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Treats

Costumed characters will roam the streets this week, shouting the traditional greeting of “tricks or treats.” Parents will watch carefully as their children file up to the homes of strangers to accept handfuls of candy. In some neighborhoods, like mine, kindly neighbors will also pass out plastic cups of wine to the parents to give them a little Halloween treat as well. Wouldn’t it be grand if every week we could treat each other like this? I know that I would surely visit more neighbors if this were the case.

Last week, the Securities and Exchange Commission dropped a little something in our Halloween bags and it was a welcome treat. The SEC issued three no-action letters on October 26 regarding the European Union’s Markets in Financial Instruments Directive (MiFID II). As you will read below, these no-action letters will give broker-dealers a 30-month reprieve from complying with U.S. rules that would conflict with MiFID II. Given the decline in sell-side research coverage in recent years, NIRI quickly reached out and thanked the Commission for protecting investors from the disruption that would have resulted if broker-dealers had abruptly discontinued coverage of small-cap and mid-cap issuers to comply with MiFID II.

Equity research helps to ensure fair valuation. But many factors, such a shift to passive investing strategies and declines in trading commissions, have contributed to a reduction in the number of sell-side research analysts who cover companies. Within the past 18 months, several brokerage firms, including BB&T, Avondale Partners, and Nomura, have closed their research divisions. According to a Reuters analysis, the number of companies in the small-cap Russell 2000 index that lack any formal Wall Street analyst coverage has risen 30 percent over the past three years. This trend likely would have accelerated if the Commission had not granted the no-action relief on MiFID II. In June 2017, a McKinsey & Co. report estimated that MiFID II would prompt the 10 largest sell-side firms to lay off hundreds of analysts and reduce their spending on research by $1.2 billion.

NIRI members have seen first-hand the challenges that companies face when they lack sell-side research coverage. Companies with no analyst following have significantly greater difficulty in attracting new investors, as many institutional fund managers won’t invest in issuers that lack coverage. The erosion of research coverage also is harmful to retail shareholders as they are left with fewer independent sources of information about a company’s prospects. Without this information, these investors likely will miss out on the investment returns that many small companies generate as they grow.

During the 30-month period of delayed implementation of MiFID II, NIRI is encouraging the Commission staff to work with broker-dealers, independent research providers, investment managers, IR professionals, and European regulators to develop recommendations to promote more research coverage of small- and mid-cap companies in both the United States and Europe. As a helpful first step, NIRI suggests that the Commission convene a roundtable on equity research to hear the views of market participants.

But, failing a permanent solution, the SEC’s treat will be gone in a flash, just like those little chocolate bars and licorice twists (the red ones, not the black ones) collected on Halloween. It is not too early to start thinking about what a fully implemented MiFID II world will mean for IR professionals. Is there a yummy treat here, perhaps new frontiers for IR? Or will it mean just more work and stress – the equivalent of Charlie Brown’s rock?

Meanwhile, please pass that little plastic cup so I can toast the SEC.

All the best,
Gary

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