

CHAZEN INSTITUTE RESEARCH BRIEF

Unbundling of Analyst Research

KEY TAKEAWAYS

- ✓ MiFID II set a new standard for research to be unbundled from transactions, improving transparency for investors.
- ✓ As a result of unbundling, the market for research analysts becomes more competitive. Inaccurate analysts drop out and those who remain produce more accurate research.
- ✓ Selling analyst research separately reduces research quantity but improves its quality.

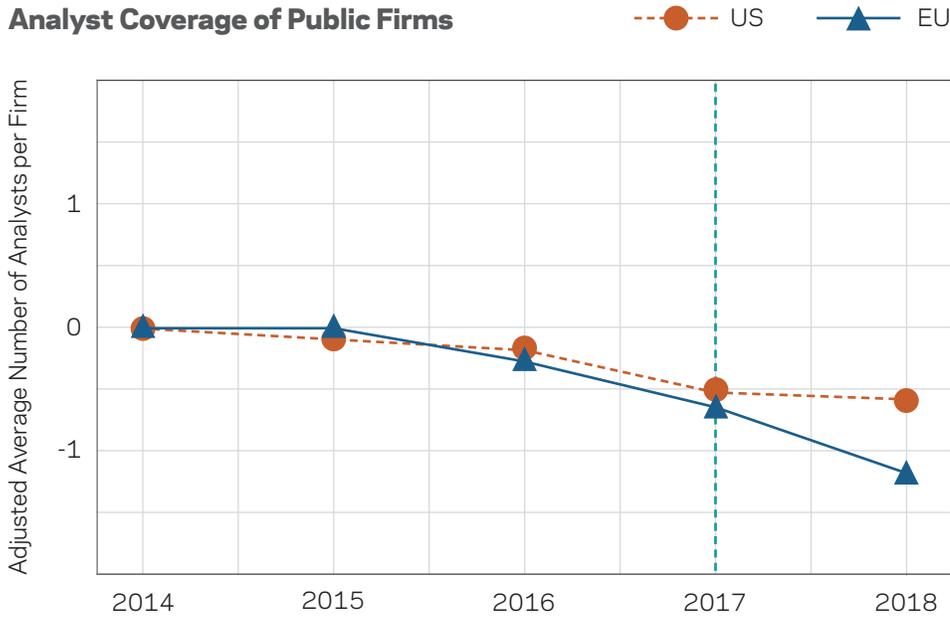
Analyst research is traditionally bundled into sell-side trading. In fact, it's often viewed as a freebie when trading with brokerage firms: "if you trade with me, the research is gratis." But in 2018, the European Commission set a new standard, [Market in Financial Instrument Directive II \(MiFID II\)](#), which requires payments for sell-side research to be unbundled from trading commissions. The regulation promises more transparency for investors. But what are the consequences of such regulation? And is it optimal to unbundle research from transactions?

In "[Should Information Be Sold Separately? Evidence from MiFID II](#)," Columbia Business School PhD candidates **Yifeng Guo** and **Lira Mota** investigate the impact of unbundling on sell-side research. What they find is that, under the new regulation, the quantity of analyst forecasts decreases but the quality improves as a result of increased competition among research analysts. This study was supported through a grant made by the Jerome A. Chazen Institute for Global Business.

Research

The new rules force asset managers with a physical presence in the EU to separate payments for sell-side research from trading commissions. This enabled the researchers to analyze the effects of unbundling by comparing EU public firms (the treatment group) and US public firms (the control group), and

Analyst Coverage of Public Firms



was concentrated in large firms, not small firms. In addition, analysts who were squeezed out of the market tended to be those who produced more inaccurate research. At the same time, the authors find that analysts who remain in the labor market produce more accurate research since the implementation of MiFID II.

The authors conclude this is the result of increased competition for good market research. First, asset managers internalize research costs and become more selective. To cater to asset managers' demand for quality, analysts need to provide more accurate research. Second, by making research a standalone product, analysts are also incentivized to produce higher quality research because they are being evaluated by the service they actually provide, as opposed to conflating their performance with trading recommendations. The result is, in turn, overall improved research quality.

The unbundling of sell-side trading in the EU, particularly the sale of research, has far-reaching implications. Asset managers and banks are beginning to adapt their practices worldwide to comply with MiFID II. Guo and Mota suspect this regulation will upend the traditional model for analyst research—and shape the market globally for years to come.

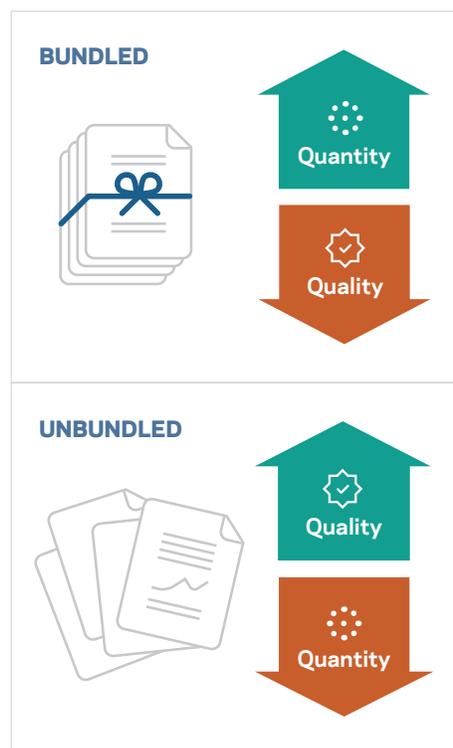
to determine how the different rules affected the market for, and production of, investment research.

Prior to MiFID II, Guo and Mota point out, asset managers could easily pass research costs to end investors in the form of trading commissions. They did not worry much about the quality of research and sometimes overcharged clients. Following the implementation of MiFID II, however, the authors find an increased focus on research quality over quantity, because asset managers are forced to internalize these research costs.

Results

The research reveals that analyst coverage of public firms generally decreases as a result of the regulation (7.67 percent relative to the average coverage of these firms prior to the regulation). However, contrary to media and industry concerns, the decrease

Bundling vs. Unbundling



+ [Download](#) the full paper.

[Learn](#) more about Chazen Institute Doctoral Grants.

[Subscribe](#) to Chazen Global Insights.