



October 16, 2018

The Honorable Walter Jay Clayton
Chairman
United States Securities and Exchange
Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Public Comments from Interested Parties on MiFID II's Research Provisions

Dear Chairman Clayton:

I am writing on behalf of MFS Investment Management ("MFS")¹ in response to the invitation by the U.S. Securities and Exchange Commission ("SEC") to provide views on a temporary no-action letter ("SIFMA Letter") issued by the SEC's Division of Investment Management.² The issuance of that letter was critically important to allow MFS and other global asset managers to comply with the European Union's MiFID II research provisions³ without operating in conflict with the U.S. federal securities laws. Nonetheless, we urge a broader and permanent approach.

We encourage the SEC to issue, before the relief in the SIFMA Letter expires, a permanent rule to exempt broker-dealers from investment adviser status when providing research services to money managers, regardless of how the broker-dealer is paid for those services. Such a rule would be broader and more impactful for U.S. investors than the relief contained in the temporary no-action letter. We discuss our views of the SIFMA Letter and our recommendation in more detail below.

¹ MFS Investment Management traces its history to 1924 and the creation of the country's first open-end mutual fund, Massachusetts Investors Trust. Today MFS is a global investment manager managing approximately \$485 billion in assets through a variety of collective investment vehicles and separate account, including approximately \$256 billion managed in registered investment companies for which MFS serves as the primary investment adviser.

² *Securities Industry and Financial Markets Association*, SEC Staff No-Action Letter (pub. avail. Oct. 26, 2017).

³ The term "MiFID II" refers to the Directive 2014/65, of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Commission Directive 2002/92 and Council Directive 2011/61, O.J. (L 173) 57, 349 and equivalent national rules of member states.

The SIFMA Letter

As an initial matter, MFS wishes to express gratitude to the staff for issuing the SIFMA Letter and the two other letters that accompanied it. At the time, global asset managers faced enormous uncertainty about how to comply both with MiFID II and with U.S. regulations applicable to research. We commend the staff for the thoughtful and timely engagement to find a temporary solution to this matter of global significance.

The SIFMA Letter appropriately permits a broker-dealer to provide research services to an investment manager that is required by MiFID II, either directly or by contractual obligation, to pay for the research services by using money from one or a combination of two sources – money from a separate research payment account (“RPA”) funded with its clients’ money and/or the manager’s own money. Absent the SIFMA Letter’s relief, a broker-dealer providing research potentially would have faced a new obligation to register as an investment adviser merely because a non-U.S. law required a different payment method for that research than has historically been used in the United States.

Had the staff not issued the SIFMA Letter, we believe research services would have been diminished by broker-dealers seeking to avoid the need to register as investment advisers. However, the relief should be made permanent and should end artificial distinctions between: (i) EU and non-EU investors; and (ii) EU and non-EU money managers.

The SIFMA Letter by its terms expires in July 2020 – thirty (30) months after MiFID II’s implementation date of January 3, 2018. Temporary relief, by its very nature, creates uncertainty around regulatory expectations and makes business decisions challenging. Permanent relief would aid market participants in understanding their long-term global compliance obligations.

In addition, and in contrast to MFS’s proposal set forth herein, the SIFMA Letter provides that the client of an investment adviser will be able to pay an execution-only commission rate on a transaction only if the client is domiciled in the EU or the account is being managed in whole or in part from within the EU. Other clients must beware that a portion of client commissions will be used to pay for research even if the client’s money manager is otherwise willing and able to pay for research out of the money manager’s own pocket.

We believe that this result is inconsistent with the broad remedial purpose of the Investment Advisers Act of 1940 (“**Advisers Act**”) to “substitute a philosophy of disclosure for the philosophy of *caveat emptor*,” as the Supreme Court said in its *Capital Gains* decision.⁴ To the contrary, the staff’s temporary no-action relief has the effect of creating and magnifying conflicts of interest that money managers might otherwise be able to avoid. This, too, is at odds with the Congressional intent recognized by the

⁴ *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963) (“*Capital Gains*”).

Capital Gains court for the Advisers Act “to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested.”⁵

The SIFMA Letter actually creates a new conflict of interest. On the one hand, the SIFMA Letter facilitates money managers paying for research out of their own pocket for EU-domiciled clients and client accounts managed out of the EU. On the other hand, the SIFMA Letter does not extend this same treatment for U.S. clients. The result is a pecuniary incentive for money managers to pay for research using client commissions of non-EU clients or with respect to accounts not managed within the EU. The other odd result is that (i) similarly situated clients are treated differently solely by virtue of whether they are domiciled in the EU and (ii) similarly situated money managers likewise are treated differently solely by virtue of whether they have operations in the EU.

We greatly appreciate the staff’s efforts to react promptly to provide temporary relief, but we urge a more expansive and permanent approach – one that eliminates the conflict of interest and disparate treatment of similarly situated clients and money managers noted above.

MFS’s Recommendation

MFS urges the SEC to propose a rule to permanently exempt broker-dealers from investment adviser status when providing research services to money managers, regardless of how the broker-dealer is paid for those services. Such a rule would:

- end artificial distinctions between EU and non-EU investors and money managers;
- provide maximum flexibility to investors, money managers and broker-dealers to structure arrangements for the procurement of research;
- acknowledge that as long as at least one party in contractual privity with the ultimate investor is subject to a fiduciary duty, then there is no need to apply a fiduciary duty to a broker-dealer providing research to that party, regardless of the payment arrangement between the broker-dealer and the investment adviser; and
- stay true to your well-articulated core principle that regulation should best serve the long-term interests of retail investors.

Even more significant, the rule should dramatically mitigate the conflict of interest that the SEC itself has recognized is inherent in the use of client brokerage commissions to

⁵ *Id.* at 191-92.

pay for research. Today, money managers effectively are forced to use client brokerage commissions to pay for much external research and disclose and manage the conflicts of interest that are associated with that research. This is because the money manager has very few options for paying for that research, at least from registered broker-dealers. Many broker-dealer research providers simply do not allow money managers to pay for research separate from client commissions because those broker-dealers do not wish also to be registered and regulated as investment advisers.

The issue arises from the text of Section 202(a)(11)(C) of the Advisers Act, which excepts from the definition of “investment adviser” a broker-dealer “whose performance of [advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.” The SEC and its staff have interpreted the receipt by broker-dealers of fees separate and apart from brokerage commissions as “special compensation” for purposes of the Advisers Act.⁶

We agree with a prior SEC statement that Section 202(a)(11)(C) was intended to identify the *type* of advisory services provided by broker-dealers for compensation.⁷ It simply is counterintuitive for a regulatory scheme to impose fiduciary obligations upon a broker-dealer when the broker-dealer provides research to an investment adviser that itself is a fiduciary, is involved in an arm’s length relationship with the broker-dealer, and has no expectation of the broker-dealer actually acting as a fiduciary in its provision of research. If the SEC sees a need to clarify what research should qualify for the relief, we believe it could appropriately limit the relief to “research services” as used in Section 28(e) of the Exchange Act and as interpreted by the SEC in 2006.⁸

Once the type of services has been identified, the manner in which the broker-dealer is compensated for those services, whether by an RPA or the manager’s own money, should not be relevant. MFS requests that the SEC reflect such a concept in a permanent rule. Indeed, contrary to the SEC’s statement quoted above, the current regime turns instead on whether or not the investment adviser pays for the research with the commission paid by clients or the adviser’s own money. If the latter, the broker-dealer is a fiduciary; if the former, it is not. That is a uniquely odd basis for determining whether a person is a fiduciary, and we urge the SEC to permit payments by both hard dollars and soft dollars for research in a permanent rule.

⁶ *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, Investment Advisers Act Rel. No. 2376 (Apr. 12, 2005), 70 FR 20423, 20431 (Apr. 19, 2005).

⁷ *Id.*, 20431 n. 73.

⁸ Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Rel. No. 34-54165 (July 18, 2006). We acknowledge that the term “research services” includes information that is not investment advice, but nonetheless is a clear, demarcation for the type of research that should qualify a broker-dealer for an exemption from being an investment adviser.

We acknowledge that the SEC must grapple with a decision by the D.C. Circuit that vacated a rule that has some similarities to the one we recommend. The vacated rule sought to add an exemption for broker-dealers from the definition of “investment adviser” that was in addition to the exemption for broker-dealers that exists under Section 202(a)(11)(C) of the Advisers Act.⁹ We believe, however, that the exemptive authority granted to the SEC in Section 206A of the Advisers Act – authority that the SEC did not assert to support its vacated rule – gives the SEC ample grounds in this case to adopt an exemptive rule that would permit broker-dealers to accept cash payments from money managers for research without being deemed to be investment advisers.

Section 206A of the Advisers Act grants the SEC very broad authority to:

by rules and regulations . . . conditionally or unconditionally exempt any person or transaction, or any class or classes of persons, or transactions, from any provision or provisions of this subchapter . . . if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter.

Section 206A was intended to provide the SEC with “broad exemptive authority to administer the Advisers Act in a flexible manner.”¹⁰ We believe that this broad authority can be used to permit broker-dealers to accept cash payments from money managers in lieu of commissions for research while operating under an exemption from being investment advisers for purposes of the Advisers Act.

The *FPA* majority stated, in vacating the rule, that the SEC affirmatively disavowed reliance on Section 206A of the Advisers Act for its adoption of the vacated rule, and relied only on other authority that the *FPA* court determined was too narrow to support the exemptive rule. Indeed, the *FPA* court itself noted the breadth of the exemptive authority provided by Section 206A, though the court did not reach any conclusion as to that authority had the SEC asserted it.¹¹

We also believe strongly that the SEC has ample bases for concluding, for purposes of Section 202(c) of the Advisers Act, that such a rule would protect investors and would promote efficiency, competition, and capital formation. Indeed, the rule could provide a dramatic expansion of competition of research providers themselves because the

⁹ *Financial Planning Ass’n. v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (“*FPA*”).

¹⁰ H.R. Rep. No. 91-1382 (91st Cong, 2nd Sess.), at 13.

¹¹ See *FPA*. The opinion states that “the SEC disavows any reliance on § 206A in promulgating the final rule, see 70 Fed. Reg. 20,453; Respondent’s Br. at 27 n. 10, and thus the court has no occasion to express an opinion on the SEC’s authority under it.” *Id.* at 493.

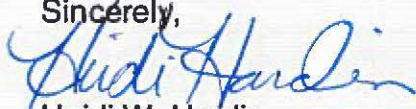
payment for research would not necessarily be linked any further to commissions and brokerage services.

The securities markets have evolved dramatically in the 78 years since the enactment of the Advisers Act – from the unfixing of securities commissions, to the enactment of the Section 28(e) safe harbor, to the abolition of off-board trading restrictions on exchange-listed securities, to the demutualization of exchanges, to the advent of electronic communications networks, alternative trading systems and dark pools. The effect of these developments argue in favor of utilizing the SEC's broad exemptive authority to enable sophisticated market participants to pay, and accept payment for, investment research offered in conjunction with traditional brokerage services, in a manner that both producers and consumers find mutually beneficial, rather than forcing those participants who are not subject to MiFID II into a regulatory structure that is unchanged from the era of fixed commission rates.

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We appreciate the opportunity to provide our views on the temporary no-action relief. If you have any questions regarding this comment letter I would be happy to discuss. I can be reached at [REDACTED]

Sincerely,



Heidi W. Hardin
General Counsel

cc:

The Honorable Kara M. Stein
Commissioner
U.S. Securities and Exchange Commission

The Honorable Robert J. Jackson, Jr.
Commissioner
U.S. Securities and Exchange Commission

The Honorable Hester M. Peirce
Commissioner
U.S. Securities and Exchange Commission

The Honorable Elad L. Roisman
Commissioner
U.S. Securities and Exchange Commission

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Dalia Blass, Esq.
Director, Division of Investment Management
U.S. Securities and Exchange Commission

