Investment Company Act of 1940 and Rule 17d-1 thereunder, and Section 206 of the Investment Advisers Act of 1940
Investment Company Institute

October 26, 2017

RESPONSE OF THE CHIEF COUNSEL'S OFFICE
DIVISION OF INVESTMENT MANAGEMENT

Your letter dated October 20, 2017 requests our assurance that the staff of the Division of Investment Management would not recommend enforcement action to the Securities and Exchange Commission ("Commission") under Section 17(d) of the Investment Company Act of 1940 (the "1940 Act") and Rule 17d-1 thereunder, or Section 206 of the Investment Advisers Act of 1940 (the "Advisers Act") against an investment adviser that aggregates orders for the sale or purchase of securities on behalf of its clients in reliance on the position taken in SMC Capital[1] while accommodating the differing arrangements regarding the payment for research that will be required by the 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, as implemented by the European Union member states ("MiFID II").[2]

In SMC Capital, the staff stated that the mere aggregation of orders for advisory clients, including collective investment vehicles in which the adviser, its principals or employees have an interest, would not violate Section 17(d) of the 1940 Act, Rule 17d-1 thereunder, or Section 206 of the Advisers Act if the adviser implements procedures designed to prevent any account from being systematically disadvantaged by the aggregation of orders.[3] Our position was based on, among other things, a representation that each client who participates in an aggregated order will participate at the average share price with all transaction costs shared on a *pro rata* basis.[4]

You state that MiFID II and a related Delegated Directive published by the European Commission, which go into effect on January 3, 2018, require the separation of execution and research payments. Accordingly, an adviser may obtain research from third parties, including executing brokers, if it pays for the research directly from its own resources or if the research is paid for from a MiFID II-compliant research payment account.[5] As a result of the various potential research arrangements and combinations thereof, such clients may not pay a *pro rata* share of *all* costs (*i.e.,* research payments) associated with that aggregated order as contemplated in SMC Capital although all clients will continue to pay the same average security price and execution costs. You assert that absent no-action assurances, advisers may be forced to place into the market competing orders in the same security, possibly 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 Capital sought to prevent.

You request that the position taken in SMC Capital with respect to aggregation of orders be expanded to accommodate the differing arrangements regarding the payment of research that will be required by MiFID II. You point out that post-MiFID II, each client in an aggregated order will continue to pay/receive the same average price for the purchase or sale of the underlying security and will pay the same amount for execution thereof. You believe that the payment of varying amounts of research should not preclude an investment adviser's ability to aggregate orders on behalf of its clients, and that aggregating orders, under the circumstances described in your letter, will minimize the risk that any particular account will be systematically advantaged (or disadvantaged). You represent that advisers will adopt policies and procedures reasonably designed to ensure that (1) each client in an aggregated order pays the average price for the security and the same cost of execution (measured by rate), (2) the payment for research in connection with the aggregated order will be consistent with each applicable jurisdiction's regulatory requirements and disclosures to the client, and (3) subsequent allocation of such trade will conform to the adviser's allocation statement (as described in your letter) and/or the adviser's allocation procedures.

Based on your facts and representations, the staff would not recommend enforcement action to the Commission under Section 17(d) of the 1940 Act and Rule 17d-1 thereunder, or Section 206 of the Advisers Act against an investment adviser that aggregates orders for the sale or purchase of securities on behalf of its clients in reliance on the position taken in SMC Capital while accommodating the differing arrangements regarding the payment for research that will be required by MiFID II.[6] This response expresses our view on enforcement action only and does not express any legal or interpretive position on the issues presented. Because our position is based upon all of your facts and representations, any different facts or representations may require a different conclusion.

Aaron T. Gilbride
Senior Counsel

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[1] SMC Capital Inc., SEC Staff Letter (Sept. 5, 1995) ("SMC Capital"). You state that your request is not intended to supersede the relief granted in SMC Capital; the position taken in this letter would provide an alternative approach regarding Section 17(d), Rule 17d-1 and Section 206 in the

context of order aggregation. We agree. These assurances do not supersede SMC Capital and are intended to provide an alternative approach to address concerns that have arisen in light of the adoption of MiFID II.

[2] *See* 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 (available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2014:173:TOC) and equivalent national rules of member states. *See, e.g.,* Questions and Answers, On MiFID II and MiFIR investor protection and intermediaries topics, ESMA35-43-349 (Oct. 3, 2017) (discussing, among other things, the sharing of research among intragroup entities). Available at https://www.esma.europa.eu/sites/default/files/library/esma35-43-349_mifid_ii_qas_on_investor_protection_topics.pdf.

[3] SMC Capital. The staff also stated in SMC Capital that "[i]f a portfolio manager allocates trades in such a way as to disadvantage a registered investment company, a joint enterprise or arrangement raising the concerns section 17(d) was designed to address may result." *See also, e.g., In re Kemper Financial Services, Inc.,* Investment Advisers Act Release No. 1387 (Oct. 20, 1993) (settled action).

[4] SMC Capital ("SMC states that it will allocate trades at an average price and, if not completely filled, on a pro rata basis. Although you have not asked us to express an opinion on any other allocation method, we note that there may be other allocation methods that advisers can use without violating section 17(d) or section 206.").

[5] After MiFID II goes into effect, within a given aggregated order, some clients (including registered investment companies) may pay total transaction costs that include the cost of execution as well as research services, while other clients may pay different amounts in connection with the same order (including possibly execution only) because of varying research arrangements and budgets and/or if the adviser has elected to pay for research for such clients in whole or part using its own resources.

[6] This position does not apply to an investment adviser that is not subject to MiFID II (either directly or contractually).

Incoming Letter

The Incoming Letter is in Acrobat format.

http://www.sec.gov/divisions/investment/noaction/2017/ici-102617-17d1.htm

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