



This is an excerpt of Chapter 17: **Research and Research Analysis of Broker-Dealer Regulation (Second Edition)**(#32789), by Clifford E. Kirsch. Reprinted with permission for King & Spalding LLP.

No part of this may be used or reproduced by any means, graphic, electronic, or mechanical, including photocopying, recording, taping, or by any information storage retrieval system without the written permission of the publisher (except in the case of brief quotations). No part of this may be shared with or used by any third party, including any generative AI system such as ChatGPT, or any person who is not an Authorized User. Questions can be directed to plipress@pli.edu.

Chapter 17

Research and Research Analysts

Russell D. Sacks*

Partner, King & Spalding LLP, New York City

Steven R. Blau

Counsel, King & Spalding LLP, New York City

[Chapter 17 is current as of August 7, 2025.]

§ 17:1 Introduction

**§ 17:2 Overview of the Research Function and Research Payment
Models**

§ 17:2.1 Overview of the Research Function

§ 17:2.2 Soft Dollar Model

§ 17:2.3 MiFID II and the Trend Towards a Hard Dollar Model

* The authors gratefully acknowledge John T. Bostelman, retired partner, Sullivan & Cromwell LLP, who authored the original version of this chapter. The authors thank Achim Döser, Kasia Thevissen, Costa Burkov, Kathrynne Hunter, Thomas H. Burton, and Avery Juan for their contributions to this chapter. The authors also gratefully acknowledge the mentorship of Charles S. Gittleman and the late Lynne Johnson, who guided their careers during the time of the Global Research Settlement and the SRO research rules.

§ 17:2.4	SEC No-Action Relief for Receipt of Hard Dollar Payments from Firms Subject to MiFID II
§ 17:2.5	Distribution of Research As an Investment Advisory Product
§ 17:3	Distribution of Research into the United States from Abroad
§ 17:3.1	Distribution Under Rule 15a-6
[A] Overview; Required Disclosures	
[B] Distribution Under Rule 15a-6(a)(2)	
[C] Distribution Under Rule 15a-6(a)(3)	
[D] Distribution Under Rule 15a-6(a)(4)	
§ 17:3.2	Distribution by a U.S. Broker-Dealer As Third-Party Research
§ 17:4	Research Publication During a Securities Offering: Securities Act Rules 137, 138, and 139
§ 17:4.1	Research Reports As Potential Securities Act Offers and Prospectuses
§ 17:4.2	Overview of Rules 137, 138, and 139
Table 17-1	Overview of Rules 137, 138, and 139
§ 17:4.3	Definition of Research Report for Rules 137, 138, and 139
§ 17:4.4	Rule 137 (Publications or Distributions of Research Reports by Brokers or Dealers That Are Not Participating in an Issuer's Registered Distribution of Securities)
§ 17:4.5	Rule 138 (Publications or Distributions of Research Reports by Brokers or Dealers About Securities Other Than Those They Are Distributing)
§ 17:4.6	Rule 139 (Publications or Distributions of Research Reports by Brokers or Dealers Distributing Securities)
§ 17:4.7	Rule 139b: Investment Funds Research
§ 17:4.8	Research on EGCs Is Eligible for Rule 139-Like Protections
§ 17:4.9	Pre-IPO Research
§ 17:5	Regulation M and Research Reports
§ 17:6	History of Research Regulation: From Inquiry to Rulemaking
§ 17:6.1	Initial Regulatory Inquiries
§ 17:6.2	Sarbanes-Oxley Act's Impact on Research Regulation
§ 17:6.3	From Inquiry to SRO Rulemaking
§ 17:6.4	SEC Regulation AC
§ 17:6.5	Global Research Settlement
§ 17:7	Global Research Settlement: A Detailed Look at the Enforcement Action That Changed an Industry
§ 17:7.1	Overview of the Settlement and the Obligations It Imposes on Settling Firms
Table 17-2	2004 Settlement Agreement: Key Provisions
§ 17:7.2	Scope
	[A] U.S.-Oriented Applicability
	[B] Definition of Research Report
	[C] Exempt Investment Adviser Affiliates

§ 17:7.3	Communications Firewalls Between Research and Investment Banking
	[A] Views About the Merits of a Proposed Transaction, a Potential Candidate for a Transaction, or Market or Industry Trends, Conditions, or Developments
	[B] Communications to Commitment or Similar Committee
	[C] Confirming the Adequacy of Disclosure; Joint Due Diligence
	[D] Post-Mandate Communications
	[D][1] Views on Pricing and Structuring
	[D][2] Sales Force Education
§ 17:7.4	Conferences
	[A] Matters of General Firm Interest
	[B] Legal and Compliance Issues
	[C] Communications Not Related to Research or Investment Banking
§ 17:7.5	Research Coverage Decisions
§ 17:7.6	Independent Monitor
§ 17:7.7	Obligation to Provide Independent, Third-Party Research
§ 17:7.8	Amendments and Compliance Certification
§ 17:7.9	Savings Clauses
§ 17:8	FINRA's Equity Research Regulation: Equity Research Rule and Research Analyst Registration
§ 17:8.1	History of the Equity Research Rule
§ 17:8.2	Scope of the Equity Research Rule
	[A] General Definition of "Research Report"
	[B] Carve-outs for Certain Categories of Communications from the Definition of Research Report
	[C] Definition of Research Analyst
§ 17:8.3	Overview of Equity Research Rule Obligations
§ 17:8.4	Research Department Separation
	[A] No Supervision of Research by Investment Banking
	[B] Restrictions on Prepublication Review of Research by Non-Research Personnel
	[C] Restrictions on Prepublication Review of Research by Subject Companies
	[D] Prohibition on Promises of Favorable Research
	[E] Prohibition on Directing Analysts to Undertake Selling or Marketing Efforts
	[F] Prohibition on Research Solicitation of Investment Banking Business
§ 17:8.5	Prohibition on Three-Way Communications Involving Investors
§ 17:8.6	Requirement of Fair and Balanced Communications
§ 17:8.7	Review of Analyst Compensation

§ 17:8.8	Quiet Periods for Research and Public Appearances
	[A] Managers and Co-Managers of a Secondary Offering
	[B] Underwriters and Dealers in an IPO
	[C] Expiration of “Lock-Up” Agreements
	[D] Exception for Significant Events
§ 17:8.9	Notice of Termination of Coverage
§ 17:8.10	Restrictions on Personal Trading by Research Analysts
	[A] Prohibition Against Purchasing or Receiving Certain Pre-IPO Securities
	[B] Trading Against Recommendation
	[C] Application to Managed Accounts
§ 17:8.11	Blackout Periods
§ 17:8.12	Distribution of Research Reports; “Research Huddles” Enforcement Action
	[A] “Research Huddles” Enforcement Action
	[B] Prohibition on Differentiating Research Product by Timing
§ 17:8.13	Disclosure Requirements
	[A] Manner of Disclosure: Placement and Conditional Language
	[B] Conflict of Interest Disclosures in Research Reports
	[C] Disclosure Required for Third-Party Research Reports
	[D] Third-Party Research Disclosure Exemptions
	[E] Supervision of Third-Party Research
Table 17-3	Principal Review of Third-Party Equity Research to Be Distributed
	[F] Meaning and Distribution of Ratings
	[G] Price Charts and Price Targets
	[H] Special Rules for Compendium Reports
§ 17:8.14	Required Disclosures in Public Appearances
§ 17:8.15	Exemption from Certain Obligations for Firms with Limited Investment Banking Activity
§ 17:8.16	2012 Amendments Addressing Emerging Growth Companies
§ 17:8.17	Content Standards for Research Reports
§ 17:8.18	Registration Requirements for Equity Research Analysts and Research Principals
	[A] Registration for Equity Research Analysts
	[B] Registration Is Not Required for Fixed-Income Research Analysts
	[C] Registration Requirements for Research Supervisors
§ 17:9	Communications Between Research Analysts and Companies
	Prior to an Offering Under the Equity Research Rule: Toys “R” Us Enforcement Actions and FINRA’s May 2015 Research FAQs
§ 17:9.1	Toys “R” Us Enforcement Actions
§ 17:9.2	FINRA May 2015 Research Rules FAQs Regarding Analyst Activities and the IPO Process
	[A] Solicitation Period

- [B] **Solicitation Periods During Secondary Offerings**
 - [C] **Pre-IPO and Post-Mandate Periods**
 - [D] **Communications or Conduct by Issuers**
- § 17:10 Fixed-Income Research Rule**
- § 17:10.1 Overview of the Fixed-Income Research Rule**
 - § 17:10.2 Scope of the Fixed-Income Research Rule**
 - [A] **Definition of Debt Research Report**
 - [B] **Desk Commentaries and the Definition of Debt Research Report**
 - § 17:10.3 Fixed-Income Research Rule for Institutional-Only Research**
 - [A] **Investors to Which Firms May Distribute Institutional Fixed-Income Research**
 - [B] **Firms Distributing Institutional-Only Research: Disclosures**
 - [C] **Firms Distributing Institutional-Only Research: Policies and Procedures**
 - § 17:10.4 Fixed-Income Research Rule for Firms Distributing Retail Fixed-Income Research**
 - [A] **Required Disclosures**

Table 17-4 Required Disclosures: The Equity Research Rule Versus the Fixed-Income Research Rule

Table 17-5 Required Policies and Procedures: Equity Research Rule Versus the Fixed-Income Research Rule

§ 17:11 SEC Regulation Analyst Certification (Reg. AC)

- § 17:11.1 Summary**
- § 17:11.2 Research Analyst Certification for Research Reports**
- § 17:11.3 Public Appearances**
- § 17:11.4 “Covered Persons”—Application of Regulation AC to Persons Associated with a Broker-Dealer**
- § 17:11.5 Application to Investment Advisers Not Eligible to Register with the SEC**
- § 17:11.6 Application to the News Media**
- § 17:11.7 Third-Party Research**
- § 17:11.8 Interpretive Guidance on What Is and Is Not Research for Regulation AC**
- § 17:11.9 Who Is a Research Analyst?**
- § 17:11.10 Application to Research Provided by Non-U.S. Firms**
- § 17:11.11 Alternative Compliance Methods for Certain Research**
 - [A] **Quantitative and Technical Research**
 - [B] **Compendium Reports**
- § 17:11.12 Supervision and Review of Research**
- § 17:11.13 Enforcement; Fraud Liability Under the Federal Securities Laws**

§ 17:12 Sources of Regulatory and Private Liability from Research

- § 17:12.1 FINRA Regulatory Enforcement**
- § 17:12.2 Private Litigation**

§ 17:1 Introduction

Production and distribution of securities research is a key function of U.S. broker-dealers, with the U.S. Securities and Exchange Commission (SEC) noting that providing research is “one important, long-standing service of the brokerage business.”¹ During the era of fixed commission rates, research developed as a key means through which brokerage firms sought to distinguish themselves; although fixed commission rates were abolished in 1975, research continues to be a key broker-dealer offering. Information is the lifeblood of the modern capital markets, and given the tremendous volume and complexity of information and raw data that is available, research analysts play an important role in the relationship between companies and investors, both retail and institutional.² Research is a valuable service to a firm’s sales-and-trading clients, and generally elevates the profile of a firm in a particular industry or sector.³

Research is also a function that has historically received some of the closest regulatory scrutiny and can present some of the thorniest compliance and conflicts considerations. Firms with both research and other functions often undertake many potentially conflicted roles, and the firm’s non-research activities have the potential to place pressure on the objectivity and independence of the research function and/or to seek to enlist it in the firm’s efforts to secure investment

-
1. See SEC. & EXCH. COMM’N, OFF. OF COMPLIANCE, INSPECTIONS & EXAMINATIONS, INSPECTION REPORT ON THE SOFT DOLLAR PRACTICES OF BROKER-DEALERS, INVESTMENT ADVISERS AND MUTUAL FUNDS (Sept. 22, 1998), <https://www.sec.gov/news/studies/softdolr.htm>.
 2. The 1969 *Wheat Report* (authored by a study group chaired by SEC Commissioner Francis M. Wheat) noted: “[e]ven the casual observer cannot fail to note the increase in the output of market letters, industry surveys, recommended lists and similar publications by the brokerage community. This flow of material to customers and prospective customers not only responds to investors’ demands but constitutes a primary medium for the dissemination of information about securities to the investing public.”
 3. Especially where smaller issuers are concerned, research can be a valuable means to sift, digest, and transmit information in a manner useful to investors. Investors view research into smaller companies as an important component of the information environment, and thus, the liquidity of smaller issuers benefits from the spotlight provided by investment research. As recently as 2022, the SEC and its staff have made statements and issued reports on these benefits. See SEC Staff Report on the Issues Affecting the Provision of and Reliance Upon Investment Research into Small Issuers (Feb. 2022), https://www.sec.gov/files/staff-report-investment-research-small-issuers_0.pdf.

banking or other business.⁴ Similarly, issuers and their management care deeply about the quality of research coverage, and are known to reward investment banks with preferred coverage through underwriting or other mandates; this reality can lead to conflicts that are not easily addressed by regulation of the investment bank producing the research.

A series of actions and investigations by the SEC, Congress, the NASD, NYSE, and state regulators that began in the late 1990s and continued into the early 2000s led to a host of regulations seeking to address potential research analyst conflicts of interest:

- SEC Regulation Analyst Certification ("Regulation AC"), adopted in 2003, requires certain analyst certifications in connection with equity and fixed-income research reports and public appearances;
- The Global Settlement, a 2003–04 settlement agreement among twelve firms and federal and state regulators, the NASD, and the NYSE (the NASD and NYSE Regulations have since merged to become FINRA) that continues to impose certain structural obligations on firms that are party to the settlement, and the requirements of which have been widely adopted across the industry even by firms not party to the settlement;
- FINRA Rule 2241 (formerly NASD Rule 2711 and NYSE Rule 472) governs equity research production and distribution and the relationship between research and investment banking functions; and
- FINRA Rule 2242 governs fixed-income research production and distribution and the relationship between research, investment banking, and principal-trading functions.

Today, perhaps the most significant headwind faced by "sell-side" research is not purely regulatory but rather is a developing shift in the research payment model from soft dollars to hard dollars, a shift that was accelerated by a change in European regulation. The European Union's MiFID II Directive⁵ came into effect in January 2018 and

-
4. As of December 31, 2019, FINRA's membership included approximately 3,517 broker-dealers, and as of November 2010 approximately 220 firms conducted both investment banking and research activities. U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-209, SECURITIES RESEARCH: ADDITIONAL ACTIONS COULD IMPROVE REGULATORY OVERSIGHT OF ANALYSTS CONFLICTS OF INTEREST (Jan. 2012), <https://www.gao.gov/assets/590/587613.pdf>.
 5. The Markets in Financial Instruments Directive II ("MiFID II").

included a requirement that asset managers subject to the Directive pay for research either using (i) the manager's own hard dollars, or (ii) a pre-budgeted commission-sharing arrangement, with research costs unbundled from execution costs and disclosed to clients. In practice, this effectively ended the use of soft dollars by EU-resident managers,⁶ and accelerated a shift towards hard dollar payments by U.S. asset managers on a voluntary basis, based on a view that doing so may be viewed positively by clients and would be a proactive response to current events. The European Union and the United Kingdom have both since re-evaluated the Directive's unbundling requirements. In 2021, the EU Parliament and Council approved a partial removal of the unbundling requirements for the trading on stocks issued by small and medium-sized enterprises. Specifically, MiFID II was amended to allow firms to combine the costs of research and trading related to issuers with a market capitalization of EUR 1 billion or less.⁷ In April 2024, the European Parliament approved the EU Listing Act, which removes the market capitalization threshold and allows for the bundling of payments for research and execution services, if certain requirements are met, as further described in section 17:2.3 below. The new rules shall apply eighteen months from the date of entry into force of the Listing Act. In April 2024, the UK Financial Conduct Authority (UK FCA) issued Consultation Paper 24/7 requesting comment on proposed rules that would permit asset managers to pay for research and execution through a bundled payment option, noting that "[h]igh quality, easily available investment research supports deep capital markets, listed companies, and economic growth."⁸ The proposal would require firms using the bundled payment option to comply with certain conditions.

Although the soft-dollar model is alive and well in the United States, client preference towards or requirement of hard dollar payments, and the trend towards buy-side in-sourcing of research,⁹ puts

-
6. *See, e.g.*, Richard Henderson, *T. Rowe Price Latest Fund Manager to Cover Research Costs Globally*, FIN. TIMES (July 16, 2019), <https://www.ft.com/content/c453e0dc-a7d3-11e9-b6ee-3cdf3174eb89>.
 7. Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU.
 8. *Payment Optionality for Investment Research*, FIN. CONDUCT AUTH. (Apr. 2024), <https://www.fca.org.uk/publication/consultation/cp24-7.pdf> [hereinafter 2024 FCA Proposed Rule].
 9. *See, e.g.*, POONEH BAGHAI, ONUR ERZAN & JU-HON KWEK, MCKINSEY & CO, THE NEW GREAT GAME IN NORTH AMERICAN ASSET MANAGEMENT (Nov. 15, 2018), <https://www.mckinsey.com/industries/financial-services/our-insights/the-new-great-game-in-north-american-asset-management#> ("Unbundling of research costs has catalyzed a re-think by leading

pressure on the sell-side research function in two ways: firms that accept hard dollars may have to distribute such research as an investment advisory product subject to the U.S. Investment Advisers Act of 1940 (the “Advisers Act”),¹⁰ and it tends to decrease the buy-side funds available to compensate for research.¹¹ In March 2019, SEC Chairman Jay Clayton stated: “I am concerned that the broad availability of research may then be reduced as a result of MiFID II.”¹² From the time of implementation of MiFID II until July 3, 2023, the SEC staff mitigated this issue through use of an interpretive letter; in 2022, SEC staff indicated that such relief would not be extended in 2023 and it did in fact expire on July 3, 2023. This issue is described in detail in this chapter.

This chapter is structured as follows: section 17:2 provides an overview of the broker-dealer research function and a discussion of the research payment models. Section 17:3 examines how research may be distributed into the United States from abroad. Section 17:4 covers the Securities Act Offer and Prospectus considerations of research (Rules 137, 138, 139), while section 17:5 covers Regulation M and research reports. Section 17:6 traces the history of U.S. research regulation, beginning with the inquiries and investigations of the late

asset managers concerning how they get their insights now that broker-provided research and corporate access is no longer ‘free.’ This is precipitating three major shifts: first, a reshuffling of research relationships, in some cases in favor of smaller, specialized research providers; second, more centralized management of hard-dollar research budgets; and third, a move on the part of the very largest managers to consider bringing additional elements of investment research in-house”).

10. Some prominent firms have begun distributing some research as an investment advisory product, as noted by Dalia Blass, Director of the Division of Investment Management, in March 2019: “At the same time, some broker-dealers have explored or taken steps to offer research through a registered advisory business.” Dalia Blass, Dir. of the Div. of Inv. Mgmt., U.S. Sec. & Exch. Comm’n, Keynote Address: ICI Mutual Funds and Investment Management Conference (Mar. 18, 2019), <https://www.sec.gov/news/speech/speech-blass-031819> [hereinafter Dalia Blass March 2019 ICI Speech].
11. As of 2017, the total global annual budget for sell-side research was estimated to be \$16 billion. See Robin Wigglesworth, *Final Call for the Research Analyst?*, FIN. TIMES (Feb. 7, 2017), <https://www.ft.com/content/85ee225a-ec4e-11e6-930f-061b01e23655>. In 2018 and 2019, European fund managers clipped research spending markedly as compared to 2017, and U.S. managers decreased the same somewhat.
12. Jay Clayton, Chairman, U.S. Sec. & Exch. Comm’n, Remarks at Meeting of the Investment Advisory Committee (Mar. 28, 2019), <https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-032819>.

1990s. Section 17:7 discusses the global research analyst settlement between the SEC, the NASD and NYSE, the New York State Attorney General, state securities regulators, and some of the nation's leading investment firms. Section 17:8 reviews the FINRA Equity Research Rule (Rule 2241) and research analyst registration. Section 17:9 discusses communications between a research analyst and company prior to a securities offering and examines the "Toys 'R' Us" enforcement action. Section 17:10 covers the FINRA Fixed-Income Research Rule (Rule 2242), while section 17:11 covers SEC Regulation AC. The final discussion in section 17:12 considers enforcement and litigation trends regarding research.

§ 17:2 Overview of the Research Function and Research Payment Models

§ 17:2.1 Overview of the Research Function

Sell-side research analysts serve an important role in the markets, promoting efficiency by compiling publicly available information and offering analysis and insight on companies and industries. Analysts cover a particular industry (a "coverage universe") and publish research reports on the securities of companies or industries that they cover. These research reports are distributed to customers of the firm—typically free of charge—and often include a specific recommendation (for example, buy, sell, hold) and the analyst's expectation of the future price performance of the security (the "price target").

In addition to publishing research reports, analysts will speak with sales-and-trading clients regarding the subject matter of the research reports (all statements in which must be consistent with the analyst's published research), may speak to prospective investors during a primary or secondary offering in which their firm is an underwriter or selling agent, may speak with a firm's investment banking function to provide their views on an industry or on a particular company or transaction, and may give their views to an underwriting commitment committee.¹³ Analysts also may make public appearances at

13. Conversations between a research analyst and the investment banking team are subject to significant policy-and-procedure requirements, and are chaperoned by legal and compliance personnel. For example, the investment banking team must not seek to have the analyst identify a potential investment banking transaction, and may not direct the analyst to meet with a company, among many other restrictions. Further, if the conversation is for purposes of "vetting" a non-public transaction, the analyst must be brought over-the-wall. See discussion of the permissible types of communications between research and investment banking, *infra* section 17:7.3.

industry conferences and in the media, and the research function can also help to arrange corporate access meetings between research clients and covered companies, including but not limited to non-deal road shows.¹⁴ Investors often view analysts as experts on and important sources of information about the securities they cover and rely on their advice, and research reports can move markets.

At the top of the research function is a head of research or group of research management personnel who are “above the wall” and can field inquiries from a firm’s investment banking group, or from others outside the research function, that would not be appropriate conversations for a publishing analyst.¹⁵

§ 17:2.2 Soft Dollar Model

“Soft dollar” arrangements developed as a link between the brokerage industry’s supply of research and the money management industry’s demand for research. The SEC has defined soft dollars as arrangements under which products or services other than execution of securities transactions are obtained by an adviser from or through a broker-dealer in exchange for the direction by the adviser of client brokerage transactions to the broker-dealer.¹⁶ By definition, then, soft dollar or commission-sharing arrangements always involve three parties: (a) the investor, (b) the broker-dealer executing the transaction and providing the service (which may be research), and (c) the service (research) provider. Sometimes, the latter two parties are the same person.

In a soft dollar arrangement, the recipient of the research does not pay for the research directly but rather voluntarily directs a portion of the commissions on executed trades to the firm providing the research, which trades may be executed by firms other than the

-
14. U.S. investors paid \$2 billion in soft dollars for corporate access in 2016, or more than a third of the money spent on stock research and related services, according to consulting firm Greenwich Associates. Serena Ng & Thomas Gryta, *New Wall Street Conflict; Analysts Say ‘Buy’ to Win Special Access for Their Clients*, WALL ST. J. (Jan. 19, 2017), <https://www.wsj.com/articles/new-wall-street-conflict-analysts-say-buy-to-win-special-access-for-their-clients-1484840659>.
 15. The supervision of “above the wall” personnel contains its own pitfalls and must be carefully considered given the inherent information control issues that arise with “above the wall” personnel. See 2004 Interpretive Responses, *infra* note 138.
 16. U.S. SEC. & EXCH. COMM’N, OFF. OF COMPLIANCE, INSPECTIONS & EXAMINATIONS, INSPECTION REPORT ON THE SOFT DOLLAR PRACTICES OF BROKER-DEALERS, INVESTMENT ADVISERS AND MUTUAL FUNDS (Sept. 22, 1998), <https://www.sec.gov/news/studies/softdolr.htm> [hereinafter SEC SOFT DOLLAR REPORT], at section II.A.

provider of the research. These commissions may be directed by the so-called "broker vote."¹⁷

Soft dollar arrangements developed in the fixed-commission era as a means of discounting commission rates. After fixed commission rates were abolished, Congress enacted section 28(e) of the U.S. Securities Exchange Act of 1934 (the "Exchange Act"). Section 28(e) provides that a person who exercises investment discretion for an account shall not be deemed to have acted unlawfully or to have breached a fiduciary duty solely by reason of his having caused the account to pay more than the lowest available commission, if such person determines in good faith that the amount of the commission is reasonable in relation to the value of the brokerage and research services provided.¹⁸ This was in response to concerns expressed by money managers and brokers that, under the new system of negotiated commission rates, if managers caused a client account to pay anything but the lowest commission rate available in order to obtain research, they would be held in breach of their fiduciary duty to their clients.¹⁹

Section 28(e) addresses the regulatory concerns of the investment manager directing the soft dollars. Broker-dealers are likewise permitted to receive soft dollars without triggering investment adviser status, even though soft dollar arrangements would seem to cause the receiving broker-dealer to come within the definition of investment adviser set forth in section 202(a)(11) of the Advisers Act:

[A]ny person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities

The section 202(a)(11) definition provides that persons who (i) as part of a regular business, advise others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities (which securities research certainly does advise on), (ii) for compensation (which soft dollars certainly are), are investment advisers.

However, section 202(a)(11)(C) provides an exception from the definition of investment adviser for any U.S.-registered broker-dealer

-
- 17. The broker vote is essentially a report card that the "buy-side" gives the "sell-side," where buy-side firm personnel rank sell-side firms based on the utility of the research provided, with firms receiving more votes receiving more of the buy-side firm's soft dollar payments.
 - 18. SEC SOFT DOLLAR REPORT, *supra* note 16, section II.A.
 - 19. *Id.* section II.C.

"whose performance of [investment adviser] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor" [emphasis added]. For a broker-dealer distributing securities research, the key question is generally whether it receives "special compensation" for such research.

Soft dollar payments, being payments for transaction services, are viewed as commission payments rather than special compensation.²⁰ The receipt of hard dollar payments for research, however, calls into question the status of a broker-dealer seeking to rely on section 202(a)(11)(C).

§ 17:2.3 *MiFID II and the Trend Towards a Hard Dollar Model*

The revised EU Markets in Financial Instruments package—known as MiFID II—took effect on January 3, 2018.²¹ One of MiFID II's aims is to give investors transparency into the cost of both research and trading commissions, by requiring payments for these elements to be unbundled by EU investment firms.²²

The research²³ that investment managers typically receive from brokers is, under MiFID II, generally classified as a prohibited

-
- 20. *See, e.g.*, Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Release No. 34-54165 (July 18, 2006), 71 Fed. Reg. 41,978 (July 24, 2006).
 - 21. The MiFID II package comprises a revised Markets in Financial Instruments Directive II (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, O.J. (L 173)), the new Markets in Financial Instruments Regulation (Regulation 600/2014 of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Regulation (EU) 648/2012), and supplementary secondary legislation and guidance.
 - 22. The European Union operates a harmonized regulatory regime that is based on regulated activities rather than the type of a license. Therefore, any regulated entity that carries out MiFID regulated activities will fall under the MiFID II regime. For ease of reference, references to "an EU investment firm" here would include EU portfolio managers, advisers, investment banks, and brokers, where they carry out MiFID investment services. Notably, though, national implementation and supervisory practices may vary between different EU countries due to the directive-based nature of some of the MiFID II package.
 - 23. "Research," for purposes of MiFID II, is understood as covering research material or services concerning one or several financial instruments or other assets, or the issuers or potential issuers of financial instruments, or as covering research material or services closely related to a specific industry or market such that it informs views on financial instruments,

“inducement,”²⁴ unless the investment manager pays for the research either: (i) directly from its own resources; (ii) from a “Research

assets, or issuers within that industry or market. It is also defined as material or services that “explicitly or implicitly recommend or suggest an investment strategy and provide a substantiated opinion as to the present or future value or price of such instruments or assets” (Article 24 para. 9a MiFID II; Recital 28 of Commission Delegated Directive (EU) 2017/593), but would not include “short term market commentary on the latest economic statistics or company results for example or information on upcoming releases or events, which . . . contains only a brief summary of its own opinion on such information that is not substantiated nor includes any substantive analysis such as where they simply reiterate a view based on an existing recommendation or substantive research material or services” (Recital 29 of Commission Delegated Directive (EU) 2017/593) that are considered to be a minor, non-monetary benefit.

24. MiFID II restricts the payment or receipt of all fees, commission, and non-monetary benefits (“inducements”) unless these enhance the quality of service provided to a client, and do not impair an EU investment firm’s duty to act in the best interests of its client (Article 24 para. 9 MiFID II, Recital 21 of Commission Delegated Directive (EU) 2017/593). Research that concerns issuers with a market capitalization of up to EUR 1 billion is not to be considered as an inducement; this exemption was introduced by the MiFID II “Quick Fix” (Directive (EU) 2021/338)—investment firms that provide portfolio management services or independent investment advice. These restrictions on inducements mean that entities subject to MiFID II may only provide or receive research, hospitality, or corporate access which qualifies as “minor non-monetary benefits” (Article 12 para. 2 Commission Delegated Directive (EU) 2017/593). Some uncertainty arises as to which benefits are minor non-monetary benefits and, according to the UK FCA review of implementation of the rules (which is not legally binding in the European Union), some asset managers take a cautious approach to the rules. The FCA confirmed in response that: (i) asset managers need not block all marketing material or free trials from new research providers, as these are acceptable minor benefits if they satisfy the requirements, however, firms should set their own approach; (ii) asset managers may accept “issuer-sponsored” or house-broker research, including that which is particularly important for Small and Medium-Sized Enterprise (SME) issuers, provided that there is no inducement or conflict of interest for the asset manager; and (iii) generally, trade association member events are outside of the inducements framework. FIN. CONDUCT AUTH., IMPLEMENTING MiFID II—MULTI-FIRM REVIEW OF RESEARCH UNBUNDLING REFORMS (Sept. 19, 2019), <https://www.fca.org.uk/publications/multi-firm-reviews/implementing-mifid-ii-multi-firm-review-research-unbundling-reforms> [hereinafter UK FCA THEMATIC REVIEW OF MiFID II]. The state of this issue in the United Kingdom is somewhat more complex, as the U.K. FCA relaxed its bundling rules in 2022 through expansion of its list of permitted non-marketing benefits. A full discussion of the U.K. contours of this issue is beyond the scope of this chapter.

Payment Account" (RPA) funded with an advisory client's money²⁵ and with the client's prior approval; or (iii) a combination of the two methods (provided it is not for the same research service).²⁶ "Soft dollar" commissions are not allowed, unless done through an RPA, and most EU investment managers have elected to pay for research out of the adviser's P&L rather than utilizing an RPA structure.²⁷

A U.S. broker-dealer without any EU place of business is not generally within the scope of MiFID II, because national regulatory perimeters are generally preserved, unless it proactively targets EU-based clients, in which case it can become subject to MiFID II directly. However, a U.S. broker-dealer will likely be indirectly impacted through its dealings with entities that are subject to the full MiFID II requirements, since those entities will need to comply with the MiFID II rules relating to commissions and inducements in full (regardless of the location of their customers or counterparties). Put simply: MiFID II has led to EU investment managers generally paying hard dollars for research, including to U.S. broker-dealers.²⁸

-
- 25. Which may include soft dollar commissions.
 - 26. Article 13, Commission Delegated Directive (EU) 2017/593.
 - 27. While not directly applicable in the European Union, by way of example, the UK FCA has stated in a thematic review that brokers may still contribute to consensus forecasts and that their contribution can be attributed to them by the platform disclosing their identity, and that this will not amount to a material benefit under the inducements rules. The rules would apply if an asset manager then wanted to discuss the research with the broker's analyst or receive the underlying research report. UK FCA THEMATIC REVIEW OF MIFID II, *supra* note 24. The FCA also confirmed that paying for corporate access using an RPA was not compliant with the rules.
 - 28. *See, e.g.*, Chris Flood, *Blackrock to Foot Bill for External Research under Mifid II*, FIN. TIMES (Sept. 14, 2017), <https://www.ft.com/content/fb9e2552-9939-11e7-a652-cde3f882dd7b> (citing, in addition to Blackrock, that Vanguard, JPMorgan, and Axa have determined that any research costs incurred for MiFID II-impacted funds and client accounts will be paid for through the manager's own funds). However, some firms have announced that they will seek to pay for research through RPAs and thereby directly pass on research costs to their clients. Robin Wigglesworth, *Fidelity to Set Up 'Research Payment Account' for Clients Affected by Mifid II*, FIN. TIMES (Oct. 30, 2017), <https://www.ft.com/content/9a3ef636-e25a-360f-95ae-8e22958f8083>. As part of the process of establishing the RPA structure, EU Investment Firms must set a research budget, which must be agreed in advance, reviewed on a regular basis, and must provide each client with annual information on the total research costs that have been deducted from the resources of the client. The budget cannot be linked to the volume or value of transactions.

As a result of MiFID II:

- executing U.S. broker-dealers that are used to receiving a single, bundled commission are often asked by EU investment managers to receive separate, hard dollar payments for research and execution; and
- U.S. delegates that provide sub-advisory or managed account services to EU asset or portfolio managers may be required by contract to comply with MiFID II or equivalent unbundling requirements.²⁹

As noted above, a broker-dealer registered with the SEC that receives hard dollars for research risks investment adviser status and may not be saved by the definitional exception found at section 202(a)(11)(C) of the Advisers Act.

As discussed above, the European Union and the United Kingdom have both re-evaluated the Directive's unbundling requirements. In 2021, EU Parliament and Council approved a partial removal of the unbundling requirements for the trading on stocks issued by small and medium-sized enterprises. Specifically, MiFID II was amended to allow firms to combine the costs of research and trading related to issuers with a market capitalization for the period of thirty-six months preceding the provision of the research not exceeding EUR 1 billion. In April 2024, the European Parliament approved the EU Listing Act, which removes the market capitalization threshold and allows for the bundling of payments for research and execution services, if the following requirements are met: (1) an agreement has been entered into between the investment firm and the third-party provider of research and execution services establishing a methodology for remuneration; (2) the investment firm informs its clients of its choice to pay either jointly or separately for execution services and research and makes available to them its policy on payments for execution services and research; (3) the investment firm assesses on an annual basis the quality, usability, and value of the research used; and (4) where the investment firm chooses to pay separately for execution services and third-party research, the provision of research by third parties to the investment firm is received in return for either of the following: (i) direct payments by the investment firm out of its own resources; or (ii) payments from a separate research payment account controlled by the investment firm. The new rules must be implemented by the EU Member States by June 5, 2026, and applied

29. In addition, U.S. investment advisers may be required to purchase research in a MiFID II-compliant manner when they deal with EU brokers.

from June 6, 2026. In April 2024, the UK FCA issued Consultation Paper 24/7 requesting comment on proposed rules that would permit asset managers to pay for research and execution through a bundled payment option, noting that “[h]igh quality, easily available investment research supports deep capital markets, listed companies, and economic growth.”³⁰ The FCA then issued its policy statement in July 2024, requiring firms who would like to take up the new payment option to make sure that they comply with the new set of the FCA requirements, and have updated their internal procedures from August 1, 2024, onwards. The FCA has also updated its Conduct of Business rules related to research and inducements for collective portfolio managers in May 2025.

§ 17:2.4 SEC No-Action Relief for Receipt of Hard Dollar Payments from Firms Subject to MiFID II

For U.S.-registered broker-dealers, the regulatory issue resulting from MiFID II and alluded to above is that receipt of hard dollar payments for research potentially triggers investment adviser status under the Advisers Act. Receipt of soft dollar payments is not viewed as “special compensation” for investment advice, and thus broker-dealers receiving such payments are eligible for the Advisers Act section 202(a)(11)(C) exception from the definition of investment adviser. Receipt of hard dollar payments for research, however, calls into question the status of a broker-dealer seeking to rely on section 202(a)(11)(C).

In response to the potential disruption to the broker-dealer research model presented by MiFID II, in October 2017, SEC staff issued a no-action letter providing temporary relief from enforcement action under the Advisers Act to broker-dealers that provide research services that constitute investment advice to an investment manager that is subject, either directly or by contractual obligation, to MiFID II’s requirement to either to pay for research services from its own money, from an RPA, or from a combination of the two.³¹ The scope of relief provided by the no-action letter is limited however as the letter does not provide relief for broker-dealers that accept hard dollar payments from investment managers that adopt a hard

-
30. *Payment Optionality for Investment Research*, FIN. CONDUCT AUTH. (Apr. 2024), <https://www.fca.org.uk/publication/consultation/cp24-7.pdf> [hereinafter 2024 FCA Proposed Rule].
31. Securities Industry & Financial Markets Ass’n, SEC No-Action Letter (Oct. 26, 2017), <https://www.sec.gov/divisions/investment/noaction/2017/sifma-102617-202a.htm>.