



Vijay Chander, Executive Director of Fixed Income at ASIFMA, tells MLex's Tsering Namgyal, how its members are dealing with new far-reaching European rules, notably regulations on research unbundling, and how prepared are Asian firms in meeting obligations under MiFID II.

It appears from the ASIFMA's MiFID II grid, EU-domiciled Asian firms as well as Asian firms in their own jurisdictions serving EU clients would all be subject to MiFID II research unbundling rules.

Yes, that is correct. If the client is an EU buy-side investment firm, regardless of whether the bank/investment bank providing the research is an Asian firm in the EU, or an EU firm dealing directly with an EU investment manager, the research unbundling rules apply.

For us, there's also lots of chatter about how fund managers are adapting. Are they simply going to absorb the costs of buying research (pay from their own pocket), or charge their clients?

Basically, a buy-side firm (if it is covered by the research unbundling obligation) can choose to pay for research either through a separate "Research Payment Account" (RPA) or pay for the research out of its own funds – at the manager level. Basically, in the second option the fund manager absorbs the cost of the research without imposing further/additional charges on its clients. Now, managing payments out of an RPA requires a lot of administrative effort. I understand the administration of the "RPA" can be done either through the fund's own operations or back office, a custodian or a third-party broker who agrees to administer this account. Thus, purely from an administrative viewpoint, the second option is "easier" to administer. I understand a number of buy-side firms are taking this approach (i.e., paying out of their own pocket).

On the separate point about being a "bit more choosy" about the research, each buy-side firm consumes or chooses to "do without." Absolutely, these are choices all buy-side firms are currently grappling with and they have tough decisions to make. So, for instance, a buy-side house may choose to consume research from only 4-5 broker dealers (instead of say, 20) because they have a limited budget. In that sense, they will be foregoing or doing without the research that they used to get from the other 15 houses.

The sell-side, too, faces tough decisions in this regard. If you are a sell-side house with an expensive research team, but are unable to cover costs because the buy-side refuses to pay for your particular/specific research, then you have to look for a different research model, ranging from closing down research altogether to moving to a "desk analyst" type model where the research team is part of the trading team/front office.

Other countries may shape their rules (or not) around MiFID II's unbundling rules?

Starting with the largest market, the US is unlikely to follow the EU model on research unbundling. In fact, currently in the US, a firm has to be registered as an "investment advisor" to be able to provide research. Thus, a US sell-side firm, if it is caught up by the MiFID II rules, would need a specific exemption from the US regulatory authorities in order to comply with the EU MiFID II guidelines. The US Securities and Exchange Commission has just announced that it has given a 30-month reprieve on research unbundling for Wall Street firms.

DEVELOPING ASIAN CAPITAL MARKETS

Asia, too, does not require unbundling, and this could pose problems for Asian sell and/or buy-side firms (the latter, especially if they are part of a global/EU group, with a significant EU presence). As a practical administrative matter, it would be difficult to have, say, one set of research reports that are paid for separately (i.e., unbundled) and another set of reports which continue to be produced and consumed in the old-fashioned way (i.e., as part of a broader service which is not charged for separately). This would be the case in most Asian jurisdictions.

So to avoid “administrative” issues, some buy-side firms may decide to follow a “global” unbundling policy (even in jurisdictions where such unbundling is not required) just for the ease of administration. While anything is possible, I still do not see the rest of the world following the EU’s lead in “requiring” research to be unbundled. This is likely as I said to lead to “difficulties” from a compliance viewpoint – like in the US example mentioned earlier.

And what are concerns about “equivalence” between jurisdictions in Asia and the EU?

This deals with the trading obligation for EU-listed shares. So if you have a share listed in both the EU and on one or more Asian exchanges, the Asian exchanges have to be found “equivalent” to the ones in the EU, if EU-based intermediaries (like Deutsche, Barclays, BNP Paribas, for example) are to be continued to be allowed to trade and execute orders for clients on Asian exchanges. An example of this is HSBC shares that are listed in both HK and London. For EU entities to continue to trade HSBC in Hong Kong, the HKEX (Hong Kong Exchange & Clearing) has to be found equivalent. I understand these equivalence decisions are likely to be in place by 3 January 2018, for at least a few of the major Asian exchanges.

Which are some of the Article 39 opt-in EU jurisdictions? When are they expected to do so?

Article 39 “opt-in” or “opt-out” refers to European (i.e., EU) countries. This pertains to the treatment of “third country” firms in individual EU countries. So, if an EU country opts in to “Article 39”, it is required to allow branches of non-EU firms in other EU member states to give access (i.e., a “passport”) to professional clients but not necessarily retail clients (for which a branch may be required in the respective EU country/ies). If a country chooses not to “opt in” (I understand the UK has not “opted in” to Article 39), then in terms of third country access, whatever the rules are in the “not opted in” EU country would apply regarding third country access (so for instance, the UK rules regarding third country firm access to clients in the UK would apply).

How would Article 30 impact Asian firms doing business in the EU?

As for the Asian firms that are impacted, I cannot comment on individual companies. One useful point of reference would be for you to see if, say, Asian firm X, has a branch in the UK (non Article 39 opt-in) versus say Asian firm Y (which has branches in Paris and Frankfurt but not in the UK – these are Article 39 “Opt-In Countries”). Clearly, the impacts would be a bit different for the UK branch of firm X and the Paris/Frankfurt branches of firm Y. Of course, another hugely complicating factor is Brexit which I am not even going to get into for the moment. For the purposes of this entire discussion, we are assuming that the UK is and will continue to be full-fledged EU member – for the time being anyway.

Your MiFID II grid says that “when the non-EU firm has been delegated to act for an EU client by an EU firm that is a portfolio manager or independent adviser the non-EU firm may need to comply with the MiFID II research and unbundling obligation.” If an Asian securities firm ABC is executing a trade in Hong Kong for a large French pension fund, ABC is expected to comply with unbundling rules? What are some of the implications?

Yes, that is correct. The implications here have more to do with unbundling “brokerage” and “execution” costs. Research is not really impacted here. As merely an “executing” broker, ABC is unlikely to be

distributing research to the French pension fund but the costs incurred by the broker include “brokerage”, “execution fees”, other “exchange fees” etc. It is these costs that ABC has to unbundle and “account” for separately.

From a larger perspective, we wonder how this new rule would have the intended effect of bringing more transparency and less corruption in the ways in which the brokers and banks operate. I understand it is also leading to a proliferation of new independent research firms.

Yes, as you say, more transparency is always welcome but the costs of compliance (plus the remaining ambiguities that are still there in a number of areas) make this a particularly daunting exercise. And yes, one consequence of “research unbundling” is that it does support more independent research. Of course, we will all know come 3 January 3 2018 (or shortly thereafter), how prepared Asia is when it comes to MiFID II compliance.