



September 15, 2017

Via Electronic Mail (whiteka@sec.gov)

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

Re: Recommendation to Address Best Execution and Research Payments Issues Arising from MiFID II Implementation

Dear Chairman Clayton:

We at the Healthy Markets Association are excited to work with you to continue improving the US capital markets. We write to supplement our June 13, 2017 letter to you<sup>1</sup> by offering further details and recommendations regarding the implementation of MiFID II. We encourage you to consider directing the Commission to adopt two distinct sets of guidance; one for broker-dealers that provide research to investment advisory clients, and another for investment advisers who seek to fulfill their best execution obligations.

Without appropriate guidance, we fear selected research providers, broker-dealers, investment advisers, and investors, will be unduly and irreparably harmed by the disparity between the US and European approaches to payments for research. In particular, any actions taken or not by the Commission could significantly impact the number and diversity of research providers, the amount of research provided, and the number and diversity of investment advisers consuming that research--all of which may dramatically negatively impact investors and the overall economy.

Lastly, we are also deeply concerned about the process being utilized by the Commission to consider making this significant decision that will, regardless of the action taken, dramatically alter the costs of financial products for US asset owners, the regulation of investment advisers and broker-dealers who provide important research, as well as the competitive landscape amongst investment advisers and broker-dealers. This should be done through a public rulemaking process. In particular, we have concerns that any action taken by the Commission as a result of this secretive process may be invalidated as non-compliant with the Commission's procedural obligations, such as those of the Administrative Procedures Act.

## About Healthy Markets

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<sup>1</sup> Letter from Healthy Markets Association to Securities and Exchange Commission, June 13, 2017, *available at* <https://static1.squarespace.com/static/5576334ce4b0c2435131749b/t/5947e49c37c5812feb98bd29/1497883805079/LettertoChairmanClayton6-13-17+%281%29+%281%29.pdf>.

The Healthy Markets Association is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets.<sup>2</sup> Since our launch in September 2015, we have become a leading voice for investors in the market structure debates, and have offered significant input to the Securities and Exchange Commission and its Equity Market Structure Advisory Committee.

## Current Payment for Research and Best Execution “State of Play”

In the US, investment advisers are statutorily permitted to pay for research using commission dollars, if certain criteria are met. For many asset managers, particularly small and mid-sized, active managers, this is a critical element to their ongoing business. At the same time, several very large US firms have sought—for more than a decade—to unbundle research and execution costs, and have been largely unsuccessful.

One of the fundamental issues confronting the Commission now is that US regulators have never clearly articulated the parameters and expectations for best execution for investment advisers. This stands in sharp contrast to the expectations articulated by FINRA Rules and Guidance for broker dealers.

At the same time, neither the Commission nor FINRA have ever clearly articulated the parameters for exactly how a research provider may be compensated. For example, some large firms have traditionally required investment advisers to pay for that research by sending them orders for execution. While the justifications for these demands vary, some have notably argued that they could not accept checks for the research without having to register as investment advisers. Unfortunately, this insistence forces investment advisers and asset owners to choose between getting the research they need and the ability to shop for likely higher quality or lower cost executions. This poses significant challenges to investment advisers seeking to fulfill their best execution obligations.

In sharp contrast to these views, however, other large research providers who also provide research to their investment adviser clients have been willing to accept checks and other form of payment for their research.

Healthy Markets -- like nearly every asset owner and many investment advisers -- would like for investment advisers to have the option to pay for essential research by check or soft dollars. Further, investment advisers should not be precluded from paying for research out of their own profits and losses, if they so choose.

## Impact of MiFID II Requirements

MiFID II is pushing firms operating in Europe to use Research Payment Accounts or pay directly in hard dollars. But its impact is also being felt by even purely US investment advisers, as US and

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<sup>2</sup>To learn more about Healthy Markets or our members, please see our website at <http://healthymarkets.org>.

European customers are demanding consistent policies and practices. This move is driving many firms to develop costly compliance regimes for research provision and payment.

Several large investment advisers have recently announced that they intend to respond to the new rules by directly paying for research for their European customers, while treating their US customers differently.<sup>3</sup> In Europe, those costs would be borne by the investment advisers, while in the US, unless the Commission takes action, asset owners will continue to absorb those costs directly--in addition to having their advisers being denied the opportunity to shop for better execution quality.

We understand that some broker-dealers and their trade associations would like to continue to permit some broker-dealers to force their research clients to route orders to them to pay for that research. We understand that they have asked for assurances that the staff will not recommend that the SEC take enforcement action under the Advisers Act against a broker-dealer registered with the SEC that provides research services that constitute investment advice under Section 202(a)(11) of the Advisers Act to an investment manager that is required under MiFID II, either directly or by contractual obligation, to pay for the research services from its own money or from an RPA funded by the investment manager's clients and/or its own money.

We understand why some broker-dealers -- and even a select handful of investment advisers -- might want this narrow relief. It would:

- allow firms that provide important research to demand order flow and executions from the marketplace--even if the execution costs are higher or quality is lower than could otherwise be found;
- force many US asset owners (as opposed to investment advisers) to continue paying for the research out of their returns--even if this means they are subsidizing research for accounts that are unbundled as a result of MiFID II; and
- systematically disadvantage smaller investment advisers and others who are more dependent upon third-party research--both in their trading costs and overall returns for their underlying asset owners.

This "relief" would be the worst of all possible outcomes for all US asset owners and many US investment advisers (particularly smaller advisers). For example, imagine a US-based firm with ten separate accounts with the same strategy, two of which are for European investors. One potential result could be that the adviser would be writing a check to cover 20% of the cost of the research out of its own pocket for the European investors, while potentially getting subpar executions for its US investors (which also comes out of those investors' pockets). This also raises significant concerns over the fair treatment of different investment advisory customers, whose trades may be combined on the same order ticket.

Put simply, the relief some would suggest the Commission grant would effectively prevent unbundling in the US--even if asset owners and their investment advisers would want it. And it

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<sup>3</sup> See, e.g., Chris Flood, *BlackRock to foot bill for external research under Mifid II*, Financial Times, Sept. 14, 2017, available at <https://www.ft.com/content/fb9e2552-9939-11e7-a652-cde3f882dd7b>; see also Jennifer Thompson, *T Rowe Price to absorb Mifid II research costs*, Financial Times, Aug. 21, 2017, available at <https://www.ft.com/content/46fff37d-d422-34db-ab41-fb83258f5e4a>.

would continue and expand the conflict wherein investment advisers must sacrifice their customers' execution quality, if their need for research is sufficiently large.

We think that investment advisers and asset owners in the US should be able to separately identify and pay for the best research while still ensuring that they receive the best execution of their orders.

## Recommended Guidance

As we stated before, we are concerned that the process for evaluating these important issues has, to date, been conducted without the benefit of a formal notice and comment process. Further, we are concerned that the Commission staff may be exceeding its authority in taking actions proposed by market participants or their trade associations, including Healthy Markets.

Nevertheless, if the Commission staff is to take action, Healthy Markets recommends two distinct sets of guidance: one for providers of research and another for investment advisers.

For research providers, we urge the Commission to issue guidance that clearly articulates that cash compensation paid by an investor or an investment adviser to a broker-dealer that is solely in exchange for the provision of research--by itself--does not trigger the Advisers Act. This would further the Commission's goal of promoting fair and efficient markets, should not be controversial, and has precedent from the Commission.<sup>4</sup> It would also dramatically improve investment advisers' abilities' to fulfill their best execution obligations.

To avoid cross-border, regulatory arbitrage that would disadvantage US investors and markets, the Commission should consider declaring that if a research firm accepts checks for research from some customers (such as advisers in Europe), it must accept checks from others (such as advisers in the US).

Importantly, if the Commission and staff were to not take this approach, we would alternatively recommend the Commission provide no regulatory relief to research providers than take the action recommended by SIFMA. This would most likely have the practical impact of ensuring that research providers align their regulatory status with their operations so that asset owners and investment advisers in the US and Europe would be similarly situated. Again, providing the narrow relief currently being sought by some trade associations and broker-dealers would severely disadvantage US asset owners, many investment advisers, and broker-dealers (such as those who may provide higher quality executions, but cannot command order flow in exchange for research).

We further urge the Commission to delineate basic principles and expectations for best execution (e.g., periodic reviews of execution quality, best execution committees, policies and procedures, etc.), which should also include a reiteration of the purposes of the statutory permission for soft dollars. This should include explicit support for diversity of research and diversity of research providers, as well as the impacts on smaller investment advisers. This guidance should also offer

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<sup>4</sup> See, e.g., *Amendment and Extension of Temporary Exemption From the Investment Advisers Act for Certain Brokers and Dealers*, Investment Advisers Act Rel. No. 471, 40 Fed. Reg. 38156 (Aug. 27, 1975).

practical solutions to scenarios with co-managed separate accounts whose trades may be put onto combined trade tickets.

## Conclusion

US-based research providers, investment advisers, and asset owners are going to be dramatically impacted by the implementation of MiFID II. We encourage you to press the Commission to take prompt action to ensure that US asset owners are not disadvantaged, and that US investment advisers are able to freely shop for the best research and executions available. Inaction, or simply offering narrow relief to research providers, will irreparably harm investors and the US capital markets. Please act soon.

Thank you for your consideration and we look forward to working with you to continue making the US capital markets the best in the world.

Sincerely,

A handwritten signature in black ink, appearing to read "Tyler Gellasch". The signature is fluid and cursive, with a long horizontal stroke at the end.

Tyler Gellasch  
Executive Director

Cc: Hon. Michael S. Piwowar, Commissioner  
Hon. Kara M. Stein, Commissioner  
Heather Seidel, Acting Director of the Division of Trading and Markets