March 9, 2023

The Honorable Ann Wagner
Chairman
Subcommittee on Capital Markets
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Brad Sherman
Ranking Member
Subcommittee on Capital Markets
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Re: Discussion draft to codify certain Securities and Exchange Commission no-action letters that exclude brokers and dealers compensated for certain research services from the definition of investment adviser.

Dear Chairman Wagner and Ranking Member Sherman,

The Securities Industry and Financial Markets Association ("SIFMA")[1] would like to express our appreciation for your work to facilitate access to capital for small businesses, protect individual investors, and promote meaningful investor engagement by modernizing our securities laws and regulations through the discussion draft to codify certain Securities and Exchange Commission no-action letters that exclude brokers and dealers compensated for certain research services from the definition of investment adviser ("Discussion Draft").

SIFMA strongly believes the Discussion Draft provides necessary relief under the Markets in Financial Instruments Directive II ("MiFID II")[2] to allow broker-dealers to receive cash payments for research without being deemed investment advisers subject to the Investment Advisers Act of 1940 ("Advisers Act").

The widespread dissemination of research by broker-dealers has historically been critical to capital formation. Preserving the breadth and depth of research that broker-dealers provide, including research about smaller issuers seeking to raise capital, is critical to maintaining the competitiveness and efficiency of the U.S. capital markets, facilitating capital formation in the U.S., and promoting informed investment decisions by institutional investors.

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's 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. For more information, visit http://www.sifma.org.

[2] 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, as implemented by the European Union ("EU") member states.

Background on MiFID II

Investment managers rely on a robust and diverse offering of investment research to fully inform their decision-making processes and to support the performance of their fiduciary duties to clients. Investment research also plays a critical role in the efficiency of the markets.

In January 2018, MiFID II and related rules and regulations were implemented, and investment managers subject to MiFID II (which includes both EU- and UK-based investment managers and U.S.-based investment managers that manage certain EU and UK accounts) were immediately required to separate, or unbundle, payments for research, as broadly defined under MiFID II, from payments for trade execution.

While an EU directive, MiFID II affects investment managers located outside of the European Union and United Kingdom in a number of ways. First and foremost, MiFID II impacts U.S. broker-dealers given the global nature of the U.S. capital markets. Non-U.S. and global investment managers rely on research services provided by U.S. broker-dealers, and U.S. investors invest in funds managed by investment managers subject to MiFID II. For example, the requirements of MiFID II apply to an investment manager that delegates its investment management responsibilities to a manager located outside of the European Union and requires the delegating manager to contractually obligate the other manager to comply with MiFID II's requirements regarding the unbundling of research. Additionally, due to the global and interconnected nature of many managers' businesses, a number of managers have reported that there are numerous complications caused by MiFID II because it forces them to unbundle research payments being made by affiliates across their entire organization.

As a result of the MiFID II requirements, U.S. broker-dealers that provide research services to investment managers subject to MiFID II are now receiving separate payments for those research services. This, however, is problematic because the receipt of payments for research services directly or indirectly out of an investment manager's own money subject broker-dealers' research services to the Advisers Act, which has different requirements and an entirely different regulatory regime that would apply in addition to the broker-dealers' current comprehensive regulatory framework overseen by the SEC and the Financial Industry Regulatory Authority (FINRA).

Relief Provided by Current, but Expiring, SEC No-Action Relief

SIFMA has raised strong concerns over the requirement that registered broker-dealers accepting such required unbundled payments for research services consumed by the MiFID II managers would be subject to regulation as investment advisers under the Advisers Act.[3] In October 2017,[4] the SEC responded to these concerns with the issuance of a no-action letter that it subsequently extended in November 2019 (together, the "No-Action Letters").[5] The no-action relief under the most recent extension will expire on July 3, 2023.

[3] *See* https://www.sifma.org/wp-content/uploads/2023/02/Need-for-Continued-MiFID-II-Relief-Overview-of-Key-Issues-and-Challenges-under-the-Advisers-Act.pdfeed for Continued MiFID II Relief: Overview of Key Issues and Challenges under the Advisers Act (sifma.org)

[4] *See* Secs. Indus. & Fin. Mkts. Ass'n., SEC Staff No-Action Letter (Oct. 26, 2017).

[5] *See* Secs. Indus. & Fin. Mkts. Ass'n., SEC Staff No-Action Letter (Nov. 4, 2019).

The No-Action Letters have been critical in helping to preserve a market for investment research by providing relief from the conflicts between U.S. and international laws that have impacted research providers and investment managers since the implementation of MiFID II.

Studies have shown that the introduction of MiFID II led to the reduction of research consumed by managers subject to its requirements. In fact, given the reduction in the amount of research available in Europe, European regulators have proposed rolling back the MiFID requirement to pay for research through unbundled payments, with the goal of making such research more widely available.

For instance, the European Commission has proposed that the MiFID II unbundling requirement apply only to listed companies with a market capitalization above €10bn, which would provide relief for more than 95% of companies listed in the EU. Further, the British Treasury recently unveiled its Edinburgh Reforms regarding the proposed implementation of UK financial regulation post-Brexit. Among the items included is a formal review of "the provision of investment research in the UK, including the effects of the EU's MiFID unbundling rules, which aren't applied in leading markets such as the US."[6] This review is especially noteworthy given that we understand the MiFID unbundling requirement was originally conceived by UK policymakers when the UK was part of the EU.

We believe that the expiration of the SEC's no-action relief in July of this year will lead to a further reduction in available research. Given the significant change in posture in the EU and the UK, SIFMA believes it is imperative that Congress codify the no-action relief now to provide a solution for US-based entities and to avoid significant, irreversible and entirely unnecessary disruptions to the market for investment research.

Expiration of No-Action Relief Will Cause Significant Market Disruption

Many of the requirements of the Advisers Act are fundamentally incompatible with how research and sales and trading services are typically provided to investment managers. Moreover, U.S. broker-dealers are already subject to comprehensive regulation that addresses conflicts of interest and other issues in providing research services. For example, Regulation AC under the Securities Exchange Act of 1934 and FINRA Rules 2241 and 2242 establish requirements for broker-dealers in managing conflicts of interest in the preparation and dissemination of research reports.

The business models of research providers vary, but a large portion of research is currently provided by broker-dealers offering a suite of services to investment managers. These services may constitute "research" under the broad definition in MiFID II regulations. These include written research reports and models produced by the broker-dealers' independent research departments, sales and trading commentary and other bespoke trade advisory services, and interactions with research analysts, either with or without the participation of sales and trading personnel. In addition to these research services, broker-dealers typically also provide traditional sales and trading brokerage services to the same managers or their end clients.

Most large broker-dealers have not moved their research services into an investment adviser to accept hard-dollar payments because they have been unable to do so without significantly limiting the services

[6] *See* https://www.gov.uk/government/news/edinburgh-reforms-hail-next-chapter-for-uk-financial-serviceser for UK Financial Services - GOV.UK (www.gov.uk)

that they have traditionally provided to investment managers. SIFMA's members have spent an enormous amount of time examining how to provide services that may constitute research under the MiFID II regulations through an investment adviser, including sales and trading content and related interactions, and a number have concluded that it would require significant and potentially detrimental changes to how they service investment managers and their clients given numerous conflicts and challenges.

The challenges are twofold:

- Because of the often-bespoke nature of research services that are expected by investment managers and provided by broker-dealers, it would be very challenging for firms to ensure that the advice provided as part of their research services is curtailed or limited so as to avoid the application of the Advisers Act restrictions on agency and principal trading in Section 206(3). That rule prohibits advisers from making principal trades unless the adviser discloses all material information about the proposed trade to, and obtains the consent of, such client before the completion of the transaction. This raises significant questions for a broker-dealer evaluating the feasibility of moving its research services to an investment adviser, as such a move could significantly limit the activities of, and thus jeopardize its sales and trading business.

- Although broker-dealers are subject to extensive obligations when providing research services to brokerage clients, they are not treated as fiduciaries based on the same common-law principles that underpin the Advisers Act. In part, this is because the SEC has long understood that the provision of research by broker-dealers play an important role in soliciting securities transactions. It could be unduly burdensome, if not impossible, for a broker-dealer research provider to tailor its research services to the many different investment managers to whom it provides services. At best, a broker-dealer research provider would be subjecting itself to significant risk in undertaking those obligations, and most firms have been unwilling to take on that level of risk. If a broker-dealer research provider were required to limit or filter its content to satisfy fiduciary standards under the Advisers Act, that would be a disservice to investment managers who want to receive all of the research services that the provider has to offer and make their own decisions about what Research Services to use when making investment decisions for their clients.

Immediate legislative action is needed. Come July and absent the relief provided the Discussion Draft, many broker-dealers will curtail the research services that they currently provide to investment managers subject to MiFID II. These broker-dealers will instead focus instead on servicing investment managers and other institutional investors that remain willing and able to pay for research services in ways that do not implicate the Advisers Act, such as paying with client commissions or soft dollars.

We urge Congress to pass the Discussion Draft, as the looming expiration of the SEC's no-action letter is already unsettling arrangements between such MiFID II managers and U.S. brokers. As a result, MiFID II managers are scrambling in anticipation that they soon will be cut off from important U.S. broker research services.

U.S. broker-dealers should not be compelled to curtail research coverage of public companies or potentially change operations solely to comply with a foreign regulatory requirement that appears likely to substantially change, if not be rescinded altogether, in its originating jurisdiction.

Sincerely

Kenneth E. Bentsen, Jr.
President and CEO, SIFMA