Revisiting the SEC 28(e) Safe Harbor:

"A Long-Overdue Discussion"

Despite its critical role in shaping how investment managers navigate commission payments and research funding, Section 28(e) of the Exchange Act has not been widely revisited in recent years. With evolving market practices, regulatory shifts, and advancements in technology, I thought it would be worth taking a fresh look at the safe harbor—particularly for those who may not be familiar with its provisions. As firms continue to refine their approach to research funding and execution costs, understanding the nuances of eligible services, cross-subsidization, and compliance expectations under Section 28(e) remains as relevant as ever.

The following provides a basic high-level overview, highlighting key points for reference and is intended as a general guide and should not be considered all-encompassing." For a more comprehensive understanding of the SEC 28(e) Safe harbor please refer to - https://www.sec.gov/files/rules/interp/2006/34-54165.pdf

Overview of SEC 28(e):

Section 28(e) of the Exchange Act provides a **safe harbor** for investment managers, allowing them to pay higher commissions to broker-dealers without breaching fiduciary duties—**as long as** they make a good faith determination that the commissions paid are reasonable for the brokerage and research services received.

Unlike other Exchange Act provisions, **the SEC cannot create formal rules** for the 28(e) safe harbor. Instead, they issue guidance through interpretive releases, focusing on what qualifies as "**research**" and "**brokerage**" services.

Eligible Research Under Section 28(e)

To qualify as **research** under the current interpretation of Section 28(e), a product or service must meet **three criteria**:

1. Product or services must constitute **advice, analyses, or reports.**
2. Product or service must also satisfy the subject matter requirement by providing guidance on securities and financial markets by offering:
    - Investment advice through publications or writings on securities valuation, trading decisions, and market availability.
    - Analyses and reports on issuers, industries, economic trends, portfolio strategy, and account performance.
3. Product or service must demonstrate **reasoning or knowledge** in its content.

Examples of Eligible Research:

- *Market data (e.g., stock quotes, economic statistics).*
- *Securities analysis (e.g., reports on companies, industries, or market trends).*
- *Portfolio strategy advice (e.g., asset allocation models).*
- *Trade analytics (e.g., pre-trade and post-trade analysis).*
- *Quantitative models (e.g., risk assessment tools).*
- *Corporate Access Services (e.g., non-deal roadshows with C-Suite of publicly traded companies).*

Examples of Ineligible Research:

- *Accounting fees and software*
- *Computer hardware that delivers research*
- *Utilities*
- *Office furniture and business supplies*
- *Mass marketing publications*
- *Rent*

Compliance Consideration:

Cross Subsidization under 28(e) occurs when commissions paid by one set of clients are used to fund research that benefits other clients. While this practice is not explicitly prohibited, investment advisers must disclose it properly to ensure transparency and fairness. The SEC emphasizes that firms should document how research costs are allocated and ensure that commission payments align with fiduciary responsibilities.

Eligible Brokerage under Section 28(e)

The **SEC's current interpretation** defines brokerage eligibility using the term **"Temporal Standard."** Brokerage begins when a **money manager transmits an order** to a broker-dealer and ends when **funds or securities are delivered** to the advised account or its agent.

Additionally, **brokerage services** may include **connectivity tools** and **trading software** (e.g., T1 lines) when used for order transmission.

Examples of Eligible Brokerage:

- *Trading software used to route orders to market centers*
- *Message services used to transmit orders to broker-dealers*
- *Post-trade matching of trade information*
- *Software that provides algorithmic trading strategies*
- *Dedicated lines between the broker-dealer and the money manager's OMS*
- *Electronic communication of allocation instructions between money managers and broker-dealers*

Examples of Ineligible Brokerage:

- *Telephones*
- *Custodial record keeping*
- *Long term custody*
- *Stress-testing a portfolio under a variety of market conditions or to monitor shift style*
- *Error correction trades or related services in connection with errors made by money manager*
- *Trade financing (e.g. stock lending feeds) and capital introduction and margin services*

Glad to discuss any of this in greater detail should anyone have interest.

John McGough

Business Development Consultant – Castine LLC

john@castinellc.com