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THE RISE OF ONLINE RESEARCH MARKETPLACES

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QUINLAN & ASSOCIATES

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EXECUTIVE SUMMARY

On 3 January 2018, the long-held practice of blending research and execution charges into bundled commission rates will come to an end as MiFID II takes effect in Europe. Though regional in its proposed application, it is becoming increasingly clear that the implications of the new regulations will extend well beyond European shores.

Since releasing our first report on research unbundling in August 2016,[1] we have seen a number of key developments on both the buy- and sell-sides as the industry prepares itself for regulatory go-live. Yet, despite the progress that has been made by brokers and fund managers to-date, we are starting to see growing signs of panic as players on both sides begin to digest the sheer scale of implementation challenges that lie ahead in the coming 9 months.

Our predictions last year on the outlook for the sell-side are starting to materialise, with global tier-2 waterfront research providers (e.g. CLSA, Barclays) being pushed out of the market, and independent research houses growing in their influence. For the global tier-1 brokers, we are also witnessing some changes in coverage and distribution models, including a heavy investment in proprietary research portals.

However, we believe further rationalisation of research coverage is required, necessitating greater selectivity around carving out a competitive niche across products, sectors and/or geographies. A fundamental re-think to research pricing is also needed, given the ongoing divergence between broker and manager expectations.

On the buy-side, we recognise many managers are still scratching their heads over how to set and monitor their research budgets, and how the new research payment model will impact their fund pricing strategy. Most critically, a number of firms still remain woefully unprepared from an operational and compliance standpoint, citing a lack of regulatory guidance around the specific policies and processes that need to be implemented to be MiFID II-compliant, as well as an absence of manpower to execute their new obligations internally. Urgent preparatory action is required now, even though details for the implementation of the directive will only be transposed into national law by European national regulators by 3 June 2017 at the latest.

1 Quinlan & Associates, 'Research in an Unbundled World: The Outlook for Sell-Side Research Providers Under MiFID II,' August 2016, available at: http://www.quinlanandassociates.com/insights-research-in-an-unbundled-world/

Taking a more holistic view of the unbundling regulations, it is clear the research industry is fundamentally changing – at its core, the business is becoming more digital, with brokers investing heavily in the development of their online research portals in an effort to move from a 'content push' strategy to one focused on 'user draw.' While such efforts are a step in the right direction, we believe they fall short of providing a truly effective solution for the buy-side, given the high subscription costs being charged by brokers for access to their platforms, a reluctance by managers to navigate a plethora of proprietary portals for their research needs, the varying degrees of content quality and user personalisation that exist across various platforms, and managers' preference for a standardised and impartial tool to measure their research consumption.

In an effort to create a one-stop-shop solution for the industry, we have witnessed a raft of online research marketplaces (ORMs) emerging, such as Alphametry, ResearchPool and Smartkarma, to name a few. These firms provide a forum for research firms and even individual influencers to contribute content, with proprietary search engines tailoring output to the end user's criteria. While still in their infancy, we see ORMs becoming the dominant platforms for content sourcing and distribution in years to come, representing ~USD 1.4 billion market by 2020 and a ~USD 2.4 billion market by 2025, comprising ~15% and ~30% of the global research wallet respectively. Given their huge potential, we believe managers and brokers should actively seek to engage with ORMs to best capitalise on the new research environment post-2018.

SECTION 1
REGULATORY RECAP

OVERVIEW

Since our last report on research unbundling, the U.K. and French authorities have issued further clarification on the operations of MiFID II in their respective jurisdictions.

The Financial Conduct Authority (FCA, U.K.) issued its 'MiFID II Implementation – Consultation Paper III'[2] in September 2016, with sections pertaining to research payments.

Autorité des Marchés Financiers (AMF, France) also issued a consultation paper in the same month[3] (see Figure 1 for a comparison of their stance).

Policy statements are expected to be published in the first half of 2017, with promulgation into national laws in July 2017.

IN-SCOPE BUSINESS AND ASSET CLASSES

Overall, the FCA is stricter in its suggested approach, with broader inclusion of firms carrying out non-MiFID II investment business, including collective portfolio management. This brings Undertakings for Collective Investments in Transferable Securities (UCITS) management companies and Alternative Investment Fund Managers (AIFMs) into scope. Hence, the managers of unit trusts, hedge funds, private equity funds, retail investment funds, investment companies and real estate funds would all be in-scope.

...THE U.K. AND FRENCH AUTHORITIES HAVE ISSUED FURTHER CLARIFICATION ON THE OPERATIONS OF MIFID II IN THEIR RESPECTIVE JURISDICTIONS.

2 Financial Conduct Authority, 'Markets in Financial Instruments Directive II Implementation – Consultation Paper III,' September 2016.

3 Autorité des Marchés Financiers, 'Public consultation by the AMF on the new rules for the funding of research by investment firms under MiFID II,' 12 September 2016.

FIGURE 1: FCA AND AMF STANCE ON RESEARCH PAYMENTS

	FCA IN SCOPE	FCA OUT OF SCOPE	AMF IN SCOPE	AMF OUT OF SCOPE	*DIFFERENCE*
INVESTMENT BUSINESS	• MiFID II business, investment advisory, and collective portfolio management (suggested)		• MiFID II business, includes discretionary management and investment advisory	• Collective management	• *Broader FCA inclusion* • *Specific AMF exclusion*
ASSET CLASS	• Research on equity, fixed income, other non-equity instruments		• Research on equity research (stance on fixed income to be considered later)		• *Broader FCA inclusion in paper*
MINOR NON-MONETARY BENEFIT EXEMPTION		• Based on substance, not labelling		• Generic information, e.g. macroeconomic analysis	• *Similar, though specific AMF out-of-scope example*
COMMERCIAL VERSUS GENERAL SERVICES		• Payments or benefits which are necessary for the provision of investment services, incl. custody fees	• Commercial services supporting investment ideas e.g. sales person passing on a market update	• Non-investment decision and order execution support services, incl. admin and portfolio valuation services	• *Similar*
CORPORATE ACCESS		• Not research, cannot be paid out of research payment account (RPA)	• E.g. introduction with intellectual services complementary to research note provision	• E.g. basic introduction • Logistics costs	• *Specific AMF inclusion*

Note: Examples are those given in the consultation papers

Source: FCA, AMF, Quinlan & Associates analysis

The AMF specifically excludes collective investment management, but makes note that discretionary management and investment advisory services are in-scope.

The FCA consultation paper is also relevant to research on fixed income and other non-equity instruments. The AMF will consider research on fixed income at a later date, although it now explicitly excludes any widely disseminated macroeconomic analysis, under the minor non-monetary benefit definition (i.e. benefits which are not charged to investment firms and hence cannot be on-charged to their clients).

SERVICES

Both regulators acknowledge that general investment services which are not related to investment decisions and order execution are not in scope services. The looser AMF stance suggests that where trade ideas provided by a broker supports investment decisions, these may fall within scope under the supply of research. A specific example refers to the provision of a trade idea by a sales team member.

In relation to corporate access, the FCA explicitly excludes corporate access from research payments. AMF, on the hand, differentiates between a straight-through introduction versus a value-added introduction where an analyst provides intellectual content to a meeting, or where the access is complementary to regular research notes coverage.

COMMISSION SHARING AGREEMENTS (CSAs)

Both regulators allow more than one Research Payment Account (RPA), although the FCA suggests only one. Both also allow the continued use of commission sharing arrangements (CSAs), though according to the FCA, research charges must be 'swept' to the RPA immediately following the associated transaction (e.g. daily or within the settlement period for the transaction) to reduce counterparty risk of money retained in brokerage accounts. The AMF leaves the onus of managing the legal security of RPAs held with brokers to the investment firm.

SUMMARY

Given the overall stricter stance of the FCA, we expect that larger investment firms with pan-European operations will follow the higher operating standard. For example, with the different treatment of collective investment management, French investment managers will still need to ring fence their MiFID II business to ensure research charges for MiFID II business are not used to pay for the research needs of collective investment management. But for those managers running both types of businesses, it may be challenging to run two different research payment models concurrently.

For smaller investment firms thinking of setting up new operations, the divergence in regulatory positioning may impact decisions around setting up in the U.K. or continental Europe. However, we believe the overall industry implications of the divergence are marginal.

The FCA, on the other hand, is expecting greater price transparency as an outcome of this new directive. It is their belief that a more open and competitive research market will to lead to new entrants and distributions models – topics which will be explored in further detail later in this report.

SECTION 2
INDUSTRY POSITIONING: THE SELL-SIDE

In our August 2016 report on unbundling, we identified nine key strategic and operational considerations that brokers would need to address in preparation for regulatory 'go-live' on 3 January 2018. With only 9 months to go until the new regulations take effect, just how prepared is the sell-side with respect to their unbundling efforts?

Overall, while we recognise strong progress has been made on some dimensions, we feel there is still much to do, especially with respect to efforts around client segmentation, product offering, pricing and billing & payments (see Figure 2).

FIGURE 2: SELL-SIDE READINESS FOR UNBUNDLING

		CRITERIA	DESCRIPTION	STATUS
STRATEGIC CONSIDERATIONS	1	GEOGRAPHIC SCOPE	• Readiness of brokers for research unbundling outside of Europe	▮▮▮▯▯
	2	CLIENT SEGMENTATION	• Segmentation of client base to calibrate service levels	▮▮▯▯▯
	3	PRODUCT OFFERING	• Revision of research product offering (i.e. content and form)	▮▮▯▯▯
	4	COVERAGE & DISTRIBUTION	• Adaptation of client coverage models and sales efforts	▮▮▮▯▯
	5	RESEARCH PRICING	• Implementation of pricing models for various research services	▮▯▯▯▯
OPERATIONAL CONSIDERATIONS	6	TECHNOLOGY & OPERATIONS	• Revamp of technological interface and operational processes	▮▮▮▯▯
	7	BILLING & PAYMENT	• Establishment of standardised billing and payment procedures	▮▮▯▯▯
	8	PERFORMANCE TRACKING	• Creation of an effective performance tracking framework	▮▮▮▯▯
	9	COMPLIANCE & CONTROLS	• Implementation of compliance policies and control frameworks	▮▮▮▯▯

▯▯▯▯▯ Critical ▮▮▮▮▮ On Target

Note: there is a high degree of variability between the readiness of tier-1 firms compared to tier-2/3 players, which is reflected in the status rating

Source: Quinlan & Associates analysis

1. GEOGRAPHIC SCOPE

Most global sell-side firms have developed a well-defined international approach with respect to their research unbundling strategy, with working groups established in their APAC and Americas operations to work in close coordination with efforts being led out of EMEA.

However, we are finding that a number of purely regional brokers operating in Asia Pacific and the Americas are still largely unaware of MiFID II and its potential impact on the research landscape outside of Europe. We believe these firms need to give immediate attention to the wider implications of unbundling on their future business models, including all of the strategic and operational considerations we outlined in our August 2016 report.

2. CLIENT SEGMENTATION

The majority of global brokers already tier their service levels based on client spend (i.e. the revenue a client generates for the firm). More recently, we are seeing a trend of 'tail' accounts being de-prioritised, with some global banks actively off-boarding these clients as part of a general de-risking exercise. For example, as part of its 'Strategy 2020' announcement, Deutsche Bank said it planned to off-board up to 50% of its clients in its Global Markets (GM) & Corporate & Investment Banking (CIB) units, given that 'tail' accounts represent 70% of the GM & CIB client base, yet generate only 20% of total GM & CIB revenues (while still incurring fixed onboarding costs and risks comparable to much larger accounts).[4]

While client-tiering based on top-line revenue contribution remains common practice across the industry, client segmentation and resource allocation based on client-level profitability remains extremely weak for most players. Few firms have strong appreciation of the true underlying economics of their key accounts. We feel there is significant room to improve profitability vs. service level calibration.

3. PRODUCT OFFERING

As we correctly predicted last year, global tier-2 waterfront houses are being pushed out the market. Notable casualties include Standard Chartered's international equities business, Barclays' Asian cash equities businesses, Nomura's European equities business and CLSA's North American equities business. We believe this trend will continue in the lead-up to January 2018, as many of these firms struggle to maintain a profitable international footprint. However, regional specialists – such as Exane, Kepler Cheuvreux and Berenberg – with less complex internal cost structures to unravel, may more easily leverage first-mover advantage and build market share in geographies where they have existing strengths.

4 Deutsche Bank, 'Executing Strategy 2020,' 29 October 2015, available at: https://www.db.com/ir/en/download/Deutsche_Bank_Strategy_2020_29_October_2015.pdf

We are also seeing the rise of boutique research houses with deep specialisation in select industries and/or countries. Relatively newer firms who are making their mark include Arete (technology) and Autonomous (financial services). We believe greater price transparency and hard dollar payments provide a more viable competitive playing field for such firms.

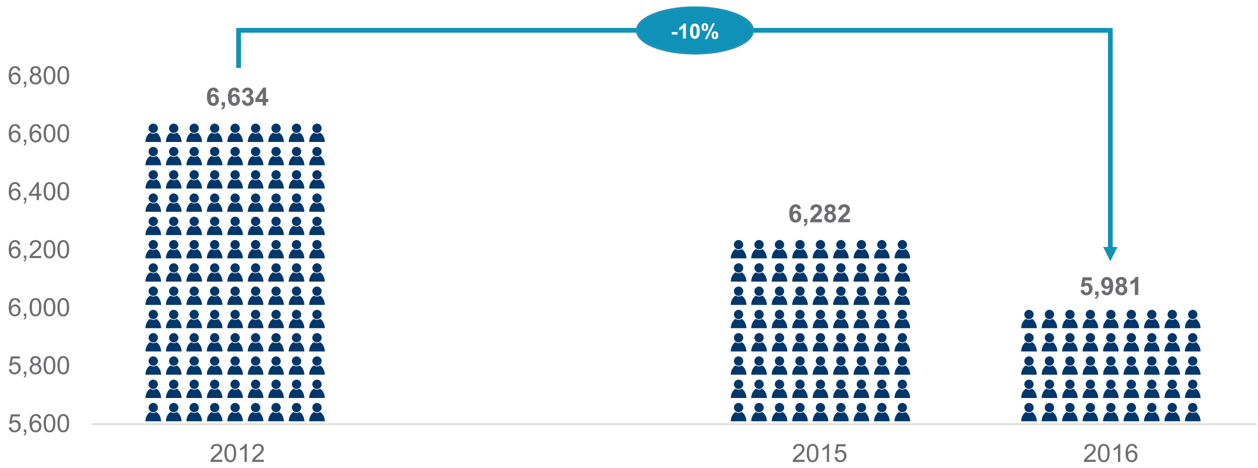
For the tier-1 global brokers, a number of adaptations have been made to research content as competition from independents heats up and the race for quality intensifies. UBS, for example, has engaged psychologists to help revamp its research reports through pinpointing more precise and insightful research questions. The bank also provides users with interactive tools which allow them to plug their own assumptions into analyst models, generating dynamic results that are specific to each client's investment outlook.[5] Upfront conclusions are also becoming the norm, leading to major changes in the way sell-side reports are being written.

Despite these developments, we believe most tier-1 houses have not been aggressive enough in their research participation choices. The majority still offer waterfront coverage, which includes the provision of research from poorly-rated teams. In fact, according to financial industry data provider Coalition, the number of analysts working at the world's 12 largest investment banks fell by 10% from 2012-16, which is slower than the pace of headcount reductions across the broader industry (see Figure 3).

WE BELIEVE GREATER PRICE TRANSPARENCY AND HARD DOLLAR PAYMENTS PROVIDE A MORE VIABLE COMPETITIVE PLAYING FIELD ...

5 Financial Times, 'UBS hires psychologists to help revamp research reports,' 30 August 2016, available at: https://www.ft.com/content/c955beac-6e92-11e6-9ac1-1055824ca907

FIGURE 3: RESEARCH ANALYST HEADCOUNT (TOP 12 GLOBAL INVESTMENT BANKS)



Source: Coalition, Quinlan & Associates analysis

We believe global tier-1 providers will struggle to monetise their waterfront offering and need to become much more selective in terms of carving out their competitive niche across products, sectors and/or geographies. We see bigger headcount cuts on the way.

4. COVERAGE & DISTRIBUTION

With the ongoing shift in trading volumes from high touch to low touch channels, we are starting to see banks rationalise their sales coverage through a mix of headcount reductions and targeted juniorisation efforts; in the past year, we have seen a number of vice presidents at global banks step up into country-level sales head roles that were previously held by managing directors. Furthermore, brokers are requesting their sales teams to only provide coverage to their highest priority accounts. This has been met with varying degrees of cultural resistance from some salespeople, given they have been asked to cease coverage of their key clients.

Brokers are also rapidly embracing social media and mobile technology to drive distribution efforts. Much of this is designed to appeal to a more tech-savvy, younger generation of buy-side professionals. However, we feel a number of firms are still overly-reliant on 'pushing out' PDFs rather than 'drawing in' users who are in search of specific insights.

5. PRICING

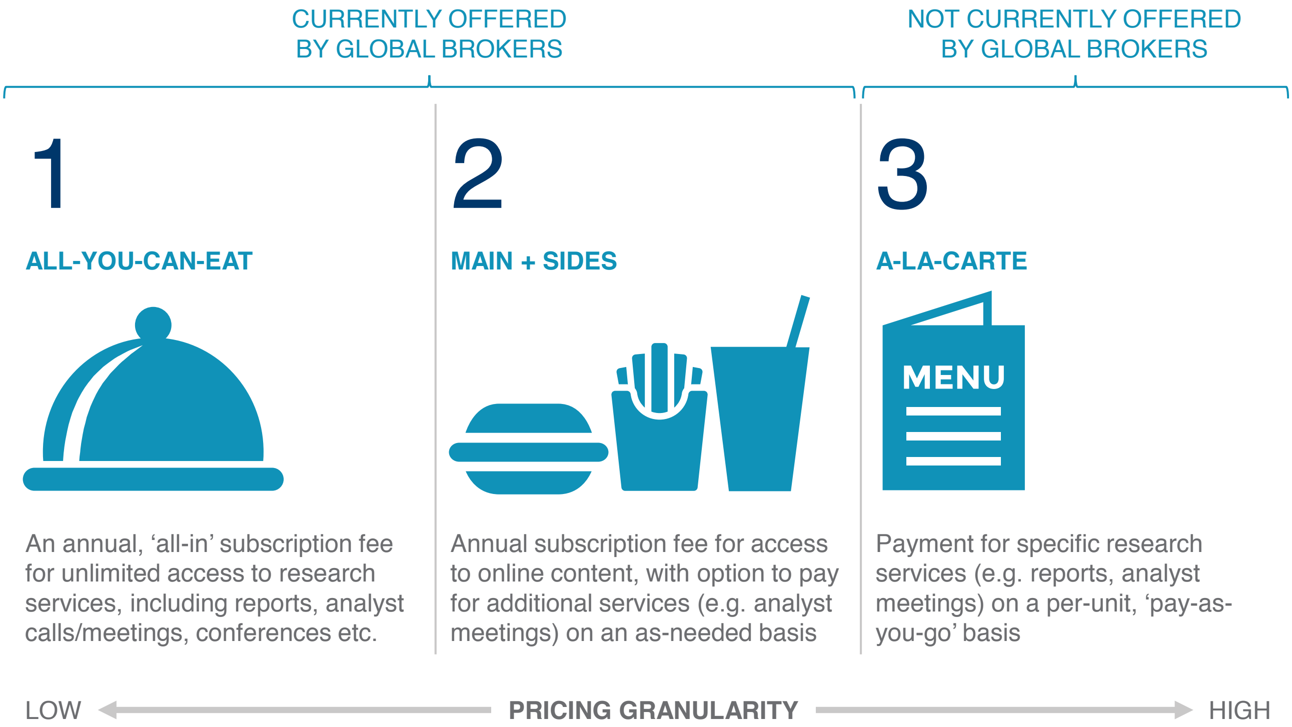
Pricing continues to remain a critical pain point for the sell-side. Most of the global bulge-bracket banks are quoting their clients based on an all-you-can-eat, 'buffet-style' access to their research platforms, which includes unlimited access to global research services. We have heard quotes ranging anywhere from up to the 'millions per year' being offered to the very largest global fund managers, down to as low as USD 250,000-300,000 p.a., with service levels varying according to the amount paid. For single-market European players, pricing for waterfront coverage is hovering around the €50,000+ mark.

Other brokers are looking to adopt a 'subscription-plus' approach to research pricing, charging clients an annual fee for access to their online research platform, together with a 'pay-as-you-go' pricing schedule for additional services. Australian investment bank Macquarie Group recently launched its Macquarie Dimension portal. Macquarie Dimension is a digital platform allowing clients to pay an agreed subscription, with the option to purchase add-on services such as direct access to Macquarie's analysts, third party research and specific client conferences for an additional fee, as and when required (see Figure 4).[6] These additional services are offered using a dynamic pricing schedule which varies according to user demand.

PRICING CONTINUES TO REMAIN A CRITICAL PAIN POINT FOR THE SELL-SIDE. MOST OF THE GLOBAL BULGE-BRACKET BANKS ARE QUOTING THEIR CLIENTS BASED ON AN ALL-YOU-CAN-EAT, 'BUFFET-STYLE' ACCESS TO THEIR RESEARCH PLATFORMS..

6 Macquarie Dimension enhances global equities research offering with flexible access, 30 January 2017, available at: http://www.macquarie.com/au/about/newsroom/2017/macquarie-dimension-global-equities-research

FIGURE 4: RESEARCH PRICING MODELS



Source: Quinlan & Associates analysis

While we believe a number of global managers want a packaged solution from their preferred providers in order to maximise operation simplicity, we see two underlying problems with the pricing models being offered by the major sell-side players. Firstly, most firms are formulating their pricing schedules using a cost-plus approach (i.e. calculating the cost of research provision and adding a profit margin). Compared to independent providers, the research cost base at many global firms remains extremely bloated, given their waterfront offering, as well as the substantial allocated costs associated with supporting the bank's primary (e.g. ECM) and secondary (e.g. sales and trading) businesses.

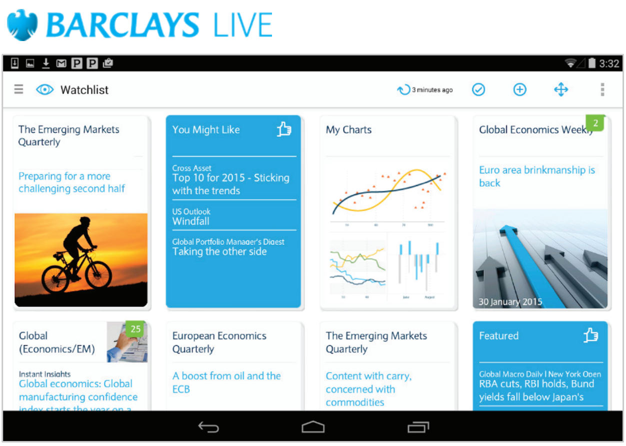
Secondly, the subscription fees being charged by global brokers are too high for many small and mid-sized managers. Even for larger funds, we have received considerable feedback that there is insufficient granularity around pricing schedules, with managers only willing to pay for the specific country and/or sector coverage they need. A fundamental re-think around research pricing is needed if brokers are to meaningfully engage with the buy-side.

6. TECHNOLOGY & OPERATIONS

Recent years have seen the majority of sell-side institutions invest considerable sums of money in research technology; namely, in the development of state-of-the-art, online research portals. Much of this has been underpinned by a desire to move away from a 'content push' engagement model to one that focuses on 'user draw.'

As part of efforts to make the online experience more engaging, interactive and user-friendly, bank portals are being designed with a number of intuitive functionalities. For example, Barclays' global research portal, Barclays Live, allows clients to create content watchlists, annotate and save research reports, and receive online messages from analysts and salespeople. It can also be downloaded as an app, which can be viewed on both iPad and Android tablets (see Figure 5).

FIGURE 5: BARCLAYS LIVE RESEARCH PORTAL



KEY FEATURES

- Interactive tiles that allow clients to organise a dashboard of content based on the asset classes, securities, currencies and analysts that are of interest to them
- A Watchlist that allows clients to "watch" content without subscribing to it
- A Workbook that allows clients to save their favorite content for easy access in the future
- Seamless synchronisation with Barclays Live on the desktop, where clients can view their tiles on the Watchlist and access their folders in the Workbook
- Annotate content and store it for offline access
- "Live" content, including real-time FX prices from BARX
- Financial forecasts from Barclays' fundamental analysts on more than 2,500 companies under coverage
- Access to market data across rates, securitised products and credit, as well as popular analytic tools from Barclays Live, including CHART, Credit Center and TRENDS
- Ability to receive messages from Barclays analysts and sales teams and create daily summary emails with desired content

Source: Barclays website, Quinlan & Associates analysis

A number of firms are also utilising smart algorithms to better understand user behaviour and dynamically curate online content to suit the specific investment objectives of each individual client.

Through recognising user patterns (e.g. how long clients spend looking at one report, how many time a report is viewed etc.), some of these portals are proactively identifying topics or ideas to help facilitate a client's investment process.

7. BILLING & PAYMENT

While brokers are making efforts to take their pricing schedules to the buy-side, the billing and payment process (e.g. the timing and frequency of payments) remains relatively ad-hoc and unstructured for some firms. We believe a more automated, standardised approach is needed for managers paying out of their own P&L and those using research payment accounts (RPAs).

It will be especially important for brokers being paid through an RPA to establish processes to rebate their clients any surplus funds in the RPA at the end of a period, or to offset it against the research budget and charge calculated for the following period (per the requirements of the European Commission). This will necessitate the implementation of an over-arching model for contract and billing processes, such as standardised rebate protocols.

8. PERFORMANCE TRACKING

Brokers are increasingly leveraging their research portals to track a wide number of metrics linked to user behaviour patterns, including: most common search criteria; which reports are being downloaded; the number of times each report is being downloaded; the average time spent looking at each report; the specific pages of each report that are being read etc. KPIs are also being developed on the back of these metrics to gauge individual analyst performance, such as revenue per analyst and analyst 'popularity' (e.g. reflecting client demand for analyst meetings). The sell-side are also starting to furnish information for fund managers around their engagement with the platform, including detailed research consumption and spend reports.

From a management information (MI) perspective, brokers are now in a much stronger position to evaluate client spend against their usage and consumption patterns. However, as mentioned earlier in this report, accurately determining client-level profitability remains problematic for many larger firms, given their unwieldy allocated cost structures. We believe a strong understanding of both revenues and costs is needed for brokers to identify their most value-add accounts and improve resource allocation decisions across their entire client portfolio.

9. COMPLIANCE & CONTROLS

We believe most research platforms have been designed with compliance requirements in mind. Most importantly, access to online portals (and the breadth/depth of that access) is being controlled by a combination of unique user logins, passwords, and access rights, ensuring only those paying for research services are receiving it (and that they get what they pay for). As such, technology will be critical in adhering to compliance obligations.

While technology is safeguarding access to – and the distribution of – digital content, we believe it must also be used to drive employee behaviour; for example, real-time alert systems to tell analysts and salespeople which calls they can answer. Closely tied to this will be the training employees receive on their duties and obligations under the MiFID II regime. We feel more needs to be done around internal policies and control frameworks as they relate to the 'people' aspect of ensuring compliance with MiFID II. Appropriate reporting guidelines for compliance breaches, together with disciplinary protocols, will also need to be instituted.

SECTION 3
INDUSTRY POSITIONING: THE BUY-SIDE

Thought not explicitly covered in our previous report, we also wanted to evaluate where the buy-side was with respect to their unbundling efforts (see Figure 6).

FIGURE 6: BUY-SIDE READINESS FOR UNBUNDLING

		CRITERIA	DESCRIPTION	STATUS
STRATEGIC CONSIDERATIONS	1	GLOBAL APPLICATION	• Extent to which unbundling is globally implemented	■■■□□
	2	PAYMENT METHOD	• Determination of research payment method (i.e. opex vs. RPA)	■■□□□
	3	INTERNAL RESEARCH	• Build-out of internal research capabilities	■■■■□
	4	BUDGET SETTING	• Methodology behind setting of annual research budgets	■■□□□
	5	CONTENT SOURCING	• Selection of preferred research providers	■■□□□
	6	FUND PRICING	• Impact of unbundling regulations on fund pricing	■■■□□
OPERATIONAL CONSIDERATIONS	7	PERFORMANCE TRACKING	• Creation of an effective performance tracking framework	■■□□□
	8	TECHNOLOGY & OPERATIONS	• Revamp of technological interface and operational processes	■■□□□
	9	COMPLIANCE & CONTROLS	• Implementation of compliance policies and control frameworks	■■□□□

□□□□□ Critical ■■■■■ On Target

Note: there is a high degree of variability between the readiness of tier-1 firms compared to tier-2/3 players, which is reflected in the status rating

Source: Quinlan & Associates analysis

1. GLOBAL APPLICATION

In our August 2016 paper, we predicted global fund managers would, to the greatest extent possible, move to a fully unbundled research payment model in order to reduce the operational complexity associated with having multiple global payment processes.

This sentiment has been widely echoed across the industry. In a poll of over 100 North American buy-side professionals conducted by independent broker ITG in January 2017, 82% of respondents said they plan to fully unbundle all of their brokers globally; this is despite the fact that only 53% believed the new regulations would have a 'direct impact' on their business.[7] In the same month, a survey conducted by ORM RSRCHXchange of over 200 buy-side firms (RSRCHXchange survey) found that 86% of US funds anticipate the MiFID II rules on research unbundling to impact them eventually.[8] A recent survey of U.S. buy-side firms by Greenwich Associates also found none of the respondents would implement two separate research payment processes for the U.S. and Europe, citing 'immense' administrative burdens and costs.[9]

While we recognise a large population of North American managers have a strong awareness of MiFID II, many APAC-headquartered managers operating solely in the Asia Pacific region – especially emerging Asia – are ill-prepared for what lies ahead; some managers we spoke to are not even aware of the unbundling regulations coming out of Europe, let alone the broader impact these regulations could have on their operations in the region. We believe a rapid education process is needed for the Asian buy-side.

2. PAYMENT METHOD

The decision to pay for research out of a firm's own P&L or through an RPA has varied between various buy-side organisations. In our view, payment choice is a function of several factors, including a fund's organisational setup, its internal operational and compliance bandwidth, its client base and its broader competitive strategy (see Figure 7).

7 ITG Website, 'North American buy side expects to unbundle wholesale in 2017,' 6 January 2017, available at: http://www.itg.com/news-article/buy-side-to-unbundle-ahead-of-mifid/

8 RSRCHXchange website, available at: http://rsrchxchange.com/rsrchxchange-mifidii-survey/

9 Financial News London, 'Asset managers import European research rules to US,' 14 March 2017, available at: ' https://www.fnlondon.com/articles/asset-managers-import-european-research-rules-to-us-20170314

FIGURE 7: RESEARCH PAYMENT OPTIONS

	OPTION 1 MANAGER P&L	**OPTION 2** CLIENT FUNDS (RPA)	
	1 OPERATIONAL EXPENSE	**2** ACCOUNTING METHOD	**3** TRANSACTION METHOD
	Paying for research out of the manager's own resources (i.e. via the manager's own P&L)	Paying for research through an explicitly agreed charge to clients (e.g. higher management fee)	Paying for research via an agreed charge alongside a transaction commission (e.g. CSA)
GLOBAL APPLICABILITY	-	×	✓
COMPLIANCE RISK	✓	✓	×
OPERATIONAL COMPLEXITY	✓	-	×
CLIENT ACCEPTANCE	✓	×	-
IMPACT ON BOTTOM-LINE	×	-	-
	Operationally clean, low compliance risks and high client favourability; highest bottom-line impact	Low compliance risks; key challenges are client acceptance and divergence to US/Asia practice	Globally consistent payment model but operationally complex with potential compliance risks

× Negative - Neutral ✓ Positive

Source: Quinlan & Associates analysis

A handful of European funds have already opted to pay for research out of their own P&L, with recent examples including Baillie Gifford, M&G, Stewart Investors, Woodford Investment Management and Jupiter Fund Management – the latter of whom said this would add £5 million to their annual cost base.[10]

Several European private banks, especially the Swiss banks, are also looking to pay for research out of their own pocket, given the complexity of allocating research charges to their many thousands of non-discretionary clients.

10 Financial Times, ''Jupiter CEO: "It's easier to pay for research ourselves",' 24 February 2017, available at: https://www.fnlondon.com/articles/jupiter-to-pay-for-investment-research-from-2018-20170224

Other funds are electing to pay for research using RPAs. In 2015, Legal & General Investment Management (LGIM) opted for a 'hard dollar' approach (i.e. accounting method), introducing a single fixed fund management fee of between 4-15 bps on its various funds, depending on the fund size and investment style. In doing so, LGIM sought to create a specific and identifiable research charge for each of its funds, on top of its existing management fee.

A number of other tier-1 managers with CSAs already in place are opting to pay for research using a soft dollar approach (i.e. transaction method) via an agreed charge alongside a transaction commission. Given their size, most of these managers have the internal resources to address the operational complexities and compliance risks associated with this payment method.

It seems there is no clear preference in terms of which research payment methodology the buy-side is choosing. In a poll of European fund managers at the FIX EMEA Trading Conference in March 2017, while 30% of respondents said they intend to use their own P&L to pay for research, 30% were still undecided (this compares to 50% in the RSRCHXchange survey). The poll also found that only 19% have no plans to change the way they access research after unbundling.[11] It appears many managers are still extremely ill-prepared for what lies ahead.

3. INTERNAL RESEARCH

As outlined in our August 2016 report, we found the buy-side has already been reducing their external research spend in favour of building their internal research capabilities. For some of the firms we spoke to, internal research budgets had risen in excess of 30% from 2012-15.

We believe this trend is likely to continue in the lead-up to 2018 as managers look to make their cost bases more sustainable over the longer-term. In fact, in a survey of 69 fund managers conducted by ORM Electronic Research Interchange (ERIC) in January of this year, 38% of respondents said they intended to expand their internal research teams in response to MiFID II.[12]

4. BUDGET SETTING

Based on our discussions with a number of industry executives, we believe there has been little thought given by many buy-side players in the setting of their research budgets. For a large number of managers we spoke to, budgets were frequently based on historical research spend, which were linked to trading volumes rather than of an independent determination of how much research was actually needed by the fund.

11 Markets Media, 'Buy Side Looks to Unbundle Research,' 6 March 2017, available at: http://marketsmedia.com/buyside-unbundle-research/

12 Electronic Research Interchange, 'Research unbundling is a major concern for asset managers,' 25 January 2017, available at: https://www.globalbankingandfinance.com/research-unbundling-is-a-major-concern-for-asset-managers/

Similar observations have been made by the FCA, who in recent years have identified several instances where firms with budgets did not limit research expenditure to pre-agreed levels, with no satisfactory explanation as to why this was the case. They also found other firms had budgets which were significantly greater than their periodic research expenditure, which called into question whether research budgets were unnecessarily large. In the view of the FCA, these practices could result in a breach its rules, including acting in the best interests of clients (COBS 2.1.1R) and its rule on the use of dealing commission (COBS 11.6.3R).[13]

We believe managers need to adopt a more robust approach around their research budget setting process. It will be important for each firm to understand the drivers of their research budgets (e.g. cost of acquiring research from an independent provider) and how it benchmarks relative to comparable institutions. This will not only be important from a regulatory compliance perspective, but also in demonstrating to end-investors that they are getting value for their money.

5. CONTENT SOURCING

In our August 2016 report, we forecast the buy-side to select a wider variety of highly-ranked research brokers for their specialist capabilities (e.g. Chinese banks, European airlines) rather than pay for a handful of waterfront providers whose content is likely to be varied in quality. Given the low barriers to entry, we also predicted a rise in the number of independent research houses, led by one or more 'star analysts' with deep sector or country expertise. We also anticipated research budgets would increasingly evolve into specialised service pots, with managers choosing firms for their specific service niches: for example, Bank A for its political connections in China and Bank B for its access to primary deal flow. Overall, it was our view that fund managers would need no more than three to five of their best content providers per relevant sector/geography under the new research payment model.

It is becoming apparent that our predictions are starting to materialise. The RSRCHXchange survey conducted in January 2017 indicated a clear shift in research budgets away from the bulge-bracket investment banks, with just 13% of respondents expecting to pay for research from all nine of the largest banks and 72% expecting to use research from less than five banks. Moreover, 67% of respondents expected these banks to constitute less than 60% of their research spend going forward.

13 Financial Conduct Authority, 'Firms continue to fail to meet our expectations on their use of dealing commission,' 3 March 2017, available at: https://www.fca.org.uk/news/news-stories/firms-continue-fail-meet-our-expectations-use-dealing-commission

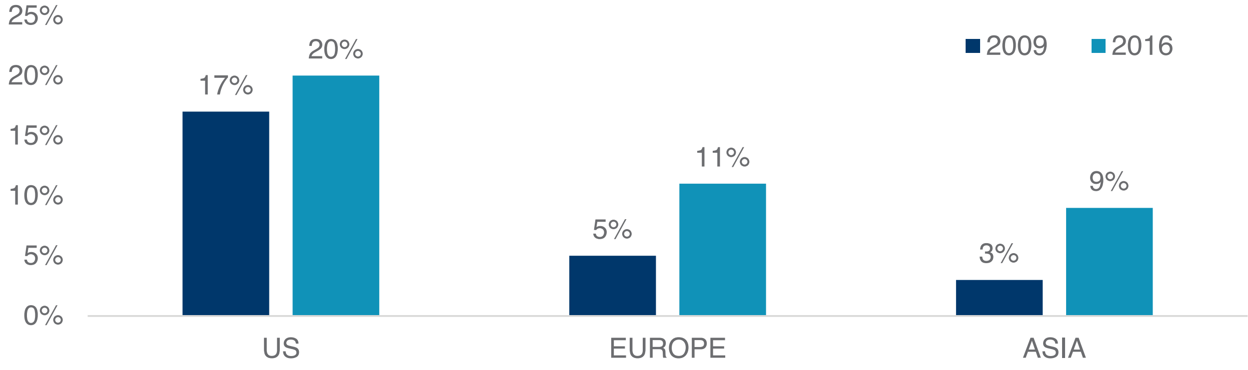
We are also seeing boutique research houses gaining traction, given their ability to provide in-depth, independent analysis at a much lower cost than the major banks. In a recent interview with the Financial Times about the growing propensity for the buy-side to engage boutique research providers, Matthew Benkendorf, chief investment officer of Vontobel Asset Management in the US, estimated that roughly a quarter of the firm's research is sourced from boutiques – and that share is rising.[14]

The rise of boutique research providers is being reflected in their financial and market performance. For example, independent U.K. research houses Autonomous and Redburn saw their 2015 revenues comes in at £90 million and £27.7 million respectively, up from £43.5 million and £5.5 million in 2009. Additionally, 53 independent research houses were nominated by asset managers for Extel's U.K. broker survey in 2016, up from 32 in 2007. Moreover, Euro IRP, a trade body for independent research, has grown from 10 members in 2004 to over 70 today.

Analysis from advisory firm Integrity Research Associates highlights the growing influence of independent research houses since the financial crisis. In Europe, for example, it estimates that the combined market share of independent research houses rose from 5% in 2009 to 11% in 2016. The combined market share of independent research houses in Asia was estimated to have risen from 3% to 9% over the same period (see Figure 8).

14 Financial Times, 'Boutique research groups set to gain from charging shakeup,' 1 March 2017, available at: https://www.ft.com/content/551ed82a-f1ff-11e6-8758-6876151821a6

FIGURE 8: MARKET SHARE OF INDEPENDENT RESEARCH HOUSES



Source: Integrity Research Associates, Quinlan & Associates analysis

6. FUND PRICING

We have seen various responses by the buy-side with respect to their fund pricing strategies in the lead-up to 2018.

Despite opting to pay for its own research costs, Woodford Investment Management confirmed there would be no increase in its existing management fee. On the opposite end of the spectrum, managers adopting a hard dollar RPA approach are increasing fees on their funds with a separate and identifiable charge for research, such as LGIM. For managers using a soft dollar RPA approach, we have generally not seen an increase in fund pricing.

Overall, we feel the buy-side will need to wear more of the costs of investment research rather than passing it on to clients through higher management fees. With the ongoing asset shift from active to passive funds and continued industry consolidation in an effort to capture economies of scale, we believe management fees are only going to go one way: down. As such, managers who are able to shoulder their research costs are likely to be much better positioned in the new competitive environment, though the impact this will have on a firm's underlying economics will need to be carefully considered.

7. PERFORMANCE TRACKING

A critical requirement for managers post-MiFID II go-live will be their ability to determine how value is being generated from their research spend; in particular, for those using an RPA, regularly assessing the quality of the research purchased based on robust quality criteria and its ability to contribute to better investment decisions.

We understand there are still a large number of managers who have not laid out these quality criteria in detail, nor understand how to prove such research is adding to their investment process.

Better performance management frameworks are needed, including the development of appropriate internal KPIs (e.g. how to rank research providers) that are endorsed within the organisation and recognised by relevant stakeholders, including clients and regulators.

8. TECHNOLOGY & OPERATIONS

The buy-side still has a considerable amount of work to do from a technological and operational perspective in order to get ready for MiFID II.

Many key challenges relate to the operational processes tied to operating in the new environment – for example, should a CSA program be established (e.g. via a CSA aggregator)? How should research budgets be communicated to clients? Should the management of an RPA be outsourced to a third-party manager? Does the manager want to measure and rank internal research consumption? The decision to in-house or outsource these functions will come with their own specific operational considerations.

Technology will also be critical in automating many of these processes that will be required of managers under MiFID II, as well as tracking many of the KPIs/metrics that will be implemented by managers post-2018. This could be as simple as creating an automated management dashboard to monitor monthly research consumption and spend, to leveraging CRM tools in an effort to further optimise client coverage.

9. COMPLIANCE & CONTROLS

We believe managers have a long way to go in terms of being MiFID II compliant.

According to a review by the FCA after visiting 17 asset managers to examine their dealing commission arrangements between 2012 and 2015,[15] it was found that many firms were still falling short of the FCA's expectations, including:

- assessing whether a research good or service received is substantive (including the setting of research budgets, as mentioned earlier)
- attributing a price or cost to substantive research if they receive it in return for dealing commission
- recording their assessments to demonstrate they are meeting COBS 11.6.3R and are not spending more of their customers' money than necessary

While the FCA has seen an improvement in practices over the past few years, they still identified poor practices at the majority of firms they visited, with a number of managers unable to demonstrate meaningful improvements in terms of how they spend their customers' money through their dealing commission arrangements. In fact, some firms were found to be using dealing commission to purchase non-permissible items, such as corporate access and market data services, contrary to FCA rules.

From a system, control and record-keeping perspective, the FCA also found arrangements to demonstrate only 'substantive' research is paid for using dealing commission were either poor or missing, with records lacking sufficient information to prove this. Challenge and validation from front-line management was also missing for many firms.

We believe a renewed focus on compliance and controls is urgently needed by the buy-side, given the potential for breaches to be met with punitive regulatory action, and the consequential fallout this is likely to have for a manager's reputation and future operations. However, we also feel greater regulatory guidance would be extremely beneficial, with many industry participants citing a lack of clarity around the specific policies and processes that need to be implemented to be MiFID II-compliant

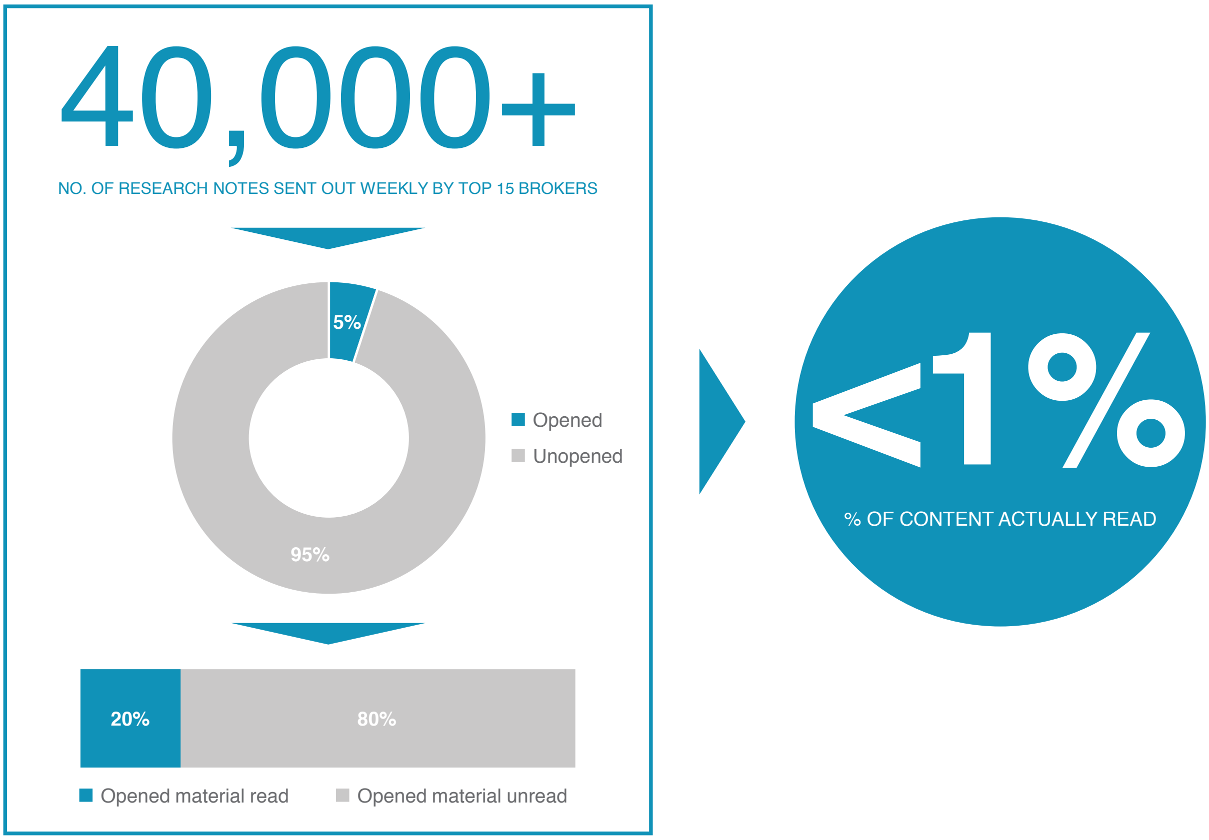
15 Financial Conduct Authority, 'Firms continue to fail to meet our expectations on their use of dealing commission,' 3 March 2017, available at: https://www.fca.org.uk/news/news-stories/firms-continue-fail-meet-our-expectations-use-dealing-commission

SECTION 4
LIMITATIONS OF PROPRIETARY RESEARCH PLATFORMS

As highlighted earlier in this report, for many decades banks have distributed their research to clients as PDF reports attached to widespread email blasts. However, in a rapidly digitised world, such mechanisms are proving increasingly ineffective. In fact, we estimate that well over 40,000 research notes – from comprehensive reports to minor updates linked to corporate announcements – are sent out every week by the top 15 global investment banks, of which less than 5% are opened.

Even for those reports which are opened, our conversations with buy-side professionals reveals less than 20% of a report's content is actually read; most managers we spoke to limit their focus to the executive summary and key takeaways. As a whole, this means less than 1% of all content being sent out by brokerages is actually being consumed by the buy-side (see Figure 9).

FIGURE 9: RESEARCH PENETRATION RATES

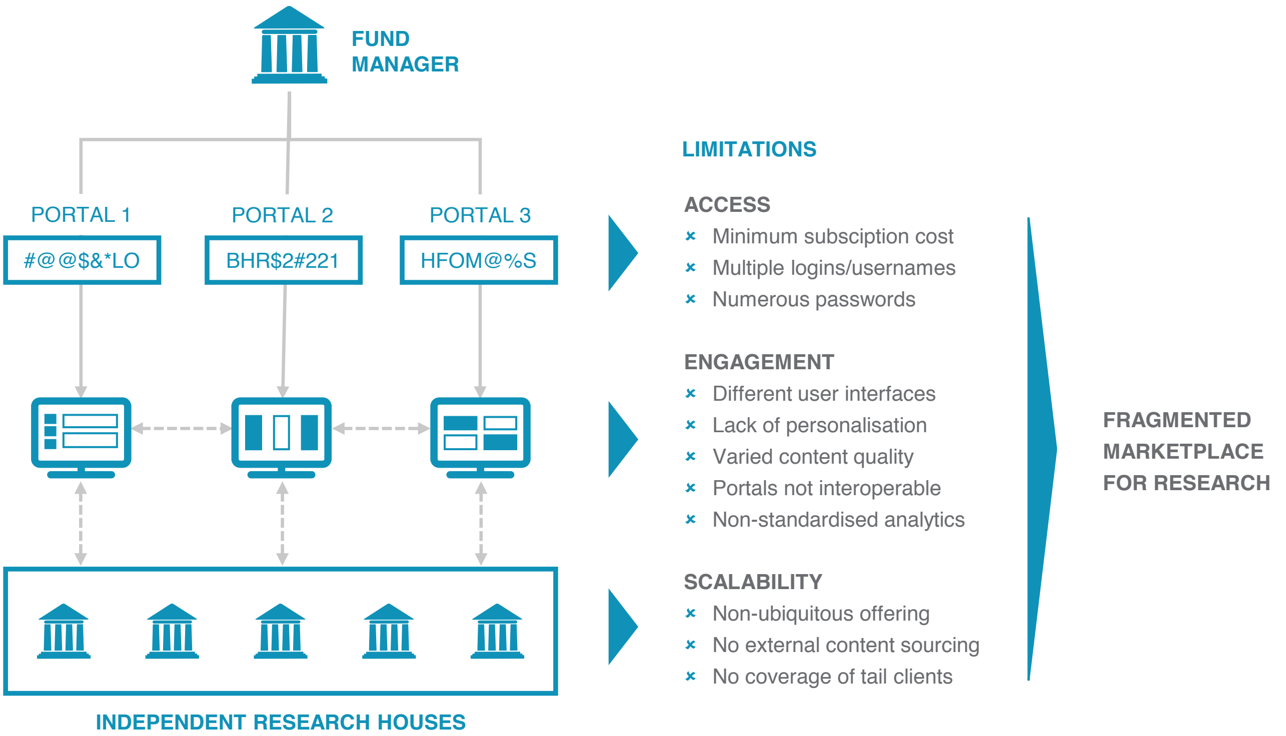


Source: Quinlan & Associates proprietary estimates

As highlighted in Section 2, the global brokers are responding by investing heavily in the development of proprietary research portals (e.g. Barclays Live), seeking to move from a 'product push' to 'customer pull' strategy. Many firms are also leveraging mobile apps, as well as social media and multimedia channels, as a means to enhance the overall user experience, making it more personalised, interactive and engaging.

While the development of online research portals is a step in the right direction side, we feel proprietary platforms fall short of providing a truly effective solution for the buy-side. This is due to a number of issues associated with: (1) access, (2) engagement and (3) scalability (see Figure 10).

FIGURE 10: LIMITATIONS OF BROKER RESEARCH PORTALS



Source: Quinlan & Associates proprietary analysis

1. ACCESS

As previously outlined, most global brokers are looking to charge a minimum 'subscription fee' for access to their online research portals. For the vast majority of these firms, pricing is being based on the provision of waterfront coverage (i.e. unlimited access to their online content), which is out of reach for smaller fund managers. Moreover, given their targeted investment focus, many of these funds are looking to source more tailored content (i.e. research on specific countries and/or sectors) as opposed to receiving – and paying for – wholesale international coverage.

Even for managers who can afford the minimum subscription costs being charged by larger brokers, they will still need to navigate multiple logins/usernames and passwords of their research providers, which is likely to be highly burdensome.

2. ENGAGEMENT

We believe one of the main problems with online research portals relates to user engagement.

First and foremost, each platform will employ a different user interface, meaning managers will need to familiarise themselves with the functionalities that are unique to each broker's online portal (e.g. page layout, search engine). This is likely to create considerable inefficiencies with respect to manager time. Some interfaces will also be less intuitively designed vis-à-vis the competition, making them harder to navigate and significantly detracting from user appeal. Moreover, many brokers are still too reliant on distributing their reports in PDF format, which are hard to search, lack interactivity and are difficult to view on mobile devices.

Broker portals also offer varying degrees of personalisation; while some filtering of content will take place depending on the specific manager and their needs, many users are presented with a homogenous dashboard featuring each brokers' latest insights, which may not be of any relevance to the investment strategy of that particular manager. Smart algorithms will be needed to ensure manager usage behaviours are well understood so that only relevant information is presented and done so in a timely manner.

Even for brokers who are able to fully customise their research portals to provide content that is relevant to each individual client, research quality will vary considerably across products, sectors and geographies, given each broker's respective strengths and weaknesses relative to other firms. It is our long-held view that managers will be unwilling to pay for – or even want – content from a poorly-ranked team and will only be looking to source their specific content needs from a selection of their most-preferred provider/s. Proprietary portals will be unable to deliver on this.

Closely tied to this problem is the fact that broker research portals are not interoperable. We firmly believe the buy-side will want the flexibility to select their most relevant content from a multitude of providers without navigating multiple platforms. One senior executive at a global investment bank we spoke to echoed this sentiment, commenting that many of their clients only wanted to use a single portal to manage their research needs.

Finally, each research portal is likely to generate its own analytics and metrics for users that are specific to the individual broker. For example, usage could be defined as total downloads of a report, number of unique downloads, or time spent with report open in an active window. These metrics will be important from a buy-side management information (MI) perspective, as well as meeting the many audit and compliance requirements tied to the use of RPAs. This is particularly relevant to the budget setting process and demonstrating the 'value add' of purchased research. We believe common, industry-wide metrics are needed for the buy-side to gain maximum utility from the use of online platforms. If not, managers will be spending a considerable amount of time manually standardising outputs from each provider to not only ensure they align with their own internal policies around research consumption and payment, but can be furnished in a fast and digestible manner to regulators.

3. SCALABILITY

While many global brokers – particularly the bulge-bracket banks – claim to offer waterfront research coverage, the content they are providing to their clients is far from universal; it is, in reality, only one point of view from a single firm.

The majority of sell-side institutions we spoke to did not allow independent research providers to distribute content through their online platforms. Instead, many independents are turning to ORMs as a distribution channel. We believe such a move is a critical miss for the sell-side, given the huge opportunity for brokers to leverage their proprietary portals as a means to share content outside of their coverage universe.

Efforts to capture this opportunity were made by Bank of America Merrill Lynch (BAML) in 2007, when it launched its Open Minds alternative research platform to run alongside its proprietary research offering. Open Minds provides BAML's institutional clients with specialised independent research covering a range of subjects – such as regulation, litigation, predictive analytics and corporate integrity risk – that the bank itself does not offer.

In addition to sourcing content from independent providers, none of the major brokers are currently distributing their research through the aggregation platforms. As a consequence, they are failing to access a growing population of 'tail' clients (including start-up hedge funds and individual investors) who are interested in sourcing specific content but can't afford the minimum subscription costs being charged by the international research houses. We see this as a missed wallet opportunity.

SUMMARY

Whilst we have highlighted the various limitations of the proprietary research portals, we believe they will still have an important role in future. However, we believe all brokers will ultimately need to feed their content to ORMs in order to cover the widest spectrum of buy-side clients possible, especially as managers look for a one-stop-shop solution for their research needs. We also believe there is intrinsic value that major brokers will continue to provide in terms of premium services around access to corporates and primary deal flow. However, it is clear that ORMs are going to be a major disruptor.

SECTION 5
THE DEMOCRATISATION OF RESEARCH

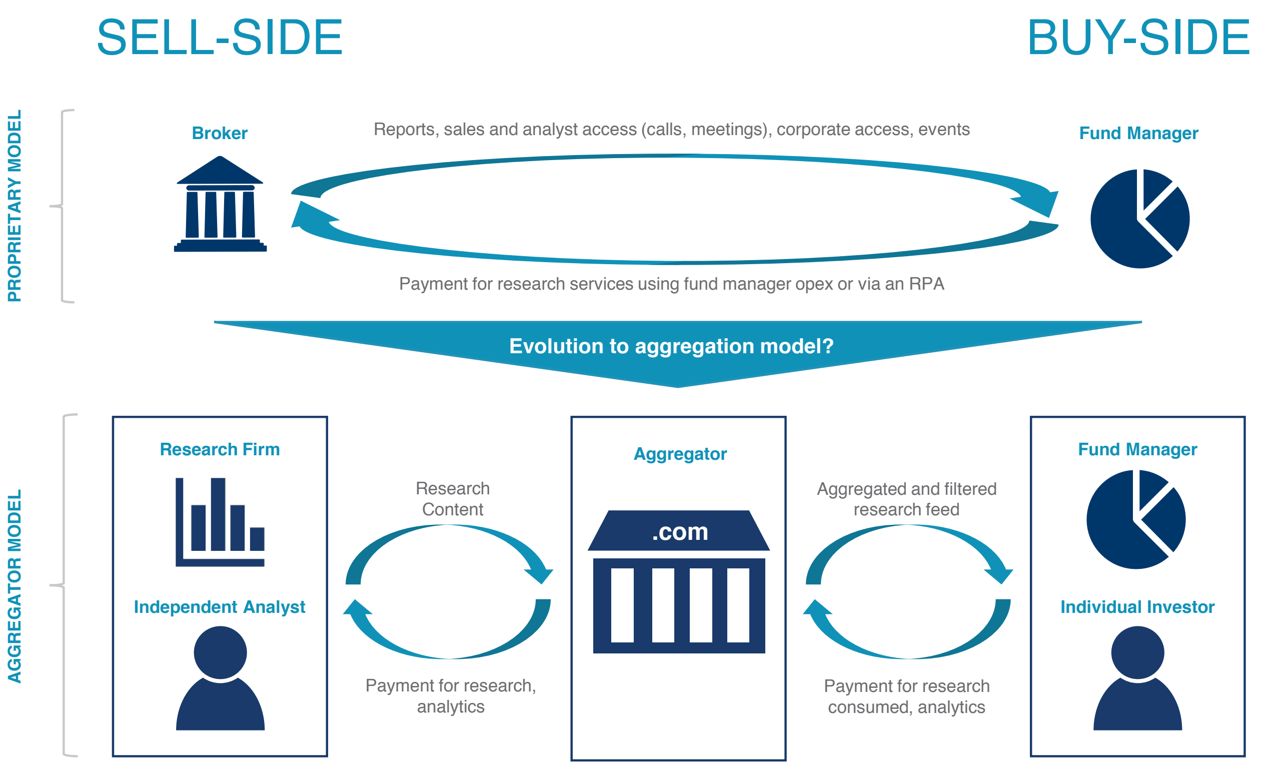
THE RISE OF ORMs

In recent years, we have seen the advent of disruptive, technology-based marketplaces across a number of industries, including consumer goods (e.g. eBay) and travel & tourism (e.g. Expedia). These companies have positioned themselves as key aggregation intermediaries for suppliers and consumers in their respective industries; Alibaba, for example, has established itself as a market-leading business-to-business portal for thousands of categories of physical goods. Common to each platform is the ability to filter a large universe of suppliers, with a mixture of quality validation via peer ratings, greater price transparency and/or dynamic pricing, together with an element of insurance for end users.

Similar developments are now taking place in the investment research world. In the past 2-3 years, we have witnessed a slew of ORMs emerging, such as Alpha Exchange, Alphametry, Electronic Research Interchange (ERIC), ResearchPool, Smartkarma and StockView, to name a few. The ORMs provide a forum for research firms and even individual influencers to contribute content, with proprietary search engines tailoring output to the end user's criteria (see Figure 11).

IN RECENT YEARS, WE HAVE SEEN THE ADVENT OF DISRUPTIVE, TECHNOLOGY-BASED MARKETPLACES ACROSS A NUMBER OF INDUSTRIES, INCLUDING CONSUMER GOODS (E.G. EBAY) AND TRAVEL & TOURISM (E.G. EXPEDIA).

FIGURE 11: THE EMERGENCE OF RESEARCH AGGREGATORS



Source: Quinlan & Associates proprietary estimates

KEY FEATURES

Typical pricing models observed for emerging ORMs range from pay-per-report to subscription models for unlimited access to content. Value-added services such as email or video interactions with contributors, as well as bespoke research engagement, can be purchased for an additional fee. In response to mounting regulatory requirements, these ORMs also provide detailed analytics around the users' own research consumption and spending patterns.

At present, most of the research providers who have signed up on these ORMs are generally smaller, independent research houses. We believe ORMs will have particular appeal to asset managers running specialised portfolios (such as small-cap stocks and frontier markets), as well as managers with more limited research budgets.

On the other end of the spectrum, Smartkarma recently partnered with Societe Generale (SocGen) in the provision of Asian equity coverage (which SocGen had previously not covered itself in the region) for the bank's institutional clients. The arrangement provides Smartkarma's contributors with a significant 'captive' audience while giving the bank the ability to market independent content to its clients in Asia without incurring any internal research overhead.

OUTLOOK

While the development of ORMs is still relatively nascent, we expect many research providers to distribute their research across more than one platform, much in the same way as most hotels (even the largest hotel chains) offer their rooms across all the major accommodation marketplaces such as Bookings.com and Hotels.com.

We also believe the larger research providers, including global waterfront houses, would benefit from disseminating their content via ORMs, given the mix of intangible (e.g. branding) and P&L benefits to accessing a growing body of smaller clients (e.g. new hedge funds) that won't be able to afford the subscription costs being charged by the major brokers.

For research consumers, we believe the main differentiators which will determine the relative success of an individual ORM will include ease of use, pricing terms, and exclusive or value-add capabilities, such as spend/usage reports, bespoke research and access to the contributor and/or corporate. Many of these considerations mirror those for the online accommodation marketplaces (see Figure 12). Easily digestible, HTML5-capable formats that offer a visually enriched experience will also be critical in enhancing a portal's 'pull' factor, as well as the provision of unbiased analytics on research consumption.

As discussed earlier, we do not expect the buy-side will want to use multiple proprietary platforms to manage their research needs. An industry-wide solution is needed. We believe the ORMs are an important step in providing a workable interface for both the buy and sell-side.

FIGURE 12: AGGREGATOR PROPOSITION FOR CONSUMERS

	ACCOMODATION	RESEARCH
	Booking.com, trivago, HotelsCombined, Hotels.com	ResearchPool, alpha exchange, smartkarma, ERIC
INTERFACE	• Filter and sort by price, location, room configuration, and other criteria • View location of options on map	• Fully customisable dashboard • Filter research by asset class, sector, region, trading theme
BREADTH OF OFFERING	• Total number of rooms • Major hotels / boutique hotels on offer • B&B options available	• Number of reports and providers • Small cap and frontier country coverage • Independent firms and analysts
PRICING	• Price for the same room • Cancellation policy • Book ten nights, get one free	• Price for the same report • One subscription price • Multi-user access
FEEDBACK	• Rated by TripAdvisor and site's consumers • Last time booked	• Rated by site's consumers • Number of downloads
ACCESSIBILITY	• Desktop • Mobile app	• Desktop • Mobile app
VALUE-ADD	• Package deals • Exclusive deals • Hotel photos and details	• Budget and consumption reporting tools • Company price feed and high level financials • Analyst interaction and corporate access • Bespoke research

Source: Company websites, Quinlan & Associates analysis

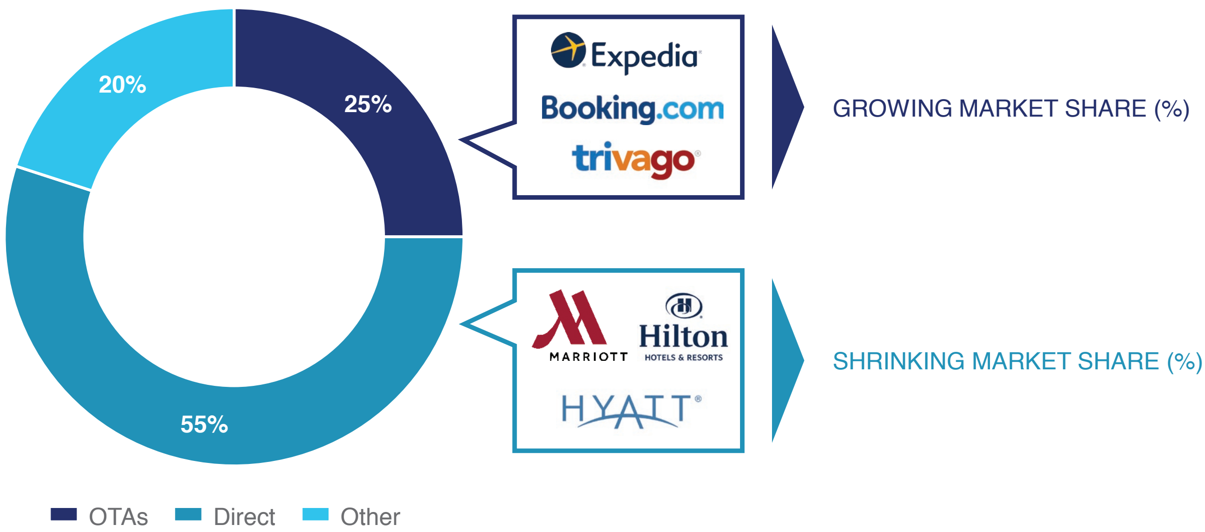
OPPORTUNITY

While we maintain our forecast that global research spend will decline by 25-30% by 2020, we expect the addressable market for ORMs to grow exponentially in coming years. There will be three underlying forces driving this trend:

1. The growing influence of boutique research houses and independent analysts, who will look to distribute their content through ORMs in an effort to raise their visibility;
2. The movement of research spend by smaller 'tail' clients to aggregation platforms, either as a result of being off-boarded by global banks (as part of their wider 'de-risking' efforts) or because they are not able to afford the minimum subscription costs being charged by international brokers for access to their proprietary research portals;
3. The increased distribution of global broker content through ORMs as the buy-side demands the ability to search and compare research via a 'one-stop-shop' portal (and bulge bracket banks look to maximise their revenue streams per unit of content produced).

So just how much of the research market are the ORMs likely to capture? To draw a parallel, when looking at data from the travel and tourism industry, it is clear that online travel agents (OTAs) have been steadily gaining market share over the years. According to a recent study by HOTREC (the Europe Trade Association of Hotels, Restaurants and Cafes) of over 2,000 hoteliers, one in four bookings are now made through OTAs, with the two largest players (Booking.com and the Expedia Group) commanding nearly 80% market share in the European OTA space in 2016. Similarly, direct hotel bookings are on the decline and accounted for ~55% of all online bookings in Europe in 2016 (see Figure 13).

FIGURE 13: SHARE OF ONLINE TRAVEL AGENT BOOKINGS (EUROPE)



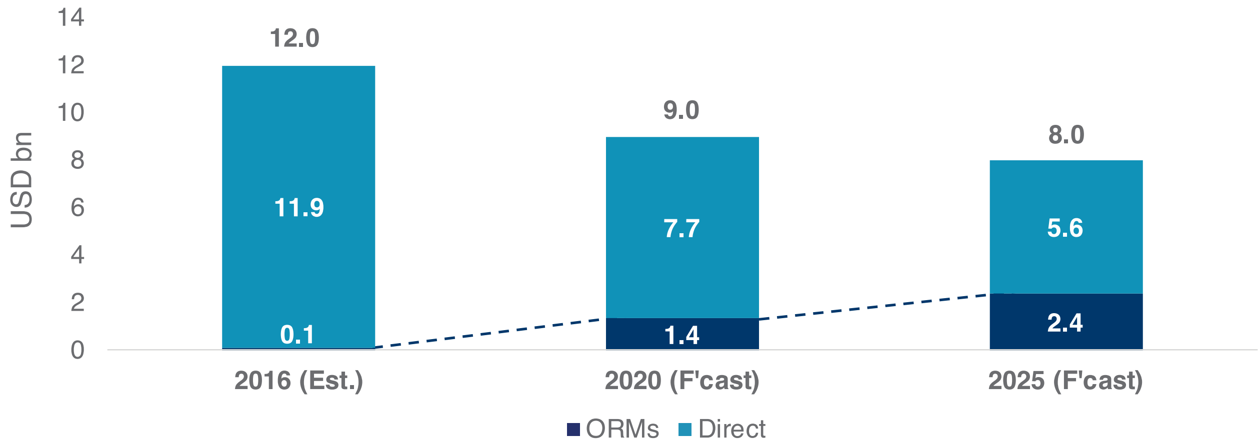
Source: HOTREC, Quinlan & Associates analysis

We believe similar trends are likely to emerge in the research space. In fact, user engagement with ORMs might even be higher than OTAs for a number of reasons:

1. Unlike the average traveller who may only book accommodation a handful of times each year, fund managers will need to access investment research – and hence their online platforms – on a daily basis, which will make navigating multiple proprietary portals extremely burdensome;
2. The need to access content is considerably more time sensitive than booking a hotel. Given the capacity for some research calls to move the market, fund managers will need instantaneous access to a wide spectrum of reports;
3. Hotels are a static commodity; consumers generally know what they are getting or, at very least, they can see what they should be getting before making a purchase (i.e. via photos and customer reviews). Research, on the other hand, is a dynamic, ever-changing product whose quality can only be evaluated once it is paid for. As such, an analyst's reputation is critical. The rating mechanisms being offered by the ORMs will allow the managers to compare and contrast different providers instantaneously and on an ongoing basis.
4. There are many comparable substitutes in the hotel market; if one's preferred hotel is booked out, there are usually plenty of alternative options a traveller would be happy to stay at. This is not the case with research reports, where ideas – and their capacity to influence trading decisions – are unique to the individual analyst. Ubiquitous access to the latest insights on an instantaneous basis is critical, which is something proprietary portals are unable to deliver.
5. Hotels have many different loyalty and incentive programs that attach customers to specific brands (e.g. points, bulk discounts, and club benefits). Brokers, however, have not developed any such programs as yet for their research portals. Brand loyalty in the research business is about the individual analyst, not the firm, which detracts from the value of proprietary platforms.
6. There is a clear operational and compliance benefit to using ORMs; their ability to provide standardised and impartial research consumption and evaluation solutions (including reports) helps users meet their compliance obligations under MiFID II. This makes them an extremely attractive proposition when compared to the different reporting solutions offered at present by each individual broker.

Based on this, we forecast ORMs to capture 15% of the research market by 2020, representing a ~USD 1.4 billion wallet opportunity. By 2025, we see these figures rising to 30% and USD 2.4 billion respectively (see Figure 14).

FIGURE 14: ORM SHARE OF RESEARCH WALLET



Note: 2016 research wallet is split ~USD 10bn for equity research and ~USD 2bn for fixed income research

Source: Greenwich Associates, Quinlan & Associates estimates

For our forecasts to materialise, we will need to see a willingness by the major brokers to distribute their research on ORMs, just as the major hotel groups have done with the OTAs. While no major brokers have opted to do so as yet, we believe this will soon change as global sell-side players struggle to monetise their waterfront coverage offering via their proprietary portals and as managers demand an industry-wide solution to their research consumption needs.

SECTION 6
CASE STUDY

We had the opportunity to interview the team at ResearchPool, an ORM that allows the buy-side to access leading independent investment research via a single, online marketplace.

BACKGROUND

ResearchPool was set up in 2015 by a team of seasoned financial market infrastructure specialists who believe that a more efficient and transparent investment research market will eventually replace the current modus operandi.

In July 2015, ResearchPool was the first company to launch an ORM as a minimum viable product. It now has a fully operational online platform, bringing together a significant number of research providers and consumers.

The company's core proposition is to democratise research production, intermediation and consumption by:

1. Making research discovery open and free to all users anywhere and anytime;
2. Aggregating all research content via a single online storefront with intuitive filtering;
3. Empowering users to consume and transparently pay for the research of their choice only;
4. Empowering providers to set their own prices and be transparently compensated for each report or subscription sold.

For professional consumers, the company also provides research spending, usage and evaluation solutions to assist them in meeting regulatory requirements and improve organisational productivity.

HOW IT WORKS FOR RESEARCH CONSUMERS

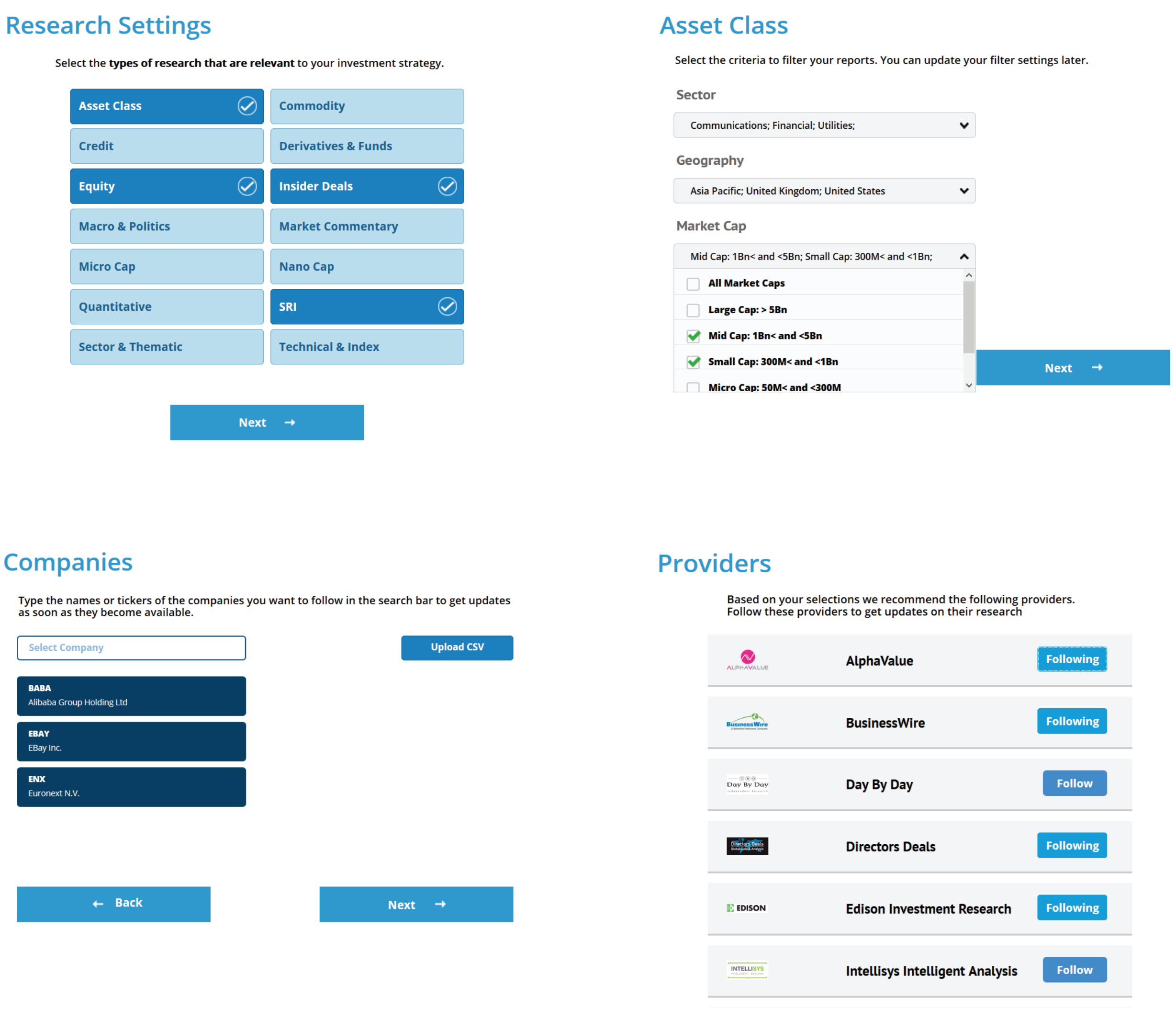
USER EXPERIENCE

As the ResearchPool marketplace is currently live, there is the ability to immediately register for and access the web portal. The simplified registration process means users can immediately start using certain aspects of the portal without waiting for access to be activated, or a salesperson to contact them. We believe that this instant access is leading to strong uptake by new users.

Following registration, the research feeds can be customised according to an individual user's criteria, including type of analysis, asset class, industry, region, and research provider (see Figure 15). We found that this process only took a few minutes to complete, and preferences can be easily updated.

After opting to follow a number of companies, a list of providers is suggested based on research interests and companies followed. The dashboard then displays a live feed of published articles from those chosen providers, or for the investment strategies, industries or stocks being followed (see Figure 16). We could easily imagine this dashboard becoming a key news feed for some users. There is also a predictive search function which offers research suggestions broken down by company, provider, etc.

FIGURE 15: RESEARCHPOOL – SETTING UP THE RESEARCH FEED



Source: ResearchPool, Quinlan & Associates analysis

After opting to follow a number of companies, a list of providers is suggested based on research interests and companies followed. The dashboard then displays a live feed of published articles from those chosen providers, or for the investment strategies, industries or stocks being followed (see Figure 16). We could easily imagine this dashboard becoming a key news feed for some users. There is also a predictive search function which offers research suggestions broken down by company, provider, etc.

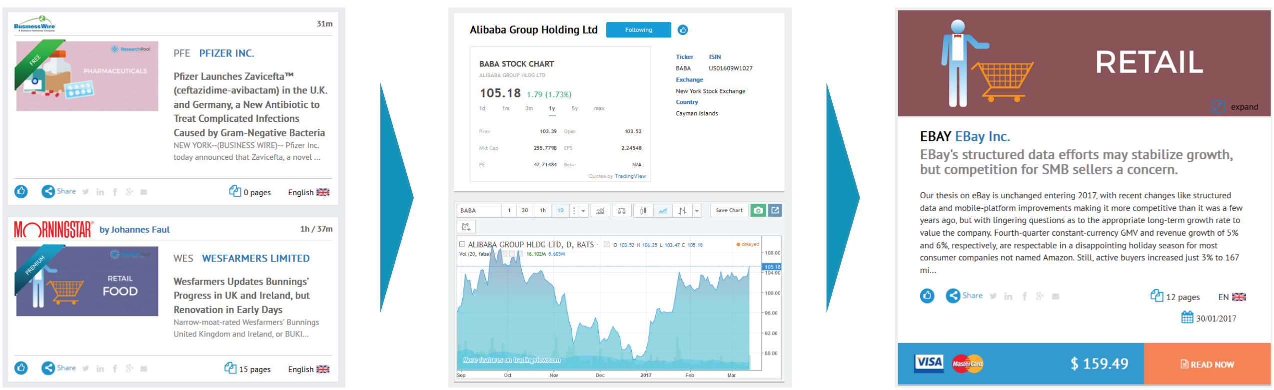
Each covered company also has a profile page which displays a live price feed and all the research about that stock offered by different providers. Research providers also have their own profile pages.

Upon selecting a report, and prior to purchase of that report, the title and a three-line summary can be viewed by marketplace users.

ResearchPool has adopted an open discovery process which means that the title and summary of a report are available on search engines, allowing providers to be more easily discovered and making it easier for consumers to find relevant research. The company has also actively adopted social media into their dissemination model with reports also fed to ResearchPool's Twitter account.

FIGURE 16: RESEARCHPOOL – VIEWS

REPORT FEED | COMPANY OVERVIEW PAGE | REPORT OVERVIEW



Source: ResearchPool, Quinlan & Associates analysis

Once a report is read, users have an option to rate the quality of the publication (from 1 to 5 stars), with the results shared with individual users from the same investment manager or user organisation. Currently, ratings are not made available to the general public, given the proprietary nature of the opinions. We believe that as critical mass is obtained, this model may change, whether in terms of the granularity or observability of ratings.

PRICING

There is a two-tier pricing model for research:

1. **Premium:** pay per report, ranging up to USD 250
2. **Subscription:** a fixed amount for all reports from a provider

The subscription model provides full access for us to five users for a fixed periodic fee with incremental charges for each additional user which caps out at a fairly high number of users.

Payment via credit card is available to all users, whilst payment via bank transfer or from RPAs is only available to verified business accounts.

CONTENT SOURCING

There are currently over 200,000 articles in the marketplace from approximately 150 providers, including Morningstar and Standard & Poor's, as well as boutique analysts for markets in Africa, Asia, Eastern Europe and the Middle East. Not all articles are research reports. Business Wire, for example, is a contributor which feeds company news such as corporate press releases. Such articles are available to users for free.

Whilst some of the other ORMs allow contributions from individual influencers, ResearchPool only sources content from licensed research providers that already have a reputation in the market. This is not limited to well-established firms, but also boutiques founded by experienced sell-side analysts.

CONSUMPTION AND EVALUATION SOLUTIONS

For verified business accounts, spend dashboards can be customised to track total spend against agreed budgets, with allocation of budgets down to individual fund or individual user levels. Unlike consumption reporting from sell-side providers, ResearchPool provides an independent data source aggregating across all the different providers that have been utilised – including research consumed outside ResearchPool.

As MiFID II requires a determination of the value of research consumed in order to support payment decisions, ResearchPool also provides a consistent methodology for rating providers and analysts used across an organisation, whether on Research Pool or not, as described above.

VALUE-ADDED SERVICES

Beyond research report aggregation, ResearchPool has partnered with Corporate Access Network (CAN) to provide corporate access to the companies covered by its registered analysts. CAN is an online corporate access platform which currently provides access to over 2,000 companies, including some of the biggest companies in North America and Europe. Other value-added services are also being developed.

SUMMARY

Overall, we found the dashboard and filtering functionalities intuitive and easy to use, with a solid line-up of contributors providing breadth and some interesting niche specialisations, such as Eastern Europe, Middle East and North Africa coverage. The pricing of the subscription model for professional users appeared comparable to other ORMs.

If we draw parallels to the consumer marketplaces that have developed in recent years, certain functionalities are still not seen across the ORMs. These include much more advanced filtering of content, based on factors such as number of report downloads and number of followers of a provider, which will help facilitate report and provider selection. This will be vitally important as the volume of data that we anticipate will migrate to the ORMs will be enormous. Dynamic pricing will be another element that will enhance price discovery for research reports.

We expect to see rapid improvements and refinements to functionalities as ORMs such as ResearchPool react to feedback from early adopters.

SECTION 7
CONCLUSIONS & RECOMMENDATIONS

With only 9 months to go until MiFID II takes effect, we believe the industry still has much to do to prepare for regulatory go-live. However, we see ORMs fundamentally altering the research industry as we know it.

On the sell-side, as the global investment banks loosen their stranglehold on investment research and independent providers grow in their influence, we are likely to see an increasingly larger share of content making its way to ORMs as brokers – both large and small – look to increase their visibility and expand their client reach. ORMs will also be critical enablers in the price discovery process, helping to create a transparent, market-determined value for investment research. On the far end of the spectrum, tie-ups like the one between Smartkarma and SocGen call into question the entire value proposition of banks in-housing investment research. Going forward, we believe major brokers need to think much more seriously about their engagement with ORMs, given the very real limitations of their proprietary research platforms.

On the buy-side, we believe ORMs can help to address the many strategic and operational challenges facing managers in Europe and abroad. Not only are ORMs likely to make the ‘idea shopping’ experience more intuitive, engaging, rapid and comprehensive, but the various consumption and evaluation solutions on offer by leading platforms can help managers minimise their operational burdens while concurrently meeting their MiFID II compliance obligations in a more standardised, one-stop-shop manner.

For the ORMs themselves, we see ample opportunity in coming months to engage with both buy-side and sell-side stakeholders in an effort to raise awareness and increase critical mass of research providers and consumers. While a number of ORMs have set up operations in the past 24 months, we are likely to see consolidation post-2018 as market participants gravitate towards firms who are able to provide users with the best overall experience and value-add solutions. A clear first-mover advantage is waiting to be captured by the strongest platforms. Funding will be a key differentiator between the ultimate winners and the losers.

With ORMs forecast to represent a USD 1.4 billion market opportunity by 2020 and USD 2.4 billion by 2025, managers and brokers are advised to take the necessary steps to capitalise on an industry that is facing rapid – and major – disruption.

SECTION 8
HOW CAN WE HELP?

Our consultants have worked with a number of brokers, buy-side players and ORMs on their strategies in response to MiFID II's research unbundling regulations.

SELL-SIDE

As outlined in Section 2, the sell-side still faces key challenges around client segmentation, product offering, pricing and billing & payments. Example of areas where we can help include:

- Conduct client-level profitability segmentation analysis to improve coverage decisions
- Benchmark performance of research offering to drive product re-calibration decisions
- Develop workable research pricing schedules to maximise firm economics and client demand

BUY-SIDE

We recognise many buy-side firms are still extremely unprepared for MiFID II implementation, especially players in Asia Pacific. Examples of areas where we can help include:

- Assess the impact of regulations on current business model, broker interactions and service offerings, and governance models, especially for regional businesses
- Determine appropriate research payment option (i.e. P&L vs. RPA)
- Develop methodology for research budget setting and monitoring (including setting up KPIs)

ORMs

We believe the new landscape is providing ample opportunities for newer entrants with the right strategy and execution roadmap. Examples of areas where we can help include:

- Develop a strategic plan for independent research providers to capture the new opportunities, including a comprehensive review of their value proposition and unique selling points (USPs)
- Determine the most appropriate collaboration and distribution channels for providers
- Introduce new entrants to potential collaborators

REGULATORS

We believe regulators can facilitate the implementation of MiFID II's unbundling provisions by providing greater guidance to the market. Examples of areas where we can help include:

- Work with European regulators to develop prescriptive guidance papers clarifying the types of processes and procedures that would be compliant with MiFID II
- Engage U.S. and APAC regulators to evaluate the case for implementing research unbundling outside of Europe

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STRATEGY WITH A DIFFERENCE

ABOUT US

Quinlan & Associates is an independent strategy consulting firm specialising in the financial services industry.

We are the first firm to offer end-to-end strategy consulting services. From strategy formulation to execution, to ongoing reporting and communications, we translate cutting-edge advice into commercially executable solutions.

With our team of top-tier financial services and strategy consulting professionals and our global network of alliance partners, we give you the most up-to-date industry insights from around the world, putting you an essential step ahead of your competitors.

Quinlan & Associates. Strategy with a Difference.

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