MEMO# 30826

August 10, 2017

EU MiFID II Investment Research Requirements - Update on Request for No-Action Relief for Trade Aggregation and UK FCA Response on Delegation; Member Call on August 17 at 3 p.m. ET

[30826]

August 10, 2017 TO: Equity Markets Advisory Committee
ICI Global Regulated Funds Committee
SEC Rules Committee RE: EU MiFID II Investment Research Requirements - Update on Request for No-Action Relief for Trade Aggregation and UK FCA Response on Delegation; Member Call on August 17 at 3 p.m. ET

The Markets in Financial Instruments Directive (MiFID) II introduced significant changes to the restrictions on inducements received or paid by an investment firms, including asset managers, and firms must comply with the new requirements no later than January 3, 2018.[1] This memorandum is to update members on two issues related to the MiFID II investment research provisions:

- ICI request for no-action relief for advisers to aggregate client orders; and
- U.K. Financial Conduct Authority's (FCA) response to the Alternative Investment Managers Association (AIMA) on the application of the MiFID II inducements provisions where portfolio management services are outsourced to a third country firm.

Request for No-Action Relief for Advisers to Aggregate Client Orders; Call on August 17

As members are aware, the MiFID II Delegated Directive requires the separation of execution and research payments; an adviser may obtain research from third parties either by paying for the research directly from its own funds or by paying for the research from a MiFID II-compliant research payment account. Current Securities and Exchange Commission (SEC) rules and guidance permit firms to aggregate trade orders for advisory clients provided that, among other requirements, transaction costs will be shared pro rata based on each client's participation in the transaction. It is unclear whether, under Section 17(d) of the Investment Company Act of 1940, trades can be aggregated when certain clients are paying a bundled rate that includes execution and research charges, while others pay execution only, or where clients may be paying a different amount for research. In other words, there is uncertainty whether advisers can aggregate trades of clients if they pay different total transactions costs even though they receive the same price for the security.

Working with members and outside counsel, we have prepared the attached draft no-action letter that seeks assurances from the staff of the Division of Investment Management that it will not recommend enforcement action to the SEC under Section 17(d) and Rule 17d-1 thereunder, or Section 206 of the Investment Advisers Act of 1940, if a registered investment adviser continues to aggregate orders for the purchase or sale of securities on behalf of its clients (which may include registered investment companies (RICs)) following the implementation of MiFID II requirements, subject to the provisions specified in the letter. Specifically, the ICI requests that the position taken in *SMC Capital, Inc.* (pub. avail. Sept. 5, 1995) with respect to the aggregation of trades be expanded to accommodate the differing arrangements regarding the payment for research that will be required by MiFID II. We explain that, absent the expansion of the relief granted in SMC, advisers may be forced to place into the market competing trades in the same security, resulting in worse execution for clients overall, and the potential to benefit one set of clients at the expense of another, precisely the harm that the relief granted to SMC sought to prevent.

We will be holding a call on Thursday, August 17 at 3 pm ET to discuss the letter. If you would like to join the call, please contact Ruth Tadesse at rtadesse@ici.org for the dial-in details. Alternatively, you may provide written comments or contact us directly by Friday, August 18.

FCA Response to AIMA on Delegation

In April, AIMA submitted a letter to the FCA setting out its views on outsourcing under MiFID II, and in particular the application of the inducements provisions (specifically the investment research provisions) to third country firms that have been delegated portfolio management services from a MiFID firm. AIMA had requested the clarification because of significant uncertainty in this area. The FCA provided a response to AIMA on August 7. (Although the letter is dated July 19, AIMA received the letter on Monday, August 7.) Unfortunately, the FCA takes the view that the obligations do extend to non-MiFID firms to which portfolio management services have been outsourced and that the non-MiFID firm would, at a minimum, "need to take steps to secure an equivalent level of protection for its clients under a delegation arrangement." There is, however, language in the letter that discusses how a US manager may comply with those obligations that may be operationally different than for MiFID firms.

We are considering the implications of the FCA position and welcome member feedback on this matter.

We are available at Jennifer Choi (jennifer.choi@ici.org or 202-326-5876) or Eva Mykolenko (emykolenko@ici.org or 202-326-5837).

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Attachment No. 1

Attachment No. 2

endnotes

[1] MiFID II comprises both a European Union directive (the Markets in Financial Instruments Directive), as well as a separate European Union Regulation (the Markets in Financial Instruments Regulation).