

Response to ESMA35-335435667-5979:**Draft technical Advice to the European Commission on the amendments to the research provisions in the MiFID II Delegated Directive in the context of the Listing Act**

From Morningstar Inc.

Submitted online at www.esma.europa.eu 'Your input - Consultations'.

Date 28th January 2025

Dear Ladies and Gentlemen,

Morningstar welcomes the opportunity to comment on the important issues tackled in ESMA's paper.

Morningstar is a leading provider of independent investment research, with a long history of advocating for transparency in global markets and brings several perspectives to the proposed rules. Morningstar's mission is to help investors reach their financial goals by providing them and their advisors with rigorously researched analysis and insights. This letter contains a summary of our views together with specific responses to individual questions posed in the consultation paper.

Overall, Morningstar is supportive of the proposals to expand the options available for payment in respect of research. Firstly, the change will create an environment that allows for more consistency for those buy-side firms consuming both U.S. and U.K. research. Secondly, while it is unknown how many firms might avail themselves of the re-introduced bundled-payment option, any large or early adopters may create momentum in this regard. Thirdly, it will potentially stem the reduction in research coverage that has been seen alongside the price compression that has been seen since the MiFID changes were introduced.

That said, it is vital that a level playing field exists across providers and which recognizes the value of independent research. Independent research is an essential component of a diverse and effective investment ecosystem, offering unique perspectives and enhancing decision-making for asset managers. To sustain the availability and quality of independent research, it is imperative that these providers are adequately compensated for their contributions.

Importantly, the framework should ensure that not only brokers with execution desks but also independent research providers are eligible for fair remuneration. Clear provisions enabling asset managers to engage and pay independent research providers will foster competition, drive innovation, and ultimately benefit end investors by promoting a more dynamic and informed market.

Below, we provide further responses in relation to specific questions posed in the consultation paper.

We hope our responses are helpful and will be happy to answer further questions or provide more information.

Yours faithfully,

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Responses to ESMA Questions

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.

Maintaining the original objectives of MiFID II's unbundling rules—namely, achieving transparency in research costs and minimizing conflicts of interest—remains of paramount importance.

It is crucial to ensure that (a) research is not utilized as an inducement to trade or to procure other banking services and (b) a level playing field exists across providers and recognizes the value of independent research. Independent research is an essential component of a diverse and effective investment ecosystem, offering unique perspectives and enhancing decision-making for asset managers. To sustain the availability and quality of independent research, it is imperative that these providers are adequately compensated for their contributions.

In order to be effective, we highly recommend clear guidelines for this payment option and making sure that there will be no impediment that would cause any research providers (even those without trading facilities) to be excluded from such payment option. Further, a framework which facilitates more consistent research payment approaches internationally, while preserving the aims of MiFID II, can be of help for asset managers with global operations.

To prevent conflicts of interest, appropriate levels of disclosure must be implemented. However, these disclosures should not create obstacles to switching between research providers. We are concerned that the emphasis on managing inducement risks appears to have been diminished in the revised text compared to the previous version.

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.

In principle, Morningstar is supportive of the concept of research comparisons. In practice, it is challenging to develop meaningful and consistent measures across a range of important factors.

While metrics can be established to monitor the performance of ratings and their predictive accuracy, other factors beyond volume, such as quality and availability of timely research during times of market turbulence are also important. In this regard it is important that the nature of the research provider, i.e. independent or broker/ investment bank, is indicated, to account for the different priorities and circumstances that drive their coverage and updating cycles.

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).

In addition to our response to question 2 we believe it is important to clearly distinguish the dissemination of research (e.g., the level of service provided by sales teams) from the intrinsic quality of the research itself. Marketing and sales-driven efforts, akin to advertising, should not influence research quality assessments. These elements primarily reflect distribution efficiency rather than the actual substantive value of the research.

Further, we recommend the exclusion of corporate access from research evaluations to prevent significant conflicts of interest. While corporate access is undoubtedly valuable to asset managers, it must be treated as a separate service and entirely disentangled from research quality evaluations.

This proposed framework ensures that the evaluation of research focuses on transparency, quality, and fairness. By preventing conflicts of interest and maintaining a clear distinction between different services, it fosters a competitive and objective environment for research providers.

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?

Comparing alternative research providers is an important way to ensure that asset managers access the best research services tailored to their needs. Although discovery mechanisms for evaluating research can add complexity, it ultimately benefits asset managers and end investors by ensuring access to high-quality research.

Free trials provide a practical opportunity for asset managers to sample research and assess its relevance before committing to a subscription. However, guardrails are vital to protect providers intellectual property and to prevent extended use of unpaid-for research.

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.

A payment option through which all investment research (independent as well as broker research) can be paid for, provides operational flexibility for industry participants.

To avoid unintended consequences adversely impacting the fairness and competitiveness of the research market, the operational guidelines for this research payment option should make clear that there will be no barriers that would cause asset managers to exclude any type of research providers, like independent research providers, to benefit from such payment option.

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.

We believe additional guardrails should be outlined, even if some of these will ultimately fall under Level 2 or Level 3 measures, or the jurisdiction of NCAs. In particular, it is our view that transparency of research cost allocations are important, given the fundamental differences between independent research and broker/connected research. A breakdown of spending on these categories in annual research purchase reports would shine a light on the proportion of a research budget that is allocated to independent versus potentially conflicted research.