REPLY OF THE SPANISH INSTITUTE OF ANALYSTS TO ESMA'S CONSULTATION ON THE DRAFT REGULATORY TECHNICAL STANDARDS FOR THE ESTABLISHMENT OF AN EU CODE OF CONDUCT FOR ISSUER-SPONSORED RESEARCH

The Spanish Institute of Analysts (hereinafter "IEA") welcomes the opportunity to provide comments and feedback on the European Securities and Markets Authority's (hereinafter "ESMA") consultation paper on the "*Draft regulatory technical standards for the establishment of an EU code of conduct for* issuer-sponsored *research*"[1] (the "Code").

I.- Background

Since the 2008 financial crisis, professional intermediaries and investors have been forced to rationalise their operating costs, which has reduced the coverage of financial analysis, especially for small and medium-sized companies.

This development has been accentuated by European regulation and the constraints imposed on providers of financial analysis on securities and listed companies. The entry into force of the Market Abuse Regulation (MAR) in 2016 and, above all, of the MiFID II Directive in 2018, have also contributed to a generalised reduction in supply of this analysis service on companies issuing securities on the markets. In particular, the negative impact of the regulation of "unbundling[2] , which requires the separation of the cost of the analysis service from the cost of trade execution, a practice used by the European industry to finance this service on a widespread basis, is particularly noteworthy.

These rules led professional investors and managers to reduce the fees paid to financial analysis providers, weakening the economic conditions under which the latter operate.

Although these cost separation measures included in MiFID II had a legitimate objective of protecting investors and limiting risks of conflicts of interest, the practical application of the rule has led to an unintended consequence: a reduction in the level of coverage in general and especially on SME issuers by analysts.

Over time, this situation has become a structural problem of the European securities market, such as the shortage of financial research coverage, and the consequent negative implications on the liquidity of markets, mainly those of growth companies targeting small and medium-sized companies. A report published by ESMA in February 2021 on the impact of MiFID II *unbundling* on SMEs concludes, among other things, that the liquidity of this type of company improves when they have analyst coverage and monitoring.

Due to MiFID II, financial research providers sought an alternative solution to finance the reporting of listed companies, particularly smaller ones, through "sponsored research", which has developed in recent times. This practice consists of offering issuers, and in particular small and medium-sized companies, coverage of their

[1] The "investigation" is also referred to in this report as "financial analysis", terminology more commonly used in Spanish law.

[2] The IEA has spoken out several times against unbundling.

company for a fee paid by the issuing company itself. For their part, issuers in this segment have become aware of the importance of this practice to increase the dissemination of information and contribute to growing liquidity for their shares in the market.

The European Union has also become aware of the need to optimise the role of the market in corporate finance and in this context the possibility of setting specific rules for issuer-sponsored research has emerged. In addition, the European Commission's "Listing Act" regulatory package, which partially entered into force on 4 December 2024, reflects the recognition by European authorities of the growing importance of financial analysis, both independent and sponsored, to ensure greater visibility of small and medium-sized company issuers for investors.

The development of "sponsored research", as distinct from "independent" research to whose remuneration the issuer does not contribute, could raise several questions about the existing rules in general and on the conditions under which sponsored reports should be distributed to investors at European level. However, there remains another type of sponsored research that the draft ESMA Regulatory Technical Standard (RTS) does not mention: that sponsored by stock exchanges. The latter consists of a mutualisation of the service between a plurality of issuers, analysts and the market itself[3]. This service is not subject to the potential conflicts of interest that may exist in issuer-sponsored research and we understand that it is not affected by these rules.

II.- General assessment of the initiative

Before the Listing Act, there was no specific regime for issuer sponsored research and it had the same regulatory environment as any other type of financial analysis (MiFID II Directive, MAR Market Abuse Regulation and its implementing rules). These rules already set out the general obligations around the research service, describe the requirements necessary to prevent conflicts of interest, specify the information to be disclosed in the research produced and specify how it should be distributed.

The Listing Act now provides that issuer-sponsored research must be fair, clear and not misleading and be clearly identified as such only if the reports comply with the EU Code of Conduct. For its regulation, ESMA has chosen to include it as an annex to a new NTR which will be a Delegated Regulation supplementing MiFID II[4], to encourage issuer-sponsored research.

However, most conflicts of interest exist in both types of reports (sponsored and independent), for which the regulation is exhaustive and very detailed. In fact, the

[3] In Spain, the Lighthouse service has been developed at the behest of the Spanish Institute of Analysts (IEA), to the financing of which the Spanish equity markets contribute. This service is provided by the IEA, with its own team and free of charge for orphan issuers (with little or no coverage), preserving the independence, objectivity and integrity required of all analytical reports and with a minimum presence of potential conflicts of interest.

[4] Although its incorporation as an annex makes it a "soft law" for financial research providers, investment firms may only produce or distribute issuer-sponsored research labelled as such if they or the research providers comply with the provisions of the Code. Otherwise, such reports must be treated as marketing communications and identified as such.

Code of Conduct submitted for consultation includes a large part of the requirements that are already provided for in the current Commission Delegated Regulation 2016/958 of 9 March 2016.

The overall assessment of this initiative is positive in that the authorities recognise the importance of financial analysis on issuers and seek to improve their coverage to revitalise the securities market.

In our view, the proposed Code of Conduct is based on the same key issues that are already covered by European legislation. Therefore, we do not consider it appropriate to consider sponsored research as a particular source of risk, beyond making transparent the potential conflicts of interest that may potentially arise in such arrangements.

The main concern about the establishment of this Code of Conduct is that issuer-sponsored research may be questioned a priori as not being independent and objective. To avoid this, we believe that it should be sufficient to disclose the existence of any such contractual arrangement as a potential conflict of interest prominently on the cover page of the sponsored report.

We do not believe it is necessary to give the issue of issuer-sponsored research undue prominence or to focus on it as if it were a priori suspect. The key issues affecting it are common to those of independent analysis. Further barriers or excessive requirements for a company to be covered by an analyst could jeopardise the development of this initiative. To conclude, the proposed Code should be simplified and excessive rules that reduce the sponsorship of analysis should be avoided. Even more so in the current context where European authorities recognise that regulation can be an obstacle to the competitiveness of our companies and are engaged in a process of regulatory simplification.

Given that regulation is always complex and time-consuming to implement and amend, we favour regulating capital markets only when strictly necessary, whether to protect market functioning, safeguard investor interests or manage potential conflicts of interest.

Effective oversight of financial analysis reports by competent authorities should identify and correct actions that are shown to be inappropriate.

III.- Reply to ESMA's questionnaire

The questions for public consultation are then answered and commented upon.

Question 1: *Are you aware of or do you adhere to another code of conduct for issuer-sponsored research that ESMA could take into account? If so, what is the degree of endorsement and adherence to such a code of conduct and what specific parts of the code of conduct would be appropriate for the EU code of conduct to take into account? Please give reasons for your answer.*

There is no similar code in our jurisdiction.

Currently issuer-sponsored research has the same guidelines as non-sponsored or independent research, as outlined above. Any contract with an issuer company that

includes sponsored research indicates that the coverage is developed independently and based on the current rules cited above. The main difference now would be that the fact that the coverage is sponsored is disclosed in the section on potential conflicts of interest.

But the current standard already specifies that there should be no difference in means and content between sponsored and independent reports (this is also stated in Article 2(3)(a) of the Code which is the subject of this report). Also, with regard to references to personal operations, Chinese walls, separation of functions, independence. These are already generally regulated.

Question 2: *Do you agree with the proposed approach? Please give reasons for your answer.*

ESMA has opted for option 3, which is to use as a starting point the commitments contained in the existing French code of conduct, adapting it to a broader context including specific amendments for the development of the European code. ESMA also proposes not to integrate several obligations contained in the existing code of conduct that applied to issuers, to ensure that issuers face as few obstacles as possible to having their company covered.

We support option 3 chosen by ESMA with the recommendation that the EU Code of Conduct should focus on the principles of independence, objectivity and disclosure of potential conflicts of interest. Anything appropriate to support the integrity of such an investigation is to be welcomed. However, we do not consider it necessary to introduce any additional principles on how to prepare the report, as in our view this is already sufficiently covered by the existing rules. We believe that efforts should be made to simplify the Code and to limit the number of new requirements applicable to the preparation and distribution of sponsored research affecting the providers of these services, investment firms and issuers. Too many requirements would discourage the development of issuer sponsored research.

IEA acknowledges the French Code of Conduct as a valuable reference but urges ESMA to also consider best practices from global capital markets, particularly in the UK and US, where flexible self-regulatory approaches have allowed robust investment research ecosystems to thrive. A broader comparative approach would ensure European capital markets remain competitive and attractive for research providers.

Question 3: *Do you agree with focusing the requirements mainly on research providers, or do you think that additional requirements for issuers are necessary? Please give reasons for your answer.*

We believe that there is no need for additional requirements for issuers precisely to encourage such reporting and make this practice simple for them. In fact, the main requirement set out for issuers in the existing French code of conduct is the completion of a mandatory press release when coverage of sponsored research is initiated. In any case, the EU Code of Conduct should provide guidance on how to disclose contractual arrangements with broadcasters relating to this type of sponsored research. In our view, the crucial point is to emphasise the independence and objectivity of research providers and to this end, the Code of Conduct should increase confidence in this type of reporting.

Question 4: *Do you agree with a minimum initial contract term of two years, or should the initial term be longer or shorter, or should the code of conduct allow for ad hoc reporting in the case of initial public offerings? Please give reasons for your answer*.

We recognise the logic of having a minimum period in such contracts to maintain continuity and consistency of the research service and to incentivise its use by investors. Experience shows that issuers should be able to know the quality of the research, without interfering with the independence of the research, and should have the option to cancel the contract earlier in case they have doubts about the quality of the reports.

The usual market practice in these cases is to provide for contract durations ranging from one to three years. However, in general, we believe that contractual conditions such as duration, price and time of payment should be left outside the regulation and should be freely agreed between the parties. Moreover, if the aim is to encourage small and medium-sized companies to contract this service, it would make it easier for this segment to contract for a shorter period, e.g. one year.

Regarding the possibility of the issuer sponsoring the preparation of specific reports, coinciding with initial public offerings or capital increases, we believe that it makes economic and market sense to consider this possibility, provided that there is a commitment to continue the service for at least one year in order to provide investors with more information on the monitoring of the transaction.

Question 5: *Do you agree with a minimum down payment of 50% of the annual remuneration, or should this percentage be higher or lower? Please give reasons for your answer*.

It is a standard market practice for issuer-sponsored research to contractually require an upfront payment of the full amount of the service, or a very significant part thereof, at the time of signing the contract. This is primarily to ensure that the issuer has no leverage to interfere with the report by withholding or delaying payments.

However, we also believe that this is an issue that should be left out of the regulation and be the subject of direct negotiation between the parties. To make it easier for small and medium-sized companies to contract this service, quarterly recurring payments could also be envisaged. But we insist that the ideal would be to pay the largest amount in advance, and to include clauses for reimbursement in the event of early termination of the contract without predetermining minimum percentages in the Code. We believe that this contractual issue should be left to the discretion of the parties.

Question 6: *Do you agree with the information listed in clause 7 of the code of conduct that providers of research services must make available to investment firms? Is anything missing? Please give reasons for your answer*.

Any issuer-sponsored research, as well as that sponsored by third parties, is clearly identified in the disclosure of potential conflicts of interest. We would agree to make such disclosure more prominent in general at the head of the reports, but we do not consider it appropriate to include sponsored research as a particular source of risk, over and above all other potential conflicts of interest that occur generally.

We believe that sponsored research may even be a lesser source of risk than other types of relationships between issuers and investment banking, since any contractual agreement explicitly states the independence of the research report and its objectivity, and it would be exactly against the issuer's interest to raise any doubts in this respect.

The requirements set out in Article 7 of the Code of Conduct and Recital (12) of the Draft RTS seem to us to be excessive in that the sponsored research provider has to make available to investment firms all information necessary to be able to make such a Code of Conduct compliance assessment. In particular, we believe that the contract between the issuer and the research service provider, including its price, should not be disclosed. We understand that this is a matter of business and market strategy. It would be sufficient to indicate that this is issuer-sponsored research and that remuneration arrangements do not impede its objectivity and independence without the need to make them explicit.

We also find excessive the reference in recital (12) of the Draft RTS to referral of independent third-party opinions, such as an external auditor, to verify that research is conducted following the EU Code of Conduct. This requirement could unnecessarily limit the distribution of sponsored research by investment firms, reducing its dissemination in the market.

Question 7: *Do you agree that only when the issuer has paid for the research in full should it be made available to the public immediately, or should research paid for in part by the issuer also be made available to the public immediately? Please give reasons for your answer*.

The primary objective of issuers entering into these research agreements is to make them public and thereby contribute to improving the market's understanding of the company. We therefore believe that if the issuer has paid for them in full, they should be made available to the public immediately, provided that it is in the issuer's interest to do so.

If they were partially paid for, it would mean that the research would be funded by sources other than the issuer itself, e.g. investors, and their interests should also be taken into account concerning the publication of the report. In those cases, it should be acceptable for reports to be made public after a reasonable period (1 or 2 months).

Question 8: *Do you think that further requirements should be introduced in the code of conduct? Please give reasons for your answer*.

No. In our view, the main concern regarding this EU Code of Conduct is that issuer-sponsored research may be challenged as not being independent and objective. We believe that it should be sufficient to disclose any such contractual arrangement as a potential conflict of interest, stating also that any research produced by the respective research provider complies with the Code of Conduct and that the research is produced under the guidance of the same standards.

If we want the production of financial analysis to develop effectively, we would not give the issue of issuer-sponsored research a special relevance compared to that of independent analysis.