

POST- MIFID II RESEARCH BENCHMARKING SOLUTIONS

With the FCA having harmonized the new research rules between MiFID II-scope funds (PS24/9) and UCITs/AIFMD funds (PS25/4), the way is now clear for managers to take advantage of new rules related to charging clients for research/ESG. This will clearly require some form of “Benchmarking”.

Note: *This document and analysis does not constitute legal or investment advice. It is intended as a practical guide to asset managers decision-making and implementation frameworks.*

(Not Quite – But Still) “Benchmarking”- Final PS24/9 Rules

While the term “Benchmarking” has been removed from the final PS24/9 rules, this requirement remains.

- (7) the firm must periodically, but at least annually:
- (a) assess the value, quality and use of research purchased using joint payments and its contribution to the investment decision-making process; and
 - (b) ensure that the amount of research charges to clients is reasonable compared with those for comparable services; and

Section (b) stipulates that research charges to clients must be *compared to comparable services annually*.

Timing of Demonstrating Compliance – Rapidly Approaching

Manager Research Payment Method	Research Benchmark Requirement	Related Considerations
Currently Using Client Money for Research	Annual: <i>Rule Introduced July 26, 2024</i>	- Are research cost being fairly allocated between funds? - Are cross-subsidization issues being effectively managed?

Together with the requirement that research charges must be fairly allocated at the fund/strategy level, Section (b) provides a clear indication of the type of research price comparison (or benchmarking) that is required.

Relevant Benchmarking Lens

Drawbacks of Some Current Approaches

- Some current benchmarking approaches compare the prices paid by **firms** (asset managers at an aggregate level) for **products** (document/analyst access) versus one another (other asset managers).
- This is irrelevant to the Section (b) requirement above because it does not compare research charges to **clients** – only to other managers. Because most managers funding research via P&L do not have fund-level research budgets, it is difficult, if not impossible, to attribute these research charges to a client (and therefore fund/ strategy) level – because the research services themselves have not been allocated beyond the firm level

- Asset owners don't care how much their managers pay Bank A versus Bank B. They do care about how the strategy research spending of the funds they're invested in compare to their peers.

The Relevant Regulatory Framework – Frost Research Benchmarks

We believe that the strategy/fund or product level research spend benchmarking is the most relevant lens through which asset owners can understand the appropriateness of asset manager research spending.

Solutions

In conjunction with a major TCA provider, Frost has developed FrostDB Research Strategy Benchmarks that fulfil the FCA requirement, and helps managers demonstrate that their (fund/strategy) research budgets are reasonable versus the peer group of equivalent strategies. The Frost DB database has thousands of funds in dozens of equity categories.

The solution allows asset managers to demonstrate to asset owners and regulators that research budgets are aligned with the agreed investment strategy and directly support the product's return objectives. The benchmarking illustrates that the research spending is reasonable (under 28 e) versus similar strategies.

FrostDB benchmarks help asset managers to:

- Optimize research spending between strategies
- Increase the global competitiveness of their investment teams
- **Illustrate to asset owners/regulators that the manager's strategy research spending is reasonable relative to strategy peers.**

FROSTDB RESEARCH DATABASE: OPTIMIZING CAPITAL ALLOCATION



Research/ESG via P&L or Client Money

- How do we compare to our peers
- *and managers using client money?*
- Are our strategy budgets competitive?
- Crucial data for internal budgeting.



Are managers giving their investment teams the opportunity to be globally competitive?

Indicative Research Strategy Categories

Global	US	Europe	EM	Asia	Sectors
Global Equities	US Equities	Pan-Europe	Global GEMS	Asia Equities	Biotech
Global Large Cap.	US Large Cap	Europe ex-UK	CEE	Asian Ex-Japan	Commodities
Global Small/Mid-Cap	US Mid-Cap	France	EM Asia	China	Consumer Cyclicals
Global Growth	US Small Cap	Germany	EM Small Cap	China Small Cap	Consumer Staples
Global Value	US Large Cap Growth	Italy	Latam	Hong Kong	Energy
	US Large Cap Value	Netherlands	MENA	India	ESG/SRI
	US Value	Nordics		Indonesia	Financials
	US Growth	Spain		Japan	Healthcare
	US Small Cap Growth	Switzerland		Singapore	Industrials
	US Small Cap Value	UK Equities		Thailand	Media
	US Core	UK Equity Income		Vietnam	Precious Metals
		UK Small Cap			Real Estate
					Technology
					Telecoms
					Utilities

Further Use Cases

Many managers funding research from P&L in Europe, and using client money in the US, have not undertaken the exercise of allocating research budgets at the fund/strategy level.

For managers that do elect to return to client money under the new UK rules, informing clients in advance of fund/strategy research budgets in advance will necessitate this process.

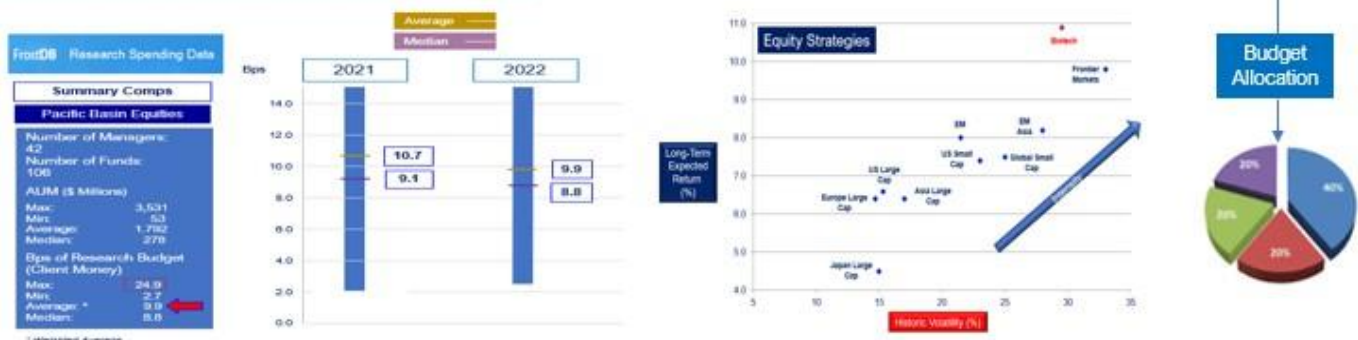
The strategy-level benchmarks can play a vital role in this firm-wide research budget allocation by suggesting a peer-driven framework that can correspond to each asset manager's product mix.

The benchmarks are useful data points in assigning individual funds to broader strategy groups. The analytical framework underpinning this approach was developed by Frost through collaboration with the CFA Institute and Stanford University, amongst others.

USING BENCHMARK DATA TO ALLOCATE RESEARCH BUDGETS TO STRATEGIES



Quantify Strategy Research Intensity and Target Budgets



Easy Data Entry

REQUIRED MANAGER DATA

Investment Product/Strategy Budget

Name	AUM (\$ Millions)	Research Budget (\$ Millions)	Research Budget (Bps)
Large Cap Growth	1,000	400,000	4.0

Please apply the following tags that you believe are relevant to this investment product:

Fund Type	Asset Class	Geography	Style	
Long Only	Equities	United States	Equities - Growth	
Market Cap	Industry	Client Base	Payment Type	
Large	Various Industries	Institutional	Client Money -	
Strategy Domicile	Benchmark	# of Investment Professionals	Docs. Only	Full Service
North America	S&P 500	12	No	Yes

Submit

Drop-Down Menus

Sample Anonymized Strategy Report

Frost Research Systems

RESEARCH BENCHMARKING ANALYSIS

FrostDB Research Spending Data

Summary Comps

Fund Category

Number of Managers:

???

Number of Funds:

???

AUM (\$ Millions)

Max: 74,730

Min: 3

Average: 2,312

Median: 844

Bps of Research Budget (Client Money)

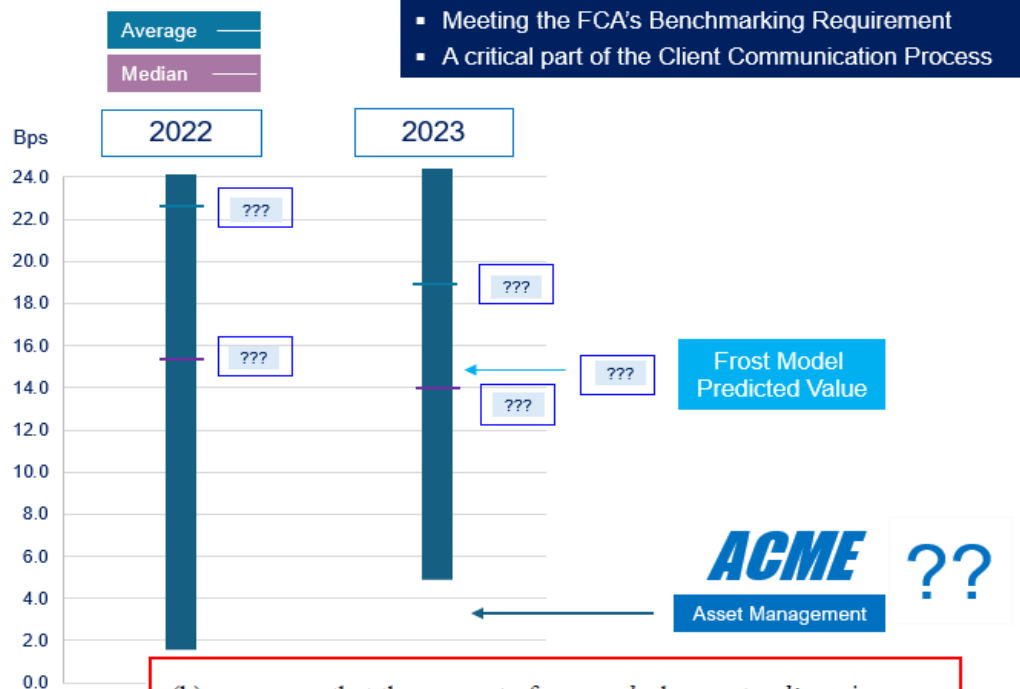
Max: ???

Min: ???

Average: * ???

Median: ???

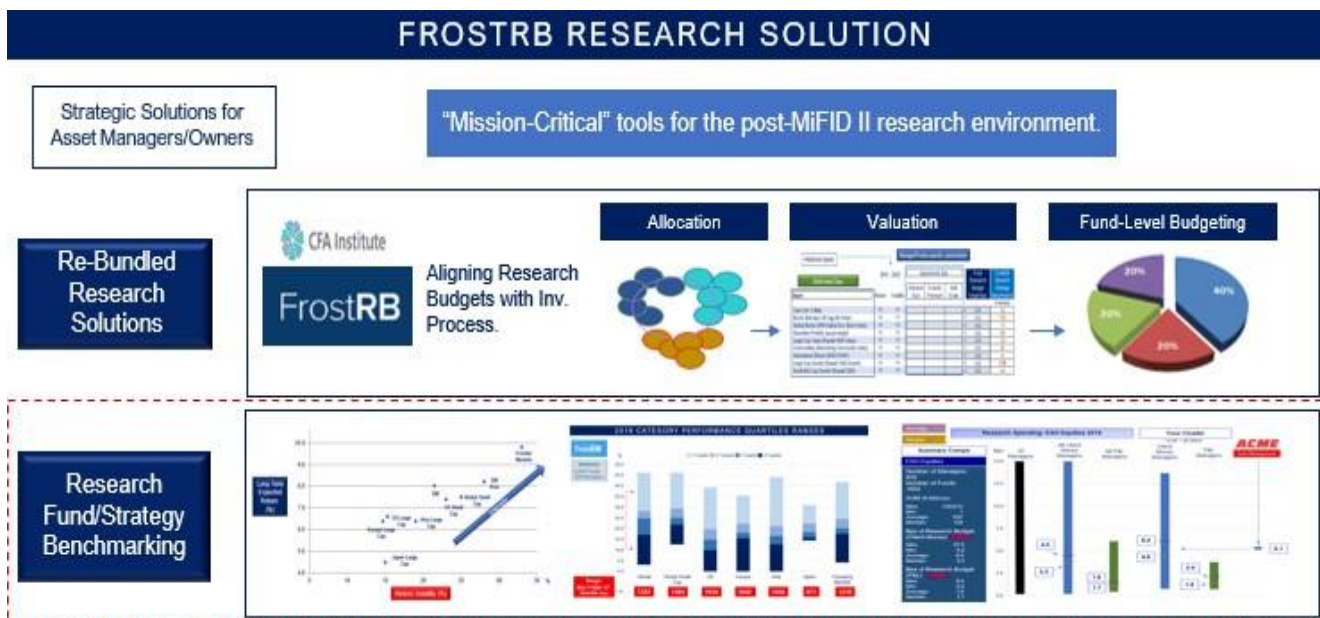
* Weighted Average



(b) ensure that the amount of research charges to clients is reasonable compared with those for comparable services;

These are all components of the wider FrostRB Research Valuation Solution that has allowed multiple managers to:

- Align Research Budgets with Fund-Level Investment Mandates – while administering research spending at the Strategy Level
- Benchmark Strategy Research Spending
- Make the transition from P&L back to research via client money with (very) limited asset owner impact.



Global Regulatory Considerations

We have noted the similarity between the PS24/9 disclosure rules and the approach advocated by the US Council of Institutional Investors which is comprised of the leading pension funds and endowments in the US:

<https://www.cii.org/us%20asset%20owners>

They, together with the CFA Institute and HealthyMarkets Association, have twice written to the SEC to suggest that fund-level research transparency and cross-subsidization control should be made mandatory for asset managers using client money under 28 e.

HealthyMarkets Association has produced an asset manager questionnaire designed to allow asset owners to better understand the research spending policies of external managers:

<https://bit.ly/3VyuTNL>

This also includes a benchmarking component.

In the EU, ESMA has proposed a cost benchmarking regime for UCITS funds under their Retail Investment Strategy (RIS).

Other Frost Research Regulatory Resources and Solutions:

<https://www.frostresearchsystems.com/post-mifid-publications>

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