

SEC STAFF RELEASES GUIDANCE FOR U.S. MARKET PARTICIPANTS REGARDING U.S. REGULATED ACTIVITIES AND COMPLIANCE WITH MIFID II

The U.S. regulatory framework has presented challenges to market participants that must also structure their practices to comply with the implementation of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (“MiFID II”), which takes effect on January 3, 2018. On October 26, 2017, the staff of the U.S. Securities and Exchange Commission (SEC) issued three related no-action letters that are designed to provide market participants with greater certainty regarding their U.S. regulated activities as they engage in efforts to comply with the MiFID II.

The no-action letters are available at:

- <https://www.sec.gov/divisions/investment/noaction/2017/sifma-102617-202a.htm>
- <https://www.sec.gov/divisions/investment/noaction/2017/ici-102617-17d1.htm>
- <https://www.sec.gov/divisions/marketreg/mr-noaction/2017/sifma-amg-102617-28e.pdf>

For example, MiFID II will, among other things, prohibit certain money managers from receiving “inducements” from a third party in connection with providing any investment or

ancillary service to a client. The term “inducements” includes a money manager’s receipt of research from a broker-dealer. Thus, under MiFID II, money managers must either pay for research out of their own pockets or agree with clients to have research costs paid by clients through research payment accounts (RPAs) funded either by a specific research charge to the client or out of dealing commissions, provided that the research element of the commission is priced separately from the execution element (i.e., “unbundled”). U.S. broker-dealers, however, are not permitted to receive “hard dollars” without invoking the “special compensation” clause that would require them to become investment advisers” pursuant to Investment Advisers Act Section 202(a)(11)(C).

Through the no-action letters, the SEC staff has offered a path to market participants to comply with the research requirements of MiFID II in a manner that is consistent with the U.S. federal securities laws.

In sum, subject to various terms and conditions, (1) broker-dealers may receive research payments from money managers in hard dollars or from advisory clients’ research payment accounts; (2) money managers may continue to aggregate orders for mutual funds and other clients; and (3) money managers may continue to rely on an existing safe harbor when paying broker-dealers for research and brokerage.

SEC staff will monitor the impact of MiFID II’s research provisions on broker-dealers (including any changes to their business models), investors, and the quantity and quality of research. To facilitate the staff’s monitoring, SEC staff has encouraged members of the public to make their views known on these matters.

The SEC issued a Press Release, available at <https://www.sec.gov/news/press-release/2017-200-0>, which provides the Fact Sheet below.

Seward & Kissel will continue to monitor any developments regarding regulatory treatment of U.S. regulated activities as market participants engage in efforts to comply with the MiFID II. If you have any questions regarding virtual currency or other issues in connection with virtual or cryptocurrencies, please contact one of the attorneys listed below or your Seward & Kissel contact attorney.

FACT SHEET

Division of Investment Management No-Action Relief

- The Division of Investment Management provided temporary relief for thirty (30) months from MiFID II's implementation date under the Investment Advisers Act of 1940 ("Advisers Act") to permit a broker-dealer to receive payments in hard dollars or through MiFID-governed research payment accounts from MiFID-affected clients without being considered an investment adviser. In connection with this temporary relief, the staff will continue to monitor and assess the impact of MiFID II's requirements on the research marketplace and affected participants in order to ascertain whether more tailored or different action, including rulemaking, is necessary and appropriate in the public interest.
- The Division of Investment Management also provided relief under the Investment Company Act of 1940 and the Advisers Act to permit investment advisers to continue to aggregate client orders for purchases and sales of securities, where some clients may pay different amounts for research because of MiFID II requirements, but all clients will continue to receive the same average price for the security and execution costs. This relief provides clarity and consistency to investment advisers by permitting the continued aggregation of orders while addressing the differing arrangements regarding the payment for research that will be required by MiFID II.

Division of Trading and Markets No-Action Relief

- The Exchange Act Section 28(e) safe harbor addresses the manner in which a money manager can use client commissions to purchase “brokerage and research services” without breaching its fiduciary duty. In the U.S., money managers often use client commission arrangements to obtain brokerage and research services from a broker-dealer, using a single, “bundled” commission that is separated after execution to pay for order execution and research.
- Under MiFID II, money managers may make payments to an executing broker-dealer out of client assets for research alongside payments for order execution, and the executing broker-dealer must transmit the payments for research into research payment accounts (“RPAs”).

The Division of Trading and Markets provided relief to allow money managers to operate within the safe harbor if the money manager makes payments for research to an executing broker-dealer out of client assets alongside payments for execution through the use of an RPA that conforms to the requirements for RPAs in MiFID II, and the executing broker-dealer is legally obligated to pay for the research, provided that all other applicable conditions of Section 28(e) are met.