March 21, 2019

Chairman Jay Clayton
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Comments on Impact of MiFID II Research Provisions

Dear Chairman Clayton:

The Securities Industry and Financial Markets Association ("SIFMA")[1] urges the Securities and Exchange Commission ("SEC") to provide permanent relief by rule or exemption allowing broker-dealers to charge separately or receive cash payments for research provided to investment managers and other institutional investors without the broker-dealers being deemed investment advisers subject to the Investment Advisers Act of 1940 ("Advisers Act"). While the SEC staff's October 2017 no-action relief was critical to minimize disruption triggered by the European Union's MiFID II directive, which effectively requires investment managers impacted by MiFID II to unbundle—that is, to pay for research separately from client trading commissions[2]—permanent and broader action is now needed given broader changes that are occurring in the global research marketplace.

SIFMA members are increasingly seeing a desire for greater flexibility and transparency in how to pay for research among investment managers and other institutional investors that are

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the US and global capital markets. On behalf of our industry's nearly one million employees, we advocate on legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. With offices in New York and Washington, DC, SIFMA is the US regional member of the Global Financial Markets Association ("GFMA").

This letter was prepared by SIFMA's Research Working Group and other interested member firms, comprising over 40 firms and including global, regional and smaller securities firms.

[2] *See* Secs. Indus. & Fin. Mkts. Ass'n, SEC Staff No-Action Letter (Oct. 26, 2017) (providing temporary relief until July 3, 2020) [hereinafter SIFMA No-Action Letter]. The SIFMA No-Action Letter permits broker-dealers to provide research to investment managers subject to MiFID II directly or by contractual obligation in exchange for cash payments, or payments from a research payment account ("RPA"), without being treated as investment advisers under the Advisers Act. By "MiFID II," we are referring to 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, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2014:173:TOC, as implemented by the European Union ("EU") member states.

not subject to MiFID II directly or by contractual obligation.[3] Unfortunately, broker-dealers are placed in a difficult position when receiving these requests. In these situations, broker-dealers have two options: (1) forego separate payments and decline to provide research and other content to investment managers that insist on paying separately from trading commissions, or (2) accept separate payments for research that may make them investment advisers, and attempt to deal with the challenges and ambiguities presented by investment adviser status. Either option could diminish the extent and value of research provided to investment managers.

Our members appreciate your leadership on this issue and share the concerns you voiced at the Investor Advisory Committee meeting on December 13, 2018 that changes in the research marketplace could result in a reduction in the availability of research. We were also encouraged by the SEC's December 21, 2018 request for data and other information on the impact of MiFID II on the research marketplace.

In response to the request, the SEC has received meaningful feedback from, or on behalf of, major investment managers and institutional investor clients expressing the critical need for the SEC to take action now to remove barriers to unbundling of research payments from trading commissions.[4] A general theme pervading these letters is that the current framework under the SIFMA No-Action Letter has created not just market uncertainty, but also an uneven playing field among investment managers and institutional investors, as well as conflicts of interest between clients, that are negatively impacting US investors. In the absence of SEC action to provide broader relief to allow broker-dealers to receive unbundled payments for research, investment managers have been forced to attempt various approaches to seek to mitigate negative consequences for their clients. While market participants will likely continue to seek innovative approaches to pay for research, ultimately, the primary obstacle will remain: that is, broker-dealers are legitimately reluctant to accept separate payments for research because of the

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[3] For ease of reference, we refer to investment managers throughout this letter, even though requests for unbundling have been made by institutional investors more broadly and our requested relief would apply not just to investment managers, but more broadly to any institutional investor.

[4] *See* Letter from Tyler Gellasch, Exec. Dir., Healthy Markets Ass'n, to Honorable Jay Clayton, Chairman, Secs. & Exch. Comm'n (Mar. 1, 2019); Letter from Doug Clark, Chairman, & James Toes, Pres. & CEO, Sec. Traders Ass'n, to Honorable Jay Clayton, Chairman, Secs. & Exch. Comm'n (Feb. 15, 2019) [hereinafter STA Letter]; Letter from Michael C. Gitlin, Partner, et al., Capital Research & Mgmt. Co., to Honorable Walter Jay Clayton, Chairman, Secs. & Exch. Comm'n (Feb. 11, 2019) [hereinafter Capital Group Companies Letter]; Letter from Amy C. McGarrity, Chief Inv. Officer, Colo. Pub. Emps.' Ret. Ass'n, to Honorable Jay Clayton, Chairman, et al., Secs. & Exch. Comm'n (Jan. 31, 2019) [hereinafter Colorado PERA Letter]; Letter from Jeffrey P. Mahoney, Gen. Counsel, Council of Institutional Investors, to Honorable Jay Clayton, Chairman, Secs. & Exch. Comm'n (Jan. 31, 2019) [hereinafter Council of Institutional Investors Letter]; Letter from David Villa, Exec. Dir./Chief Inv. Officer, State of Wis. Inv. Bd., to Honorable W. Jay Clayton, Chairman, et al., Secs. & Exch. Comm'n (Jan. 31, 2019) [hereinafter State of Wisconsin Investment Board Letter]; Letter from Tyler Gellasch, Exec. Dir., Healthy Markets Ass'n, to Honorable Jay Clayton, Chairman, Secs. & Exch. Comm'n (Dec. 21, 2018); Letter from Timothy W. Cameron, SIFMA Asset Mgmt. Grp. – Head, & Lindsey Weber Keljo, SIFMA Asset Mgmt. Grp. – Managing Dir. and Assoc. Gen. Counsel, to Honorable Walter Jay Clayton, Chairman, Secs. & Exch. Comm'n (Dec. 14, 2018); Letter from Heidi W. Hardin, Exec. Vice President & Gen. Counsel, MFS Inv. Mgmt., to Honorable Walter Jay Clayton, Chairman, Secs. & Exch. Comm'n (Oct. 16, 2018) [hereinafter MFS Inv. Mgmt. Letter]. We note that the SIFMA Asset Management Group, or "AMG," is the independent forum within SIFMA that provides a voice for the buy side within the securities industry and represents US asset management firms whose combined assets under management exceed $40 trillion.

consequences of being deemed investment advisers, and therefore fiduciaries. SIFMA encourages the SEC and its staff to listen to this important input from investment managers and institutional investors, including the need to allow broker-dealers to meet investment managers' requests for greater flexibility and transparency in how they pay for research.

SIFMA would like to advance the dialogue on these important issues by offering its perspectives on changes in the research marketplace—changes that, while precipitated by MiFID II, have expanded far beyond the EU and are now impacting US investment managers, investors, and broker-dealers. As a general matter, SIFMA believes the approach of using bundled commissions to pay for research in reliance on Section 28(e) of the Securities Exchange Act of 1934 ("Exchange Act") has served US investors and the US capital markets well. In this regard, we believe that the SEC's position that "the providing of investment research is a fundamental element of the brokerage function for which the bona fide expenditure of the beneficiary's [—i.e., an investment manager's clients'—] funds is completely appropriate, whether in the form of higher commissions or outright cash payments" remains as true now as it was in 1972.[5] Moreover, the free and widespread dissemination of research by broker-dealers—which has been facilitated by the Section 28(e) safe harbor allowing investment managers to receive research in exchange for order flow (or client commissions)—has been key to attracting order flow so important to the liquidity of our capital markets. That said, SIFMA offers five observations:

1. Whether one thinks unbundling of research and commissions is good or bad is beside the point—MiFID II, global client demands, and market dynamics have brought us to an inflection point at which an increasing number of investment managers, especially larger ones, either believe they are compelled or have decided to pay for research separately rather than using bundled commissions.

2. Some studies have indicated that, because of this unbundling, research budgets are tightening for investment managers and this "belt-tightening" is already being felt in terms of reductions in broker-dealer research teams and the depth and breadth of research coverage at many firms.[6]

3. In this environment of tightening research budgets, it is critical to eliminate unnecessary and burdensome limits on broker-dealers' receipt of separate compensation for—and correspondingly, investment manager access to—research, lest those limits exacerbate budgetary pressures that are already constricting the depth and breadth of research so central to the US capital markets.

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[5] Secs. & Exch. Comm'n, Future Structure of Securities Markets, 37 Fed. Reg. 5286, 5290 (Mar. 14, 1972).

[6] *See* Michael Mayhew, *MiFID II Causes Research Sales to Fall Again in 2019*, INTEGRITY RESEARCH ASSOCIATES (Jan. 28, 2019), *available at* http://www.integrity-research.com/mifid-ii-causes-research-sales-fall-2019/; Hannah Murphy, *UK Mid-Caps Suffer Drop in Liquidity and Analyst Coverage*, FINANCIAL TIMES (July 30, 2018), *available at* https://www.ft.com/content/21e8b5de-91ae-11e8-bb8f-a6a2f7bca546; Mike Sheen, *MiFID II Drives Liquidity Drought as Broker Research Coverage Falls*, INVESTMENT WEEK (July 30, 2018), *available at* https://www.investmentweek.co.uk/investment-week/news/3036758/mifid-ii-drives-liquidity-drought-as-broker-research-coverage-falls.

4. Decisions by investment managers to pay broker-dealers for research separately, rather than through bundled commissions, in no way change the relationships between investment managers and broker-dealers—or make broker-dealers fiduciaries—and should not drive how broker-dealers are regulated from a policy standpoint, as broker-dealers are already governed by a comprehensive regulatory framework under SEC and Financial Industry Regulatory Authority ("FINRA") rules when providing research.

5. Regulating broker-dealers as investment advisers, and thus fiduciaries, when providing research and other content that might constitute investment advice to investment managers might diminish the extent and utility of that content, especially "value-added" and important content from broker-dealers' sales and trading businesses.

Prior Relief Is Inadequate to Address Changes in the Research Marketplace

The SEC staff took an important step in the SIFMA No-Action Letter by providing critical, albeit temporary and limited, no-action relief to address immediate concerns that the impacts of MiFID II's unbundling requirements would extend beyond the EU into the US and negatively impact participants in the US securities markets.[7] However, the SIFMA No-Action Letter has proven insufficient to address changes in the research marketplace that have already occurred because of its temporary nature and limited scope and the growing paradigm change in the research marketplace that, while precipitated by MiFID II,[8] reflects a broader sentiment among many investment managers and their clients that investment managers should pay for research themselves or provide clients with greater transparency into amounts paid for research.

SIFMA believes it is critical that the SEC address these changes in the research marketplace by providing permanent relief and greater flexibility both to investment managers in deciding how to pay for research and to broker-dealers in deciding how to be compensated for

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[7] Specifically, the SIFMA No-Action Letter provides temporary relief, until July 3, 2020, to the effect that the SEC staff would not recommend enforcement action under the Advisers Act against a broker-dealer that provides research that constitutes investment advice under Section 202(a)(11) of the Advisers Act to an investment manager that is required by MiFID II, either directly or by contractual obligation, to pay for the research from its own money, from a separate RPA funded with client money, or from a combination of the two. We understand that the staff of the Division of Investment Management interprets the SIFMA No-Action Letter as applying to MiFID II as defined in the letter and equivalent national rules of the United Kingdom ("UK") following Brexit. The uncertainty related to Brexit demonstrates how pinning or conditioning SEC relief on a particular set of non-US rules is problematic because of the fluid nature of global requirements in the area, including Brexit (and the UK presumably substituting its own rules for MiFID II's requirements) and other non-EU jurisdictions that are actively considering following MiFID II's requirements. Even though the SEC staff has been helpful in addressing some of these changes, any delay or the risk of the staff not taking such positions in some cases introduces unnecessary uncertainty.

[8] Following MiFID II's implementation on January 3, 2018, many EU investment managers elected to pay for research directly and not use RPAs. According to the *Financial Times*, which maintains what it calls "The Definitive List of Asset Managers that Will Pay for Research," over 70 investment managers have announced that they would pay for research directly. *The Definitive List of Asset Managers that Will Pay for Research*, FINANCIAL TIMES, https://www.ft.com/content/d7be86de-8f1d-11e7-a352-e46f43c5825d (last updated Feb. 22, 2018).

research.[9] Specifically, SIFMA requests that the SEC provide permanent relief by rule or exemption allowing broker-dealers to charge separately or receive cash payments for research provided to investment managers and other institutional investors without the broker-dealers being deemed investment advisers subject to the Advisers Act. For purposes of this relief, an "institutional investor" should include any person that qualifies as a "U.S. institutional investor" under Exchange Act Rule 15a-6 or as an "institutional account" under FINRA Rule 2210(a)(4). Providing relief allowing broker-dealers to flexibly meet the needs of investment managers and their clients regardless of whether they are obligated to comply with MiFID II will help both investment managers' and broker-dealers' ability to navigate major changes in the research marketplace.

At this time, SIFMA believes that anything short of this relief would be insufficient. SIFMA agrees with comments from investment managers and their institutional investor clients that merely extending or making permanent the relief granted in the SIFMA No-Action Letter would be insufficient to address dynamic and evolving market demands. In addition, the letter's limitation to investment managers subject to MiFID II directly or by contractual obligation fuels concerns voiced by institutional investor clients that the disparate treatment of investment managers "creates an unlevel playing field, potentially disadvantaging U.S. investors in their efforts to seek best execution in trading and transparency in research acquisition."[10]

Moreover, SIFMA urges the SEC not to simply allow the SIFMA No-Action Letter to lapse. If the SIFMA No-Action Letter were allowed to lapse, this would not set the clock back to 2017 and the research marketplace would not simply revert back to pre-MiFID II arrangements. Rather, there would be significant uncertainty and likely substantial business disruption. In addition to the issues raised in this letter relating to the desires of non-MiFID II–impacted clients for greater flexibility in paying for research, broker-dealers would need to decide whether to unwind established arrangements with MiFID II–impacted clients, and potentially cut off their access to research, or accept separate payments for research provided as an investment adviser. Those broker-dealers that decided to provide research as investment advisers would need to grapple with thorny issues about how investment adviser and fiduciary status would impact the research, sales, and trading businesses, each of which provides content that is viewed as research

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[9] *See also* MFS Inv. Mgmt. Letter (urging the SEC to "provide maximum flexibility to investors, money managers and broker-dealers to structure arrangements for the procurement of research").

[10] *See* Colorado PERA Letter ("Ideally, we would like the no-action relief to cover *all* investors, regardless of their status under MiFID II."); *see also* State of Wisconsin Investment Board Letter (urging the SEC to "end the artificial distinctions and inherent conflict created between EU and non-EU investors and money managers and allow flexibility in structuring payments to broker-dealers for research through either hard or soft dollars"); Council of Institutional Investors Letter ("Ideally, we would prefer SEC action to grant no-action relief that would cover all investors, regardless of status under MiFID II."); MFS Inv. Mgmt. Letter (arguing that the SIFMA No-Action Letter "creates a new conflict of interest" in the form of 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" and that because of this disparate treatment, "(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").

under MiFID II.[11] Capital markets broker-dealers that have brought aspects of their research business within an investment advisory business have, to our knowledge, only done so for their formal research businesses because of concerns about how investment adviser and fiduciary status would impact their sales and trading businesses.

Questions broker-dealers might need to analyze in deciding whether to provide research as an investment adviser include, for example: How would providing content generated from the research, sales, and trading businesses as an investment adviser impact capital markets activities? Should parts of the businesses be moved offshore? For research provided as an investment adviser, is SEC or state registration required? Should research be provided through an investment adviser that is a separate entity (i.e., spun out into a standalone adviser not subject to the Exchange Act or FINRA rules governing research)? Would some investment managers still be able to pay for research with bundled commissions? How would acting as an investment adviser when providing content from the research business impact interactions with the sales and trading businesses? Would a new, preferred class of clients emerge (e.g., hedge funds or proprietary trading firms that can still pay for research or advice—specifically sales and trading content—with bundled commissions)? For those aspects of the business operated as an investment adviser, how should the compliance framework be structured, including with respect to policies, procedures, surveillance, and related controls? What disclosures are required, and how should they be drafted? How should firms socialize these changes to their businesses with clients and renegotiate arrangements with clients?

If the SEC intends to merely extend the SIFMA No-Action Letter or, even worse, allow it to lapse, rather than providing the broader relief requested in this letter, we urge the SEC to make those intentions clear to market participants now, and not to wait until July 3, 2020 approaches. We agree with the Security Traders Association that "a decision to allow the relief to expire in July 2020 risks to be highly disruptive if firms are not provided adequate time to adjust to the regulatory regime" and that the SEC needs to "include a designated transition period long enough to allow industry participants to adjust to the regulatory regime."[12]

The Broker-Dealer Exclusion Limits the Ability of Broker-Dealers to Provide Flexibility to Investment Managers

The lack of clear guidance from the SEC about what types of compensation would be viewed as "special compensation" for purposes of the broker-dealer exclusion, particularly in the

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[11] We outlined many of those issues in our letter requesting no-action relief, and incorporate that letter by reference here. *See* Letter from Steven W. Stone, Partner, Morgan, Lewis & Bockius LLP, to Douglas J. Scheidt, Assoc. Dir. and Chief Counsel, Div. of Inv. Mgmt., SEC (Oct. 17, 2017).

[12] *See* STA Letter. Indeed, time may well have passed for there to be an orderly transition when one considers the 30-month period provided in the SIFMA No-Action Letter; the 18-month period afforded hedge fund managers after Advisers Act Rule 203(b)(3)-2 was vacated resulting in a greater number of firms being deemed investment advisers subject to registration or regulation, *see* Am. Bar Ass'n, SEC Staff No-Action Letter (Aug. 10, 2006); and the 41-month period when the SEC temporarily exempted certain broker-dealers from the Advisers Act after the end of the era of fixed commissions, *see* Final Extension of Temporary Exemption from the Investment Advisers Act for Certain Brokers and Dealers, Investment Advisers Act Release No. 626 (Apr. 27, 1978), 43 Fed. Reg. 19224 (May 4, 1978) [hereinafter IA-626].

context of research content, has created unnecessary confusion among market participants and impedes broker-dealers' ability to accommodate investment managers' requests for flexibility in how they pay for research.[13]

The only SEC releases on the "special compensation" prong in effect today date from the 1970s and involve the SEC publishing positions of the staff of the Division of Investment Management, which themselves were largely new, had very limited precedent, and are not binding on the SEC.[14] The lack of clear and definitive SEC interpretive guidance on the broker-dealer exclusion creates uncertainty for market participants even for long-standing practices. Thus, broker-dealers generally—and understandably—are reluctant to charge separately or accept cash payments for research because of concerns they might be viewed as receiving "special compensation," thereby subjecting them to the Advisers Act.

Broker-dealers are placed in a difficult position when investment managers not subject to MiFID II, whether in response to client demands or for other reasons, seek to pay for research separately rather than using bundled commissions. In these situations, broker-dealers might ultimately be left with two options:

1. Forego separate payments and decline to provide research and other content to investment managers that insist on unbundling; or

2. Accept unbundled payments that may make them investment advisers, and attempt to deal with the challenges presented by investment adviser status.

Either of these options could ultimately result in a reduction in investment managers' access to important research they could use for the benefit of their clients. This is the case even though the manner in which investment managers pay broker-dealers for research—whether bundled commissions or separate payments—in no way changes the services provided, the nature of their relationships, or the underlying policy considerations on how the provision of research should be regulated.[15] There is no reason to subject broker-dealers to the Advisers Act, and corresponding fiduciary duties, where the recipients of that research have no expectation of a fiduciary relationship with those broker-dealers.[16] The receipt of unbundled payments should

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[13] Section 202(a)(11)(C) of the Advisers Act excludes from the definition of "investment adviser" any broker-dealer that provides investment advice that is "solely incidental" to its brokerage business and that does not receive "special compensation" for that advice.

[14] *See* IA-626, *supra* note 12, 43 Fed. Reg. at 19226 (stating that "because the existence or non-existence of 'special compensation' in any paricular [sic] circumstance may not be clear, the Commission considers it desirable that the current views of the Division of Investment Management on this subject be provided to broker-dealers for their guidance, while also calling for comment on this question"); *see also* Chairman Jay Clayton, Statement Regarding SEC Staff Views (Sept. 13, 2018) ("The Commission's longstanding position is that all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties.").

[15] *See* Colorado PERA Letter ("We believe the method of payment, whether direct or commission-based, neither defines the research services provided by broker-dealers, nor represents 'special compensation;' the same research is provided regardless of payment choice.") (footnote omitted).

[16] *Cf.* MFS Inv. Mgmt. Letter ("It is simply 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

not be the deciding factor in how broker-dealers are regulated from a policy standpoint when providing research.

As a federal agency, the SEC has the discretion—indeed, the responsibility—to clarify its views in this area, as they do not account for changes in the global research marketplace or the needs of our capital markets or investors.[17] Specifically, the SEC has the authority to interpret or apply the Advisers Act to allow broker-dealers to charge separately or receive cash payments for research provided to investment managers and other institutional investors without the broker-dealers being deemed investment advisers subject to the Advisers Act.[18]

Notably, the Commodity Futures Trading Commission ("CFTC") staff reached this exact policy position—that the form of payment should not drive determinations of regulatory status—in providing relief from commodity trading advisor status in response to MiFID II. In the CFTC staff's view, the "receipt of a separate payment for commodity trading advisory services is merely a factor to be considered among the facts and circumstances related to the advisory activities provided in determining whether the activities are indeed 'solely incidental' to the conduct of a [swap dealer's] business as a [swap dealer], or whether the advisory activities are a separate, independent line of business more commonly associated with the business of a [commodity trading advisor]."[19] Congress's decision in 1974 to establish only a "solely incidental" test (patterned after the Advisers Act) when excluding the equivalents of broker-dealers from being commodity trading advisors subject to the Commodity Exchange Act was intentional and represents congressional recognition that the determination of advisor status should not be driven by the form of compensation received for advisory services that are indeed incidental to the brokerage function.

Subjecting Broker-Dealers to the Advisers Act When Providing Research Is Not Necessary or Appropriate for the Protection of Investors

As a general matter, SIFMA does not believe that the Advisers Act—and corresponding fiduciary duties—were intended to apply to broker-dealers providing research to investment managers in the ordinary course of the broker-dealers' businesses.[20] As discussed above, the

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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.").

[17] Federal agencies have leeway to interpret and reinterpret undefined statutory terms. *See Nat'l Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 981–82 (2005); *Chevron, U.S.A., Inc. v. Nat'l Res. Def. Council, Inc.*, 467 U.S. 837, 842–44 (1984); *N. Am. Bldg. Trades Unions v. OSHA*, 878 F.3d 271, 302–03 (D.C. Cir. 2017).

[18] *See infra* notes 41–42 and accompanying text.

[19] *See* CFTC Staff Interpretation Regarding Commodity Trading Advisor Registration Requirements, CFTC Letter No. 17-65 (Dec. 11, 2017) (providing broad relief for commodity trading advice provided to any investment manager, and not just to an investment manager subject to MiFID II, in response to concerns that MiFID II's unbundling requirements might cause futures commission merchants, swap dealers, and introducing brokers to be deemed commodity trading advisors if they received separate payments from investment managers for commodity trading advice).

[20] *See* Certain Broker-Dealers Deemed Not To Be Investment Advisers, Investment Advisers Act Release No. 2376 (Apr. 12, 2005), 70 Fed. Reg. 20424, 20431 (Apr. 19, 2005) [hereinafter Rule 202(a)(11)-1 Adopting Release]

SEC and its staff have recognized that research is "a fundamental element of the brokerage function."[21] The existing regulatory framework for broker-dealers is appropriately structured to address investor protection concerns related to the provision of research to investment managers. Among other things, SEC-registered broker-dealers are required to:

- "[G]ive honest and complete information" and disclose "material adverse facts of which [they are] aware" when recommending a security;[22]

- Provide communications that are "based on principles of fair dealing and good faith, . . . [are] fair and balanced, and . . . provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service [and that do not] omit any material fact or qualification if the omission, in light of the context of the material presented, would cause the communications to be misleading";[23]

- Manage conflicts of interest in the preparation and dissemination of research reports in accordance with the specific requirements of Regulation AC under the Exchange Act and FINRA Rules 2241 and 2242;[24]

- Refrain from trading in a security or a derivative based on non-public advance knowledge of the timing or content of a research report, and establish, maintain, and enforce related policies and procedures under FINRA Rule 5280;[25] and

- Deal fairly with their customers and observe "high standards of commercial honor and just and equitable principles of trade."[26]

("The earliest [SEC] staff interpretations . . . reflect the same understanding, *i.e.,* that the [Advisers] Act was intended to cover broker-dealers only to the extent that they were offering investment advice as a distinct service for which they were specifically compensated (which it was 'well known' they were doing through special advisory departments)." (citing Opinion of the General Counsel Relating to Section 202(a)(11)(C) of the Investment Advisers Act of 1940, Investment Advisers Act Release No. 2 (Oct. 28, 1940), 11 Fed. Reg. 10996 (Sept. 27, 1946))); *see also* ALFRED L. BERNHEIM ET AL., THE SECURITIES MARKETS at 633–46 (1935) (describing how when the Advisers Act was enacted, broker-dealers provided advice, including through research such as market letters and other written materials, analyses of general business and financial conditions, and statistical analyses).

[21] Future Structure of Securities Markets, *supra* note 5, 37 Fed. Reg. at 5290.

[22] *See, e.g.*, *Richmark Capital Corp.*, Securities Act Release No. 8333, Securities Exchange Act Release No. 48758 (Nov. 7, 2003); *see also Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 803 F.2d 454, 459–61 (9th Cir. 1986); *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1172 (2d Cir. 1970); Securities Act of 1933 § 17(a); Securities Exchange Act of 1934 §§ 9(a), 10(b), 15(c).

[23] FINRA Rule 2210(d)(1) (Communications with the Public).

[24] *See* Regulation Analyst Certification, Securities Exchange Act Release No. 47384 (Feb. 20, 2003), 68 Fed. Reg. 9482 (Feb. 27, 2003); FINRA Rule 2241 (Research Analysts and Research Reports); FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports); *see also* FINRA Rule 2210.

[25] FINRA Rule 5280 (Trading Ahead of Research Reports).

[26] *See* FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade).

The existing regulatory regime for broker-dealers presents a more considered, tailored, and sensible approach to regulating research than the Advisers Act regulatory regime.

Providing Research as an Investment Adviser Presents Challenges in Satisfying Undefined Fiduciary Obligations and Complying with Principal Trading Restrictions

Under long-established federal and state court case law, broker-dealers are fiduciaries only when they exercise investment discretion over a customer's account other than on a temporary or limited basis, not when they provide non-discretionary advice like research.[27] Subjecting broker-dealers to fiduciary obligations would raise difficult questions as to the reach of fiduciary status, including, as discussed below, questions as to whether, when, and for how long this status might bleed over to their sales and trading businesses.[28] The SEC should not assume without appropriate analysis and consideration of regulatory relief that the industry will simply work these issues out itself, particularly given the greater stakes for our capital markets. SIFMA's members are concerned that broker-dealers would face significant and unwarranted regulatory and litigation risk if subject to the Advisers Act fiduciary duties when providing research given the lack of guidance from the SEC or its staff on how those duties apply in the context of research—including when engaging in activities that are not viewed as "fiduciary" at common law. Regulating broker-dealers as investment advisers, and thus fiduciaries, when providing research and other content that might constitute investment advice to investment managers might diminish the extent and utility of that content.

SIFMA members are also concerned that subjecting broker-dealers to the Advisers Act when providing research would raise heightened concerns because of the restrictions on agency

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[27] *See, e.g.*, *Chamber of Commerce of the USA, et al. v. US Dep't of Labor, et al.*, No. 17-10238, slip op. 46 (5th Cir. Mar. 15, 2018); *United States v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006); *United States v. Szur*, 289 F.3d 200, 211 (2d Cir. 2002); *Associated Randall Bank v. Griffin, Kubik, Stephens & Thompson, Inc.*, 3 F.3d 208, 212 (7th Cir. 1993); *MidAmerica Fed. Savings & Loan Ass'n v. Shearson/Am. Express Inc.*, 886 F.2d 1249, 1257 (10th Cir. 1989); *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 953–54 (E.D. Mich. 1978), *aff'd*, 647 F.2d 165 (6th Cir. 1981). *Cf. De Kwiatkowski v. Bear, Stearns & Co., Inc.*, 306 F.3d 1293 (2d Cir. 2002); *see also* SEC, Regulation Best Interest, Securities Exchange Act Release No. 83062 (Apr. 18, 2018), 83 Fed. Reg. 21574, 21577 n.15 (May 9, 2018) (discussing this case law).

[28] These concerns are a vastly more complicated version of the same thorny issue that led the SEC to reverse its position reflected in Advisers Act Rule 202(a)(11)-1, vacated for other reasons, that the provision of comprehensive financial planning services by broker-dealers to retail customers is subject to the Advisers Act. This position was rightly criticized by industry, clients, and consumer advocates as being unwieldy and confusing, as were efforts by the SEC staff to provide no-action relief (which has now been rescinded) as to "switching of hats" to reflect the transition between investment adviser and broker-dealer when interacting with the same retail customer. *See* Secs. Indus. Ass'n, SEC Staff No-Action Letter (Dec. 16, 2005). Even though Rule 202(a)(11)-1 was vacated for other reasons, the SEC has twice considered reinstituting principles under other provisions of the rule, but has wisely chosen not to propose subjecting broker-dealers to the Advisers Act when providing comprehensive financial planning services. *See* Regulation Best Interest, Securities Exchange Act Release No. 83062 (Apr. 18, 2018), 83 Fed. Reg. 21574, 21625–28 (May 9, 2018); Interpretive Rule Under the Advisers Act Affecting Broker-Dealers, Investment Advisers Act Release No. 2652 (Sept. 24, 2007), 72 Fed. Reg. 55126, 55126 (Sept. 28, 2007). The dynamic, ongoing interactions between clients and a broker-dealer's research, sales, and trading businesses are vastly different and more complicated than interactions between a retail customer and a broker-dealer in the financial planning context, where delivery of a financial plan typically delineates the end of any investment advisory role.

and principal trading in Section 206(3), which can make sense for investment advisers and fiduciaries (e.g., when exercising investment discretion), but run counter to the essential role of broker-dealers.[29] Section 206(3) should not apply to trading conducted by a broker-dealer providing research (whether as an investment adviser or through an affiliated investment adviser) where an investment manager is responsible for selecting broker-dealers and placing client orders. Unfortunately, there is no clear SEC or SEC staff guidance on this issue.[30] In addition, while Rule 206(3)-1 exempts a broker-dealer from Section 206(3) in connection with any transaction in relation to which the broker-dealer "is acting as an investment adviser solely" through "publicly distributed written materials" or oral statements that "do not to purport to meet the objectives or needs of specific individuals or accounts," the precise scope of the rule remains unclear because the SEC has not defined or provided guidance on when "written materials or oral statements . . . do not to purport to meet the objectives or needs of specific individuals or accounts."[31]

The absence of guidance creates particular uncertainty in the context of oral communications, particularly interactive dialogues. For example, many investment managers find discussions with broker-dealer research analysts to be particularly useful in informing their investment thinking and decisions. If these discussions might be viewed as "purport[ing] to meet the objectives or needs of specific individuals or accounts," broker-dealers might restrict analysts' interactions with investment managers, choking off important value-added research to investment managers for the benefit of their clients.

Bringing a Broker-Dealer's Research Business Under the Advisers Act Does Not Address Issues with Sales and Trading Businesses

Although some broker-dealers have brought aspects of their research businesses—specifically business units generating formal research reports—into their regulated investment advisory businesses in the wake of MiFID II, SIFMA understands that they have not done so with content distributed by their sales and trading businesses that might be viewed as investment advice (e.g., market color, alpha capture, trading ideas, bespoke analysis, and desk commentary). The challenges discussed above in providing research as an investment adviser are insurmountable for sales and trading businesses. Many broker-dealers, including the larger firms, have structured their research, sales, and trading businesses such that each business generates content that might be viewed as investment advice, and interactions with investment managers often involve a combination of research, sales, and trading touchpoints. For these firms, providing research generated by the research business through an investment adviser while providing other content through a broker-dealer might present legal and practical challenges. For example, there might be questions about the extent to which research activities should be

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[29] Concerns about Section 206(3) exist whether a broker-dealer provides research through an affiliated investment adviser or, if the broker-dealer is also an investment adviser, through its investment advisory business.

[30] *Cf.* Morgan, Lewis & Bockius LLP, SEC Staff No-Action Letter (Apr. 16, 1997).

[31] It is also unclear whether Rule 206(3)-1 is available only to dual registrants, or also to broker-dealers affiliated with an investment adviser.

separated from sales and trading activities to limit the risk that the sales and trading businesses might become subject to the Advisers Act.

Because clients have a multitude of touchpoints with many broker-dealers' research, sales, and trading businesses, firms that decide to operate their research businesses as investment advisers might need to consider whether adjustments to their overall business models and service offerings are needed. For example, broker-dealers might believe that they need to limit interaction or possibly impose barriers between their research, sales, and trading businesses when servicing their clients in order to reduce the risk that the sales and trading businesses might become subject to the Advisers Act.[32] This kind of separation could, however, inhibit broker-dealers' ability to respond to clients' needs, create confusion for clients, and potentially diminish the value of the research and other content provided to investment managers.

Moreover, firms could reach the reasonable conclusion that, if they bring aspects of their research businesses into their regulated investment advisory businesses to accept separate payments for research, they may no longer need to operate under the existing SEC and FINRA regulatory regime for broker-dealer research, which we submit offers a more considered, tailored, and sensible approach to regulating research than the Advisers Act regulatory regime. Given the changes in the research marketplace, the SEC should consider how its actions—or inactions—might contribute to what may be "regulatory arbitrage" in the area.

Subjecting Broker-Dealers to Investment Adviser Regulation Would Pose Unnecessary Costs and Reduce Availability of Research

Broker-dealers that provide research also provide a range of other services to investment managers. Many offer broad trading capabilities, including a willingness to put capital at risk, act as principal selling securities from their own accounts, or underwrite securities offerings. The costs of registering as an investment adviser and complying with the Advisers Act will vary from broker-dealer to broker-dealer and depend on, among other things, the size of the business, research provided, trading capabilities offered, and complexity of the business structure. However, in all cases these costs, which include compliance, administrative, operational, and other added costs, far outweigh any perceived benefit of requiring firms to comply with an additional regulatory regime that was not intended to apply to broker-dealer research. Additionally, the need to address the increased regulatory burden incurred as a result of Advisers Act registration could lead to a diversion of compliance and other resources that would otherwise be available for other necessary purposes.

A broker-dealer might find that the additional compliance costs are greater than the cash revenues it could expect to receive from research provided, particularly in the face of shrinking research budgets. Or a large broker-dealer with a complex business and expansive trading capabilities might decide that operating its research business as an investment adviser would require a separation of research, sales, and trading activities that could impact its ability to

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[32] This is even though the SEC and FINRA have adopted rules carefully designed to ensure the independence and objectivity of analysts in preparing research reports (e.g., Regulation AC under the Exchange Act and FINRA Rules 2241 and 2242) while permitting appropriate interaction between analysts and sales and trading personnel.

service its clients effectively. As a result, in either scenario, a broker-dealer might decline to provide research to investment managers that insist on paying separately so that it is not required to be regulated as an investment adviser, a point that has been aptly made in comments by investment managers.[33] Declining to provide research to clients that believe they are compelled under MiFID II or for commercial reasons to pay directly in hard dollars would be further detrimental to the research marketplace, which is already feeling the impact of the tightening budgets as a result of MiFID II.

Providing Relief Is Critical to Maintaining the Vibrancy of the US Capital Markets

The widespread dissemination of research by broker-dealers has historically been critical to capital formation, including by enhancing information available about those accessing the US capital markets. Preserving the breadth and depth of research that broker-dealers provide, including about smaller issuers seeking to raise capital, is critical to maintaining the competitiveness and efficiency of the US capital markets, facilitating capital formation in the US, and promoting informed investment decisions by institutional investors.[34] The Supreme Court recognized the importance of research in *Dirks v. SEC*, where the Court emphasized that the ability of research analysts to question corporate insiders and to "ferret out and analyze information" is necessary to the preservation of a healthy market.[35] Both Congress and the SEC have taken actions over the years that underscored the importance of research provided by broker-dealers. For example, Congress excluded broker-dealers from the definition of "investment adviser" in the Advisers Act; added Section 28(e) to the Exchange Act in 1975 following the elimination of fixed commissions to preserve the ability of investment managers to use client commissions to pay for research; amended the Exchange Act in 2002 to broaden the regulatory framework for broker-provided research, including requiring the adoption of rules to address conflicts impacting securities analysts and research reports; enacted the Jumpstart Our Business Startups Act in 2012 to, among other things, provide broker-dealers with greater flexibility in the publication of research reports on emerging growth companies around the time of initial public offerings in which they participate; and enacted the Fair Access to Investment

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[33] *See* Capital Group Companies Letter (observing that "broker-dealers may discontinue their research services altogether if they determine that the regulatory risks outweigh the profits earned from operating their research business" and that "[t]hese regulatory challenges may have an outsized impact on small to mid-sized research providers that do not have the scale and resources to implement the changes necessary to stay compliant").

[34] Academic studies have documented the importance of research in the investment process. *See, e.g.*, Scott E. Stickel, *The Anatomy of the Performance of Buy and Sell Recommendations*, 51 Fin. Analysts J. 25 (1995); Kent L. Womack, *Do Brokerage Analysts' Recommendations Have Investment Value?*, 51 J. of Fin. 137 (1996). They have also recognized that investment managers "view sell-side research as valuable" and that "changes in holdings are economically and statistically significant [even] when the recommendation is from an affiliated analyst," particularly "for recommendations on small and low-analyst-coverage stocks." *See* Bradford D. Jordan et al., *Do Investment Banks Listen to Their Own Analysts?*, 36 J. of Banking & Fin. 1452 (2012). They also indicate that analyst reports are "significantly price informative" and that "informativeness increases with return volatility and trading volume." *See* Richard Frankel et al., *Determinants of the Informativeness of Analyst Research*, 41 J. of Accounting & Econ. 29 (Apr. 2006).

[35] 463 U.S. 646, 657 (1983) ("The SEC expressly recognized that '[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors.'" (quoting 21 S.E.C. Docket 1401, 1406 (1981))).

Research Act in 2017 to extend the current safe harbor available under Rule 139 of the Securities Act of 1933 to covered investment fund research reports.

The SEC has also highlighted the key role broker-dealers play in providing research as a core component of brokerage services.[36] Notably, when the SEC eliminated fixed commission rates in the 1970s, the SEC reaffirmed the importance of broker-dealer research by temporarily exempting certain broker-dealers from the Advisers Act while the SEC evaluated the transition to competitive commission rates and the transition to the "soft dollar" framework established by Congress with the enactment of Section 28(e).[37] Since then, the SEC has done an important job of recognizing changes in the global markets when interpreting—and indeed, frequently *re*interpreting—Section 28(e), including 1986 guidance "withdrawing" its 1976 interpretive guidance and reinterpreting the terms "research" and "provided by";[38] 2001 guidance reinterpreting the term "commission"; and 2006 guidance reinterpreting the terms "research," "brokerage," "provided by," and "effecting," including to reflect and foster the evolution of client commission arrangements and to reflect changes to global practices in the area.[39]

Accordingly, SIFMA urges the SEC to provide *permanent relief* by rule or exemption allowing broker-dealers to charge separately or receive cash payments for research provided to investment managers and other institutional investors without the broker-dealers being treated as investment advisers subject to the Advisers Act.[40] The SEC can provide this relief through a rule adopted under Section 211(a) interpreting "special compensation" or an SEC interpretation of

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[36] *See, e.g.*, Rule 202(a)(11)-1 Adopting Release, *supra* note 20, 70 Fed. Reg. at 20428–34 (discussing the historical role of broker-dealers providing investment advice among the overall package of services provided to customers).

[37] *See* Adoption of Temporary Exemption from the Advisers Act and the Rules and Regulations Thereunder for Certain Brokers and Dealers, Investment Advisers Act Release No. 455 (Apr. 23, 1975), 40 Fed. Reg. 18424 (Apr. 28, 1975) (adopting Advisers Act Rule 206A-1T to temporarily exempt certain broker-dealers from the Advisers Act following the elimination of fixed commission rates).

[38] *See* Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, Securities Exchange Act Release No. 23170 (Apr. 23, 1986), 51 Fed. Reg. 16004, 16005–06 (Apr. 30, 1986) ("[T]he Commission has concluded that the 1976 standard is difficult to apply and unduly restrictive in some circumstances, and that uncertainty about the standard may have impeded money managers from obtaining, for commission dollars, goods and services they believe are important to the making of investment decisions. Accordingly, the Commission is withdrawing the 1976 standard and adopting a revised standard . . . .").

[39] *See* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Securities Exchange Act Release No. 54165 (July 18, 2006), 71 Fed. Reg. 41978 (July 24, 2006). As noted above, SIFMA believes that a broker-dealer should be deemed to receive commissions—and not "special compensation" under Section 202(a)(11)(C)—when receiving commissions under a CCA operating under SEC interpretations of Section 28(e) of the Exchange Act.

[40] *See also* MFS Inv. Mgmt. Letter ("encourag[ing] the SEC to issue, before the relief in the SIFMA [No-Action] 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," asserting that "[s]uch a rule would be broader and more impactful for U.S. investors than the relief contained in the temporary no-action letter," and stating that "[i]f 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").

"special compensation."[41] Alternatively, the SEC has the clear authority under Section 206A, by rule, to "conditionally or unconditionally exempt any person . . . or any class or classes of persons" from the Advisers Act.[42]

Conclusion

SIFMA appreciates the continued focus of the SEC and its staff on finding ways to respond to important developments in the US and global research marketplace—including the growing desire of investment managers and other institutional investors to unbundle research payments from commissions—and to mitigate the potential for these changes to negatively impact US investors and the US capital markets. For the reasons discussed above, SIFMA urges the SEC to provide permanent relief by rule or exemption allowing broker-dealers to charge separately or receive cash payments for research provided to investment managers and other institutional investors without the broker-dealers being deemed investment advisers subject to the Advisers Act. We agree with comments by and on behalf of major investment managers that this is a matter of pressing need. SIFMA looks forward to continued dialogue with the SEC and its staff about the requested relief.

Sincerely,

Kenneth E. Bentsen, Jr.
President and CEO

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[41] Section 211(a) authorizes the SEC "to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the functions and powers conferred upon the Commission . . . , including rules and regulations defining technical, trade, and other terms used in" the Advisers Act.

[42] Section 206A provides that the SEC "by rules and regulations, upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person or transaction, or any class or classes of persons, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, 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 [the Advisers Act]." *See* MFS Inv. Mgmt. Letter ("We believe . . . that the exemptive authority granted to the SEC in Section 206A of the Advisers Act . . . 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.").

cc: Commissioner Robert J. Jackson Jr.
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