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ESMA
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Via ESMA website

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RE: AMF Italia's draft response to ESMA's consultation on the second-level discipline related to financial research

AMF Italia welcomes the opportunity to provide ESMA with comments on the above Consultation Paper as better detailed here below.

Question 1: Do you agree with the proposed approach? Or would you prefer a more or less detailed approach? Please state the reasons for your answer.

We welcome ESMA's decision to adopt a high-level approach. In our view, such an approach should imply leaving more discretion to market participants on how to comply with the Level 1 discipline on remuneration for financial research. On the other contrary, we disagree and are against the high level of detail in the actual framework proposed by ESMA in the consultation, which blatantly contradicts its commitment for a high-level approach.

In this regards we would like to remind that a similarly excessive level of detail was adopted by the European Commission at Level 2 in relation to existing regulation on research remuneration which, as we know, only failed to achieve the greater coverage of SMEs that it sought to achieve by introducing the bundling ban, but even:

- has reduced the already inadequate level of research coverage on SMEs, resulting in reduced liquidity on their financial instruments as well. The unbundling regulation in force today has in fact resulted in an undoubted competitive advantage in favour of global brokers, whose research notoriously covers (i) only the larger issuers included in the main market indices, which they distribute globally, and (ii) the very well remunerated research that is produced only at the IPO stage on SMEs and then, normally, the coverage is dropped. On the other hand, local brokers (who are unable to take advantage of the same economies of scale and scope enjoyed by global brokers)

find hard, and often unprofitable, to bear the cost of funding the very poorly remunerated research on listed SMEs (which, as mentioned, is neglected by global brokers and done, almost exclusively, by local brokers);

- for the same reasons, the very low-price conditions at which global brokers can sell their research on larger issuers is now making more difficult for local brokers to compete in this segment of the market as well. This is obviously resulting in less diversity of opinions and less competition, and therefore less incentive for global brokers to maintain high standards of research quality. The latter is also being eroded by the increasing decline in the seniority of research teams as a result of lower remuneration for this activity, more evident in the local-brokers smaller research teams.

We also note that an excess of detail in the regulation of the way research is remunerated was even not deemed necessary neither by MiFID II (Level 1 and Level 2) legislator in regulating unbundled remunerated research, nor by Capital Market Recovery Package 2021 legislator in allowing bundled charging to the client of financial research on issuers with a capitalisation below EUR 1 billion. Since then, no market failure has emerged to justify such a tightening of the discipline in question.

Question 2: Do you agree with the introduction of new paragraph 1b in Article 13 of Commission Delegated Directive (EU) 2017/593? Please explain why.

We oppose the proposal to regulate in detail how the quality of research should be assessed and to introduce a requirement for regular comparisons of research from a wide range of providers.

Specifically, we believe that such a proposal from ESMA:

- is against the stated objective of taking a high-level approach to regulating the remuneration of financial research at Level 2 and increasing the coverage and accessibility of financial research;
- favours only global players, for the reasons already mentioned in our answer to question 1. Indeed, they are able to sell their research at very low prices, as they can benefit from very large economies of scale and scope resulting from the possibility of distributing globally the research they produce on issuers included mostly in the main indices of the markets in which they operate. The consequence of this behaviour (as stated in our answer to question 1) is not only an objective difficulty for local brokers to support the production of research on SMEs, but also a reduction in competition on research on blue chips, and therefore a negative impact on the overall quality of research;
- the above critical issues would also be exacerbated if the obligation in question would result in an asset manager being unable to use a research provider not already on its 'research provider list' without undergoing a complex, lengthy and costly benchmarking update. Thereby reducing any incentive for innovation and diversification;
- would be an obstacle to the identification of research providers in specific and important market segments, as the SMEs, due to the existence of benchmarks without a high level of sectoral and territorial granularity;

- would be a disincentive for small asset managers to build active managed portfolios because of the high costs associated with an annual benchmarking exercise, to which the investment of the assets they manage in financial instruments issued by SMEs is normally attributable;
- finally, we note that the use of mandatory benchmarks was ultimately abandoned even by the UK FCA itself, which in the final version of their financial research rules that came into force in August 2024, simply required that research costs charged to clients be 'reasonable', leaving asset managers wide discretion as to which tools to use for such an assessment[1].

Anyway, should ESMA consider moving in the direction indicated in the consultation paper, it is at least appropriate that the parameters for assessing the quality of research include the usefulness of the service provided in terms of contributing to better investment decisions[2]. However, it is essential that this usefulness be assessed in terms of consistency, frequency, reliability, subject matter expertise and depth of analysis, as well as the availability of the analyst to discuss the outcome of his analysis with his clients. Such an approach would, among other things, be consistent with what we believe should be the very notion of financial research to which policymakers should pay attention. Indeed, the notion of research can by no means be limited to a mere written paper containing an investment recommendation supported by more or less detailed analyses of the issuer's economic and financial data. Rather, financial research must be understood as an advisory service provided by the broker to the asset manager, with the aim of assisting the manager throughout the entire investment process. In this context, it is essential that, when assessing pricing conditions (and the quality of the research itself), asset managers take due account of the contribution made by the ideas provided by the sales force, which, thanks to an in-depth knowledge on local market trends, that is constantly updated, (something unknown to the sector specialists of the global brokers), makes a fundamental contribution to the definition of investment strategies.

Question 3: If you do not agree with the introduction of new paragraph 1b in Article 13 of Commission Delegated Directive (EU) 2017/593, please provide alternative suggestions and/or explain how investment firms operating a research payment account currently assess the quality of research purchased (Article 13, point 1(b)(iv) Delegated Directive).

Asset managers have since long time developed internal mechanisms to dynamically assess the quality of research provided to them by third parties, including the use of rankings published by independent external providers (e.g. Extel). This assessment is usually carried out in terms of the relevance of the research itself to their investment strategies, the appropriateness of its cost and its impact on the value generated for their clients.

The availability of free trial research to managers is also fundamental in this same regard, although the possibility of making adequate use of this tool is currently severely limited by the guidance provided by ESMA in its Q&A, which we believe should consequently be removed. In

[1] See, in this respect, the considerations expressed by the UK FCA in paragraph 1.23 of its Policy Statement 24/9.
[2] Similar concerns were expressed by the UK FCA in its Policy Statement 24/9 - see paragraph 1.19.

fact, the availability of free trials on the market is currently very limited, not only due to the limitations stemming from ESMA's guidelines, but also due to the regulation of research budgets under Commission Delegated Directive (EU) 2017/593, which has significantly reduced the resources available for the purchase of financial research. In this context, it may be useful to mention that, according to a survey we conducted, managers rarely have more than one or at most two research providers, which is obviously detrimental to the quality of research.

Question 4: Do you agree that, when conducting the annual assessment provided in new Article 24(9a)(c) of MiFID II, an investment firm could be required to include a comparison with potential alternative research providers? Please state the reasons for your answer. Please also provide feedback on the availability of free trials for research services and why they may or may not be appropriate for investment firms to fulfil their obligations under Article 24(9a)(c). If free trials are not appropriate, which other methods could be used for comparison?

We are against any annual assessment of the quality of research carried out on the basis of a comparison with research produced by other providers. As we have already pointed out above, such a mechanism:

- would favour research produced by global brokers to the detriment of research produced by local brokers, who would gradually be squeezed out of the market, with negative medium-term effects on the quality of research itself due to the reduced level of competition in the market;
- the availability of research on smaller issuers would be diminished, as a further consequence of local brokers exiting the market (or at least reducing their market presence), as research on such issuers would be almost exclusively produced by local brokers;
- asset managers would be disincentivised to diversify their research providers list because they would only be able to access research on issuers not included in their provider lists through a complex, time-consuming and costly benchmarking process, thereby reducing incentives for innovation and diversification.

On the other hand, we are in favour of the use of free trial on research, which, as we have already pointed out, is a valuable tool for asset managers to assess the quality of research produced by other providers and, at the same time, to explore investment opportunities in financial instruments not covered by the research produced by the providers included in their broker lists. However, for this tool to be fully operational, it would be appropriate to remove the conditions to which it is currently subject under ESMA's Q&A and, at the same time, to remove the requirement for the manager to prepare a research budget or, at the very least, to allow for easier review of such budgets. As noted in our response to Question 3, the conditions to which free trials are now subject, as well as the requirement for operators to prepare a research budget, have led to a drastic reduction in the research free trials.

Question 5: Do you agree with the introduction of new paragraph 10 in Article 13 of Commission Delegated Directive (EU) 2017/593? Please state the reasons for your answer.

We oppose the proposal in A13(10)(a). We do not consider appropriate for the regulator to intervene in the pricing policies of market participants, nor to regulate the amount that asset managers can allocate in their budgets to the purchase of research, which has fallen dramatically since the introduction of the ban on bundling in MiFID 1. In particular, we do not believe that it is appropriate for the research provider and the asset manager to contractually agree the criteria for determining the pricing of research in order to avoid the risk that, where the asset manager charges its client for the cost of research in a bundled mode, the client will be charged a higher cost for research than if a different mode of payment for research is adopted (out of the asset manager's own resources or by recourse to RPAs). Moreover, a similar condition for the legitimacy of research (guardrail) is not included in the new rules introduced by the FCA, according to which the manager is only and exclusively obliged to provide its clients with general information about its policy on bundled payments and to periodically review the relevant budget (which must be done by taking due account of the benefits provided to the client and setting the costs charged to the client in relation to those benefits[3]).

Moreover, such a requirement would make it more difficult and therefore discourage the bundled allocation of research costs to the client, which, as the European Commission explicitly recognised when it amended the relevant framework in 2021 with the Capital Market Recovery Package, is the only way to make the production of financial research on SMEs economically viable. In fact, only the bundled allocation of research costs to the client makes it possible to subsidise the costs of unprofitable research on SMEs with income from the much more lucrative research on large-cap issuers. In this regard, we note that while prior to 2018, with 10-15bps bundled fees, it was believed that research could account for around 2/3 of the total cost, we have now moved to a cost of research that is a fraction (sometimes quite insignificant) compared to trading fees. Therefore, any comparison with what asset managers have paid in the past would be unfair and inconsistent with the intended objective of the regime to promote an economic system capable of preserving fair economics for the production of research on SMEs.

We also note that the obligations under A13(10)(a) would go far beyond what is required by Article 24(1) of MiFID II, which simply requires investment firms to act in the best interests of their clients. In fact, such an obligation already existed under the previously in force Level 2 regime. However, such an obligation was not contemplated neither in the Delegated Directive (EU) 2019/593 dealing with unbundled remunerated research, nor by the 2021 Capital Markets Recovery Package allowing the cost of financial research on issuers with a capitalisation of less than €1 billion to be charged bundled to the client. Nor have any market failures emerged since then to justify such a tightening of the relevant discipline.

Therefore, the introduction of a ban on contracting in the absence of an agreement between the asset manager and the broker on the criteria for determining the pricing of research in line with

[3] In this respect, please refer to the provisions of paragraph 2.B3.27 of the FCA's Conduct of Business Handbook.

A13(10)(a) would be a disproportionate obligation with respect to the objectives pursued by the regulators.

Notwithstanding the above, should the regulator nevertheless confirm the proposals in Article 13 of the Commission Delegated Directive (EU) 2017/593, it would be necessary to give the asset manager wide discretion and flexibility to determine the amount of the research budget and, as mentioned above, to review it periodically. In particular, asset managers should be allowed, inter alia, to easily modify the budget ex-post, including on the basis of the amount of assets under management, the performance fees or the services offered by the broker in addition to "written research" (as in the above-mentioned case of value-added services contributed by the sales of local brokers and SMEs coverage), also allowing for a higher allocation to take into account specific interests linked to certain geographical areas or in the face of the emergence of specific events not previously budgeted for (such as, for example, corporate consolidations in certain market sectors). In this respect, it may be worth mentioning the provisions recently introduced by the FCA in paragraph 2.B3.27 of the Conduct of Business Sourcebook, which explicitly states that research costs allocated to clients must be consistent with the level of benefits obtained by the clients themselves.

Question 6: Do you think that any further requirements or conditions applicable to investment research provided by third parties to investment firms should be introduced in the proposed amendments to Commission Delegated Directive (EU) 2017/593? Please state the reasons for your answer.

On the one hand, we do not consider appropriate to impose any further condition on the legitimacy of charging the client for bundled and unbundled payments for financial research. However, we consider essential to eliminate both the proposals in new paragraph 1(b), which exploit the discretion that asset managers now have in assessing the quality of the research provided to them, and any form of control over the pricing policies of economic operators in new paragraph 10(a) , in order to prevent the newly introduced provisions from further reducing the already inadequate level of coverage of SMEs.

We believe it would be appropriate to include the provision of financial research among the elements that can be taken into account in assessing the quality of order execution under Article 27(1) of MiFID, in order to properly value the contribution of financial research in bridging the information gap between issuers and investors. Indeed, the current notion of best execution (based solely on the concept of pricing, technology and capital commitment) has led to a concentration of order flow in the hands of a few global houses at the expense of local brokers. As mentioned in our answers to questions 1 and 2, the research production of global brokers only covers issuers (mostly blue chips) whose securities are included in the major market indices. The latter, as mentioned above, penalises local brokers, who have to subsidise research production on SMEs through the income they receive from research on larger caps. It is therefore essential that the quality of research would be included among the parameters for assessing best execution, but, as mentioned in our answer to question 2, it is also necessary that this research should be considered as a “service”, whose contribution in terms of the value of the service provided to the end client is far greater than pure order execution.

The concentration of research in the hands of global brokers has also reduced the liquidity of securities in regulated markets and the effectiveness of price discovery. This is because global brokers tend to internalise order execution, with dubious benefits for price discovery and ultimately for the end client. Of course, the less liquidity there is on multilateral trading venues, the greater the discount at which financial instruments will continue to trade, thus reducing the attractiveness of IPOs, which is contradicting the ultimate goal of the EU Listing Act.

We also believe it is necessary for asset managers to regain full control of the costs associated with their activities, ensuring on the one hand a fair balance between trading and research costs, to avoid the former dominating the latter. On the other hand, we also believe it is essential that, when selecting brokers to delegate order execution, asset managers take due account of and properly value the full range of services offered to them by research providers (including the very valuable work of sales and the coverage of SMES, normally offered by local brokers).

Finally, we support the inclusion of short-term trading commentary and advice linked to trade execution within the scope of Minor Non Monetary Benefits (MNMBs), so that the conditions for the legitimacy of financial research set out in the Regulations under consultation do not apply to them. Bringing short term trading commentary and advice linked to trade execution within the scope of MNMBs would also help to ensure a level playing field with the relevant UK and US regimes.[4]

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[4] See, inter alia, the comments in the FCA's policy statement at 2.9 and 3.39, respectively.