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# New Regulatory Proposals Could Lead to Radical Changes in European Brokerage Business Model

*2014 Greenwich Leaders: European Equities*

*Q4 2014*

Although on the surface things seem relatively placid in the European equity industry, with broker commission payments leveling off in 2014 after an extended period of weakness, the European brokerage business could be on the verge of the biggest change in a generation.

In June of this year, the U.K. Financial Conduct Authority (FCA) banned the use of equity trade commissions to pay for "corporate access," or the facilitation of meetings between investors and corporate management teams. Not only did this ruling put the U.K. at odds with the United States, where commission payments for corporate access are permitted, it could also presage a more radical change in the business models of European equity brokers.

Proposals put forward by the European Securities and Markets Authority (ESMA) would make even more sweeping changes by banning altogether the traditional use of brokerage commissions to pay for equity research and advisory services. In the proposed "full unbundling" model, investors would pay for the majority of research with their own hard dollars, as opposed to brokerage commission payments generated from securities trades within their funds.

Such a move would likely eliminate the commission sharing arrangements (CSAs) now relied on as a primary revenue source by many small research providers, and could more broadly upend the business model of full-service brokers. "If implemented in current form, investors would have three choices: 1) Cut a check to research providers and absorb the cost, 2) Pay providers and pass along costs to customers via higher management fees, or 3) Stop buying certain research and services altogether," says Greenwich Associates consultant John Colon.

Although the U.K. FCA supports unbundling, it is far from certain that the proposal will be implemented in current form, given stiff opposition from the industry, and even some national regulators in Europe. EU countries are required to implement MiFID in 2016 and its rules will go into effect in 2017.

## Greenwich Share Leaders — 2014

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**European Equity Research/Advisory Vote Share[1]**

| Broker | Vote Share | Statistical Rank |
|---|---|---|
| UBS | 8.8% | 1T |
| Morgan Stanley | 8.5% | 1T |
| Deutsche Bank | 8.1% | 3 |
| Bank of America Merrill Lynch | 7.6% | 4T |
| J.P. Morgan | 7.1% | 4T |

**European Equity Trading Share[1]**

| Broker | Trading Share | Statistical Rank |
|---|---|---|
| UBS | 10.2% | 1 |
| Credit Suisse | 9.2% | 2T |
| Bank of America Merrill Lynch | 9.1% | 2T |
| Morgan Stanley | 8.6% | 4T |
| J.P. Morgan | 8.1% | 4T |
| Deutsche Bank | 7.7% | 4T |

**European Equity Algorithmic Trading[2]**

| Broker | Market Penetration | Statistical Rank |
|---|---|---|
| UBS | 63% | 1 |
| Credit Suisse | 57% | 2 |
| Morgan Stanley | 49% | 3 |
| J.P. Morgan | 38% | 4 |
| Bank of America Merrill Lynch | 35% | 5T |
| Deutsche Bank | 34% | 5T |

**European Equity Portfolio Trading[3]**

| Broker | Market Penetration | Statistical Rank |
|---|---|---|
| UBS | 54% | 1 |
| Credit Suisse | 47% | 2 |
| Morgan Stanley | 41% | 3 |
| Deutsche Bank | 36% | 4T |
| J.P. Morgan | 35% | 4T |
| Bank of America Merrill Lynch | 34% | 4T |

Note: [1]Based on responses from 202 European respondents at buy-side institutions for Equity Research/Advisory Vote Share and 197 for European Equity Trading Share, both weighted by commission spend of accounts. Greenwich Associates Research/Advisory Vote Share and Trading Share represent a broker's relative importance to the buy-side institutions within the Greenwich Associates universe. Scores are based upon the amount of business conducted with each respondent and the size of each responding institution based on commission spend with the sell-side community. [2]Based on 134 respondents. Important algorithmic or smart-order-routing trading provider includes those cited as a top 10 provider in order of commission volume for algo trading (including dark pool sourcing algos) or SMO routing trades, or as distinctive on any algorithmic factor. [3]Based on 321 respondents. Includes top 5 for agency and risk portfolio trading or distinctive on any portfolio trading factor. Top five leading brokers are cited including ties.
Source: Greenwich Associates 2014 European Equity Investors Study


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## Greenwich Share Leaders

Unbundling would have a seismic impact on the industry as a whole, since revenue generation and market share among of European equity brokers is largely determined by the breadth and depth of their research arms. Approximately 60% of all brokerage commissions paid on trades of European equities are used to pay for research and advisory services, meaning that research-related equity commission payments amount to roughly €1.5 billion annually.

UBS and Morgan Stanley are the two leading providers of European equity research. Each firm receives between an 8.5% and 8.8% weighted share of the "votes" that determine commission allocations among institutional investors. Deutsche Bank is third with an 8.1% share, followed by Bank of America Merrill Lynch and J.P. Morgan. These firms are the 2014 Greenwich Share Leaders in European Equity Research and Advisory Services.

Despite the importance of research, the list of top brokers in trading share does not perfectly mirror the list of leading research providers. Specifically, some of the biggest Bulge Bracket dealers win more trading share than their performance in research and advisory services alone would seem to warrant. This discrepancy is largely attributable to two main factors: The ability to support the technology investments needed to compete in electronic trading, portfolio trading, and CSAs, and the ability to help buy-side desks generate alpha through market color and ideas, including cross asset class ideas. The largest brokers have the biggest IT budgets and maintain the most sophisticated trading platforms, which attract client trade flows.

UBS leads the European equity market in trading with a trading share of 10.2%, followed by Credit Suisse and Bank of America Merrill Lynch, both at 9.1-9.2%, and the trio of Morgan Stanley, J.P. Morgan and Deutsche Bank. These firms are the 2014 Greenwich Share Leaders in European Equity Trading.

UBS leads the field in electronic trading, with a market penetration of 63% in algorithmic or smart-order routing trading. Credit Suisse is next at 57%, followed by Morgan Stanley at 49%, J.P. Morgan at 38%, and Bank of America Merrill Lynch and Deutsche Bank, which are tied at 34-35%. These firms are the 2014 Greenwich Share Leaders in European Equity Algorithmic or Smart Order Routing Trading.

With a market penetration score of 54%, UBS also holds the top spot in portfolio trading, followed by Credit Suisse at 47%, Morgan Stanley at 41%, and then three firms, Deutsche Bank, J.P. Morgan and Bank of America Merrill Lynch, which are tied at 34-36%. These firms are the 2014 Greenwich Share Leaders in European Equity Portfolio Trading.

## Greenwich Quality Leaders

Greenwich Quality Leaders are firms whose institutional clients award with quality ratings that top those of competitors by a statistically significant margin. The 2014 Greenwich Quality Leaders in European Equity Sales are Exane BNP Paribas and UBS. The 2014 Greenwich Quality Leaders in European Equity Research and Advisory Services are EXANE BNP Paribas, Morgan Stanley and UBS. UBS is the 2014 Greenwich Quality Leader in European Equity Trading Quality, and Morgan Stanley and UBS together claim the title of 2014 Greenwich Quality Leaders in European Equity Electronic Trading.

*Consultants Jay Bennett, John Colon and John Feng advise on the institutional equity markets globally.*

### Greenwich Quality Leaders — 2014

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Greenwich Quality Leader 2014

**European Equity Sales Quality**

| Broker |
|---|
| Exane BNP Paribas |
| UBS |

**European Equity Research and Analyst Service Quality**

| Broker |
|---|
| Exane BNP Paribas |
| Morgan Stanley |
| UBS |

**European Equity Trading Quality**

| Broker |
|---|
| UBS |

**European Equity Electronic Trading Quality**

| Broker |
|---|
| Morgan Stanley |
| UBS |

Note: Based on 202 respondents for Sales Quality and Research and Analyst Service Quality and 197 for Trading Quality. Leading brokers are displayed in alphabetical order.
Source: Greenwich Associates 2014 European Equity Investors Study

**Methodology**

*From January to March 2014, Greenwich Associates interviewed 202 portfolio managers and 197 traders at European institutions about the research, sales, and trading services they receive from their brokers. These portfolio managers and traders were also asked about current market practices, trends and compensation.*

*The findings reported in this document reflect solely the views reported to Greenwich Associates by the research participants. They do not represent opinions or endorsements by Greenwich Associates or its staff. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and reviews for presentation purposes in order to produce the final results.*

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GREENWICH ASSOCIATES

6 High Ridge Park Stamford CT 06905 USA

Tel: +1 203.625.5038/+1 800.704.1027 Fax: +1 203.625.5126 email: ContactUs@greenwich.com www.greenwich.com