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## Briefing Note

### MiFID II Pre-Deal Research Issues - Summary

7 February 2017

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#### Introduction

As requested by the FCA, this note contains a summary of concerns around applicability of Article 12(3)(b) of the Delegated Directive in connection with the investor education process when pre-deal research is produced by independent financial analysts in the research departments of firms which also underwrite or place the initial public offering and the need for clarification as to the treatment of independent pre-deal research reports and any accompanying investor education meetings discussing those reports under the MiFID II regime.

#### Background

Article 12 of the Delegated Directive provides that investment firms providing investment advice on an independent basis or portfolio management services shall not accept non-monetary benefits that do not qualify as “acceptable minor non-monetary benefits”. Therefore, any material, such as independent pre-deal research, must either be an acceptable minor non-monetary benefit or must be priced and paid for.

ESMA published Q&A on 16/12/16 on MiFID II and MiFIR investor protection topics (ESMA/2016/1444). In section 7 of the Q&A on Inducements (research) ESMA provided an answer to the following question:

*“Question 6 - In what circumstances should material received by a firm providing independent investment advice or portfolio management services be considered a minor non-monetary benefit under Article 12(3) of the MiFID II Delegated Directive rather than research?”*

In the answer to this question, ESMA cited Article 12(3)(b) of the Delegated Directive which sets out what could be deemed “acceptable minor non-monetary benefits” which states, in part:

- written material from a third party that is **commissioned** and **paid for** by a corporate issuer or potential issuer **to promote** a new issuance by the company ... provided that the relationship is clearly disclosed in the material and that **the material is made available at the same time to any investment firms wishing to receive it or to the general public**” [*Emphasis added*]

ESMA stated that “this exemption can allow investment firms to receive ‘pre-deal’ material directly relating to a new capital raising event by an issuer, which is produced by a third party such as another investment firm who is placing and/or underwriting the issue (often referred to as ‘connected research’), provided that the nature of the material is made clear and it is available at the same time to any prospective investor.” In addition, ESMA noted that “any non-monetary benefit that involves a third party **allocating valuable resources** to the investment firm shall not be considered as minor and shall be judged to impair compliance with the investment firm’s duty to act in their client’s best interest” as specified in Recital 30 of the Delegated Directive [*Emphasis added*].

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## Issues Arising

- A. The commentary above seems to indicate a view that pre-deal research typically supplied by underwriters on IPO could be considered a minor non-monetary benefit and therefore not imposing the requirement to separately price and pay for that material. However, the specific requirements of the provision cited are not consistent with pre-deal research as typically provided by independent research departments and thus would not be available for use in that context for the following reasons:
- a. **Commissioned** – While it is the policy of many firms to produce pre-deal research when they are acting as an underwriter or placing agent, it is the independent research department’s determination whether or not to produce such material for the benefit of its investor client base. Pre-deal research is educational material produced for investors that assist in the efficient functioning of the IPO marketplace. Unlike underwriting or placing services, it is not commissioned by the issuer.
  - b. **Paid** – Although issuers often do pay for printing and distribution costs of pre-deal research, such as the mailing of hard copies, issuers do not pay for the costs of creating pre-deal research and accompanying investor education, which may include analyst time, other production costs and travel.
  - c. **Promotion** – As described more fully in (a) above, pre-deal research and accompanying investor education provided by an independent research department is educational material for investors and not promotional for a new issuance. In particular, it does not contain a target price or a recommendation on an issuer. Indeed, both MiFID I (as currently transposed into COBS 12.2) and MiFID II Article 37(2) (as proposed to be transposed into COBS 12.2.21) state that “[f]inancial analysts should not engage in activities . . . inconsistent with the maintenance of that person’s objectivity. These include participating in investment banking activities such as . . . participating in ‘roadshows’ for new issues of financial instruments; or being otherwise involved in the preparation of issuer marketing.” Under both MiFID I and II, it would impair the objectivity of an independent analyst to be involved in promotion of a new issue as described in Article 12(3)(b) cited by ESMA. Similar provisions around the role of an independent analyst in an investment banking transaction exist in several non-EU jurisdictions as well. The incorrect categorisation of independent pre-deal research as promotional to an issuance and commissioned and paid for by an issuer would not be consistent with regulatory requirements designed to safeguard a financial analyst’s independence and objectivity.
  - d. **Available at the same time to any investment firms wishing to receive it or to the general public/available at the same time to any prospective investor** – As legal requirements related to pre-deal research and accompanying investor education differ by jurisdiction, for example the US and Canada where written pre-deal is generally impermissible, it is not typically provided to any prospective investor or the general public.
  - e. **Allocating valuable resources** – The production of independent pre-deal research and accompanying investor education involves the allocation of analyst time and resources. It is unclear from the ESMA Q&A guidance whether such time and resource (perhaps because it is

not ongoing but a short term limited deal specific allocation) would not be considered to be the allocation of valuable resources under the requirements of MiFID II.

### **Proposed Action**

Following the discussion at a meeting with the FCA on 30<sup>th</sup> January, AFME requests that the FCA provide additional clarification on whether independent pre-deal research and accompanying investor education meetings as currently provided in the market could be designated as a minor non-monetary benefit under the requirements of MiFID II and the list of acceptable minor non-monetary benefits as set out in the proposed text of COBS 6.1A.5A.

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