March 27, 2019

Via Electronic Mail (rule-comments@sec.gov)

Vanessa Countryman
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Comments to the Investor Advisory Committee Regarding Trends in Investment Research

Dear Ms. Countryman:

Healthy Markets Association appreciates the opportunity to offer our comments to the Investor Advisory Committee and Commission regarding trends in investment research and potential regulatory implications. In particular, we wish to focus our remarks on the importance to investors of improving price transparency, accountability, and competition for research and trading services.

For decades, investment advisers have largely paid the costs associated for research provided by their brokers by directing trading to those brokers. The costs for both the research and trading are typically bundled as a single payment to the broker out of the funds. As a result, in the United States, asset owners do not generally know how much they are paying for research, or even whether their payments dollars are being used to benefit the research.

Spurred by the adoption of the Markets in Financial Instruments Directive (MiFID II) and the Packaged Retail Investment and Insurance-Based Products (PRIIPS) regime in Europe, these practices are rapidly changing. In the United States, many market participants who have benefitted from the historical status quo are resisting change. Unquestionably, implementing these changes is not easy. In Europe, new processes to identify, value, and track research have been developed. Payment mechanisms have been reworked. And increased transparency for research costs to investors and competition has reduced some firms' profits. Much of that is already happening in the US as well.

In addition to these changes, you have likely heard some complaints about how the transparency and competition for research and trading under MiFID II has "harmed investors" or "reduced research." These claims are simply false. A few weeks ago, the

head of the United Kingdom Financial Conduct Authority, Andrew Bailey, recapped the FCA's findings on the impact of the changes, one year on, stating that

> the new rules are having a positive impact on the accountability and discipline of the buy-side when procuring research, and on the cost of execution.
>
> Dealing commissions have fallen – not only due to the removal of research costs, but also because managers are increasingly using more electronic, 'low-touch' channels.
>
> Our work also largely confirms public reports that research budgets have reduced by around 20%-30%.
>
> …
>
> the reduction in charges incurred by investors in equity portfolios managed in the UK was in the region of £180m in 2018.[1]

He continued by noting that "buy-side" firms have indicated they can still access the research they need, and that research is finally being priced and paid for as a distinct, competitive service.[2]

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The introduction of price transparency, cost accountability, and competition for research has been a success for investors.

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As you consider issues related to the acquisition and payment of research in the wake of MiFID II, we urge you to consider two basic principles:

1) Asset owners should know how much they are being asked to pay for research and have the knowledge that the research for which they are paying benefits them; and
2) Investment advisers should have the ability to competitively and separately shop for investment research and trading services.

[1] Remarks by Andrew Bailey, Financial Conduct Authority (UK), on the Markets in Financial Instruments Directive (MiFID II) at the European Independent Research Providers Association, Feb. 25, 2019, *available at* https://www.fca.org.uk/news/speeches/andrew-bailey-keynote-speech-mifid-ii-european-independent-research-providers-association.

[2] *Id.*

In 2017, the Commission issued three no-action letters to help alleviate concerns of US market participants related to the implementation of MiFID II. While two letters were issued to trade groups representing investment advisers, one letter was issued to SIFMA. Generally speaking, the SIFMA No-Action Letter permits US brokers to accept hard dollar payments for research in Europe as a result of MIFID II, without having to register as investment advisers in the US. This letter has given rise to significant controversy.

Importantly, however, no matter how the Commission ultimately addresses the SIFMA No-Action Letter, there are many broader concerns with best execution that will remain unresolved. Indeed, there are already numerous academic studies[3] and regulatory enforcement cases that strongly suggest that the regulatory framework in the United States -- for both brokers and investment advisers -- is not working properly. The Commission's efforts to address concerns with the SIFMA No Action Letter will not fully address all of the concerns with best execution. Worse, regardless of how the Commission proceeds to address the SIFMA No Action Letter, some market participants may nevertheless respond in ways that further impede best execution.

Accordingly, to better protect investors, we urge you to consider recommending that the Commission (1) formally announce that the SIFMA No Action Letter will be allowed to expire and (2) modernize best execution obligations for both brokers and investment advisers to provide clear, implementable, and enforceable expectations.[4] This should include enhanced transparency regarding research and trading costs that are borne by asset owners.

Lastly, regulatory changes are only part of the changes. In Europe, efforts to promote research price transparency and basic investor protections have led to most asset managers simply paying for research out of their own assets, as opposed to their customers' funds. That has not yet broadly happened in the United States. Some investment advisers are continuing as they have in the past--passing through research costs to their customers without any meaningful transparency. Others are starting to separately value research, and disclose those costs, while still passing them through to their customers. And still others, led by Sands Capital, MFS, Capital Group, and T. Rowe Price, are paying directly for third-party research out of their own assets (as opposed to their customers). We expect more firms to adopt this approach in the months ahead. We

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[3] *See, e.g.*, Amber Anand, et. al, *Institutional Order Handling and Broker-Affiliated Trading Venues*, Updated Feb. 22, 2019, *available at* http://www.finra.org/sites/default/files/OCE_WP_jan2019.pdf; see also, David Rushing Dewhurst, et. al., *Scaling of inefficiencies in the U.S. equity markets: Evidence from three market indices and more than 2900 securities*, Feb. 14, 2019, *available at* https://arxiv.org/pdf/1902.04691.pdf.

[4] We note that while FINRA has offered detailed rules and guidance for brokers, there are no analogous expectations for investment advisers. *See* Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, Aug. 7, 2018, *available at* https://www.sec.gov/comments/s7-09-18/s70918-4182239-172535.pdf.

also expect a much larger number of firms to continue the trend of identifying, valuing, and competitively shopping for investment research.

In the US, asset owners' demands are driving the changes to how research is procured, valued, used, and paid for even more than regulatory changes. Many US pension funds and other asset owners will no longer accept being asked to pay an undisclosed amount for research that doesn't benefit them. As a result, regardless of the actions by regulators, the markets in the US will continue to evolve. We urge you to follow this evolution closely.

About Healthy Markets Association

The Healthy Markets Association is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets.[5]

Background on US Investors' Concerns With Costs: Payments for Research and Trading

Investors in the United States have long been concerned with costs for research and trading services. For example, since March of 1998, the Council of Institutional Investors has had a policy to "support and urge full unbundling of pricing for investment management, brokerage and research services, so that institutional investors can purchase and budget for these services as they do any other expense of the plan."[6]

There's good reason for investors' desires for greater transparency in budgeting and paying for research. For example, one recent research report found that when fund managers pass the costs through to their customers, the costs may be significantly greater than if the fund managers paid directly out of their own accounts.[7] In that study, which examined 3,000 funds and 350 asset managers, advisers whose asset owners paid directly for research (through bundled commissions) paid significantly more for research than advisers who were paying with their own money.[8] As one consultant has

[5] To learn more about Healthy Markets, or our members, please see our website at http://healthymarkets.org. For additional comment letters, Congressional testimony, and reports related to exchanges' conflicts of interest and oversight, please see https://healthymarkets.org/publications/regulatory-letters-testimony.

[6] Council of Institutional Investors, *Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture*, March 31, 1998, *available at* https://www.cii.org/policies_other_issues#principles_trading_commission_softdollar.

[7] Attracta Mooney, *Mifid II rules prompt 'huge change' in research marketplace*, Financial Times, Sept. 17, 2018, *available at* https://www.ft.com/content/6ff7f30e-ea59-3e57-bfee-1e136ede6c53.

[8] Id., (commenting on the implementation of research rules changes surrounding MiFID II).

observed, the "feeling is that funds passing on costs to clients are not being selective or disciplined enough with their research spend."[9]

The traditional bundling of research and execution costs has also rendered the pricing for each service remarkably opaque. Research providers often do not assign dollar values for the research they provide, and assigning specific values may be difficult for investment advisers -- particularly smaller advisers -- to perform.[10] This lack of price transparency, when combined with the fact that the costs have often been simply passed through to fund clients, has made it difficult for many investment advisers to engage in thoughtful determinations related to research consumption. As a result, research cost has not traditionally been as significant of a factor in the competition for research provision as it is now.

Of course, the economics of the bundled research model currently favor the handful of largest "bulge bracket" research providers who can offer both research and trading services for their customers. Firms that may compel bundling enjoy excess economic rents, that may include inflated order flow volume and commissions. Investors must not only pay the research costs, but they may also absorb the costs of likely inferior execution quality. It is likely that the handful of large broker-dealer research providers who benefit the most from the current system may be net losers in a regulatory regime that permits competition and investor choice for both research and executions. But that does not mean that there will be less quality research consumed or less competition for research, much less lower investment. Notably, to date, while overall research spending has decreased significantly in Europe, most investment advisers in Europe have reported that they are still utilizing roughly the same number of research providers as prior to the implementation of MiFID II.[11]

At the same time, there appears to be strong evidence that MiFID II is not negatively impacting the provision of research for small and mid-cap stocks. For example, one recent survey of market participants found that "43% of sell-side have not altered their coverage of small & mid-caps and 57% plan to increase coverage."[12] Further, while research spending may be generally declining across the industry, we are aware of no studies suggesting that investors are struggling to obtain research they desire. Put simply, the much-hyped concerns that research is going to become less available is allayed by the facts.

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[9] Id., (quoting Brian Quinlan, Quinlan & Associates).

[10] Notably, driven in part by customer demands and by MiFID II, many US investment advisers are attempting to determine dollar values for research consumed or engaging third-parties to assist them in this process. This process often reveals a spread between the volume and perceived "value" of research provided (as viewed from the provider's perspective) and the volume and value of the research consumed as viewed from the research consumer's perspective.

[11] Greenwich Associates, *2018 European Equity Investor Study*, (2018) (finding European advisers reporting an average of approximately 15.7 research providers, statistically unchanged from 16.1 before the implementation of MiFID II).

[12] *Unbundling Research: Canary in the Coalmine*, Liquidnet, Nov 2018.

Competition for research based on quality and cost is a good thing for investors. Asset owners are increasingly focused on ensuring that their advisers are paying attention to their costs. Some asset owners are demanding that their investment advisers provide them with details of their research costs. Some are even entering commission recapture programs in attempts to mitigate their costs,[13] although these arrangements may create their own challenges for advisers and sub-advisers to obtain best execution. Put simply, asset owners are increasingly doing what they can to ensure their advisers are fulfilling their fiduciary obligations. But asset owners are also increasingly aware that their efforts to protect themselves may be insufficient.

One key contributor to investor concerns is the lack of regulatory framework for best execution for investment advisers. Historically, the Commission has offered almost no details regarding an investment adviser's best execution obligations, other than to (1) declare the adviser has a duty of best execution, and (2) flesh out some of the details regarding an exception to the best execution obligation--payments for research under Section 28(e).[14] Many investment advisers have appreciated the flexibility that has accompanied this ambiguity. That said, as the best execution landscape has evolved in recent years, this lack of specificity has created risks for advisers and asset owners.

While the Commission itself has offered no clarity, a recent OCIE Risk Alert has provided some outlines as to what would be viewed as likely violations of an adviser's best execution obligations.[15] Unfortunately, the OCIE Risk Alert still leaves many critical questions for investment advisers and their underlying asset owners unanswered. For example,

- While an adviser should perform best execution reviews, with what frequency must they be performed? Who should perform them?
- While an adviser should consider "materially relevant factors," what are they? And how should they be weighted?

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[13] *See, e.g., Commission Recapture Programs*, Government Finance Officers Association, Oct. 2010, *available at* http://www.gfoa.org/commission-recapture-programs.

[14] See, e.g., *Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters*, Sec. and Exch. Comm'n, Exch. Act Rel. No. 34- 23170, (Apr. 28, 1986), *available at*
https://www.sec.gov/rules/interp/34-23170.pdf.

[15] *Compliance Issues Related to Best Execution by Investment Advisers*, Sec. and Exch. Comm'n, at 2-4, July 11, 2018, *available at* https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20IA%20Best%20Execution.pdf (2018 OCIE Risk Alert) (noting that a firm would be deficient if it doesn't:

- perform best execution reviews;
- consider "materially relevant factors" during their best execution reviews;
- seek comparisons from other broker-dealers;
- fully disclose their best execution practices;
- disclose its soft dollar arrangements;
- properly administer mixed allocations;
- have inadequate policies and procedures for best execution; or
- follow its best execution policies and procedures).

- While an adviser should seek comparisons from other broker-dealers, what must that entail?

Further, there are also significant issues not addressed in the OCIE Risk Alert, such as whether certain soft dollar practices are still viewed as consistent with "best execution," including whether commissions generated by one fund may be used to pay for research that benefits exclusively another fund (with different investors).[16] Many investment advisers are still left questioning whether they are doing enough to ensure they meet their best execution obligations.

Unfortunately, the current applicable disclosure obligations are inadequate. The disclosures for many investment advisers -- even those with remarkably different practices -- are remarkably similar. It is not likely that even a very sophisticated asset owner would be able to differentiate between two different advisers, based on their disclosed "broker selection" or other best execution-related disclosures. Similarly, even disclosures that have been reviewed and updated since the advent of MiFID II do not appear to fully clarify for investors all the elements of how investment research may be identified, valued, allocated, and paid for. As a result, investment advisers with policies, procedures, and practices that may be more "customer friendly" are likely not directly rewarded for their approach. Customers simply can't tell them apart from other advisers with less "customer friendly" approaches.

In the absence of clear guidance, investment advisers may be retroactively viewed by the Commission, other regulators, or private parties as having failed to meet their obligations. At the same time, with few protections and almost no information about their true costs, asset owners are left exposed to significant risks of overpaying for research and trading.

Background on MiFID II Focus on Investor Costs: Payments for Research and Trading

Asset owners in Europe have also long been concerned that their advisers have not been particularly judicious with their efforts to control costs for research and trading. After a lengthy investigation, seven years ago, the United Kingdom's Financial Services Authority (FSA) found that "some firms no longer saw conflicts of interest as a key source of potential detriment to their customers" and "had relaxed controls" below what it had felt were established market norms.[17] Worse, the FSA found "breaches of our detailed rules governing the use of customers' commissions and the fair allocation of

[16] This practice appears to be consistent with some longstanding interpretations of Section 28(e).
[17] Financial Services Authority, *Conflicts of interest between asset managers and their customers: Identifying and mitigating the risks*, at 4, Nov. 2012, *available at* http://www.fsa.gov.uk/static/pubs/other/conflicts-of-interest.pdf.

trades between customers."[18] The regulator found "the majority of investment managers had inadequate controls and oversight when acquiring research goods and services from brokers or other third parties in return for client dealing commissions … [and] were unable to demonstrate … how items of research met the exemption under our rules and were in the best interests of their customers."[19]

Put simply, the UK regulator found that asset managers were passing through the costs of research – including so-called "corporate access" – on to their customers without sufficiently scrutinizing and minimizing the costs to their customers.

In May 2014, the Financial Conduct Authority revised its rules to "ensure investment managers seek to control costs passed onto their customers with as much rigour as they pursue investment returns."[20] In July 2014, the FCA followed up the rules changes with a report on best execution and payment for order flow,[21] as well as a discussion paper on asset managers' use of commissions.[22]

In the meantime, on a parallel track, the European Commission adopted significant reforms in MiFID II. Under MiFID II, firms must take "all sufficient steps" to ensure best execution. This change raised the expectation from simply having a reasonable process, to having a process that actually achieves a specific result.

Additionally, MiFID II prohibits firms from routing orders based on inappropriate "inducements" (a.k.a. "payment for order flow" or "rebates") and explicitly requires advisers to pay for research using their own assets, specially dedicated Research Payment Accounts (RPA), or some combination of the two.

The new rules require firms to have detailed specifications for selecting brokers, routing orders, and paying for research. At a minimum, this requires explicitly knowing the dollar amounts for any research that might be paid by the adviser's underlying customers. Further, to improve analysis of firms' compliance with these standards, the new rules dramatically expand disclosure obligations.[23]

The Commission's no action letters from 2017 did not insulate US market participants from the impacts of MiFID II, but did introduced significant unintended consequences.

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[18] *Id*, at 4.

[19] Financial Conduct Authority, *Changes to the use of dealing commission rules: feedback to CP13/17 and final rules* (PS14/7), at 6, May 2014, *available at* https://www.fca.org.uk/publication/policy/ps14-07.pdf.

[20] Id.

[21] Financial Conduct Authority, *Best execution and payment for order flow* (TR14/13), July 2014, *available at* https://www.fca.org.uk/publications/thematic-reviews/tr14-13-best-execution-and-payment-order-flow.

[22] Financial Conduct Authority, *Discussion on the use of dealing commission regime: Feedback on our thematic supervisory review and policy debate on the market for research* (DP14/3), July 2014, *available at* https://www.fca.org.uk/publication/discussion/dp14-03.pdf.

[23] For example, there are disclosure requirements for best execution policies, top brokers or venues with a firm may trade, and a firm's execution performance. There is also a set of required disclosures related to payments for costs -- including execution costs -- under the PRIIPS Costs and Charges framework.

The SIFMA No-Action Letter, in particular, as relied upon by some brokers, establishes a regulatory policy that:

1. Forces some US asset owners to pay for research to that does not benefit them;
2. Subjects US asset owners to higher costs and puts US advisers at a competitive disadvantage;
3. Stifles competition amongst execution and research providers; and
4. Creates significant compliance and litigation risks for advisers.

Since the no action letters were issued, US asset owners have been subsidizing foreign asset owners for research as the expense of US asset owners. Smaller, independent research providers in the US have been inhibited in their ability to compete with bulge bracket research providers. And highly specialized, smaller trade execution providers have been inhibited in their ability to effectively compete with firms who are compelling trading as the only mechanism through which they may be paid for research. And many smaller US asset managers have been squeezed to the brink of failure or consolidation.

The SIFMA No-Action Letter Results in US Asset Owners Being Compelled to Cross-Subsidize Non-US Asset Owners

Traditionally, in the US, research has been provided by the broker-dealer, used by the investment adviser, and paid by the asset owner. But while the costs are often borne by the asset owner, there is currently very little to protect them from overpaying for the research. At a very basic level, there is no requirement in the US that the research benefit the asset owner whose assets are being used to pay for it.

By contrast, under the now-implemented MiFID II regime, a covered fund's assets can be used to pay for research that is only explicitly disclosed to the asset owners and directly benefits that fund. Unfortunately, the interaction of these two disparate regimes is that an adviser with in-scope and out-of-scope accounts for MiFID II may pay for research using funds from out-of-scope customers (particularly US asset owners) to subsidize or outright pay for research for in-scope (e.g., European) customers. This is particularly likely for "corporate access," which isn't permitted "research" under MiFID II, but is in the United States.

Worse, the US asset owners have no reasonable way to identify the extent to which this may be occurring. There are no specific required disclosures for advisers to address this issue. The Commission's implicit approval of cross-subsidization for research costs across different investment advisory customers stands in sharp contrast to the

Commission's longstanding concerns with inappropriate cross-trades,[24] trade allocations,[25] and other cost allocations.[26]

Unfortunately, the SIFMA No-Action Letter does not address any of these issues, much less describe how the policy it implements protects investors, promotes "fair and efficient" markets, or otherwise is in the public interest.

The SIFMA No-Action Letter Subjects US Asset Owners to Higher Research and Trading Costs and Disadvantages Some US Investment Advisers

The businesses of providing investment research and execution are increasingly specialized. The experience, resources, and ability to provide quality research are very different than those currently required for providing high-quality trade executions. Many investment advisers in the US and around the world separate the decisions regarding research from the decisions regarding trading.[27] Further, MiFID II and UK authorities have expressly confirmed this approach as essential to fulfilling best execution obligations. Unfortunately, one interpretation of the SIFMA No-Action Letter makes this impossible in the United States.

Currently, some large research providers in the US will accept cash payments for research while others will not. At least one of those firms has informed its adviser/customer that the SIFMA No-Action Letter is the reason why that firm will not accept a hard dollar check.[28] While some firms will accept checks pursuant to Commission Sharing Arrangements, others will not, or will discriminate between customers from whom they will accept CSA payments. But what happens when an adviser believes (based upon its own transaction cost analysis and other factors) that the research provider is not likely to provide the best overall price or execution quality? In these instances, advisers will have to choose between getting the research they need and the ability to shop for higher quality or lower cost executions. Put simply, they may be effectively compelled to trade with the suboptimal broker because it may be the only way the broker will accept payment for the essential research. This poses significant challenges to investment advisers seeking to fulfill their best execution obligations.

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[24] *See, e.g., In the Matter of Putnam Investment Mgm't, LLC and Zachary Harrison*, SEC, Admin. Proc. File No. 3-18844, Sept. 28, 2018, *available at* https://www.sec.gov/litigation/admin/2018/ia-5050.pdf.

[25] *SEC v. Strategic Capital Mgm't, LLC*, No. 1:17-cv-10125 (D. Mass. filed Jan. 25, 2017), *complaint available at* https://www.sec.gov/litigation/complaints/2017/comp-pr2017-32.pdf (defendant subsequently pleaded guilty to a related criminal charge).

[26] *Risk Alert: Overview of the Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers*, Office of Compliance, Inspections and Examinations, SEC, Apr. 12, 2018, *available at* https://www.sec.gov/files/ocie-risk-alert-advisory-fee-expense-compliance.pdf.

[27] Some view this as a key component of their best execution process.

[28] It baffles us as to why firms can take such disparate interpretations of the law. For that reason alone, it is clear that the Commission's prior interpretations and the SIFMA No-Action Letter should be revisited. Divergent interpretations of what the law mandates should not be a competitive advantage.

Further, setting aside the issues with appropriately valuing the research and execution costs paid directly to the broker, this process may also lead to inflated execution costs for the investor.[29] Again, the costs come directly out of the fund without any clear or consistent disclosure to the underlying asset owners.

US investment advisers' inability to separately shop for research and executions also puts them at a competitive disadvantage to firms that have the ability to do that. For example, UK-based firms can simply trade with those who provide best execution, and then separately write checks to pay for research from whomever they desire. By contrast, US firms may be effectively forced to trade with firms that provide lower quality executions (e.g. higher trading costs), thereby reducing returns for their investors.[30]

The SIFMA No-Action Letter does not address any of these issues, much less explain how this protects investors, promotes "fair and efficient" markets, or otherwise is in the public interest.

The SIFMA No-Action Letter Stifles Competition Amongst Execution and Research Providers

The compelled bundling of research and executions stifles competition for execution quality. In particular, large banks often have the best "corporate access" and other important research services. Advisers, particularly those who rely more heavily on fundamental research and corporate access, may then be compelled to pay for it through trading.

At the same time, however, many advisers have transaction cost analysis and other reasons to believe that trading with those firms is likely to lead (or has led) to suboptimal trade executions. This directly inhibits competition for order flow based on best execution principles. Rather, it simply deprives firms that may provide higher quality executions (such as technology-driven trading firms) of the opportunity to compete for that order flow.

Similarly, what about a firm that has great research and no real execution framework? US advisers who may want that research are again in the awful position of deciding whether they can afford to pay out-of-pocket for that research, or alternatively shift the burdens to their customers (in a way that doesn't clearly show up as a disclosed fee or charge). And while this is not a new phenomenon, it is new that advisers are largely paying directly for research for their European customers. Thus, under the MiFID II regime, advisers may independently shop for research and execution, leading to more transparent research costs and lower trading costs. This allows for the proliferation of

[29] See generally, Financial Conduct Authority, *Changes to the use of dealing commission rules: feedback to CP13/17 and final rules* (PS14/7).

[30] While some firms may be able to pay through the use of Commission Sharing Arrangements or other similar arrangements, some research providers have proven unwilling to accept such payments from some investment advisers.

firms that may specialize in research or execution -- as opposed to simply promoting the aggregation of research and order flow into the same small handful of large brokers who provide both. For example, a recent research report by a leading independent broker-dealer, which was based on a survey of market participants, found that "46% [of buy-side respondents] think unbundling research has led to a change in how they source liquidity with 94% now having the freedom to select a more diverse range of execution providers."[31]

The SIFMA No-Action Letter Subjects US Asset Managers to Significant Regulatory, Legal, and Compliance Risks

There are several key distinctions between the protections for US asset owners and asset owners that are "in-scope" for MiFID II. These discrepancies give rise to significant risks for compliance and litigation, not just by the Commission, but also by state regulators and private plaintiffs. In fact, there are several recent massive changes in disclosures that impact US firms operating abroad or with foreign investors, including:

- new disclosures of execution policies under Article 27 of MiFID II;
- reports pursuant to Regulatory Technical Standards 27 (which became effective in July 2018) and RTS 28 (which became effective in April 2018);
- PRIIPS Costs and Charges disclosures; and
- customers' demands.

But there are also very clear substantive differences between the US and European regimes for how research can be budgeted, to whom it may benefit, how it may be valued, and even what constitutes "research." In general, despite these massive differences, investment advisers around the world are increasingly:

- Identifying and determining the explicit values of executions and research, separately;
- Paying for research in amounts that are not based on trading volumes (decoupling the amount paid for research from trading);
- Periodically evaluating trading decisions and adjusting routing decisions based upon increasingly sophisticated analyses;
- Creating and utilizing mechanisms to pay for research; and
- Dramatically revising their disclosures of best execution and order routing practices.

US-based investment advisers that have customers that are both in-scope and out-of-scope for MiFID II have taken a variety of approaches for attempting to reconcile their treatment of customers. Some have even gone so far as to take the incredibly burdensome (and costly) step of seeking to reimburse their customers for research costs: writing hundreds, or even thousands, of checks or transfers to alleviate direct

[31] *Unbundling Research: Canary in the Coalmine*, Liquidnet, Nov 2018.

research costs for their customers.[32] However, even this step does not alleviate the greater execution costs that may be associated with the bundled trades.

So what happens when a US asset owner learns that its returns are 7% per year, but that a foreign investor in the same strategy with that same adviser has a return of 7.25%? This type of preferential treatment of some investors over others is they type of discrimination that the Commission, state regulators (particularly those who may be acutely sensitive to pension funding), and private plaintiffs typically scrutinize. It is also simply unfair.

Unfortunately, until the asset owners have the transparency and accountability they deserve, and investment advisers have the ability to separately shop for research and trading services, investors will continue to be harmed.

Recommendations

We urge you (1) Recommend to the Commission that the SIFMA No Action Letter will be allowed to expire and (2) Recommend the Commission modernize best execution obligations for both brokers and investment advisers to provide clear, implementable, and enforceable expectations that better protect investors.[33] This should include enhanced transparency regarding research and trading costs that are borne by asset owners.

Conclusion

Thank you for your consideration. Should you have any questions or would like to discuss these matters further, please call me at (202) 909-6138.

Sincerely,

Tyler Gellasch
Executive Director

[32] *See, e.g.*, Sands Capital Management, LLC.
[33] We note that while FINRA has offered detailed rules and guidance for brokers, there are no analogous expectations for investment advisers. *See* Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, Aug. 7, 2018, *available at* https://www.sec.gov/comments/s7-09-18/s70918-4182239-172535.pdf.