July 26, 2019

Secretary William F. 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

Submitted Electronically – securitiesregs-comments@sec.state.ma.us

Re: Preliminary Solicitation of Comments on Proposed Amendments to 950 CMR 12.204, 12.205 and 12.207, Establishing a Fiduciary Standard of Conduct for Massachusetts Broker-Dealers, Agents, Investment Advisers and Investment Adviser Representatives

Dear Secretary Galvin:

The U.S. Chamber of Commerce ("the Chamber") Center for Capital Markets Competitiveness appreciates the opportunity to comment on the proposed fiduciary standard of conduct for broker-dealers and investment advisers in Massachusetts. We commend the Secretary's decision to solicit preliminary comments in connection with the proposed amendments to 950 CMR 12.204, 12.205 and 12.207 (collectively, the "Proposal") because it is vital that the Commonwealth have a full and complete understanding of the likely effect of the Proposal before taking any further action.

We agree that all investors should have access to quality, affordable investment assistance, and we believe we share the same goals of investor protection. Unfortunately, however well-intended, we believe the Proposal as written would fail to achieve these goals. We urge the Division to delay further consideration of the Proposal, and we write to explain in more detail our serious and fundamental concerns about the Proposal's likely unintended consequences. Specifically, we believe the Proposal:

- Is unnecessary because the underlying goals of the Proposal are already achieved in the strong, new Federal standards adopted by the U.S. Securities and Exchange Commission ("SEC") in Regulation Best Interest ("Reg BI") and the Form CRS Relationship Summary ("Form CRS");

- Is not justified by stated rationale for the Proposal—the examples of the Division's enforcement actions under current law would appear to demonstrate that the Division already has sufficient legal tools, not the need for a new standard;

- Would create a patchwork of conflicting state and Federal rules that would serve only to increase costs and reduce access to recommendations for investors; and

- Would face significant Federal preemption challenges.

If the Division were to move forward despite these very significant concerns, we believe it should:

- Remove the anti-fiduciary "best" test, an outcome-based standard that is impossible to meet in practice;

- Remove provisions creating an ongoing monitoring obligation for broker-dealers in their recommendations, a provision inconsistent with Sec. 913 of the Dodd-Frank law favorably cited by the Division;

- Remove the unworkable, confusing and ambiguous language directing fiduciaries to "avoid conflicts" and to develop advice "without regard to" any other factors;

- Apply the rule only to recommendations to residents of the Commonwealth; and

- Provide an 18-month implementation period.

<u>The Proposal is unnecessary because the underlying goals of the Proposal are already achieved in the strong, new Federal standards adopted by the SEC in Reg BI and Form CRS.</u>

As the Division released the Proposal less than 10 days after the SEC promulgated final rules and guidance significantly enhancing the Federal standards, the Division was afforded little opportunity to review the SEC's actions. As a result, we believe the Division has not fully appreciated the scope of Reg BI's very detailed requirements. For example, the Division's notice accompanying the Proposal's request for comments states, "In many instances, it appears that the mitigation of conflicts required under the SEC Regulation Best Interest can be accomplished through disclosure, including disclosure via the new Customer Relationship Summary (Form CRS)."[1] We respectfully submit that this is not the case, and that the Division has misread a core requirement of Reg BI.

In fact, Regulation Best Interest specifically states that disclosure alone is not sufficient with respect to compensation to broker-dealer's representatives who make recommendations to investors (which appear to be the conflicts of most concern to the Division). Explaining the rule, the SEC wrote that mitigation—not disclosure—is required in these cases, stating that Reg BI:

> "…require[s] broker-dealers to establish policies and procedures reasonably designed to <u>*identify and mitigate*</u> any conflicts of interest associated with such recommendations that create an incentive for a natural person who is an associated person of a broker- dealer to place the interest of the broker-dealer, or such natural person ahead of the interest of the retail customer…While disclosure can be an effective tool for retail customers to increase awareness of a conflict of interest…<u>*we do not believe that disclosure alone*</u> sufficiently reduces the

[1] "Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives," June 14, 2019, at https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/fiduciaryconductstandardidx.htm, last accessed on July 22, 2019.

> potential effect that these conflicts of interest may have on recommendations made to retail customers. [emphasis added]"[2]

In other words, brokers-dealers must mitigate conflicts that result from compensation to representatives, not merely disclose them. The difference between the Proposal and Reg BI is that Reg BI clearly allows the transaction-based business model to remain available with mitigation, while the practical effect of the Proposal, as we discuss in more detail below, likely would be to effectively prohibit most transaction-based recommendations.

The SEC's actions achieve the essential aims of the Proposal, but do so in a way that protects investor choice to receive financial recommendations through fee-based or transaction-based business models. Rooted in fiduciary principles, Reg BI requires broker-dealers to put the interest of their clients first. While Reg BI, like the Proposal, has strong disclosure requirements to prevent investor confusion, it does not rely on them alone. Under Reg BI, broker-dealers must provide "full and fair" disclosure in writing when making a recommendation of a security, an investment strategy or a type of account, including rollovers from retirement plans. The broker-dealer and representative must clearly explain that the representative is acting in its capacity as a broker-dealer, and the representative is not allowed to use the title "advisor" or "adviser" unless he or she actually is a registered investment advisor or a representative of an investment advisor. In addition to mitigation of compensation incentives, broker-dealers are prohibited from using sales contests, bonus or other types of incentives based on recommendations of specific products or types of products in a limited period of time. In developing recommendations, broker-dealers and representatives must adhere to a "standard of conduct [that] draws from key fiduciary principles,"[3] requiring that the representative "…exercises reasonable diligence, care, and skill."[4]

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[2] Securities and Exchange Commission Release No. 34-86031; File No. S7-07-18, "Regulation Best Interest: The Broker-Dealer Standard of Conduct" at pgs. 325-326, accessed on July 22, 2019 at https://www.sec.gov/rules/final/2019/34-86031.pdf.

[3] Statement of SEC Chairman Jay Clayton, June 5, 2019.

[4] 17 CFR § 240.15l-1(a)(2)(ii)

In short, the final Reg BI contains a duty of loyalty and a duty of care that achieve the essential goals of the Proposal without limiting consumer choice and access to the financial professionals and fee arrangements that are in investors' best interests. Reg BI fundamentally improves the regulation of financial professionals recommending securities, investment strategies and new accounts to protect consumers, and the Division's concerns are well-addressed in the new Federal standards without need for conflicting state standards in the duties of care and loyalty.

<u>The Proposal is not justified by the stated rationale.</u>

The Division's notice accompanying the Proposal's request for comments makes two primary points justifying the need for the Proposal, neither of which supports the need for the specific solution embodied in the Proposal.

First, the Proposal notes that the January 2011 SEC staff report based on Sec. 913 of the Dodd-Frank law recommended a uniform fiduciary standard that the SEC ultimately chose not to enact in favor of Reg BI. As discussed above, simply because the SEC, after years of intensive debate and consideration, chose an alternate regulatory path does not mean that Reg BI is not strong, comprehensive reform consistent with Sec. 913 and the goals of the staff report. Further, the notice omits a discussion of the other requirements of Sec. 913. Congress, recognizing the role of broker-dealers, limited the SEC's authority, preserving transaction-based compensation and rejecting ongoing monitoring of investments by broker-dealers even if the SEC did decide to adopt a uniform standard.[5] As discussed in more detail below, the Proposal, by contrast, requires ongoing monitoring and prohibits commissions in most circumstances. The Division cannot suggest that it is carrying out Congress' intent in proposing a uniform fiduciary standard when the Proposal specifically violates two essential directives from that same law.

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[5] *See* 15 U.S.C 78o(k)(1) "…The receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer. Nothing in this section shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities."

Second, the notice states that the fiduciary standard is needed because the "current 'suitability' standard for broker-dealers…does not do enough to eliminate conflicts of interest."[6] This ignores the fact that the "suitability" standard has been replaced by the "best interest" standard in Reg BI and thus will not be the legal standard beginning June 30, 2020. Further, despite the claim that a fiduciary standard would prevent the identified conflicts, each of the violations the notice cites were enforcement actions taken under pre-Reg BI 'suitability' standards, making it clear that these acts were already deemed violations by the Division under the prior standard. It is not clear to us how the Commonwealth's efforts to stop conduct it already believes is prohibited—certain sales contests, churning, unsuitable recommendations and a failure to supervise—require a new standard. Put simply, if the Division has the ability to bring actions under current rules, bringing such actions is not an argument for new rules.

The Proposal would create a patchwork of conflicting state and Federal rules that would serve only to increase costs and reduce access to recommendations for investors.

If Massachusetts adopts a final regulation establishing a new fiduciary standard, it will conflict not only with Federal standards for brokers-dealers and investment advisers, but also with other potential state standards. A patchwork of different standards from jurisdiction-to-jurisdiction is not desirable for investors, as it will increase costs and decrease access to advice.

The Chamber was part of a group of plaintiffs successfully challenging the U.S. DOL Fiduciary Rule because we saw the negative effect it was having on our members. It made many transaction-based fee arrangements impractical for savers with small account balances. As the Chamber's 2017 report explains, had the DOL Rule been fully implemented, 11 million households would have seen limited or restricted investment products available to them; up to seven million individual retirement account ("IRA") owners would have lost access to investment advice

[6] "Preliminary Solicitation of Public Comments," June 14, 2019.

altogether; nearly three quarters of financial professionals would have stopped providing advice to some of their small accounts, and 35% of those professionals anticipated no longer serving accounts below $25,000.[7]

The SEC agreed the DOL Fiduciary Rule caused significant harm and was one of the factors it considered in structuring Reg BI. In the Preamble to Reg BI, the SEC wrote, "Our concerns about the ramifications for investor access, choice, and cost…are not theoretical. 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 [citations omitted]."[8]

We anticipate similar results if broker-dealers face these barriers on a state-by-state basis, and the most harmful effect will be on small-account investors in those states. We do not believe this is what the Division intends, but it will be what the Division would create if it proceeds to a final rule.

The Proposal would face significant Federal preemption challenges.

Despite the Proposal's language at the proposed new Sec. 12.207(e) (addressing Employee Retirement Income Security Act ("ERISA") plans) and Sec. 12.207(f) (that purports to contain the scope of the Proposal to avoid creating new duties on investment advisers and broker-dealers that are preempted by the National Securities Markets Improvement Act of 1996 ("NSMIA")), we believe that significant portions of the Proposal would be preempted by Federal law.

Put simply, financial professionals cannot demonstrate compliance with the Proposal's requirements without taking actions well beyond those required by Federal law, squarely presenting preemption issues. The Proposal is not an anti-fraud

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[7] "The Data is In: The Fiduciary Rule will Harm Small Retirement Savers," U.S. Chamber of Commerce, Spring 2017.

[8] Securities and Exchange Commission Release No. 34-86031; File No. S7-07-18, "Regulation Best Interest: The Broker-Dealer Standard of Conduct" at pgs. 20-21, accessed on July 22, 2019 at https://www.sec.gov/rules/final/2019/34-86031.pdf

provision of the sort saved from preemption under NSMIA as the existing standard it seeks to replace already prohibits fraud—the intent of the Proposal is to impose new requirements on non-fraudulent conduct.

Specific Comments on the Proposal

While we would prefer the Division not proceed with this Proposal and defer to the new SEC rules that accomplish its aims, we nonetheless offer the following comments on the Proposal in the event the Division does proceed.

The Division should remove the anti-fiduciary "best" test, an outcome-based standard that is impossible to meet in practice.

The Proposal sets a non-fiduciary and unachievable standard for transaction-based business models. In proposed new Sec. 207(c)(2)(i), the Proposal establishes a "presumption of a breach of the duty of loyalty for offering or receiving, direct or indirect compensation…" for making a recommendation "that is not the best of the reasonable available options..." Put simply, the "best" is not a fiduciary concept. In fact, it is antithetical to fiduciary duty. It is also a practical impossibility in the real world.

Whether the fiduciary standard is that of ERISA, the Uniform Prudent Investor Act, or the Investment Adviser Act duties of an RIA, courts focus on the process employed to make fiduciary decisions. The core of fiduciary conduct is procedural prudence—the standard is not whether the decision is the "best" decision, but whether it was made in the proper way. In most cases, a fiduciary's duty simply is not reducible to producing one—and only one—so-called "correct" answer. This non-fiduciary legal standard would invite frivolous litigation and open the door for arbitrary enforcement decisions by regulators.

Not only is "best" not a fiduciary concept, but the "best" test cannot be met in practice. Of all the investments "reasonably available," which likely includes literally thousands of investment products, "best" means only one can be correct. This is simply not true, either in the real world or in the law. Investment recommendations inherently involve making subjective decisions from among similar investment options, and involve balancing competing investor interests of risk, reward and cost.

In confusing drafting, the Proposal then states in proposed new Sec. 207(c)(3)(ii) that, notwithstanding the prior language regarding the "best" recommendation with respect to each transaction, there is not a presumed breach if the "renumeration represents the best of the reasonable available renumeration options for the customer or client…" Whether a transaction-based or fee-based arrangement is "best" depends on a number of subjective factors, including the anticipated frequency of trading and the duration of the investments. It is not going to be obvious in many cases that the prudent answer—arrived at by weighing unknowns and the competing needs of the same investor—is the "best" answer. Thus, whether the "best" test applies to the outcome of the investment recommendation or to the form of the compensation, it is an unworkable concept that does not belong in a fiduciary regulation.

Finally, additional clarity is essential for what "reasonably available" means. This has particular implications for financial professionals recommending proprietary products, or where investment menus are limited. Reasonably available should be construed very narrowly to minimize the scope of options from which the "best" would be chosen.

<u>The Division should remove provisions creating an ongoing monitoring obligation for broker-dealers in their recommendations.</u>

While the proposed new Sec. 207(b)(1)(i) acknowledges the fiduciary obligation for a recommended transaction should not automatically extend beyond the execution of the recommended transaction, other provisions undermine the purpose of this provision and effectively eliminate its applicability. Under new proposed Sec. 207(b)(1)(ii), if there are "ongoing recommendations" or "ongoing compensation" or "provid[ing] investment advice, in any capacity," then the "…fiduciary duty shall be deemed an ongoing. [sic]" The apparent typographical error notwithstanding, this would effectively prohibit dual registrants or representatives making more than one recommendation or receiving trailing commissions from acting in their capacity as a broker-dealer.

The Proposal should not impose this duty on broker-dealers that are acting as broker-dealers, simply because they may have acted in a different capacity in a different transaction. This issue is better addressed as the SEC has done—the Form CRS Relationship Summary explains the differences between broker-dealers and RIAs in plain terms, and Reg BI requires the broker-dealer to clearly disclose the capacity in which it is acting.

<u>The Division should remove the unworkable, confusing and ambiguous language directing fiduciaries to "avoid conflicts" and to develop advice "without regard to" any other factors.</u>

There is no disagreement that the client's interests should come first. Unfortunately, the language in the new proposed Section 207(c)(2) is vague and ambiguous, creating an unadministrable standard. Section 207(c)(2) directs financial professionals to "avoid conflicts of interest and to make recommendations and provide investment advice without regard to the financial or any other interest" of anyone but the client. This language is fatally vague and undefined. What does it mean to avoid conflicts? Conflicts are inherent in all financial relationships, whether fee-based or transaction-based, and cannot be avoided entirely. The lack of definition makes it impossible to interpret the scope of the duty of loyalty.

"Without regard to" is similarly vague, as it essentially requires proving a negative. Putting the client's interest first is clear—prohibiting the consideration of any other factor, no matter how little weight it is accorded, is not. Where there is an allegation, including frivolous and unfounded complaints, how can a financial professional show she didn't consider any non-client factors?

We therefore urge the Division to instead require that the financial professional "put the client's interests first," an administrable standard ensuring the client's protection. To further minimize some of these concerns, we recommend that, if the Division does proceed, it expressly permit principal transactions, recommendations of proprietary products, and the receipt of employee benefits as compensation for statutory employees.

The Division should apply the rule only to recommendations to residents of the Commonwealth and provide an 18-month implementation period.

We urge the Division to limit the scope of any final rule to recommendations made to residents of the Commonwealth, and to exclude recommendations to out-of-state entities by financial professionals in the Commonwealth. To do otherwise will even more directly create conflicts among the states, limiting the ability of Massachusetts-based financial service providers to serve clients in other states. We also urge the Division to provide for an 18-month implementation period, recognizing the significant changes and training that would be required to comply with the Proposal. Broker-dealers simply are not equipped to monitor accounts on an ongoing basis without major and costly changes in policies, procedures and supervisory structures, all of which will take time to develop.

Conclusion

The Chamber supports efficient regulation of financial services that will ensure the protection of our members' interests. We have actively engaged in Federal and state regulatory efforts intended to protect consumers, and we will continue to do so. However, strong and efficient regulation cannot be achieved on a state-by-state basis through a patchwork of conflicting state regulations that differ materially with respect to one another as well as to Federal regulations.

Financial professionals simply cannot efficiently serve their clients if they are subject to material differences in regulation in every state regarding their legal obligations, documentation requirements and legal risks. Regulation BI represents the best protection for all Americans, and we urge the Division to stop proceeding in a manner that will conflict with Federal standards.

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Sincerely,

Tom Quaadman	James E. Rooney
Executive Vice President	President and CEO
U.S. Chamber of Commerce	Greater Boston Chamber of Commerce
Center for Capital Markets Competitiveness	