

Europe proposes rollback of Mifid II research rules for smaller companies

JUL 28, 2020

European Commission proposes exemption to help capital markets recover from pandemic

The European Commission (EC) has proposed an exemption for small and mid-cap research from Mifid II's unbundling rules as part of a package of measures designed to soften the impact of Covid-19.

Introduced in 2018, Mifid II – Europe's far-reaching regulatory reforms for the financial industry – separated out payments for execution and research, a process known as unbundling.

The move raised fears that smaller companies could see a drop in analyst coverage, given the increased financial pressure the change would put on the research market.

On Friday the EC released proposals that would see unbundling rules dropped for equity research on companies with a market capitalization of less than €1 bn (\$1.17 bn), as well as fixed-income research. The company size would be calculated by looking at the valuation over a 12-month period.

'Research on small and mid-cap companies and on fixed-income instruments has experienced a decline in research coverage for several years,' writes the EC in its proposals.

'The short-term measure we propose to incentivize the production of research on small and mid-cap companies and on fixed-income instruments is a narrowly defined exception.'

Investment firms that make joint payments would have to form an agreement with the research provider and also inform clients of the situation, adds the EC.

Studies have come to differing conclusions over the impact of Mifid II on research coverage. In September last year the UK's Financial Conduct Authority said there was ['limited evidence'](#) of a drop in

small-cap coverage. ‘Our own analysis indicates limited change in single-stock analyst coverage levels for smaller-cap listed UK companies since Mifid II was implemented,’ it said.

By contrast, French financial regulator the AMF said in a [January 2020](#) report that Mifid II had worsened the existing decline in research coverage for smaller companies.

In its report, the AMF argues that the original unbundling rules had been brought in without sufficient debate on the differences that exist between European markets. In particular, it points to the corporate broking model in the UK, through which many issuers receive research.

The UK has long been a proponent of strict unbundling rules and its departure from the European Union makes it easier for Mifid II regulations to be rolled back.

Last year, experts told *IR Magazine* that Brexit could [clear the way for changes to research-payment rules](#) on the continent. European regulators could ‘unwind some of the more draconian unbundling capabilities, or at least make modifications to them,’ said Sandy Bragg, principal at Integrity Research Associates.

The proposed changes to European rules raise the prospect of different regimes for research payments existing in the UK, the EU and the US – creating a complex market for investment firms and research providers.

In the US, the SEC has a no-action letter in place until July 2023 allowing US brokers to receive cash payments from fund managers operating under Mifid II rules. Normally, US brokers are barred from receiving ‘hard dollar’ payments for research unless they register as investment advisers.

The EC’s proposal on equity research is part of a bundle of measures called the ‘Capital markets recovery package’. Other changes include the introduction of new prospectus rules to help companies raise equity more easily. Regulators are worried that companies may focus excessively on debt to boost balance sheets, creating a burden that could slow future growth.

‘The alleviated prospectus rules will enable companies to issue capital more easily and, therefore, reduce their debt-to-equity ratios, thereby helping them stay solvent,’ says the EC.