April 12, 2019

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

Re: Comments on the Impact of MiFID II Research Provisions
IMMiFIDII@sec.gov

Dear Chairman Clayton

Thank you for the opportunity comment on the research provisions of MiFIDII and its unbundling requirements.[1] I wish to identify a concern with the "reverse preemption" provision in Section 28(e) ("Section 28(e)") of the Securities Exchange Act of 1934 ("the Exchange Act").

Background

Congress added Section 28(e) as part of the Securities Acts Amendments of 1975[2], to help facilitate the market's transition as broker-dealers moved from fixed commissions to negotiated rates. Congress added the preemption provision to ensure that money managers would not violate state fiduciary laws by "paying up" for research. Section 28(e) gives investors the choice as to whether to pay with "soft dollars" or to pay for research separately. Research helps ensure that financial markets are vital and efficient. In my view, Section 28(e) has worked well to achieve that goal.

MiFID II forced an unbundling of research fees in the EU,[3] with implications for the U.S. The SEC staff's three no-action letters were a major accommodation to the EU framework.[4]

[1] SEC Staff Encourages Continued Engagement on Impact of MiFID II Research Provisions, Press Release 2018-301, available at https://www.sec.gov/news/press-release/2018-301.
[2] S.49, Public Law No. 94-29, 89 Stat.97, June 4, 1975
[3] MiFIDII at §24(b)(7) and (8), available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2014:173:FULL&from=EN.
[4] Investment Advisers Act of 1940 - Section 202(a)(11), Staff letter to Securities Industry and Financial Markets Association October 26, 2017; Investment Company Act of 1940 and Rule 17d-1 thereunder, and Section 206 of the Investment Advisers Act of 1940, Staff letter to Investment Company Institute October 26, 2017; Asset Management Group Securities Industry and Financial Markets Association; Staff Letter to Asset Management Group, SIFMA, Division of Trading & Market, October 26, 2017. *See also* SEC Press Release 20017-200, October 26, 2017.

Issue of Concern

Section 28(e) permits the any state to reassert its individual fiduciary law:

> (e)(1) No person using the mails, or any means or instrumentality of interstate commerce, in the exercise of investment discretion with respect to an account shall be deemed to have acted unlawfully or to have breached a fiduciary duty under State or Federal law **unless expressly provided to the contrary by a law enacted by the Congress or any State subsequent to the date of enactment of the Securities Acts Amendments of 1975** solely by reason of his having caused the account to pay a member of an exchange, broker, or dealer an amount of commission for effecting a securities transaction in excess of the amount of commission another member of an exchange, broker, or dealer would have charged for effecting that transaction, if such person determined in good faith that such amount of commission was reasonable in relation to the value of the brokerage and research services provided by such member, broker, or dealer, viewed in terms of either that particular transaction or his overall responsibilities with respect to the accounts as to which he exercises investment discretion. [**Emphasis Added**] ****

The first part of the highlighted language is a truism – Congress always may change a law that it enacts. Indeed, one Congress cannot tie the hands of a future Congress.

But the second portion of the highlighted language is problematic. It allows any state to override Section 28(e) by amending its own fiduciary laws at any time in the future.[5] To my knowledge, in the intervening 44 years, no state has availed itself of this authority.

From time to time, Congress affords states the opportunity to override federal legislation, particularly on an issue that may affect state law directly. However, Congress typically imposes a time limit ("sunset") on the authority of a state to override federal law.[6] In the case of Section 28(e), Congress did not include a sunset provision.

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[5] The Senate report notes:

> By way of emphasis, the Committee should point out that this language is specifically intended to preempt common law principles of fiduciary conduct and any State or Federal statutory law in effect on or enact prior to the date of enactment of the bill which would expose fiduciaries to liabilities solely on the basis that they failed to obtain the lowest commission cost available. With experience in a competitive rate environment, however, State and Federal legislative bodies may wish to redefine the responsibilities and duties of particular fiduciaries with respect to the use of commission dollars for the compensation for brokerage and research services, and the Committee believe that this section would expressly permit a State to enact legislation on this subject subsequent to the date of enactment of the bill.

Report of the Committee on Banking, Housing, and Urban Affairs, United States Senate, to accompany S. 249, 94th Cong., 1st Sess., April 14, 1975, at 139. The report mislabels the provision as subsection (d), but the text of the bill refers to subsection (e). *Id.* at 251.

[66] *E.g.* Section 17A(f) of the Exchange Act. That provision allows the SEC to preempt state law to facilitate the transfer of uncertificated securities. Subsection (3) allows a state to institute its own law within two years after the

Recommendation

Congress should repeal the highlighted language in 28(e). Currently, it is a formidable challenge to reconcile U.S. and E.U. (and subsequently, U.K. law) with respect to research. But it would be chaos for investors, money managers, broker-dealers, and the market as a whole if individual U.S. states were to enact laws imposing their own unique conditions for soft dollars. If no state has found it necessary to override Section 28(e) since 1975, it seems unlikely that there is a meaningful public policy reason that would warrant such action. As the SEC staff revisits MIFIDII and soft dollars on a comprehensive basis, I respectfully suggest that the Commission consider recommending that Congress strike this "reverse preemption" provision from Section 28(e).

These views are my own and do not represent the view of any other person or entity. I would be pleased to discuss my suggestion with you or your colleagues in greater detail.

Sincerely yours,

/s/

Stuart J. Kaswell, Esq.
[redacted]

date of enactment. Market Reform Act of 1990, H.R. 3657, (101st Cong., 2d. Sess.), Pub. L. 101–432. 136 Cong. Rec., Part 18, September 28, 1990, House, 26629-31.