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Invested in America

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

January 6, 2020

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 350 large, medium and small broker-dealers, investment banks and asset managers comprising more than 75% of market share and 50% of assets under management (AUM). Our members serve millions of retail and institutional clients in every state, including Massachusetts. Virtually all of our members serving retail clients do so both as a broker-dealer (BD) under the Securities Exchange Act of 1934 ('34 Act) and as an investment adviser (IA) under the Investment Advisers Act of 1940 ('40 Act).

The U.S. securities industry plays an active and vital role in Massachusetts. The industry proudly employs 45,000 people in the state and is responsible for another 52,000 jobs.[2] In 2019, it underwrote more than $40 billion in municipal and corporate bonds and $13.25 billion in equity offerings - including $1.78 billion in initial public offerings.[3] The industry also managed well more than $580 billion in assets[4] for state residents and institutional clients and helped residents save for college through a state-run 529 plan.

We appreciate the opportunity to further comment on the Massachusetts Securities Division's (the "Division's") Proposed Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives ("Proposal") dated December 13, 2019. As you

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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] According to the U.S. Department of Labor Bureau of Economic Analysis Input-Output Modeling System (RIMS II), each job in the securities industry in Massachusetts translates to 2.17 jobs statewide.

[3] Refinitiv (2019).

[4] Discovery Data (2019). This is a conservative estimate based on voluntarily reported information with only 28% of advisers reporting.

know, SIFMA submitted comments[5] in July of 2019 on the Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives ("Preliminary Proposal").[6] The Proposal unfortunately does not remedy many of the concerns we and other commenters previously raised. We respectfully reiterate our interest in meeting with the Division to more fully discuss our concerns before you make the decision to finalize a state-specific fiduciary rule.

Brokerage services represent an important, cost-conscious choice for consumers and provide access to affordable advice, particularly for buy-and-hold investors and investors with moderate resources. There are many benefits to the public from having access to full-service brokerage services, for example zero commission trading that some firms have implemented, and the goal should be to continue to allow the public this access.

SIFMA has supported the creation of a federal heightened conduct standard for BDs and their representatives when providing investment advice to consumers for over a decade. In our view, the debate was not about whether to raise investor protection but how to do so in a way that didn't limit client access or choice.

As you well know, in June of 2019, the Securities and Exchange Commission ("SEC") adopted Regulation Best Interest ("Reg BI"). Reg BI creates a new, nationwide, heightened standard of conduct for BDs and their representatives. Reg BI substantially raises the bar from existing FINRA suitability standards and adds meaningful new investor protections. It provides significant and material changes to the way brokerage services will be provided and impacts nearly every aspect of a BD's operations. We have heard from our members that implementation of Reg BI is at the forefront of their efforts and that significant resources – both in terms of personnel and dollars – are being deployed to meet the SEC compliance deadline. For example, while we at SIFMA have not yet quantified this effort, one firm told us that they have "several hundred" people working on Reg BI. Another has, since September, spent 3280 manhours per week on compliance. A third, smaller firm, has devoted roughly 5300 hours to date on the issue.

In the Request for Comment, the Division expressed concern that Reg BI does not create a single uniform standard for BDs and investment advisers ("IAs").[7] While Section 913 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[8] permitted the SEC to establish a uniform standard, it did not require the SEC to do so. After years of debate, careful study and analysis, the Commission chose not to adopt a uniform rule, concluding that "a more tailored approach will better serve our retail investors and our markets."[9]

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[5] SIFMA comment letter dated July 26, 2019, available at: https://www.sifma.org/resources/submissions/ma-fiduciary-proposal/. SIFMA also joined with eleven other financial services trade associations in a letter, which can be found here: https://www.sifma.org/resources/submissions/joint-trades-on-ma-fiduciary-prop.

[6] Preliminary solicitation of public comments: Fiduciary conduct standard for broker-dealers, agents, investment advisers, and investment adviser representatives, June 14, 2019. Available at: http://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/fiduciaryconductstandardidx.htm.

[7] The Commonwealth of Massachusetts, Request for Comment, December 13, 2019 at page 2. Available at: https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

[8] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, Section 913.

[9] The regulation itself, first published for comment in April of 2018, incorporated input from seven investor roundtables, more than 200 meetings, and over 3000 unique comment letters from individual investors, consumer advocacy groups, financial services professionals, state regulators and others.

This more tailored approach substantially enhances investor protection while also protecting investor choice and access to products and services. In his comments introducing the final rule, Chairman Jay Clayton recognized the value of both BDs and IAs in helping retail investors reach their financial goals. He noted that BDs and IAs offer different types of relationships, services and fee models. He further stated that a "one size fits all" approach would likely reduce investor choice and increase costs, which "would be a loss for our Main Street investors."[10]

We fully recognize the time and effort that the Division has put into developing the formal rule proposal. While there are some helpful changes, we regrettably remain concerned that the proposal will limit the investment options and products available to consumers and their access to critical financial education, one-on-one advice and guidance, resulting in consumers' insufficient preparedness to meet their short- and long-term financial needs. In addition, substantial inconsistencies between the federal standard and the Proposal will create tremendous confusion both for consumers and financial professionals and will result in significant operational and compliance costs, which could result in a reduction in services to those consumer most in need of financial guidance and advice.

As detailed in our July letter, we saw many of these negative impacts when firms started working to implement the now vacated Department of Labor ("DOL") fiduciary rule. These included:

- Millions of clients, who had been able to discuss ideas with a real person, being left with only internet or call center options where they would receive execution-only services.[11]

- Retirement investors having access to narrowed platforms of investment products,[12] which excluded common investment options such as index funds.[13]

- Firms making plans to "disengage" from some retirement investors in response to the Rule and concerns that advice would be too costly.[14]

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[10] 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.

[11] *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.

[12] 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.

[13] 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.

[14] *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.

To avoid a similar outcome, we strongly encourage you to allow Reg BI to be fully implemented before moving forward with the Proposal. Once Reg BI is fully operational and the SEC, FINRA, and your Division begin examining firms for compliance, we are confident you will find that Massachusetts investors are receiving substantial additional protections from Reg BI while continuing to have access to the numerous choices of investments and services that they have today. If the Division decided to move forward at that stage, it would have a better sense of what gaps, if any, needed to be filled and how to do so without unnecessarily limiting investor access and choice.

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I. Massachusetts should wait for Reg BI to be fully implemented and enforced.

More than six months have passed since the SEC unveiled a new nationwide, heightened standard of conduct for BDs and their representatives when dealing with retail customers.[15] As you well know, under Reg BI, a BD making a 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; (3) where disclosure is insufficient, mitigate or in certain instances eliminate the conflict; and (4) establish robust policies and procedures to achieve compliance with Reg BI in its entirety.

The Division "believes that Reg BI fails to provide investors the protection they need from harmful conflicts of interest."[16] We respectfully but strongly disagree. These requirements are substantial and meaningful. Reg BI impacts nearly every aspect of a broker-dealer's operations, including business and product strategy, legal, compliance, HR, marketing, technology, management, operations, finance, and risk. SIFMA member firms are working full-time to understand the impact of the rule package, including how to comply with the Care Obligation, address conflicts of interest, and how to implement the required disclosures throughout the customer life cycle.

SIFMA has been assisting firms in this massive effort. Among other things, we have:

- Helped educate the industry on the rule's requirements;
- Submitted seventeen interpretive questions to the SEC's dedicated Implementation Committee thus far for clarification;
- Developed with Deloitte an 86-page, principles-based implementation guide[17] with recommendations for developing a Reg BI governance program;
- Held regular calls to discuss operational and implementation issues; and
- Organized an upcoming forum to provide attendees with an overview of the implementation considerations and various products, tools and services available to assist in this effort.

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[15] *See* Reg BI Adopting Release at p. 768, which defines retail customer 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." Available at: https://www.sec.gov/rules/final/2019/34-86031.pdf.

[16] The Commonwealth of Massachusetts, Request for Comment, December 13, 2019 at page 3. Available at: https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

[17] SIFMA, "A Firm's Guide to the Implementation of Regulation Best Interest and the Form CRS Relationship Summary," September 27, 2019. Available at: https://www.sifma.org/wp-content/uploads/2019/09/SIFMA-Reg-BI-Program-Implementation-Guide.pdf.

While we acknowledge the State's authority to promulgate regulations designed to protect investors, we respectfully suggest that the Division will not be in a position to fully assess Reg BI's positive impact on investor protection and the relationship between financial professionals and their clients until after Reg BI is fully operational and the SEC, FINRA and the Division begin examining for compliance. We encourage you to delay further state action until after Reg BI has been in place for at least 18 months and there is a better sense of what gaps, if any, need to be filled.

II. Massachusetts' ongoing fiduciary duty obligation conflicts with federal law, is inconsistent with the brokerage model and will likely limit consumer choice.

In our July letter, we expressed concern that the draft proposal imposed an ongoing fiduciary duty obligation on BDs - rather than limiting that obligation as Reg BI does to the point in time when a recommendation is made. While we appreciate the Division's efforts to try and rework this language, the breadth of the ongoing duty remains highly problematic and will likely result in firms limiting or eliminating brokerage services in the state.

Four specific areas are of particular concern. First, the Proposal imposes an "ongoing" fiduciary duty when a BD or agent engages in any act, practice or course of business which results in the customer having a "reasonable expectation" that his or her accounts are being monitored on a regular or periodic basis.[18] This is a highly subjective standard which could be open to numerous interpretations. Common customer service courtesies that might be misinterpreted by customers likely would be eliminated. Arguably, the only way to ensure that clients do not have these "reasonable" monitoring expectations is to provide execution-only services. This cannot be the Division's intention. Moreover, not providing periodic client check-ins at a minimum would be inconsistent with Reg BI which encourages voluntary monitoring of customer accounts.[19]

Second, the Proposal imposes an "ongoing" fiduciary duty if the BD or agent has contractually agreed to monitor a client's account on a regular or periodic basis.[20] We strongly suggest that the Division clarify that an ongoing duty is not the same as a continuous duty. Without such clarification, BDs or agents in Massachusetts likely will not contractually agree to monitor a client's account, because to agree for example to quarterly monitoring could trigger a continuous monitoring requirement.

Third, the ongoing duty would be triggered automatically if any combination of a wide range of common titles are used.[21] Virtually every financial professional uses some combination of the terms "adviser, manager, consultant or planner" in conjunction with the terms "financial, investment, wealth, portfolio or retirement." Based on these titling restrictions, virtually every type of financial professional would be subject to an ongoing fiduciary duty. It is difficult – if not impossible – to describe brokerage services without using any of those terms. Even if a new title were developed, it would likely still be problematic under the "or any terms of similar meaning or import" language. Moreover, this restriction would bring about additional investor confusion with respect to a large number of dually-registered financial professionals.

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[18] Proposed 950 CMR 12.207 (1)(b)(5).

[19] Reg BI Adopting Release at p. 106 and footnotes 218 and 220, available at: https://www.sec.gov/rules/final/2019/34-86031.pdf.

[20] Proposed 950 CMR 12.207 (1)(b)(3).

[21] Proposed 950 CMR 12.207(1)(c).

Fourth, under the Proposal, there is an ongoing fiduciary duty if a BD or agent "receives ongoing compensation or charges ongoing fees for advising a customer or client."[22] Many common investment products (such as mutual funds) have 12b-1 fees, trailing commissions or other costs that can be characterized as "ongoing compensation." This compensation is plainly not received "for advising a customer or client." Indeed, the BD receives these payments even if the purchase of the fund is wholly unsolicited and the BD provided no advice at all. We encourage you to make clear that such fees are not intended to trigger a requirement of ongoing monitoring. Without such clarification, products that are widely offered in brokerage accounts will be limited or eliminated.

In each of the four instances above, BDs would be subject to an ongoing fiduciary duty – and presumably required to engage in continuous and ongoing monitoring of their customers' accounts. As the SEC explained in its 2019 interpretive guidance, however, providing continuous monitoring in a brokerage account may not be consistent with the "solely incidental" prong of the BD exclusion from the definition of investment adviser[23] and could result in federal law violations.

Consequently, BDs subjected to a continuous monitoring requirement could be forced to: close investors' brokerage accounts; convert investors to self-directed brokerage accounts; or offer to move them to advisory accounts (but only if it was in the client's best interest to do so considering such accounts typically have higher account minimums and charge higher fees). Each of these outcomes would be a major disservice to the many Massachusetts consumers who choose to hold BD accounts today and who want to continue to receive episodic brokerage advice under a transaction-based compensation model.

The Division has indicated that it "does not agree that the Proposal is likely to have a significant negative impact on investor choice of, or access to, quality advice, products and services."[24] We respectfully suggest that prior experience with the now vacated DOL Fiduciary Rule demonstrates otherwise.

In addition to the examples provided on page 3 above, a 2017 U.S. Chamber report found that, if the DOL Fiduciary Rule had been implemented, 71% of advisers would have stopped providing advice to at least some of their small accounts, and 92% of firms were considering limiting or restricting investment products for their customers.[25] The SEC similarly noted that "With the adoption of the now vacated Department of Labor ("DOL") Fiduciary Rule, there was a significant reduction in retail investor access to brokerage services, and we believe that the available alternative services were higher priced in many circumstances."[26]

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[22] Proposed 950 CMR 12.207(1)(b)(4).

[23] 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.

[24] The Commonwealth of Massachusetts, Request for Comment, December 13, 2019 at page 3. Available at: https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

[25] U.S. Chamber of Commerce, "The Data is In: The Fiduciary Rule Will Harm Small Retirement Savers," Spring 2017. Available at: https://www.uschamber.com/sites/default/files/ccmc_fiduciaryrule_harms_smallbusiness.pdf.

[26] Reg BI Adopting Release at pp. 20-21, available at https://www.sec.gov/rules/final/2019/34-86031.pdf.

The Division minimizes the value of choice by declaring it "illusory" if it "means preserving the option to choose opaque, poorly-understood products that are sold via heavily conflicted advice."[27] There are vastly more brokerage accounts than managed accounts in the U.S. today. Our members provide both services, and customers choose the service they wish to purchase. Further, the industry is extremely competitive, and customers can and do vote by moving their assets. Any suggestion that all brokerage is bad or "illusory" is not supported by the facts or by customer demand. Moreover, any potential for nefarious activity is addressed by Reg BI – with its duty of loyalty, duty of care, disclosure obligations, compliance framework and requirements to mitigate or eliminate certain conflicts.

To avoid limiting consumer choice and access to products, we recommend that the Proposal conform the duration of the fiduciary duty to be consistent with Reg BI, which provides that a BD's best interest obligation applies at the point in time of a recommendation. At a minimum, we would strongly encourage you to clarify that any "ongoing" or regular monitoring required in connection with an ongoing fiduciary duty may be periodic, i.e., quarterly, and is not required to be continuous.

III. Massachusetts' duty of loyalty is ambiguous and incompatible with the new Federal standard and will likely further limit brokerage products and services.

We believe that the Proposal's duty of loyalty provisions will also likely limit consumer choice and access to products and accelerate the move from brokerage to fee-based accounts. We recognize that the duty of loyalty provisions has been substantially revised and appreciate some of the changes that were made. However, significant concerns remain. We respectfully request that you consider the following:

a. Avoid, Eliminate and Mitigate Conflicts

The Proposal's duty of loyalty requires that BDs and their agents "make all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts that cannot be avoided, and mitigate conflicts that cannot be avoided or eliminated."[28] We appreciate that the Division tried to improve upon the prior "avoid conflicts" language. The new language, however, contains substantial ambiguity. For example:

- What constitutes "all reasonably practicable efforts?"
- How does one demonstrate that "all" efforts have been made?
- Who decides and how do they decide if a conflict can be avoided?
- If a conflict can be avoided, does it have to be avoided?
- If a conflict can be eliminated, does it have to be eliminated?
- Is mitigation only an option if conflicts can't be avoided or eliminated? Is this true even if the client would have preferred another option?
- How does the duty to "disclose all material conflicts of interest" fit in?

[27] The Commonwealth of Massachusetts, Request for Comment, December 13, 2019 at page 3. Available at: https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

[28] Proposed 950 CMR 12.207 2(b)(2).

- If disclosing or mitigating conflicts alone does not meet or demonstrate the "duty of loyalty," what does?

Moreover, the new conflicts language is incompatible with, and imposes new and different requirements than, the Conflict of Interest Obligation under Reg BI. Under Reg BI, all material conflicts must be disclosed, conflicts that created an incentive for a financial professional to place its interest ahead of the interest of the customer must be mitigated and select conflicts must be eliminated.[29]

To avoid ambiguity in the new conflicts language while still providing enhanced investor protection, the Proposal should conform to the Conflict of Interest Obligation under Reg BI.

b. Disclose material conflicts

The Proposal now requires that BDs, agents, investment advisers and investment adviser representatives "disclose all material conflicts of interest." While we appreciate the addition of the materiality qualifier, the disclosure provision continues to be undercut by language that "disclosing or mitigating conflicts alone does not meet or demonstrate the duty of loyalty."

Appropriate disclosure allows a retail client to evaluate a proposed transaction or relationship with the benefit of all relevant and material information necessary to make a well-informed choice about whether to implement a particular investment strategy or transaction. In some instances, disclosure alone should be sufficient to demonstrate the duty of loyalty. Without such clarification, BDs may not be able to provide important advice that is currently offered to clients or may not be able to do so without additional charge. We urge Massachusetts not to eliminate this valuable information from the investing public.

As mentioned in our July submission, an adviser registered under the Advisers Act may rely on disclosure and the customer's consent to satisfy his or her fiduciary duty.[30] 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[31] facts relating to the scope and terms of the relationship, and all material facts relating to conflicts of interest associated with the recommendation.[32]

We encourage you to replace the current disclosure language with language stating that the disclosure obligation of an associated person of a BD is satisfied by fulfilling the Disclosure Obligation under Reg BI.

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[29] Reg BI Adopting Release at pp. 302,329-330, 340-342,337, and 342, available at https://www.sec.gov/rules/final/2019/34-86031.pdf.

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

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

[32] Reg BI Adopting Release at pg. 766, available at https://www.sec.gov/rules/final/2019/34-86031.pdf.

c. "Without regard to" language

The Proposal's duty of loyalty provision requires that BDs and their agents "make recommendations and provide investment advice *without regard to* the financial or any other interest of any party other than the customer or client" (emphasis added).[33] We reiterate concerns expressed in our July 26 letter that this language creates unnecessary ambiguity and is not achievable.

Brokerage professionals make their living making recommendations and providing episodic investment advice. They of course get paid for their services. Under this provision, simply knowing that they will be paid will make brokerage professionals vulnerable to claims that they did not satisfy their duty of loyalty obligation.

The SEC initially considered using this same "without regard to" language but replaced it with "without placing the financial or other interest … ahead of the interest of the retail customer."[34] 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 reflected the underlying intent of the "without regard to" formulation. The now vacated DOL fiduciary rule also contained this "without regard to" language, which helped trigger some of the negative impacts on investors described above.

We respectfully suggest that you strike the "without regard to" language and align it with the SEC terminology from Reg BI.

d. 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. We note that the Request for Comment states that it did not believe "it is necessary or appropriate to include these transactions in the text of the proposal itself. These transactions are not prohibited under the Proposal but they do present conflicts of interest that must be addressed and managed according to the Proposal."[35]

The Proposal's duty of loyalty provisions requires that BDs and their agents "make recommendations and provide investment advice *without regard to* the financial or any other interest of any party other than the customer or client."[36] In addition, the Proposal requires that the BD "make all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts that cannot be avoided, and mitigate conflicts that cannot be avoided or eliminated […]."[37] This language and the express provision that disclosure and mitigation of conflicts do not satisfy the duty of loyalty raise concerns and create uncertainty about whether these types of recommendations would breach the Proposal's fiduciary duty.

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[33] Proposed 950 CMR 12.207(2)(b)(3).

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

[35] The Commonwealth of Massachusetts, Request for Comment, December 13, 2019 at page 3. Available at: https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

[36] Proposed 950 CMR 12.207(2)(b)(3).

[37] Proposed 950 CMR 12.207(2)(b)(2).

For example, in a principal transaction, the BD, acting for its own account in order to facilitate client transactions, buys a security from, or sells a security to, the account of a client. In the municipal bond market, trades done on a principal basis are the most common form of trading. Principal transactions also cover underwriting activities where a BD is part of an underwriting syndicate for municipal or corporate bond offerings or for equity offerings (including IPOs). Some markets, such as fixed income and currency, operate virtually entirely as principal markets.

Principal transactions would not appear to satisfy the Proposal's requirements that BDs "avoid conflicts of interest" and act "without regard to" anyone but the client's financial interest. At a minimum, a BD engaged in principal transactions with retail clients leaves itself open to the challenge that it is taking its own financial interest into account in violation of the Proposal. Yet these types of transactions are beneficial to a BD's clients and to the municipalities and companies who benefit from these issuances.

Separately, we are concerned about the language in the Request for Comment that principal transactions "present conflicts of interest that must be addressed and managed according to the Proposal." We are not clear how to effectively "address and manage" the conflict - particularly since the Division also indicated that "disclosing or mitigating conflicts alone does not meet or demonstrate the duty of loyalty." The Division also stated in the Request for Comment that "[o]n a case by case basis, the Division may deem it to be a breach of the duty of loyalty to effect a principal transaction when an agency transaction would have been cheaper for the customer."[38] We note that BDs already follow FINRA "best execution" rule 5301 and request that this be considered a "safe harbor" for compliance with the Division's rule.

Because of the uncertainty surrounding principal transactions, many BDs acting as an underwriter may not distribute such offerings to Commonwealth retail clients as an underwriter but rather will do so only through an agency transaction. This will likely depress Commonwealth issuers' access to a broad retail investor base, affecting the price of their securities while increasing the cost to such investors.

We urge the Division to exempt principal transactions from the Proposal's purview or at the very least agree that compliance with the Investment Advisers Act and the SEC's rulemaking on principal trading would be a safe harbor for compliance with the rule.

e. Sales contests, quotas and other special incentive programs

Reg BI requires firms to eliminate "sales contests, sales quotas, bonuses and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time."[39] This is a concrete and appropriately targeted conflict of interest provision which protects investors.

[38] The Commonwealth of Massachusetts, Request for Comment, December 13, 2019 at page 11. Available at: https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

[39] Proposed 950 CMR 12.207(2)(b)(2).

The Proposal, however, now contains much broader language which creates a presumption that virtually all sales contests, quotas, or other special incentive programs violate the duty of loyalty.[40] Specifically, we are concerned that:

- The restriction on sales contests, quotas or other special incentive programs applies not just to securities but to commodities and insurance products.

- The provision bars "implied or express quota requirements" – which is broad, ambiguous and undefined.

- The provision prohibits "special incentive programs" – which also is broad, ambiguous and undefined.

- The current language could prevent firms from using minimum productivity levels as part of employee performance assessments.

- The language could be read as prohibiting firms from using overall sales productivity as a factor in determining employment compensation.

- The language could prevent firms from using incentives to existing and potential representatives based on gathering assets under management.

As Reg BI recognized, there is a distinction between reasonable and neutral measures of performance and productivity that firms use, and those other types of conflicts – such as sales contests improperly favoring certain investment products – that may not be possible to mitigate. We posit that Reg BI struck the right balance, and we encourage the Division to adopt the same sales contest language contained in Reg BI.

IV. The duty of care should provide guidance on how to assess and balance cost considerations consistent with the new Federal standard.

The Proposal's duty of care requires a consideration of costs. It states that "a [BD] shall make a reasonable inquiry, including . . . risks, ***costs***, and conflicts of interest related to all recommendations made and investment advice given" (emphasis added).[41]

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.).[42]

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[40] Proposed 950 CMR 12.207(2)(d).

[41] Proposed 950 CMR 12.207(2)(a)(1).

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

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 may not be in the customer's best interest)? Is it sufficient to inform the customer of its availability? Does the BD have an obligation to canvass possible lowest cost options before making a recommendation, in order to satisfy the duty of care?

This concern is underscored by the Division's Request for Public Comment, which provides:

> "Among other things, the Division intends to pursue enforcement action for breach of the duty of loyalty if transaction-based compensation is paid or received for a recommendation or advice, and other options were available which would have been less remunerative or reasonably expected at the time of the recommendation to result in a better outcome for the customer or client. Likewise, the Division intends to pursue enforcement action for breach of the duty of loyalty if transaction-based compensation is unreasonable or if another available compensation structure would result in a greater benefit to the customer or client."[43]

In addition, the language in the Proposal refers to "duties of *utmost* care and loyalty to the customer . . ." (emphasis added).[44] What is the legal import of the word utmost? What obligations or requirements, if any, does it entail? If none, then it should be stricken.

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

V. The Proposal should be amended to expressly exempt commodities and insurance products.

In comments on the preliminary proposal, SIFMA and others had asked the Division to make clear that its proposed fiduciary duty obligation would not apply to variable annuities as they are excluded from the definition of security under the Massachusetts Uniform Securities Act and are already subject to extensive regulation by the Massachusetts Insurance Division, SEC and FINRA.

The Proposal does not make this clarification. Instead, it broadens the scope of the fiduciary duty obligation beyond just securities to the "purchase, sale, or exchange of any security, commodity, or insurance product"[45] and separately extends the sales, quota and special incentive program prohibitions to insurance products.

We respectfully reiterate that variable annuities and other insurance products are not within the jurisdictional mandate of the Division and the appropriate state regulator for insurance products is the Massachusetts Division of Insurance ("DOI"). The Securities Division "acknowledges that annuities are not considered securities" but asserts it has authority "regardless of the presence or absence of securities."[46]

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[43] The Commonwealth of Massachusetts, Request for Comment, December 13, 2019 at page 11. Available at: https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

[44] Proposed 950 CMR 12.207(2).

[45] Proposed 950 CMR 12.207(1)(a) and (2)(d).

[46] The Commonwealth of Massachusetts, Request for Comment, December 13, 2019 at page 6. Available at: https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

While the Division has limited authority to bring enforcement actions against its registrants, DOI is the primary regulator of the insurance business in the Commonwealth. The Division's Proposal is not consistent with the state's current conduct standard for insurance products. Moreover, as the DOI noted in its comments on your Preliminary Proposal, it is "concerned that the Proposed Standard may not be consistent with ongoing efforts to update national standards for recommending annuity products to consumers."[47]

We respectfully suggest that the Division exclude insurance products from its Proposal. It is not the primary regulator of such products and its efforts could undercut DOI's own efforts to elevate the conduct standard for recommending annuity products in the state. Moreover, the Proposal's applicability to such products would create substantial confusion and inconsistencies. Individuals registered with the state to sell insurance products should all be subject to the same standard. Some individuals should not be held to a different standard simply because they concurrently hold a registration with the Securities Division. Commodities are similarly situated outside the purview of state securities regulation and should also be exempted.

VI. 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 customers who reside in other states and are not legal residents of Massachusetts. Moreover, the state's fiduciary duties may be inconsistent with the duties owed to the client in their state of domicile. Without further clarification, BDs and IAs with a limited presence could choose not to do business in the state. Advisers could likewise decide not to locate in the state or, if already established, choose, depending on their existing client base, to relocate. 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.

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

The exclusion in Section 12.207(4) should be expanded to apply to any activity insofar as it relates to an employee benefit plan subject to the Employee Retirement Income Security Act ("ERISA"). While we believe this provision is an attempt to avoid ERISA preemption, as written it could be interpreted as applying only to BDs or advisers who are ERISA fiduciaries. However, imposing a state-law fiduciary duty – even on a person who is not an ERISA fiduciary – is inconsistent with ERISA's broad preemption provision which applies to "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan […]."[48]

Furthermore, while the Proposal provides an exemption for ERISA fiduciaries and providing investment advice to ERISA plans with at least $100 million, it would otherwise apply to investment advice to plan fiduciaries. Plan fiduciaries are responsible for evaluating the risks and performance of the investments and potential investments for their retirement plan.

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[47] Massachusetts Division of Insurance comment letter, dated July 26, 2019, at page 1. Available at: http://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/preliminarycomments/2019-07-26-Massachusetts-Division-of-Insurance.pdf.

[48] 29 U.S.C. §1144(a).

Service providers and advisers 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 $100 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 $100 million at a disadvantage in fulfilling their fiduciary responsibilities. Accordingly, the proposal should be revised to exclude any employee benefit plan from the definition of "customer" or "client" regardless of the amount of assets held by the plan. This exclusion should also be expanded to include plans not subject to ERISA (such as governmental plans and church plans).

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 result in additional cost and confusion for retirement savers.[49] If compliance with the Proposal were to cause BDs to become fiduciaries under ERISA, then transactions would either need to comply with a prohibited transaction exemption or be prohibited entirely. Complying with the prohibited transaction exemption would increase compliance burdens and costs to BDs, and in some cases, BDs may 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.

VIII. The Proposal raises preemption and other legal concerns.

We continue to believe that the Proposal has a variety of potential preemption issues. These include, but are not limited to the following:

A. The National Securities Markets Improvement Act ("NSMIA") Preempts the Proposal's Applicability to SEC-registered IAs ("RIAs") and their Investment Adviser Representatives.

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.[50] NSMIA preempts 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.[51]

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[49] 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.

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

[51] 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

In our July letter, we asked for clarification that the proposed rule was limited to state registered IAs. We believe that the Proposal tries to accomplish this. By using the term investment adviser (rather than just adviser) throughout the document, the formal rule proposal presumably triggers the state definition of investment adviser which excludes federal covered advisers. We would appreciate an express declaration from the Division that 12.204, 12.205 and 12.207 cannot be read as imposing a fiduciary duty on federal covered advisers.

We also ask for clarification that the Proposal does not apply to investment adviser representatives ("IARs") of federal covered advisers. The Massachusetts Securities Act defines "investment adviser representative" to include employees or persons of federal covered advisers "subject to the limitations of section 203A of the Investment Advisers Act of 1940."[52] Section 203A permits states to bring "enforcement actions with respect to fraud or deceit." This is substantially different from imposing substantive conduct requirements on employees or persons of federally covered advisors. Moreover, application of the Proposal to IARs of federal covered advisers would be indirect substantive regulation of SEC-registered advisers and would be contrary to NSMIA.

B. The Proposal imposes new and different books and recordkeeping requirements for BDs that are preempted by NSMIA and should be eliminated.

NSMIA also precludes states from imposing new books and records requirements on BDs 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]."[53]

The Proposal imposes on BDs 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.[54]

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)).

[52] M.G.L. c. 110A, § 401(n)(B).

[53] 15 U.S.C. §78o(i)(1).

[54] 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.

- Duty of loyalty. The Proposal's duty of loyalty requires, among other things, that BDs and agents disclose all material conflicts, make all reasonably practicable efforts to avoid, eliminate and mitigate conflicts, and make recommendations "without regard to the financial or any other interest of any other party other than the consumer or client."[55] 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.

It is important to note that 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.[56] 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 950 CMR 12.207 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],"[57] 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.

C. The Division has exceeded its authority as the Proposal seeks to impose investment advisory requirements on broker-dealers in contravention of Massachusetts law.

As noted in Section II above, subjecting broker-dealers to an ongoing fiduciary duty – and requiring them to engage in continuous and ongoing monitoring of their customers' accounts – is inconsistent with the "solely incidental" prong of the BD exclusion from the definition of investment adviser and with the language in Dodd-Frank that broker-dealers should not be required to have a continuing fiduciary duty.

In addition to being potentially violative of federal law, this is clearly in contravention with Massachusetts law. Specifically, in creating the Massachusetts Uniform Securities Act, the legislature defined "investment adviser" as:

> (m) "Investment adviser' means any person who, for compensation, engages in the business of advising others, either directly or through publication or writings, as to value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities. "Investment adviser" also includes financial planners and other persons who, as an integral

[55] Proposed 950 CMR 12.207(2)(b).

[56] *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).

[57] Proposed 950 CMR 12. 207(f).

component of other financially related services, provide the foregoing investment advisory services to others for compensation and as a part of a business or who hold themselves out as providing the foregoing investment advisory services to others for compensation. "Investment advisor" shall not include . . . "(F) a registered broker-dealer or broker-dealer agent."[58]

The Division does not have the authority to issue a regulation that would nullify this statute.

D. The Proposal suffers from additional preemption and other legal infirmities that make the regulations invalid and ultimately unenforceable.

The Proposal suffers from additional preemption and other legal infirmities including but not limited to the following:

- Express and Implied Preemption – Advisers Act / Exchange Act. The Proposal directly conflicts with the Advisers Act, Exchange Act and the Commodity Exchange Act, and/or interferes with the achievement of federal objectives in those Acts.

- Conflict Preemption. The Proposal directly conflicts and prevents compliance with core provisions of Reg BI, including the SEC's reaffirmation that BDs who provide advice that is "solely incidental" to their primary business of effecting securities transactions are exempt from fiduciary standards imposed on investment advisers through the Investment Advisers Act of 1940.

- ERISA Preemption. Any portions of the Proposal that apply or relate to any employee benefit plan are explicitly preempted by ERISA.[59]

- Commerce Clause of the Constitution. The imposition of a fiduciary duty under the Proposal is unconstitutional because it imposes a burden on interstate commerce that is clearly excessive in relation to the putative local benefits.

- Massachusetts Administrative Procedure Act. The Proposal potentially violates the Massachusetts APA. Among other things, the Division did not consider the impact to small business retirement plans which are often set up through SEP and SIMPLE-type plans. The Division's proposal would capture these plans leading to those business owners being unable to get access to advice through brokerage services.[60]

- No private right of action. The Proposal should explicitly clarify that it does not create a private right of action. To the extent it does, it is expressly preempted by the Federal Arbitration Act because it restricts the enforcement of arbitration agreements commonly found in BDs' and (and sometimes in IAs') customer agreements, and is also contrary to and preempted by the Advisers Act, which prohibits Massachusetts' imposition of a private right of action against RIAs.

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[58] M.G.L. c. 110A, § 401(m)(1)(F).

[59] Pursuant to ERISA Section 514(a), ERISA supersedes all state laws insofar as they relate to an employee benefit plan subject to ERISA. ERISA 514(b)(2)(a) provides a limited exception to ERISA's broad preemption of state law for certain state laws that regulate insurance, banking or securities. This proposal does not fall within this limited exception. Further, this Proposal is also subject to conflict preemption because it upends ERISA's carefully crafted fiduciary responsibility and remedies provisions. Aetna Health Inc. v. Davila, 124 S. Ct. 2488 (2004).

[60] US Chamber Report: https://www.uschamber.com/sites/default/files/us_chamber_-_locked_out_of_retirement.pdf.

The foregoing preemption and other legal infirmities render the proposed regulations as drafted invalid and ultimately unenforceable.

IX. Any formal rule should specify an appropriate future effective date and provide for a sufficient implementation period.

The Proposal also suffers from failing to specify an effective date. While we understand that final regulations are typically effective upon publication in the Massachusetts Register,[61] the Securities Division does have discretion to establish a future effective date in "extremely special circumstances."

Should the Division decide to finalize this rule proposal, we believe it properly falls within the "extremely special circumstances" category. Firms would need sufficient time to identify whether and how to modify their business activity to comply with the new regulation. They would also need to develop significant infrastructure, new policies and procedures, training programs, and compliance systems. This would be a complex and resource-intensive undertaking. Based on the likely changes needed, we would recommend an effective date to align with Reg BI on June 30, 2020 or after and include an implementation period of at least 18 months.

Alternatively, if the Division chooses to not delay the effective date, we would encourage you to delay the enforcement date. There is recent precedent for this. The Division's much more limited Amendments to Investment Adviser Disclosure Regulations[62] become effective upon publication in the Massachusetts Register on June 14, 2019 but had an enforcement date of January 1, 2020. Should you choose this option, we would strongly encourage you to delay enforcement for at least 18 months.

Conclusion

We appreciate the opportunity to comment and your consideration of our views. We believe Reg BI has meaningfully raised the bar for financial professionals and includes many important investor protections while preserving investor choice. We are concerned that, as was the case with the DOL fiduciary rule, the Proposal will confuse investors, increase costs, and diminish access to advice, products and services.

We respectfully suggest that you delay any decision making until after Reg BI is fully implemented and regulators have examined for compliance. Under this reasoned approach, Massachusetts investors will have the benefit of seeing how firms have changed their practices to comply with this heightened standard and the investor protection benefits it provides. At that point, the Division can determine what, if any, gaps remain and if further rulemaking is necessary.

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[61] Secretary of the Commonwealth, William Francis Galvin, "The Regulations Manual," May 2016. Available at: https://www.sec.state.ma.us/spr/sprpdf/manual.pdf.

[62] Adoption of Amendments to Investment Adviser Disclosure Regulations, available at: https://www.sec.state.ma.us/sct/sctfeetable/feetable-adoption.htm.

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

Sincerely,

Kenneth E Bentsen, Jr.
President and CEO
SIFMA