May 23, 2023

The Honorable Patrick McHenry
Chairman
House Committee on Financial Services
2129 Rayburn HOB
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Committee on Financial Services
4340 O'Neill HOB
Washington, DC 20515

Re: Opposition to H.R. 2622 (Codification of SIFMA No-Action Letter)

Dear Chairman McHenry and Ranking Member Waters:

The Healthy Markets Association,[1] CFA Institute,[2] and Council of Institutional Investors[3] write jointly to express strong opposition to H.R. 2622, which we understand the House Financial Services Committee could vote on as early as this week. This legislation stands to codify and expand a 2017 "No-Action" letter ("No-Action Letter")[4] issued by United States ("U.S.") Securities and Exchange Commission ("SEC" or "Commission") addressing the "bundling" of certain research and trade execution services into a single commission. We oppose the proposed legislation on the shared belief that separating the decisions of where to trade and where to buy research is in the public interest as it fosters better price discovery and more efficient allocation of resources related to research and trading, benefitting investors, including millions of American pension beneficiaries and long-term investors.[5]

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[1] Healthy Markets Association ("HMA") is a not-for-profit member organization of public pension funds, investment advisers, broker-dealers, exchanges, and market data firms focused on reducing conflicts of interest and improving the transparency, efficiency, and fairness of the capital markets. To learn more about HMA or our members, please see our website at https://healthymarkets.org.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 190,000 CFA charterholders worldwide in more than 160 markets. CFA Institute has nine offices worldwide and 160 local societies. In the U.S., it has nearly 82,000 members and 67 societies. For more information, visit www.cfainstitute.org or follow us on Linkedin and Twitter at @CFAInstitute

[3] Council of Institutional Investors ("CII") is a nonprofit, nonpartisan association of United States ("U.S.") public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management. For more information about CII, including its board and members, please visit CII's website at http://www.cii.org.

[4] Letter from Elizabeth Miller, SEC, to Steve Stone, Morgan Lewis (on behalf of SIFMA), Oct. 26, 2017, available at https://www.sec.gov/divisions/investment/noaction/2017/sifma-102617-202a.htm ("No-Action Letter").

[5] *See, e.g.,* Council of Institutional Investors, Policies on Other Issues, Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture (adopted Mar. 31, 1998),

Congress should reject calls to codify "temporary" MiFID No Action relief.

H.R. 2622 would, if enacted, purportedly codify a "no-action" letter first issued by the SEC staff in 2017 related to the bundling of "research" and "trade execution" services.

Shortly before MiFID II's implementation, SIFMA petitioned the Commission staff for no-action relief, asserting that subjecting research providers who would soon be compelled to accept cash payments in Europe to U.S. Investment Advisers Act of 1940 ("Advisers Act") regulations "could disrupt a broker-dealer's role in providing liquidity and acting as counterparty to its clients."[6] Weeks before MiFID II went into effect, the Commission staff released a time-limited no-action letter declaring that it "would not recommend enforcement action ... if a broker-dealer provides research services ... to a Manager that is required to pay for the research services" from its own money, from a separate research payment account funded with its clients' money, or a combination of the two.[7] That letter was scheduled to expire on July 3, 2020. The Commission staff revised and extended the letter in November 2019 until July 3, 2023.[8]

Because this was an SEC staff-issued no-action letter rather than a Commission rulemaking, it was issued without the benefit of comprehensive economic analysis. If this bill is enacted, however, it would turn the temporary No-Action relief into a permanent rule. We respectfully urge Congress to consider the economic impact that the permanent rule contemplated in this bill would have, including the effect on competition among research providers.

The temporary nature of the no-action relief was intentional, because it was intended to provide sufficient time for market participants to revise their businesses, if necessary. Now, nearly six years after the temporary relief was first granted, research providers have had adequate time to prepare the expiration of the No-Action Letter. Further, all of the significant research providers who might be subject to the law upon expiration have affiliated registered investment advisers. In fact, there are over 15,000 registered investment advisers in the U.S., up from around 12,000 in 2017. Complying with the law should be neither a surprise nor particularly difficult.

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https://www.cii.org/policies_other_issues#principles_trading_commission_softdollar ("Like any other expense of the plan, trading costs need to be managed to minimize the cost and ensure that maximum value is received. But current brokerage industry practices of bundled pricing for services make it difficult to break out the exact costs of services (for trade execution, research or other things), may be antithetical to the fiduciary obligation of obtaining best execution, and hold too much potential for conflicts of interest and abuses [and] [w]e support and urge full unbundling of pricing for investment management, brokerage and research services, so that institutional investors can purchase and budget for these services as they do any other expense of the plan.").

[6] Letter from Steve Stone, Morgan Lewis LLP, to Douglas Scheidt, SEC, at 3, Oct. 17, 2017, *available at* https://www.sec.gov/divisions/investment/noaction/2017/sifma-102617-202a-incoming.pdf.

[7] SIFMA No-Action Letter.

[8] Letter from Elizabeth Miller and Erin Moore, SEC, Nov. 4, 2019, available at https://www.sec.gov/investment/sifma-110419.

Investors benefit significantly from policy requirements that enable the separation of decisions for where to trade from where to buy research. There is evidence that such separation tends to foster better price discovery and more efficient allocation of resources related to research and trading, benefiting investors and asset owners.[9] By contrast, the No-Action Letter has effectively preserved broker-compelled bundling in the U.S. by many large research providers.

This regime harms U.S. investors and markets in significant ways. It allows banks with strong research to effectively preclude U.S. investment advisers from competitively, separately shopping for trading and research services, making it more difficult to achieve best execution and thwarting competition for those trading and research services. It puts U.S. investment advisers and their customers—who are compelled to trade to obtain research—at a competitive disadvantage to their European counterparts. It encourages investment advisers to use customer assets to generate commissions to pay for research that may not benefit the paying customers.

While several of the top 50 US-based brokers have chosen to rely upon the No-Action Letter, some of the top US-based research providers have responded by embracing the separate competitions for research and trading services. For example, Bank of America and Jefferies provide research through their investment adviser affiliates. And, of course, many independent research providers have long been registered rather than relying upon the No-Action Letter.

The SEC's No-Action relief was explicitly designed to be temporary; its extension threatens competition and transparency goals for research and trading services.

The 2017 no-action relief sought to address concerns that were unique to that particular point in time: the fear that providers of investment research might withdraw from the U.S. or European market, rather than sell their investment research products through a regulated investment adviser affiliate. While these theoretical fears about lost access to investment research or trading never materialized, the No-Action Letter has been allowed to remain in effect. During that time, its impacts have been experienced by the marketplace in negative ways.[10]

Bundling is widely associated with higher trading costs and commissions rates, and these costs are often not disclosed to investors.[11]

In July of 2022, the Director of the SEC's Division of Investment Management confirmed that the SEC intends to let the no-action relief expire as scheduled.[12] We applauded this decision.

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[9] Financial Analysts Journal. By Patel, Keyur. "To Bundle or Not to Bundle? A Review of Soft Commissions and Research Unbundling," June 23, 2021, *available at* https://www.cfainstitute.org/en/research/financial-analysts-journal/2021/to-bundle-or-not-to-bundle.

[10] Patel, Keyur. Ibid.

[11] As CFA Institute has noted, "The majority view was that research obtained with soft commissions adds less value than the costs created by premium commissions."

[12] Remarks of William Birdthistle, SEC, before the Practising Law Institute, July 26, 2022, *available at* https://www.sec.gov/news/speech/birdthistle-remarks-pli-investment-management-2022-072622.

Notably, the expiration of the No-Action Letter *would not compel* U.S.-based investment advisers to pay for research out of their own expenses. It *would not compel* U.S. unbundling. Rather, it would simply require research providers in Europe that are also subject to federal securities laws and are not already registered as investment advisers to (1) register as investment advisers so as to receive separate payments for research from MiFID II-covered clients; (2) move their research provisions under already registered affiliates; or (3) make other changes, including no longer accepting payments for research in Europe.

There is no basis for codifying an uneven and unequal playing field.

In effect, the No-Action Letter has discriminated against U.S. investors as it allows brokers who provide research to accept cash payments as a result of MiFID II without having to register under the Advisers Act. By its terms, the No-Action Letter applies only to clients subject to MiFID II by law or contract. The relief does not allow brokers to accept cash payments for research from the vast majority of U.S. investors. As a result, millions of U.S. investors are still paying the cost of bundled research despite not being informed (1) how much they are paying, or (2) whether the research is benefiting them. Worse, in many cases, many asset managers are being compelled to trade with specific brokers to obtain their research, even if they would prefer to trade with other brokers.[13]

Relying in part upon the No-Action Letter, some global banks have continued to require U.S.-based investors (including public pension funds) to trade with them in order to pay for separately provided investment research. While this may provide the bank with greater trading volumes (and revenues), it may not provide the U.S. investors with better execution. After all, quality research is materially different from quality trading services.

Pricing for brokerage and research services is critically important to the global securities marketplace and millions of U.S. workers and retirees that rely on pension funds and other institutional asset managers and grow their retirement savings. Congress should not seek to codify (and expand) a temporary, ad-hoc policy crafted without the benefit of comprehensive economic analysis to benefit some broker-dealers at the expense of millions of U.S. investors.

The policy choices contemplated by H.R. 2622 go beyond codifying the No-Action Letter.

Moreover, while simply reversing the SEC's determination to let the temporary no-action letter expire is bad policy for investors, the bill does further damage. It creates a new loophole to registration under the Advisers Act. Rather than exempting from the Advisers Act only those institutions subject to MiFID II, H.R. 2622 would exempt all broker-dealers from being subject to the Advisers Act if they receive compensation for investment research from a wide range of investors, potentially allowing U.S. investment advisers with limited European activities to escape registration, resulting in lesser protections for their clients.

The right path forward is to let the no-action relief expire, and promote market efficiency.

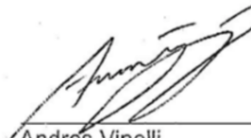
There are steps that Congress and the SEC can and should take to improve the transparency of soft dollar payments for research in the U.S. The first and essential step is to let the 2017 no-action relief expire this summer, as planned.

Beyond this, Congress should direct the SEC to revise guidance under Section 28(e) of the Exchange Act of 1934 to: (1) require investment managers and advisers who seek to rely on the safe harbor to disclose amounts paid for research from client assets; and (2) require investment advisers who seek to rely on the safe harbor to have procedures to ensure research benefits the asset owners who pay for it.

Thank you for the opportunity to share our perspective on this important legislation.

Sincerely,

Tyler Gellasch
Healthy Markets Association



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