour larger firms and cause a shift away from niche markets (such as coverage of SME and intermediate-sized enterprises).

The sustainability of the business model and a high quality investment research therefore necessitate funding by all users (corporate and investment banks, retail investors or investment funds), conflicts of interest being essentially addressed through control and transparency of budgets allocated to the research firms employed.

A priority of CMU must be to promote a global approach to the funding of investment research

The AMF considers that one of the priorities of CMU must be to promote a global approach to investment research, with the imperative of developing a more diversified and abundant research covering issuers of all categories. The issue of the funding of investment research is critical but cannot be treated in isolation. The establishment of clear and transparent budgets where significant spending amounts are reached should be the first area of focus in order to ensure both reliable investor information and satisfactory visibility for companies on capital markets. This would allow investors to fund businesses selected on the basis of objective and varied analyses, in a climate of confidence and, therefore, without disproportionate risk premiums.

Autorité des marchés financiers

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