Via e-mail: securitiesregs-comments@sec.state.ma.us

July 26, 2019

The Honorable William Francis Galvin
Office of the Secretary of the Commonwealth
Attn: Proposed Regulations – Fiduciary Conduct Standard
Massachusetts Securities Division
One Ashburton Place, Room 1701
Boston, MA 02108

Dear Secretary Galvin:

The Securities Industry and Financial Markets Association (SIFMA)[1] is a national trade association which brings together the shared interests of more than 340 broker-dealers, investment banks and asset managers, many of whom have a strong presence in Massachusetts. Our industry has almost 18,000 registered representatives in the State and 475 broker-dealer branch offices. We are also proud that, in 2018 alone, our industry managed more than $587 billion in assets for Massachusetts residents and institutional clients and raised over $18 billion for Massachusetts municipalities and businesses.

We appreciate the opportunity to comment on the Massachusetts Securities Division's (the "Division's") proposed regulation ("Proposal") "to apply a fiduciary conduct standard on broker-dealers, agents, investment advisers, and investment adviser representatives when dealing with their customers and clients." We are concerned that the proposal, while well intentioned, will limit both the choices available to consumers and their access to one-on-one assistance.

Saving for retirement, for college education, or even for an unforeseen change in circumstance is important. The international research group, CIRANO, recently updated a study of Canadian households on the value of working with a financial professional. This Study found that, among comparable households, those that used a financial professional gained 69% more value for their investment assets after four years than their unassisted counterparts. After 15 years or more, the additional value climbed to 290%, or 3.9 times the value of those who didn't use a financial professional.[2] Limiting access to critical financial education, advice and guidance has a substantial negative impact on consumers.

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. For more information, visit www.sifma.org.

[2] Study, *The Gamma Factor and the Value of Financial Advice*, available at: https://www.cirano.qc.ca/files/publications/2016s-35.pdf.

We believe that this Proposal limits access by imposing additional fiduciary requirements that will result in further constriction of the brokerage model. Consumers will be adversely affected by the limitations placed on programs available to them, the pricing of those programs, and the investment products available – which could include losing access to personal, one-on-one assistance. Substantial inconsistencies between the federal standard and the proposed Massachusetts rule will also create confusion for consumers and financial professionals and come with significant operational and compliance costs.

We have seen these negative consequences before. When the Department of Labor ("DOL") proposed its change to the definition of fiduciary, we saw many negative impacts when the firms started working towards implementation to comply with the Rule. These are some of the changes we saw happen:

- Firms directing millions of clients, who had always been able to discuss ideas with a real person, to an internet or a call center option where they would receive execution only services, with no human interaction. Note that this is contrary to the way 75% of IRA investors prepare for retirement.[3]
- Firms narrowing the platform of investment products available to retirement investors. Multiple firms announced such changes to their overall fund line-up, which limited options for investors in retirement accounts.[4]
- Firms making index funds unavailable because selling them causes non-level compensation of advisors.[5]

These negative and unintended impacts on investors were a direct result of the burdensome requirements placed on firms and advisers, despite the DOL's best intentions to impose a heightened standard of care.

Similarly, if this Proposal is enacted, it is likely that many consumers will lose all contact with an investment professional. A report by CoreData Research during the implementation time of the Department of Labor's rule found that 71% of advisors made plans to "disengage" from a segment of investors in response to the Rule and concerns that advice will be too costly.[6] The Massachusetts

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[3] *See* "SIFMA Survey," SIFMA letter re: RIN 1210-AB79; Proposed Delay and Reconsideration of DOL Regulation Redefining the Term "Fiduciary." Pg. 12. Available at: https://www.sifma.org/wp-content/uploads/2017/05/SIFMA-Comment-Letter-RIN1210-AB79-w-Appendix.pdf. *See also* ICI Research Perspective, March 2019, Vol. 25, No. 1 (demonstrating that if Massachusetts limits the brokerage industry to only no-fee investments, 60% of the mutual fund market would be immediately eliminated). Available at: https://www.ici.org/pdf/per25-01.pdf.

[4] Deloitte White Paper, "The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors." *See* pp. 9, 14, 15, 23. Available at: https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf.

[5] Deloitte White Paper, "The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors." *See* pp. 16, 24. Available at: https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf.

[6] *See* "Access to Services, Products and Retirement Savings Information," SIFMA letter re: RIN 1210-AB79; Proposed Delay and Reconsideration of DOL Regulation Redefining the Term "Fiduciary." Pg. 6. Available at: https://www.sifma.org/wp-content/uploads/2017/05/SIFMA-Comment-Letter-RIN1210-AB79-w-Appendix.pdf.

proposal, particularly with its ongoing fiduciary duty obligation and its requirement that a recommended security or account type be "the best of the reasonably available options," would likely result in comparable outcomes. Moreover, as discussed in greater detail below, the Proposal and its "without regard to" language could be materially disruptive to the Massachusetts municipal and other bond issuance process.

These potential negative consequences can be avoided. On June 5, 2019, the SEC adopted Regulation Best Interest ("Reg BI"), which creates a new, nationwide, heightened standard of conduct for broker-dealers.[7] Under Reg BI, a broker-dealer making a personalized recommendation to a retail customer must act in the client's best interest. This new standard has the benefit of raising the standard of care received by investors while avoiding the negative consequences of an overly broad rule. In remarks introducing the final rule, SEC Chairman Jay Clayton recognized both the importance of a heightened standard and the value of the brokerage model, noting that a single standard of conduct for financial professionals would be a "loss for our Main Street investors" as it "likely would reduce investor choice and access to products and services and increase costs.[8]"

Reg BI has a June 30, 2020 implementation date. We would encourage Massachusetts to allow Reg BI to be fully implemented before moving forward with a state-specific fiduciary rule. We believe that, once Reg BI is fully operational and the SEC, FINRA and state regulators begin examining for compliance, the Division will find that Massachusetts investors are receiving substantial additional protections while continuing to have access to the numerous choices and opportunities they have today.

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[7] 17 C.F.R. Part 240 (2019). Available here: https://www.sec.gov/rules/final/2019/34-86031.pdf.

[8] Chairman Jay Clayton, Statement at the Open Meeting on Commission Actions to Enhance and Clarify the Obligations Financial Professionals Owe to our Main Street Investors (June 5, 2019). Available here: https://www.sec.gov/news/public-statement/statement-clayton-060519-iabd.

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I. Regulation Best Interest creates a new standard to protect Massachusetts consumers.

On June 5, 2019, the SEC passed Reg BI, creating a new nationwide, heightened standard of conduct for broker-dealers ("BDs") and their representatives when dealing with their retail customers.[9] Under Reg BI, a BD making a personalized recommendation to a retail customer in a brokerage account involving a securities transaction or an investment strategy must act in the client's best interest, without placing its financial or other interest ahead of the client's interest. This best interest obligation requires a BD to, among other things: (1) disclose all material facts about the scope and terms of the relationship and all material facts relating to conflicts of interest; (2) exercise diligence, care and skill, including understanding the risks, rewards and costs associated with a recommendation; and (3) mitigate or eliminate conflicts of interest associated with the recommendation.

Reg BI substantially raises the bar from the existing FINRA suitability standard and adds meaningful new investor protections. Some of the key changes are highlighted below:

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[9] A retail customer is defined on page 768 as "a natural person, or the legal representative of such natural person, who: (i) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer or a natural person who is an associated person of a broker or dealer; and (ii) uses the recommendation primarily for personal, family or household expenses." https://www.sec.gov/rules/final/2019/34-86031.pdf.

- *Duty of loyalty – conduct standard:* Reg BI establishes an explicit requirement that recommendations must be ***in*** the customer's "best interest," and not just suitable.[10] And, the BD cannot place its interest ahead of the interest of the customer.

- *Duty of loyalty – account types and transfers:* Reg BI extends to recommendations about account types and account transfers (e.g., IRA rollovers, etc.).

- *Duty of loyalty – implicit hold recommendations:* If a BD agrees to account monitoring, then Reg BI applies to *implicit* recommendations to *hold*.

- *Duty of care – skill:* BDs must exercise reasonable "diligence, care and skill" in making recommendations. This raises the bar by holding a BD accountable for failures of knowledge or skill.

- *Duty of care – cost:* BDs must explicitly consider the cost of a security or strategy as a factor in determining whether to recommend such security or strategy.

- *Duty of care – reasonably available alternatives:* BDs must consider "reasonably available alternatives" as part of having a "reasonable basis to believe" that the recommendation is in the best interest of the customer.

- *Duty of care – quantitative suitability:* Under Reg BI, the quantitative suitability requirement applies regardless of whether the BD has actual or de facto control over the customer's account.

- *Disclosures:* BDs must make full and fair disclosure under the Disclosure Obligation. The suitability standard has no specific disclosure requirements.

- *Disclosure alone not enough:* Reg BI cannot be satisfied by disclosure *alone*. BDs must also have policies and procedures to disclose and mitigate (e.g., limited product menu, proprietary products only, etc.), or eliminate (e.g., representatives should not be incentivized to act against a client's interest) certain conflicts.

- *Scienter:* Scienter (intent or knowledge of wrongdoing) is not required to establish a violation of Reg BI. In contrast, scienter is required to establish a violation of the current suitability obligation under the antifraud provisions of the federal securities laws.

Firms will be making substantial changes over the next year to put this new rule in place, likely with additional SEC guidance and interpretation. We strongly encourage Massachusetts to wait to assess Reg BI until it is fully operational before considering layering on state-specific fiduciary requirements that could add little to no additional investor protection at great cost to consumers and to the industry.

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[10] Under the suitability rule, BDs are not explicitly required to make recommendations that are *in* a customer's best interest. *Compare with* FINRA Regulatory Notice 12-25 (recommendations should be *consistent with* the customer's best interest).

II. Ongoing monitoring is inconsistent with the brokerage model and will likely limit consumer choice.

The Proposal imposes a broad and ongoing fiduciary duty obligation on broker-dealers and their agents. This expansion is inconsistent with federal securities laws and will likely limit consumer choice.

First, the Proposal distinguishes between a "standalone recommendation"[11] and an "ongoing recommendation."[12] The terminology is important. A representative who makes a standalone recommendation is subject to a fiduciary standard only at the point in time when a recommendation is made. A representative who "makes ongoing recommendations" is subject to an ongoing fiduciary duty. Neither "standalone" or "ongoing" is, however, defined. While we do not believe this was the intention, the language could be read as imposing a point in time duty for a single broker-client transaction but requiring an ongoing duty if the broker has recommended more than one investment product over a period of time.

Second, the Proposal imposes an ongoing fiduciary duty if a broker-dealer, agent or adviser "provides investment advice, in any capacity, to a customer or client." While we think this language is intended to impose an ongoing fiduciary duty in a brokerage account in situations where a dual registrant acts as both an IA and a BD to the same customer, that is not what a literal interpretation of the language suggests. Depending how the phrase "investment advice," as used in the Proposal, is interpreted, every brokerage transaction could be subject to an ongoing fiduciary duty. Yet, even if the rule text was narrowed, it would remain problematic. As a practical matter, this requirement would impose on dually registered BDs a new duty to monitor the ongoing performance of a customer's brokerage account in cases where the customer also maintains an investment advisory account.

Third, the Proposal imposes an ongoing fiduciary duty if a broker-dealer, agent or adviser "receives ongoing compensation in connection with the recommendation or advice."[13] Many common investment products, such as mutual funds, have such "ongoing compensation." An ongoing duty to monitor such products will likely result in limiting or eliminating those products' availability in brokerage accounts or shifting clients from brokerage to fee-based advisory services.

Under Reg BI, the duration of a BD's best interest obligation is generally limited to the point in time when a recommendation is made. There is no ongoing obligation to monitor brokerage accounts.[14] We believe this is the right outcome. Brokerage accounts represent an important, cost-conscious choice for consumers and provide access to affordable advice, particularly for small, buy-and-hold investors. BDs generally do not have supervisory systems or procedures – or a

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[11] Proposed 950 CMR 12.207(b)(1)(i).

[12] Proposed 950 CMR 12.207(b)(1)(ii).

[13] Proposed 950 CMR 12.207(b)(ii).

[14] Reg BI does make clear that if a BD voluntarily monitors an account, then Reg BI would apply to explicit recommendations to hold. If a BD engages in agreed-upon account monitoring, then Reg BI applies to both explicit and implicit recommendations to hold. SEC Release No. 34-86031; File No. S7-07-18, RIN 3235-AM35 ("Adopting Release"), pp. 101 – 106. Available here: https://www.sec.gov/rules/final/2019/34-86031.pdf.

compensation structure – in place to provide continuous and ongoing monitoring of securities purchased, sold, or held due to recommendations made in their BD accounts. If ongoing monitoring is required, some BDs would likely limit brokerage services to call center based execution and platforms and recommend that clients seeking more guidance move to advisory accounts, which typically have higher account minimums and charge higher fees. These outcomes would be a major disservice to the hundreds of thousands of Massachusetts consumers who choose to hold BD accounts today and who want to continue to receive episodic brokerage advice through a transactionally based compensation model or platform.

Moreover, as the SEC explained in its recent interpretive guidance, providing continuous monitoring in a brokerage account would not be consistent with the "solely incidental" prong of the BD exclusion from the definition of investment adviser, and thus would subject the BD to the Advisers Act.[15] BDs would therefore be required to either recommend that their brokerage clients move to fee-based advisory accounts if appropriate or move those accounts to internet or "call center based" execution only platforms. This was the consequence that was seen when the DOL moved forward with its fiduciary rule.[16]

The ongoing fiduciary duty provision is also problematic because in many cases it would apply to BD accounts where the BD does not make any recommendations (e.g., an unsolicited transaction or a self-directed account). In these instances, the BD has not engaged in any conduct that should be subject to a fiduciary duty at all, much less an ongoing fiduciary duty.

Thousands of middle-income consumers in Massachusetts make occasional purchases of mutual funds with the assistance of a BD and hold them in their BD accounts. Many of these consumers do not need, nor are they willing or able to pay for, a more extensive fiduciary relationship. The proposed overbroad fiduciary duty, however, would cause some BDs to consider limiting such brokerage services to Massachusetts clients, thereby requiring many investors of modest means either to purchase such additional services or forego any services. In this regard, the Proposal undermines investor choice of and access to the level of services that they want and currently enjoy, subject to an acceptable compensation structure.

Accordingly, we recommend that the Proposal conform the duration of the duty to be consistent with Reg BI, which provides that a BD's best interest obligation applies at the point of transaction unless a BD voluntarily monitors an account or engages in agreed-upon monitoring. We also recommend that an explicit exemption from the fiduciary duty be added for unsolicited transactions and self-directed accounts (even where the customer maintains both investment advisory and self-directed accounts), and to BDs that do not make securities recommendations to retail customers at all (e.g., clearing firms, etc.).

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[15] SEC Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, Release No. IA-5249 (June 5, 2019), at p.21, available at: https://www.sec.gov/rules/interp/2019/ia-5249.pdf.

[16] 53% of brokerage firms surveyed by Deloitte had begun either recommending or requiring clients to move to fee-based advisory accounts. Two-thirds of participants began limiting access to non-fee-based services. Deloitte anticipated even more firms doing so as they moved forward with their implementation of the DOL's fiduciary standard. *See* Deloitte White Paper, "The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors." Pp. 5 – 13 and 27. Available at: https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf.

III. A "Best of" standard is impossible to satisfy.

The Proposal requires that a recommended security or account type must be "the best of the reasonably available options" and that any transaction-based fee received by the BD must be both "reasonable"[17] and "the best of the reasonably available fee options…."[18] No such "best of" standard exists under current federal securities laws, nor are we aware of any other fiduciary law that imposes a similar standard. In fact, federal agencies and securities regulators have generally accepted the fact that it is not possible to definitively identify a single "best" option without the benefit of hindsight, essentially rendering the standard unattainable and impossible to satisfy.[19]

Specifically, the "best of" standard is deficient and unworkable in the following respects:

- *Securities* – The Proposal fails to recognize that there is no such thing as the "best" security in most cases. Is it the security with the lowest cost, the highest return, the lowest risk, the most liquid, the most market makers, the most research analysts covering it, or some combination thereof? And, how does one account for the customer's preference, as set forth in the customer account profile? This standard is unworkable and would invite "20-20 hindsight analysis" that would inevitably identify a different security that has performed better (using whatever criteria is selected, often after the fact) over time.[20]
    - The Proposal also fails to define what securities are "reasonably available." Is it limited to the universe of securities offered by the firm, or is it limited to the perhaps even more limited universe of securities in which the registered representative regularly transacts business (e.g., bonds, proprietary products, etc.)? Or is it the universe of all possible securities that *could* be offered by a firm even if it chooses not to? If it is not so limited, then what specifically is the obligation of the BD or IA to recommend from among "reasonably available options"? (e.g., Does "reasonably available" include every publicly offered option? Every U.S. based option? Every option with sufficient liquidity? Every option with no up-front sales charges, or below a certain fee level?)

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[17] FINRA rules already require that BD commissions and fees be fair and reasonable. *See* FINRA Rules 2100 et seq. Accordingly, we recommend that the Proposal adopt the definition and interpretation of "reasonableness" as set forth under FINRA rules and associated guidance.

[18] Proposed 950 CMR 12:207(c)(2) and (3).

[19] Both the SEC and FINRA have long recognized that there is no single "best" security recommendation, which is a core tenet of modern portfolio theory. *See, e.g., SEC Beginner's Guide to Asset Allocation, Diversification and Rebalancing*, available at https://www.sec.gov/reportspubs/investor-publications/investorpubsassetallocationhtm.html. *See also FINRA's Diversifying Your Portfolio*, available at http://www.finra.org/investors/diversifying-your-portfolio. Even the DOL conceded as much in connection with its now vacated fiduciary rule. *See* Preamble to the BIC Exemption, 81 Fed. Reg. at 21,029 ("… the [DOL] also confirms that the Best Interest standard does not impose an unattainable obligation on Advisers and Financial Institutions to somehow identify the single 'best' investment for the Retirement Investor out of all the investments in the national or international marketplace, assuming such advice were even possible."), available at https://www.federalregister.gov/documents/2016/04/08/2016-07925/best-interest-contract-exemption.

[20] Even the DOL fiduciary rule stated that "an Adviser and Financial Institution do not have to recommend the transaction that is the lowest cost or that generates the lowest fees without regard to other relevant factors." 81 FR 21,030 (April 8, 2016).

- *Account types* – By imposing a "best of" standard on account types, the Proposal again invites a "20-20 hindsight" review of existing BD and IA accounts to assure they remain the "best" account type.[21] What does "best" account type even mean when comparing brokerage to investment advisory? Is it based on the range of services or products and cost structures available in different account types? What, if anything, does the term "reasonably available" require of firms that only offer a single account type? If a customer moves from one account to another, does that suggest that the initial account was not best for the client, thereby triggering a potential fiduciary duty violation?

- *Transaction-based fees* – Similar to the account-type provision, the Proposal fails to specify how to determine that transaction-based fees are the "best" or even what other fee options – other than fee-based accounts – are "reasonably available."

  - Does this provision impose a duty to analyze each transaction to compare the fees of that transaction versus what a client could have been paying in an alternate fee arrangement at the firm? If so, BDs would have to supervise potentially millions of trades on a trade-by-trade basis to determine whether the commission was actually "best." That is clearly an unreasonable supervisory burden.

  - What if someone trades significantly more or less than expected, thereby changing their fee calculus over time? What if certain share classes with different fee amounts are only available for purchase in certain account types?

  - Does "reasonably available" mean that a firm must match the discounts offered by every competitor?

  - Can a BD discount a transaction for one customer and not another customer for the same security, but have that discounting decision be based on relationship pricing? Is Massachusetts banning the use of discounting commissions? If not, how exactly can a BD meet the duty of loyalty regarding discounting?

For the foregoing reasons, the Proposal should eliminate the vague, unreasonable and unworkable "best of" standard for account types, securities, and transaction-based compensation.

IV. The duty of loyalty provision needs to be made consistent with the new federal standard under Reg BI.

a. "Avoid Conflicts" and "Without regard to" language. The Proposal's duty of loyalty "requires a broker-dealer, agent or adviser to avoid conflicts of interest . . . ." This requirement is not limited in any manner and the term "avoid" is not defined.

[21] Moreover, the language of the rule is so broad (i.e., "the opening of or transferring of assets to a specific type of account") that it would apply to more than just recommendations about commission and fee-based accounts; it would presumably require, for example, that if a BD recommended a retirement account, then it would need to be "the best" account type (as among traditional, Roth, etc.).

The Proposal's duty of loyalty also requires that BDs, agents and advisers "make recommendations and provide investment advice without regard to the financial or any other interest of the [BD, IA or agent] …."[22] Notably, in Reg BI, the SEC replaced the "without regard to" language with the phrase "without placing the financial or other interest … ahead of the interest of the retail customer."[23] The SEC did so out of concern that the "without regard to" language could be inappropriately construed to require a BD to eliminate *all* of its conflicts (which is impossible) and because the SEC believed that its own formulation appropriately reflects the underlying intent of the "without regard to" formulation.

We believe the SEC formulation accomplishes the same purpose as the Division's "avoid conflicts" and "without regard to" formulation but does so with greater clarity and less confusion about the expectations associated with the obligation. For these reasons, we recommend that the Proposal strike the "avoid conflicts" and "without regard to" terminology and replace them with the SEC's formulation.

b. Principal transactions, affiliated & proprietary products, and limited range of products. Neither the preamble nor the text of the Proposal makes any reference to certain common brokerage activities, including recommendations of principal transactions, affiliated or proprietary products, or making a recommendation based on a limited range of products. Both Congress in the Dodd-Frank Act[24] and the SEC in Reg BI,[25] however, explicitly call-out these categories of recommendations as ones that may well be consistent with a fiduciary and/or best interest standard, respectively.

Given the Proposal's "avoid conflicts" and "without regard to" clauses and its disallowance of disclosure to satisfy the duty of loyalty, the Proposal's failure to address these specific types of recommendations raises concerns and creates uncertainty about whether these types of recommendations would breach the Proposal's fiduciary duty. Yet, these types of transactions are not only critical to the operation of our securities markets but also represent a clear benefit to retail investors.

For example, in a principal transaction, the broker-dealer, acting for its own account, buys a security from, or sells a security to, the account of a client. (This contrasts to an agency transaction where a BD arranges a transaction between different clients.) In addition, principal transactions are deemed to occur when a BD acts as an underwriter, alone or as part of a syndicate of underwriters, for the issuance of new securities, such as equities (e.g., equity initial public offerings) or fixed income (e.g., municipal bonds, corporate bonds), and sells those new issue securities to the clients of the broker dealer (or an affiliate).

Principal transactions such as these could violate the proposed fiduciary standard. A broker must "avoid conflicts of interest" and act "without regard to the financial or any other interest of the broker-dealer." When a broker-dealer is both buying for its account and then selling the same

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[22] Proposed 950 CMR 12.207(c)(2).

[23] 83 FR 21586; Adopting Release at pp. 62 – 67. Available at: https://www.sec.gov/rules/final/2019/34-86031.pdf.

[24] Dodd-Frank Act, § 913, available at https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

[25] 83 FR 21586, 21609, and 21620; Adopting Release at pp. 175, 188 – 190.

security to its client, it would appear to be taking its own financial interest into account. Similarly, with respect to underwriting activities, if a broker-dealer is part of an underwriting syndicate, and earns a fee for that participation, and then recommends its retail clients purchase the same new issue that it helped to underwrite, then that would be potentially violative of the "without regard to" duty of loyalty.

Without further clarification, broker-dealers may need to withdraw from participating in new issue municipal bond offerings if they are not able to then recommend that their Massachusetts or other retail clients purchase those same municipal new issue bonds. This could be very disruptive to the Massachusetts municipal underwriting market if broker-dealers that both participate in the underwriting syndicate for the bonds and then sold those same bonds to its clients decided not to participate in the bidding process for municipal underwritings.

Moreover, if those municipal bonds were offered by another BD which was not part of the underwriting syndicate, and a Massachusetts client purchased those municipal bonds on an agency basis (i.e., not principal) in a secondary market transaction, we expect that the client may pay a higher cost than if they purchased the same bonds in the new issue offering. This is because the cost to the client in purchasing the bonds may now include, in addition to any underwriting discounts payable to the underwriting syndicate members, any mark-ups or commissions charged by other broker-dealers who have sourced the bonds from the underwriting syndicate members.

Thus, without further clarification from the Massachusetts Securities Division, we believe that this Proposal will be materially disruptive to the Massachusetts municipal and other bond issuance process and will result in higher costs to Massachusetts residents.

Accordingly, we recommend that the Proposal be amended, consistent with Reg BI, to explicitly acknowledge that: it does not prohibit recommendations of principal transactions, affiliated or proprietary products, or from among a limited range of products; that such recommendations do not presumptively breach the proposed fiduciary duty; and that the "best of" and "reasonably available" standards discussed above do not apply to such recommendations.

*c. Disclosure obligation***.** The Proposal's duty of loyalty also states that "disclosing a conflict of interest in and of itself …" does not presumptively satisfy the duty.[26] The essential purpose of disclosure under the federal securities laws is to facilitate meaningful and informed choice by retail investors. Effective disclosure allows a retail client to evaluate a proposed transaction with the benefit of all relevant and material information necessary to make a well-informed choice about whether to execute that particular transaction.

In general, an adviser registered under the Advisers Act may rely upon disclosure and the customer's consent to satisfy his or her fiduciary duty.[27] Similarly, under Reg BI, an associated person of a BD can satisfy his or her Disclosure Obligation by providing, prior to or at the time of a recommendation, in writing, full and fair disclosure of all *material*[28] facts relating to the scope and

[26] Proposed 950 CMR 12.207(c)(2)(ii).

[27] See *Amendments to Form ADV*, Advisers Act Rel. No. 2711 (Mar. 3, 2008).

[28] Adopting Release at pp. 199, 201 (as the term materiality is defined in the Supreme Court's *Basic v. Levinson* decision).

terms of the relationship, and all *material* facts relating to conflicts of interest associated with the recommendation.[29] Separately, under Reg BI, a BD firm has a Conflict of Interest Obligation to establish, maintain, and enforce written policies and procedures reasonably designed to identify and: (i) *disclose* all conflicts of interest associated with recommendations (in accordance with the Disclosure Obligation); (ii) *mitigate* conflicts that create an incentive for a BD's associated person to place the interest of the BD or associated person ahead of the interest of the customer; (iii) *disclose* any material limitations on securities or products that may be recommended (e.g., limited product menu, proprietary products only, etc.) and prevent such limitations from causing the BD to place its interest ahead of the customer; and (iv) *eliminate* sales contests, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.[30]

Consistent with current federal securities laws and Reg BI, the Proposal should: (i) strike the provision in 12.207(c)(2)(ii) that "[t]here shall not be a presumption that disclosing a conflict in and of itself shall satisfy the duty of loyalty"; (ii) clarify that disclosure obligations are limited to *material* conflicts of interest (as defined by the U.S. Supreme Court in *Basic v. Levinson*)[31] thereby making the Proposal consistent with Reg BI; and (iii) explicitly state that the disclosure obligation of an associated person of a BD is satisfied by fulfilling the Disclosure Obligation under Reg BI.

V. The duty of care needs to be made consistent with the new federal standard under Reg BI.

The Proposal's duty of care (like the duty of loyalty discussed above) requires a consideration of costs. It states that "a [BD] shall make a reasonable inquiry, including risks, ***costs***, and conflicts of interest related to the recommendation..." (emphasis added).[32] Likewise, Reg BI's Care Obligation explicitly requires that costs be considered. The SEC explained that costs are generally one of many important factors to consider when determining whether the recommendation is in the best interest of the customer. If choosing among "identical securities" available, it would be inconsistent to recommend the more expensive alternative for the customer. When choosing among reasonably available alternatives, the BD would need a reasonable basis to believe the higher cost was justified based on other factors (such as the product's investment objectives, characteristics, volatility, etc.).[33]

The Proposal, however, provides no such guidance on how to consider and address cost. As a result, it creates uncertainty about how to address this requirement. Under the Proposal, for example, must BDs recommend the lowest cost option without regard to other factors (which would probably not be in the customer's best interest), or inform the customer of its availability, or canvass all possible lowest cost options before making a recommendation, in order to satisfy the duty of care?

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[29] Adopting Release at pp. 130 – 195.

[30] Adopting Release at pp. 302 – 352.

[31] Basic, Inc. v. Levinson, 458 U.S. 224 (1988).

[32] Proposed 950 CMR 12.207(c)(1)(i).

[33] *See* 83 FR 21612; Adopting Release at p. 249.

Based on the foregoing, we recommend that the Proposal be amended to provide additional guidance on how to assess and balance cost considerations, consistent with the guidance set forth in Reg BI.

VI. The Proposal would accelerate the move from brokerage to fee-based accounts, significantly reducing the availability of brokerage services in the State.

The Proposal imposes on BDs, among other things, an onerous, ongoing, fiduciary duty under certain circumstances and an impermissibly vague "best of" standard for account types, securities, and transaction-based compensation, among numerous other issues and concerns.

The foregoing conditions would lead firms to: (i) recommend clients who want continued access to advice to consider switching from brokerage accounts to fee-based accounts; (ii) scale back brokerage services to execution only (i.e., do not provide brokerage advice or other brokerage services in the State); (iii) raise prices to cover the higher costs; and/or (iv) discontinue service to BD accounts in Massachusetts (i.e., terminate their relationship with the client). The Proposal may also create an incentive for BDs to limit what is available on their platforms in order to control what products or offerings are deemed "reasonably available," and facilitate comparison of securities and ultimately the selection of the "best" security. Notably, such an outcome would only further limit investor choice.

These are all potential outcomes that Reg BI is explicitly intended to *avoid*. BD accounts represent an important choice for retail investors – often the less expensive choice – and provide access to affordable advice, particularly for smaller, buy-and-hold investors. For that reason, the SEC recognizes that these types of accounts should be maintained and encouraged, not stamped out by problematic regulations.[34]

In addition, Massachusetts should carefully consider the negative impact of its Proposal on the offering and servicing of specialized BD accounts in Massachusetts, including 529 college savings plans, Coverdell education savings accounts, and UTMA/UGMA custodial accounts, which serve specific, beneficial purposes and may not be offered or available in fee-based advisory accounts.

Furthermore, while the Proposal provides an exemption for ERISA fiduciaries and providing investment advice to financial institutions or persons with at least $50 million, it does not exclude investment advice under the federal securities laws for an IA who is not acting as an ERISA fiduciary. Plan fiduciaries are responsible for evaluating the risks and performance of the investments and potential investments for their retirement plan.

Service providers and advisors assist plan fiduciaries by providing them with education and information about investment options that may meet their needs, which is not typically considered to be acting as an ERISA fiduciary. Under the Proposal, providing such education and information on security products may be considered to be providing investment advice. Based upon this potential legal risk, plan fiduciaries in Massachusetts under $50 million dollars may no longer receive such services, thereby unnecessarily curtailing the level of services that plan fiduciaries currently enjoy that assist them in determining which investment options best meet their plan's needs. This outcome could put plan fiduciaries under $50 million at a disadvantage in fulfilling their fiduciary responsibilities.

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[34] Adopting Release at pp. 6, 17, 21 – 23.

VII. The Proposal should be amended to expressly exempt variable annuities.

The Massachusetts Uniform Securities Act expressly excludes from the definition of security ". . . any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period."[35] Similarly, the Act exempts "[a]ny security issued by and representing an interest in or a debt of, or guaranteed by, any insurance company organized under the laws of any state and authorized to do business in this State."[36] In addition, variable annuities are already subject to extensive regulation by the SEC and FINRA. We respectfully urge the Division to include language in the Proposal that expressly excludes variable annuities from the Proposal's purview.

VIII. The Proposal should explicitly limit its application to retail investors who are legal residents of Massachusetts or who reside in Massachusetts.

Given the harmful consequences detailed above, it is important that firms have the ability to limit the application of the Proposal to retail customers who are legal residents of or who reside in Massachusetts. A BD or IA who has a place of business in Massachusetts should not owe the fiduciary duty imposed by the Proposal to all of their clients, regardless of whether those clients have any nexus to the State. Moreover, the State's fiduciary duties may be inconsistent with the duties owed to the client in their state of domicile. Accordingly, we recommend that the Proposal be revised to explicitly limit its application to retail investors who are legal residents of Massachusetts or who reside in the State.

IX. The Proposal should expand the scope of the employee benefit plan exclusion.

The exclusion in Section 12.207(e) should be expanded to include a person acting in a fiduciary capacity to an employee benefit plan, its participants or beneficiaries, whether or not the plan is subject to ERISA (thereby including governmental plans and non-electing church plans). For example, for over a decade, BDs have been acting as fiduciaries to participants in non-ERISA plans when providing in-plan investment allocation advice and have been managing any related conflicts, including in connection with proprietary investments, by relying on the guardrails set forth in the DOL Advisory Opinion 2001-09A (aka the "SunAmerica Opinion"). Those guardrails include getting authorization from a plan sponsor and sourcing the advice through an independent third-party expert.

We similarly believe that the exclusion should apply to individual retirement accounts (IRA) and other plans and accounts subject to Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code"). There is a risk that compliance with the Proposal's "fiduciary" standard of care may cause some to argue that the BD could also be considered a fiduciary for purposes of the prohibited transaction rules in Section 4975 of the Code. This would be an unintended consequence that could

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[35] MGL Chapter 110A, Section 401(k); Available at: https://malegislature.gov/Laws/GeneralLaws/PartI/TitleXV/Chapter110A/Section401.

[36] MGL Chapter 110A, Section 402(a)(5); Available at https://malegislature.gov/Laws/GeneralLaws/PartI/TitleXV/Chapter110A/Section402.

result in additional cost and confusion for retirement savers.[37] If BDs were to become fiduciaries under ERISA and the Code, then transactions would either need to comply with a prohibited transaction exemption or be prohibited entirely. Complying with the prohibited transaction exemptions would increase compliance burdens and costs to BDs, and in some cases, compliance may be so complex that the BD will decide not to offer a particular product or service. Many types of transactions, such as principal transactions with an affiliate, or purchase of IPOs or municipal securities where an affiliate participates in the offering would simply be prohibited, as no exemption would be available.

X. The Proposal raises pre-emption and other legal concerns.

We believe the Proposal has a variety of potential pre-emption issues. We will focus our comments on potential conflicts with the National Securities Markets Improvements Act ("NSMIA") but reserve the right to raise other legal and pre-emption issues if and when a formal proposal is issued.

As the Division well knows, Congress enacted NSMIA in 1996 to promote efficiency in the financial markets by eliminating the dual system of state and federal registration of securities and securities professionals.[38] With respect to RIAs specifically, NSMIA added section 203A(b)(1) to the Advisers Act which states:

> No law of any state or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser or supervised person of an investment adviser shall apply to any person (A) that is registered under section [203] as an investment adviser, or that is a supervised person of such person, except that a State may license, register or otherwise qualify an investment adviser representative that has a place of business located within that State; or (B) that is not registered under [Section 203] because that person is excepted from the definition of an investment adviser under section [202(a)(11)].[39]

In the Rules Implementing Amendments to the Advisers Act, the SEC explained that Section 203A(b)(1), as amended by NSMIA, preempts not only a state's specific registration, licensing, and qualification requirements, but also all regulatory requirements imposed by state law on RIAs relating to their advisory activities or services, except those provisions relating to enforcement of anti-fraud prohibitions.[40] We assume that the Division does not intend to apply the proposed rule to federally registered investment advisers but ask that it expressly state that is the case.

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[37] In 1975, the Department of Labor issued regulations that created a five-part test that must be satisfied in each instance before a person can be treated as a fiduciary adviser. We are not suggesting, nor do we believe, that compliance with the Massachusetts regulation by definition meets the five-part test.

[38] Pub. L. No. 104-290, 110 Stat. 3416 (1996).

[39] 15 U.S.C. §80b-3a(b)(1).

[40] Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA–1633, File No. S7–31–96, (May 22, 1997), available at https://www.govinfo.gov/content/pkg/FR-1997-05-22/pdf/97-13284.pdf ("On its face, section 203A(b)(2) preserves only a state's authority to investigate and bring enforcement actions under its antifraud laws with respect to Commission-registered advisers. The Coordination Act does not limit state enforcement of laws

NSMIA also precludes states from imposing new books and records requirements on broker-dealers and their representatives. Specifically, NSMIA added Section 15(i)(1) to the Exchange Act, which states: "No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish […]making and keeping records, […] that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act]." [41]

The Proposal imposes on BDs (and in many cases, IAs) the following new books and records requirements, among others, that differ from, or are in addition to, those imposed by federal law and/or FINRA rules:

- Ongoing fiduciary duty. Under the Proposal, BDs owe an ongoing fiduciary duty to the customer in the brokerage account. Under current FINRA rules and Reg BI, however, BD conduct standards apply only at the point of recommendation and not beyond. By subjecting BDs in certain instances to an ongoing fiduciary duty – and thus a new duty to monitor the performance of an account, the Proposal would require BDs to develop new supervisory systems and procedures and make and keep new records to document compliance with the new requirement.[42]

- The "best of" standard. The Proposal requires that a recommended security or account type must be "the best of the reasonably available options" and that any transaction-based fee received by the BD must be "the best of the reasonably available remuneration options…."[43] Under current federal securities laws, no such "best of" standard exists. BDs would need to develop new supervisory systems and procedures to address this new standard and make and keep new records to document compliance with it.[44]

- Duty of loyalty. The Proposal's duty of loyalty requires, among other things, that recommendations be made "without regard to the financial or any other interest of the [BD] …" and that disclosure of conflicts of interest does not presumptively satisfy the duty[45]. Again, these standards are new and different than those currently applicable under the federal securities laws. BDs would need to develop new supervisory systems and procedures to address these new standards and make and keep new records to document compliance with them.

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prohibiting fraud. Rather, states are denied the ability to reinstitute the system of overlapping and duplicative regulation of investment advisers that Congress sought to end." (text at fn.155-56)).

[41] 15 U.S.C. §78o(i)(1).

[42] Moreover, FINRA Rule 3110(B), available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11345, requires firms to establish, maintain, and enforce written procedures to supervise in accordance with applicable securities laws, including the Proposal, and that such written procedures would be in addition to and different from SEC and FINRA rules.

[43] Proposal at Section 12.207(c)(2)(i) and (c)(3)(ii).

[44] See FINRA Rule 3110(B) referenced in footnote 40 above.

[45] Proposed 950 CMR 12.207(c)(2).

NSMIA not only limits state regulations that *directly* impose new or different recordkeeping requirements, but also state regulations that by their nature require BDs to make and keep new or different records than those required by federal law and FINRA rules.[46] Thus, any state regulations that impose new or different standard of conduct requirements on BDs, including those enumerated above which would require new supervision obligations and compliance procedures, would in turn trigger new or different record-keeping obligations, which would in turn be subject to express federal preemption under NSMIA.

Although the Proposal states that "[n]othing in this section shall be construed to establish any requirements for … making and keeping of records … for any [BD] … that differ from, or are in addition to, the requirements of [NSMIA],"[47] this provision does not relieve the state of, or legally insulate it from, its obligation to avoid imposing, directly or indirectly, NSMIA-preempted books and records requirements. As currently drafted, the Proposal cannot be reconciled with NSMIA and therefore would be unlikely to survive a legal challenge on NSMIA grounds.

XI. Any Proposal should specify an appropriate future effective date and provide for a sufficient implementation period prior to such date.

We understand that this is a proposed solicitation and not a formal rulemaking. Should you decide to move forward, we would encourage you to allow for a sufficient implementation period.

Firms would need to develop significant new infrastructure and policies and procedures, which would be a complex and resource intensive undertaking, particularly considering the range of business models that would be subject to the proposed regulations. Firms would also need sufficient time to implement training programs and to build systems to comply with the prospective new regulations, including those necessary to create new books and records.

Alternatively, firms would also need sufficient time to identify whether and how to scale back all or a portion of their business activity in the State in order to comply with the new regulations.

Based on the foregoing, we recommend that Massachusetts provide an implementation period of at least 18 months, followed by an initial effective date thereafter (the "Effective Date").

Conclusion

We appreciate the opportunity to comment and your consideration of our views. We understand that this is a preliminary solicitation and that the Division will decide, after digesting all comments, whether to move forward with a formal rule proposal. We respectfully suggest that you delay any decision making until after Reg BI is fully implemented and regulators have examined for compliance.

By waiting, Massachusetts will have the benefit of seeing Reg BI operationalized. It can assess how entities changed their practices to comply with this heightened federal standard and the

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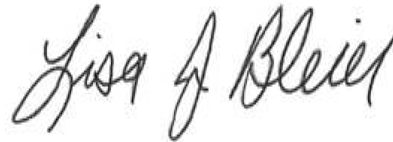
[46] *See* Exchange Act Rule 17(a)-4, requiring broker-dealers to keep a record of *"all communications … by the member … relating to its business as such…"* (emphasis added). 17 CFR §§ 240.17a-4(b)(4).

[47] Proposal at Section 12.207(f).

investor protection benefits it provided. It can also evaluate any negative results or unintended consequences of the federal rule and calculate whether an additional state rule and its potential protections is worth the possible cost. With DOL, those costs included fewer account choices, fewer financial professionals to speak to, limited product choices and relegation of retirement savers to the internet or call centers.

If you have any questions or require additional information, please feel free to contact me at 202-962-7329 or Kim Chamberlain at 202-962-7411.

Sincerely,



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