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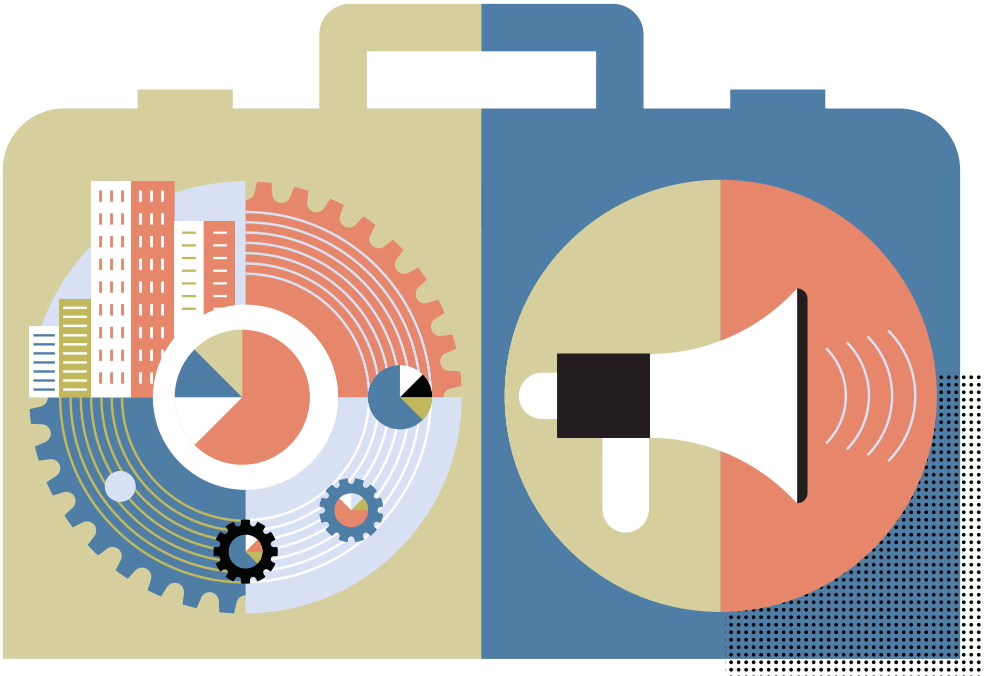

MIFID II GALVANISES IR

The separation of research and execution is fundamentally changing the way companies engage investors.

By Alexandra Cain

MiFID heralds a new dawn for investor relations. In particular, it's a game changer for sell-side research and corporate access. IR teams around the country – as well as investment banks – are at different stages of readiness for the new normal.

MiFID II, the European Union's latest financial markets regulation that came into force in January, is designed to improve transparency in markets. It requires separate pricing for executing trades on and producing research for the same company. Previously, research and execution were bundled together. For IR professionals, the new MiFID II rules have prompted a contraction in sell-side research coverage, as a recent study by the Australasian Investor Relations Association (AIRA) bears out.

It found 38.8 per cent of the IR professionals surveyed for the research said the number of sell-side analysts covering their stock had dropped over the last 18 months. Additionally, 46.3 per cent said the number of analyst reports prepared about their business had fallen over the same period.

"The market has seen MiFID II coming and some firms have been ahead of it while others have waited until the last minute to act," says AIRA CEO Ian Matheson.

Matheson supports the new regulations and believes they are positive for markets and investors. "There has long been cost subsidisation in many aspects of investment, including research and trading. The point of MiFID II is to make the true cost of products and services more transparent and to ensure the end investor is not charged for things for which they receive little benefit."

However, he says MiFID II's effect has been uneven and he expects the situation to evolve over the next few years. "There will always be a role for brokers in research and also corporate access. But corporates are having to do more when it comes organising roadshows and supplementing services that have traditionally been provided by brokers.

"This is on top of organising one-on-one meetings with investors who don't use brokers and want to meet with companies direct. This is impacting different companies differently and having an impact on offshore conferences in different ways across different geographies."

It's understood some of the UK broker conferences earlier this year were not able to attract the volume of investors they may have in the past, which led to some companies cancelling their trips to the UK. This is a marked change to the pre-MiFID II environment, when going to one of the flagship UK conferences was a cost-effective way of meeting with investors in that part of the world.

"Pretty much all the local investors would attend those events and it was very efficient because people were able to stay in the same venue to meet investors. But these days, not all investors attend those conferences because there is an explicit cost associated with them," says Matheson.

"So, depending on the company, you may or may not find you have a full dance card [at a broker conference] anymore. The issue for companies going to the UK and Europe is how to fill out the schedule that once would have been filled by one broker," he adds.

Matheson notes until now many companies have not had the resources to do this work. "They have the resources to meet their existing shareholders, but non-deal roadshows are all about targeting new shareholders and that's where brokers have always played such an important role. In some cases, their sell-side desk would have dealt with these investors on a day-to-day basis and would know whether they might be interested in buying a stock."

Although the work of local sell-side desks has always been important, the number of desks dedicated to Australia has been declining. This is another reason why companies have increasingly had to either supplement the meetings brokers organise with their own work or use more than one broker to fill up the schedule. It tends to be a combination of all these things.

Also, while the Australian market will always be relevant, Aussie companies developing their share register will have to work harder to attract more offshore investors to their registers from a mix of different geographies.

Says Matheson: "Different companies are popular at different times. The Australian market is thematic. House prices, the Aussie dollar and exposure to China's growth are just some themes that have played out for or against Australian companies when marketing to offshore investors over the years.

"So, it's really about identifying where and when a company's strategy will be attractive to investors in different parts of the world at different times. Not all investors will be interested all of the time, so investor relations officers (IROs) need to be effective in targeting the right investors for the right time."

From the IR perspective, Jill Campbell, group head of investor relations for big four bank ANZ, is closely monitoring MiFID II and working with both the buy and sell side offshore. "Our aim is to ensure the buy side has the access it needs both for those that hold us and those that are considering ANZ," says Campbell.

"While MiFID II might have ambitions to improve clarity and information flow, in reality there will almost certainly be unintended consequences, including for sell-side resourcing," she adds.

Campbell notes while it is relatively easy for the very large, well-resourced funds to consider their options and rework their resources, including insourcing analytics and dealing more directly with corporates, there will be a far larger number of funds that find the new environment more challenging.

Additionally, resources are one issue, the economics around separating trading and research is another. "Costing a comprehensive research product has proved enormously challenging for the industry, and there have been wide variations in the prices that have been put to fund managers," says Brett Dimon, principal of Farnsworth Investor Relations.

Concurrent with MiFID II, market pressures and the heightened regulatory environment are squeezing broker profits. Consequently, research analysts have become stretched – covering more stocks and sectors – leading to a 'juniorisation' effect across the industry. The rise of independent, non-broker research providers is also changing industry dynamics.

AIRA survey: research suffers

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IR fights back

Against this backdrop, many IROs have become much more active in the information and messaging they provide to the market.

"Many IROs are now distributing information in ways that are much more easily packaged by research analysts for redistribution," says Dimon.

"It's very common to see messaging that the IRO has dispersed redistributed in analyst reports. IROs have become much more involved in the specific ways that their messages are distributed to the market," he adds.

As a result, the broker's role as an intermediary between companies and institutional investors is much less dominant than it was in the past. Subsequently, there is now a much more direct relationship between corporates – driven by IR professionals – and institutional fund managers, across not just research but also areas like corporate access.

"Where previously IROs could rely on a small number of broking relationships as a gateway to hundreds of institutional investors, both domestically and offshore, now more of that relationship responsibility falls on the IR team, which inevitably leads to questions about systems and resourcing," he says.

Despite some of the challenges, many brokers still employ skilled analysts and maintain comprehensive distribution networks. So it is still important to maintain relationships with brokers, while recognising their growing limitations.

"Many IROs say they hear very little from the analysts that cover their company – in many cases the nature of the relationship has swung heavily towards the IROs being the initiator of engagement rather than the analyst, as it was previously. It is increasingly common to see companies engage non-broker researchers and corporate access providers, as well as the fund managers directly," he explains.

IROs across the industry are facing the MiFID II challenge head on. It's likely it will take some time for the effects of this new regulation to cascade across the industry. When it is fully implemented it will have changed the nature of IR and the way companies communicate with the market forever.