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:

We the undersigned trade associations appreciate the opportunity to comment on the Massachusetts Securities Division's proposed regulation "to apply a fiduciary conduct standard on broker-dealers, agents, investment advisers, and investment adviser representatives when dealing with their customers and clients." We collectively represent a broad cross section of the financial services industry, and many of our members do business and serve retail investors in Massachusetts.

We understand that this is a preliminary solicitation and that the Division will review and digest all comments before determining whether to pursue a formal rulemaking. While many of us have sent separate letters, we thought it was important to highlight some universal concerns and to strongly encourage you not to move to a formal rulemaking at this time. Specifically, we urge you to consider the following:

1. Regulation Best Interest's heightened standard adds substantial and meaningful new investor protections. As you well know, on June 5, 2019, the SEC adopted Regulation Best Interest

("Reg BI") which creates a new nationwide, heightened standard of conduct for broker-dealers ("BDs") and their representatives when dealing with retail customers. The Reg BI rulemaking package is substantial – made up of four distinct components and totaling more than 1300 pages. The attached link highlights some of the ways Reg BI substantially and materially exceeds the existing FINRA suitability standard.

We believe the enhanced protections will be even more evident once Reg BI is fully implemented, likely with additional SEC guidance and interpretation, and federal and state regulators examine for and enforce compliance. We respectfully request that you give Reg BI a chance before considering any action.

2. A "Best of" standard is impossible to satisfy and should not be used. 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"[1] and "the best of the reasonably available remuneration options…."[2] 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.[3] We would encourage you to avoid this standard for account types, securities and transaction-based compensation.

3. An ongoing monitoring requirement is inconsistent with the brokerage model and will likely limit consumer choice. The Massachusetts proposal would impose a broad and ongoing fiduciary duty obligation on broker-dealers and their agents that would limit investor choice and be costly to implement. Conversely, Reg BI does not restrict consumer access to financial services. Reg BI generally limits the duration of a BD's best interest obligation to the point in time when a recommendation is made; there is no ongoing obligation to monitor brokerage accounts[4].

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[1] 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.

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

[3] 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 acknowledged 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.

[4] 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.

We believe Reg BI got it right. 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 compensation structure – in place to provide continuous and ongoing monitoring of securities purchased, sold, or held due to recommendations made in their BD accounts.

An ongoing duty to monitor would likely result in firms limiting their brokerage service options. Clients would then have to choose between moving to more expensive fee-based advisory accounts or moving to internet or call center-based execution-only platforms. To avoid this potential outcome, we would suggest that the Proposal conform the duration of the duty to be consistent with Reg BI. We also recommend that an explicit exemption from the fiduciary duty requirement be added for unsolicited transactions, self-directed accounts and BDs that do not make securities recommendations to retail customers (e.g., clearing firms, etc.).

4. An "Avoid Conflicts" requirement is unworkable. 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. We believe it is not possible to avoid all conflicts. We encourage you to strike this language and replace it with Reg BI language, which requires eliminating or mitigating conflicts.

5. The Proposal's "without regard to" language is highly problematic. 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] …."[5] 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."[6] 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." We believe the SEC formulation accomplishes the same purpose as the Division's "without regard to" formulation but does so with greater clarity and less confusion about the expectations associated with the obligation. We encourage you to adopt this approach.

6. The Proposal should be amended to expressly exempt variable contracts. Existing Massachusetts law excludes annuities from securities regulations. The Massachusetts Uniform Securities Act (the "Act") expressly states that "'Security' does not include 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.[7]"

   Moreover, the Act provides an exemption for guaranteed insurance products such as annuities. Section 402 (a)(5) exempts from the Act "[a]ny security issued by and representing an interest in

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

[6] 83 FR 21586; Adopting Release at pp. 62 – 67. Available at: https://www.sec.gov/rules/final/2019/34-86031.pdf.

[7] 110 MGL 401(k).

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." [8]

Further, variable annuities are already subject to extensive regulation by the SEC and FINRA. An additional layer of state regulation is unnecessary and would create redundant and potentially conflicting standards.

For these reasons, we respectfully urge the Division to include language in the Proposal that clearly and expressly excludes variable annuities.

7. The Proposal should be amended to explicitly exempt principal transactions. In a principal transaction between the Broker-Dealer and its retail client, the BD, acting for its own account, either buys a security from, or sells a security to, the account of a client. Indeed, in the municipal 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 bonds, or for an initial public offering.

Principal transactions would not appear to satisfy the requirement that BDs "avoid conflicts" and act "without regard to" their own financial interest. Principal transactions are in the underwriters' interest – or they wouldn't be participating in the underwriting syndicate. If the BD is both an underwriter and then turns around and sells that same bond from its inventory to a Massachusetts retail client, that could be viewed as also acting in the BD's interest. However, the BD is acting in the clients' interest since clients now have access to securities that may not be available on the open market, or, if they are available, can only be purchased (or sold) on an agency basis at higher prices than a principal trade in the exact same bond.

Without an exemption, many BDs likely will not participate in the bidding for new issue municipal and corporate bonds in the State; this will disrupt the underwriting process and make it more difficult and expensive for both issuers and retail clients. Investors will either not have the same access to the bonds or will have to purchase them on an agency (non-principal) basis, at a higher cost, to include mark-ups and commissions.

8. The Disclosure Obligation should be made consistent with Reg BI. The Proposal's duty of loyalty also states that "disclosing a conflict of interest in and of itself …" does not presumptively satisfy the duty.[9]

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.[10] 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*[11] facts relating to the scope and terms of the relationship, and all *material* facts relating to conflicts of interest associated with

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[8] 110 MGL 402 (a)(5)

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

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

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

the recommendation.[12] 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.[13]

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 such term was defined by the U.S. Supreme Court in *Basic v. Levinson*)[14] 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.

9. The Proposal provides no guidance on how to address cost. 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 reasonable inquiry, including risks, ***costs***, and conflicts of interest related to the recommendation..." (emphasis added).[15] The Proposal, however, provides no guidance on how to consider and address cost. For example, must BDs recommend the lowest cost option without regard to other factors, inform the customer of its availability, or canvass all possible lowest cost options before making a recommendation?

   We recommend that the Division provide additional guidance consistent with the guidance set forth in Reg BI. Reg BI states that, when 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.).[16]

10. Any regulation should be limited to customers with Massachusetts domiciles. Any regulation should expressly state that it applies only to retail customers who are legal residents of Massachusetts or who reside in the state. BDs or IAs who have a place of business in Massachusetts should not owe these additional fiduciary duties to out-of-state clients.

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

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

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

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

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

11. The Proposal raises pre-emption and other legal concerns**.** We believe the Proposal has a variety of potential pre-emption issues and legal deficiencies. As the Division well knows, Congress enacted the National Securities Markets Improvements Act ("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.[17]

    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)]."[18]

    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.[19] 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.

    NSMIA also precludes state 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]." [20] The Proposal imposes on BDs (and in many cases, IAs) a variety of new books and records requirements, among others, that differ from, or are in addition to, those imposed by federal law and/or FINRA rules, including requirements related to the ongoing fiduciary duty requirement and the "best of" standard.

12. Any final regulations should include a reasonably implementation period and effective date. It will take time for entities to assess whether and how to modify their business activity in the State and to develop infrastructure, policies and procedures, and training and compliance programs for any new regulations. We respectfully suggest an implementation period of at least 18 months, with an initial effective date thereafter.

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

[18]15 U.S.C. §80b-3a(b)(1).

[19]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 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 nn.155-56)).

[20] 15 U.S.C. §78o(i)(1)

We appreciate the opportunity to comment and your consideration of our views.

Sincerely,

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