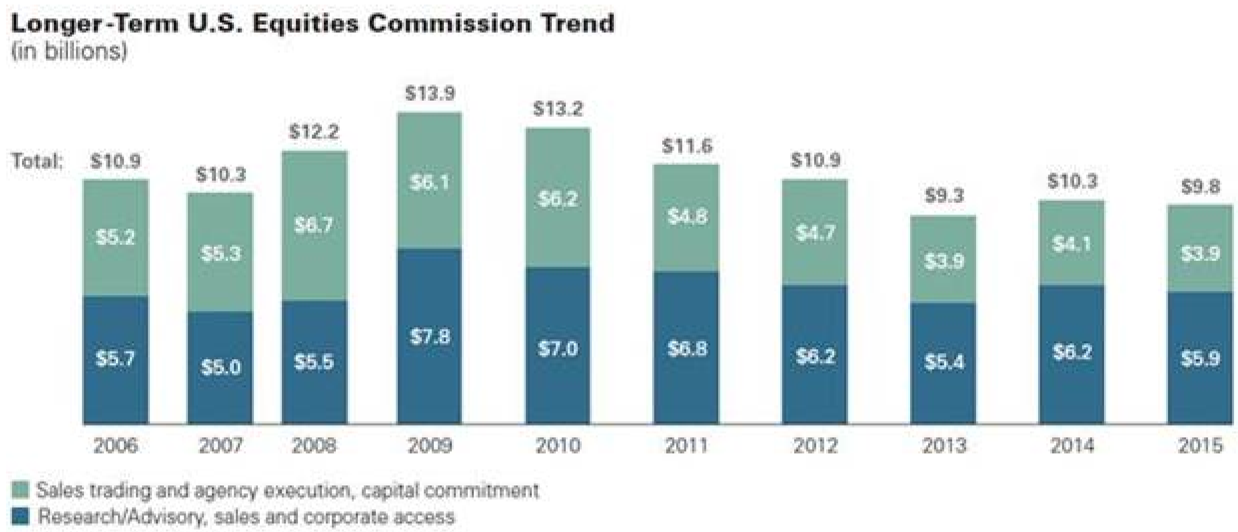
Reforms Will Reduce Quality and Availability of Sell-Side Equity Research

May 31, 2015

A move by the European regulators to "unbundle" payments for research from commissions paid on equity trades will have potentially significant and negative consequences for both the buy side and sell side. The European Commission is preparing new rules to modify or even eliminate "soft dollar" arrangements by which institutional investors currently compensate research providers with commission payments on equity trades. The most radical change under consideration is full unbundling, which would require investment managers to pay for equity research and advisory services with "hard dollars" out of their own P&Ls or pass costs along in the form of additional fees. Any rule change by the European Commission would have a significant impact on large U.S. investors, many of which have significant global operations.

In our latest report, "Business as Usual? Eying Fundamental Change in Payment for Research," I warn that, given current stagnation in institutional equity commission payments and the related pressures on broker profitability, even a modest decrease in commissions or broker trading revenues could have a meaningful impact on sell-side provision of research.

The reform proposals are a solution in search of a problem. European regulators contend that investment managers are "sloppy buyers" when spending their clients' money. I would disagree. The current system of 'broker votes' by which institutions allocate trading volumes to research providers and commission management programs brings structure to valuing and paying for research while also affording investment managers with a high level of access and flexibility and protecting the interests of their clients.



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