FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

Via email: securitiesregs-comments@sec.state.ma.us

January 7, 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 Financial Services Institute ("FSI")[1] appreciates the opportunity to further comment on the ongoing efforts of the Massachusetts Securities Division ("the Division") of the Office of the Secretary of the Commonwealth towards its *Proposed Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers and Investment Adviser Representatives* ("the Proposal"), dated December 13, 2019. FSI commented on the *Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives* ("the Pre-Proposal"), dated June 14, 2019. In this comment, we focus on the updates the Division has made to the Proposal as compared to the Pre-Proposal, and generally incorporate by reference our comment letter of July 25, 2019.[2]

FSI shares the Division's concern with ensuring investors are well protected and well served. Our core mission is to ensure that all individuals, regardless of their level of wealth, have access to competent and affordable financial advice, products, and services. Our growing network of independent financial advisors and independent financial services firms can provide those services, but for purposes of our comment to the Proposal, our focus is first and foremost investor access to advice and services. We will address the Proposal's impact on services available to investors, as well as how advisors can provide those services pursuant to the U.S. Securities and Exchange Commission's ("the SEC") Regulation Best Interest ruleset[3] and, if adopted, the Proposal.

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[1] The **Financial Services Institute (FSI)** is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 100 independent financial services firm members and their 160,000+ affiliated financial advisors – which comprise over 60 percent of all producing registered representatives. We effect change through involvement in FINRA governance as well as constructive engagement in the regulatory and legislative processes, working to create a healthier regulatory environment for our members so they can provide affordable, objective advice to hard-working Main Street Americans. For more information, please click here.

[2] For your reference, we have attached our July 26, 2019 letter to this letter. https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/preliminarycomments/2019-07-26-Financial-Services-Institute.pdf. We also note our general support for the comment letters filed by the Securities Industry and Financial Market Association ("SIFMA") and the U.S. Chamber of Commerce ("the Chamber") with regard to both the Pre-Proposal and the Proposal.

[3] The Regulation Best Interest ruleset includes Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (July 12, 2019) (the "Reg BI Release"); Form CRS Relationship Summary, 84 Fed. Reg. 33492 (July 12, 2019) ("Form CRS"); Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed.

FSI remains concerned that the Proposal, while significantly updated to attempt to align to the Regulation Best Interest ruleset, regrettably will limit access to advice, products, and services. FSI appreciates the helpful changes to the Proposal, as well as the Division's time and effort, but respectfully notes that the Proposal does not adequately complement Regulation Best Interest. The Proposal continues to conflict with the SEC's interpretation of the solely incidental exclusion in the Advisers Act. The Proposal continues to have inconsistencies with federal securities law, as well as with the Commonwealth's securities statute.[4] For example, the Proposal's duty of loyalty section conflicts with Regulation Best Interest in significant ways and would require broker-dealers to abandon practices and products to the detriment of investors. The Proposal's differences from Regulation Best Interest far outweigh its similarities, raising preemption concerns. The same concerns that could lead to a preemption analysis of the Proposal also present as workability concerns for interstate application of the Proposal. Finally, we also share our concerns regarding the application of the Proposal to investment adviser representatives of federal covered advisers notice filed with the Division.

FSI has long been a supporter of a carefully crafted heightened standard of care for broker-dealers and we believe Regulation Best Interest will significantly improve investor protection. We believe any standard of care must require reasonable and streamlined disclosures to ensure industry participants effectively communicate any material conflicts of interest to their clients and prospective clients. As outlined in further detail below, FSI provided extensive feedback as part of the Regulation Best Interest rulemaking process and remains supportive of the Regulation Best Interest ruleset adopted on June 5, 2019. While we appreciate the Division's hesitation to support Regulation Best Interest, the ruleset is robust and results in heightened investor protections without sacrificing investor access and choice. Regulation Best Interest created a new, nationwide, heightened standard of conduct for broker-dealers and their representatives, while also taking into account the broker-dealer business model. We note that numerous public statements since the June 5 adoption date further reinforce the investor protective nature of the rule.[5] FSI's members have devoted significant resources toward implementation and request that the Division either more closely align its Proposal with Regulation Best Interest, or delay the Proposal to assess Regulation Best Interest once it is implemented and been effective for a sufficient period of time.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are more than 160,000 independent financial advisors, which account for 53 percent of all producing registered representatives.[6] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers ("IBD").[7] FSI's IBD member firms provide business

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Reg. 33669 (July 12, 2019) (the "Adviser Release"); Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, 84 Fed. Reg. 33681 (July 12, 2019) (the "Solely Incidental Release").

[4] *See generally* Mass. Gen. Laws ch. 110A.

[5] See e,g, Jay Clayton, Regulation Best Interest and the Investment Adviser Fiduciary Duty: Two Strong Standards that Protect and Provide Choice for Main Street Investments (July 8, 2019), available at https://www.sec.gov/news/speech/clayton-regulation-best-interest-investment-adviser-fiduciary-duty.

[6] Cerulli Associates, Advisor Headcount 2016, on file with author.

[7] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment adviser firm.

support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $48.3 billion of economic activity.[8] This activity, in turn, supports 482,100 jobs, including direct employees, those employed in the FSI supply chain, and those supported in the broader economy.[9]

The Proposal would affect FSI's members in their capacity as broker-dealers and broker-dealer representatives; many FSI member firms are also registered with the SEC as investment advisers, thus meeting the Massachusetts Uniform Securities Act's ("the Act") definition of federal covered adviser[10] if notice filed with the Division.[11] FSI notes that federal covered advisers are not covered by the Proposal, as they are excluded from the Massachusetts statutory definition of investment adviser. However, FSI remains concerned about the impact of the Proposal on the investment adviser representatives of FSI's members that are federal covered advisers, both from the perspective of jurisdiction and workability, as well as the unfair advantages FSI advisors who are registered elsewhere will have when doing business in jurisdictions other than Massachusetts.

Overview of the Proposal

The Proposal comprises two parts: amendments to 950 CMR 12.204 and 950 CMR 12.205 and new proposed rule 950 CMR 12.207. We note that the amendments to 950 CMR 12.204 and 205 remain unchanged from the Pre-Proposal, and therefore reiterate our comments from our July 24, 2019 letter (attached). With regard to 950 CMR 12.207, we discuss below the highlights of the Division's changes to the Proposal, as compared to the Pre-Proposal. We note that the Proposal's requirement for broker-dealers, state-registered investment advisers and investment adviser representatives to act as fiduciaries has expanded beyond securities. The Proposal now includes providing advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the purchase, sale, or exchange of any security, as well as commodity or insurance products. We also note that the language referring to advice in "any capacity" has been removed from the Proposal as compared to the Pre-Proposal.

The Proposal characterizes the duties of care and loyalty as the duties of utmost care and loyalty. The addition of "utmost" is new to the Proposal as compared to the Pre-Proposal. Other than the addition of utmost, the duty of care requirements in the Proposal are largely similar to the Pre-Proposal, with certain minor additions. To satisfy the duty of loyalty under the Proposal

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[8] Oxford Economics, The Economic Impact of FSI's Members at p. 23 (July 2016), https://financialservices.org/wp-content/uploads/2017/03/FSI-Impact-Report-Final.pdf.

[9] *Id* .

[10] Mass. Gen. Laws ch. 110A § 401(o) ("'Federal covered adviser' means a person who is registered with the Securities and Exchange Commission under section 203 of the Investment Advisers Act of 1940. 'Federal covered adviser' shall not include any person who is excluded from the definition of 'investment adviser' pursuant to clauses (A) to (G), inclusive, of paragraph (1) of subsection (m)").

[11] *Form ADV,* Part 1A, Item 2C, available at https://www.sec.gov/about/forms/formadv-part1a.pdf.

requires disclosure of material conflicts; reasonably practical efforts to avoid conflicts of interest, eliminate conflicts that cannot be avoided, and mitigate conflicts that cannot be avoided or eliminated; and the provision of recommendations or investment advice without regard to the financial or any other interest of any party other than the customer or client. We note that the Proposal has added a materiality standard, as well as the concept that disclosure *or* mitigation of conflicts alone do not meet or demonstrate the duty of loyalty.[12] We also note the Proposal's addition of a presumption of breach of the duty of loyalty when a recommendation is made in connection with any sales contest, implied or express quota requirement, or other special incentive program.[13] This presumption includes recommendations for any investment strategy, the opening of or transferring of assets to a specific type of account, or the purchase, sale, or exchange of any security product, commodity, or insurance product (the inclusion of the latter two products are additions to the Proposal as compared to the Pre-Proposal).[14]

With regard to the duration of the fiduciary duty, the Proposal further expanded the requirements that could trigger an ongoing duty. The Proposal triggers a range from specifically enumerated contractual obligations to ongoing compensation. We note that the Division highlights that "the precise scope of these fiduciary principles [duties of care and loyalty] will vary based on the nature of the relationship with the customer or client. [And that] Specifically, the Proposal accommodates both ongoing advice relationships and truly episodic advice relationships."[15] We also note that the proposed rule text does not provide this level of clarity. The Proposal also added a requirement in connection with titling, whereby use of certain titles including *adviser, manager, consultant* or *planner* in conjunction with terms such as *financial, investment, portfolio*, or *retirement*, among others, would trigger regular or periodic account monitoring.

Discussion

Like the Division, FSI has been actively engaged in the standards of care debate as an active commenter. Since 2009, we have publicly supported a carefully crafted standard of care that requires both a duty of care and a duty of loyalty of all professionals providing personalized investment advice to retail clients.[16] In the most recent round of SEC rulemaking, resulting in Regulation Best Interest, FSI continued to provide information and feedback.[17] We were pleased that the importance of investor access to affordable investment products, services,

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[12] The Pre-Proposal included a provision that there shall not be a presumption that disclosure of a conflict of interest could satisfy the duty of loyalty, but the Proposal expanded this presumption to include disclosure *and* mitigation.
[13] Proposed Rule 12.207(d).
[14] Proposed Rule 12.207(d).
[15] Request for Comment at p. 6.
[16] See, e.g., Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Jay Clayton, Chairman, U.S. Securities and Exchange Commission (October 30, 2017) (responding to request for Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker Dealers), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2657870-161400.pdf.
[17] See, e.g., Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Brent Fields, Secretary, U.S. Securities and Exchange Commission (December 7, 2018), (Regarding File No. S7-07-18 Regulation Best Interest; File No. S7-08-18 Form CRS Relationship Summary), https://www.sec.gov/comments/s7-07-18/s70718-4728952-176766.pdf; *see e.g.,* Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Brent Fields, Secretary, U.S. Securities and Exchange Commission (August 7, 2018), (Regarding Regulation Best Interest; Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation; Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles), https://www.sec.gov/comments/s7-07-18/s70718-4181966-172528.pdf.

and advice was part of the final Regulation Best Interest.[18] We also appreciate the Regulation Best Interest ruleset affirms the differences of the broker-dealer and investment adviser business models, while enhancing the broker-dealers standard of care to a heightened standard.

As we noted in our response to the Division's Pre-Proposal, we are concerned that the Division will impose a new regulatory structure that varies significantly from the acknowledged broker-dealer and investment advisory business models and would drastically alter the relationships between broker-dealers and their retails clients in the Commonwealth. Additionally, we believe the Proposal would result in more costly pricing structures for brokerage services, which limits access to advice, may be inconsistent with some investors' expectations and needs, and may not, in fact, be within their best interest. We also reiterate our Pre-Proposal comment's view that a broker-dealer's relationship with its customers is fundamentally different from that of an investment adviser's relationship with its client. We note that broker-dealer arrangements can be particularly useful to low- and middle-income retail investors who would otherwise be unable to afford advice and services under a fee-based advisory arrangement, while advisory services arrangements (usually compensated on a percentage of total assets managed for a client) can be particularly useful for middle- and high-income retail investors who can afford to pay an ongoing fee for services.

FSI continues to believe that the investor protections provided under Regulation Best Interest and Form CRS closely align with the protections that would be provided under the Proposal, while also preserving investor choice and access, and preserving the distinctions between the broker-dealer and investment adviser business models. Should the Division choose to move forward with the Proposal, FSI urges the Division to consider the burden that the Proposal will have on access to advice for many Main Street Americans, and the limitations that it will impose on products and services offered by broker-dealers. This could result in many of the Commonwealth's investors with a small or moderate amount of investable assets to lose access to their chosen financial professional. When faced with the increased costs associated with monitoring customers' accounts on an ongoing basis, a broker-dealer would be forced to either move their brokerage customers to fee-based advisory accounts or cease providing brokerage services to those customers' accounts altogether. Many negative unintended consequences will result if the Commonwealth investors lose access to financial professionals as a result of the Proposal.

Beyond these overriding concerns, we offer specific constructive feedback and suggestions below.

I. Inconsistencies with Federal and State Securities Laws

FSI reiterates its concerns that the Proposal's requirement of a fiduciary duty for broker-dealers (with broad inclusion of what constitutes an ongoing obligation) blurs the meaningful distinctions between brokerage services and advisory services. There are both practical concerns —such as investor confusions—and legal concerns to these inconsistencies between federal law

[18] *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, Securities Exchange Act Release No. 86031 (June 5, 2019) at 7, available at https://www.sec.gov/rules/final/2019/34-86031.pdf ("Reg BI Adopting Release") ("This variety [different broker-dealer and investment adviser business models] is important because it presents investors with choices regarding the types of relationships they can have, the services they can receive, and how they can pay for those services. It is also common for a firm to provide both broker-dealer and investment adviser services."); *see also* 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 at https://www.sec.gov/news/public-statement/statement-clayton-060519-iabd.

and the Proposal, and between Massachusetts law and the Proposal. We outline these concerns below and recommend that the Division re-examine the Proposal to cure these inconsistencies.

A. The Broker-Dealer Exclusion from the Investment Advisers Act for Solely Incidental Investment Advice Should be Further Examined by the Division

FSI appreciates the Division's efforts in revising the Pre-Proposal's requirement regarding the ongoing nature of a broker-dealer's duty and the clarification in the Notice for Public Comment that the Proposal can apply episodic or ongoing fiduciary duty to broker-dealers and broker-dealer representatives. However, FSI remains concerned about the inconsistency between the Proposal and the well-established broker-dealer exclusion from the Investment Advisers Act for solely incidental investment advice. FSI believes that the Proposal goes against well-established law and guidance and would unnecessarily blur the meaningful distinction between brokerage and advisory services by holding broker-dealers to a fiduciary standard even when they provide services in connection with brokerage services. We especially had that concern with the Pre-Proposal's impact on dual registrants, but the Proposal, as revised, continues to raise this concern for all broker-dealers and their representatives, whether they are dual registrants or not.

The Proposal takes a position that significantly differs from the position taken by the Act and the SEC, both of which embrace the fundamental differences between brokerage services provided in a broker-dealer capacity and advisory services provided in an investment adviser capacity. For example, the Act explicitly excludes registered broker-dealers and broker-dealer agents from the definition of an investment adviser. [19] Unlike the Uniform Securities Act after which it was modeled, the Act's broker-dealer exclusion is not conditioned on the requirement that special compensation is not received.[20] This supports the conclusion that the Commonwealth's legislature acknowledges that broker-dealers may receive compensation for advice and still not trigger investment adviser registration requirements. In addition, the Official Comments to the Uniform Securities Act quote the SEC in agreeing that the exclusion for broker-dealers from the definition of an investment adviser recognizes "that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business."[21] The Official Comments note that the distinction may be drawn between investment advisers and broker-dealers. We recommend the Division further examine the inconsistencies between federal law and the Proposal, as well as between Massachusetts law and the Proposal.

B. The Duration of a Broker-Dealer's Duty to a Customer Should Remain Episodic

As noted above, we appreciate the Division's efforts in revising the Pre-Proposal's requirement regarding the ongoing nature of a broker-dealer's duty and the addition of criteria in the Proposal. However, the revisions continue to contemplate a broker-dealer to have a continuous duty in many instances, including criteria that range from objective (e.g. contractual obligations) to highly subjective (e.g. engaging in any act, practice, or course of business that results in customers' reasonable expectations of regular or periodic monitoring). These criteria are unworkable, for reasons outlined below, as well as confusing the fundamental purpose of the

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[19] Mass. Gen. Laws ch. 110A, § 401(m) ("'Investment adviser' also includes financial planners and other persons who, as an integral 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 adviser' shall not include:
….(F) a registered broker-dealer or broker-dealer agent").

[20] See Mass. Gen. Laws ch. 110A, § 401(m)(1)(F). *But see* Uniform Securities Act, § 102(f).

[21] See Uniform Securities Act of 1956, Section 401.01 (Official Code Comment) (quoting the SEC).

brokerage relationship with that of an advisory relationship. Broker-dealer relationships are based on an episodic, transaction-based duty, while investment advisers have an ongoing duty.

We noted in our response to the Division's Pre-Proposal that imposing a fiduciary duty on a customer's relationship with its broker-dealer is artificial and confuses the fundamental purpose of the brokerage relationship with that of an advisory relationship. The Proposal continues to present the same challenges for any broker-dealer relationships with customers, particularly relationships the Proposal would consider ongoing relationships with ongoing fiduciary duty. We note that an advisory relationship is generally expected to include ongoing monitoring.[22] In contrast, the federal securities laws define "broker" and ""dealer" in the context of "effecting transactions" and "buying and selling securities," respectively.[23] Similarly, as we noted above, the Commonwealth defines a "broker-dealer" in the context of "effecting transactions in securities"[24] and excludes broker-dealers from the definition of investment adviser.[25]

C. Additions to the Proposal, such as the Provisions on Titles or Ongoing Compensation, Remove Availability of Episodic Duty Component of the Proposal

Two additions to the proposal take long-held broker-dealer practices and undo the Division's confirmation that episodic duty is part of the Proposal. One addition to the Proposal is ongoing duty being triggered as a result of use of any combination of common titles. We note that based on the titling restrictions, the near totality of broker-dealer representatives would be subject to an ongoing duty, essentially undoing the Proposal's clarification that fiduciary duty obligations could be episodic. This will contribute to further compliance costs as well as investor confusion.

Second, the "receives ongoing compensation or charges ongoing fees" language is overly broad and would also trigger the Proposal's continuous duty if applied in the context of many investment products, such as mutual funds, that have various fees, trailing commissions, or other costs that could be characterized as ongoing compensation.

These additions to the Proposal further trigger the conflict between the Proposal and the broker-dealer exclusion for incidental advice, discussed immediately above.

D. Investment Adviser Representatives of Federal Covered Advisers Are Subject to Fiduciary Duty Pursuant to the Advisers Act

Most FSI member firms provide investment advice through registered investment advisers. We acknowledge the Commonwealth's authority to promulgate regulations for state-registered investment advisers and their investment adviser representatives, but note that federal covered advisers are excluded from the Massachusetts definition of investment adviser. Furthermore, the Act also refers to investment adviser representatives subject to the limitations of Advisers Act Section 203A.[26] We recommend the Division examine its over-inclusion of investment adviser

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[22] The Adviser Release at p. 33675; *see also* Mass. Gen. Laws ch. 110A, § 401(m).
[23] 15 U.S.C. § 78c(a)(4) and (a)(5).
[24] Mass. Gen. Laws ch. 110A, § 401(c).
[25] Mass. Gen. Laws ch. 110A, § 401(m) ("'Investment adviser' also includes financial planners and other persons who, as an integral 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 adviser' shall not include:
….(F) a registered broker-dealer or broker-dealer agent").
[26] Mass. Gen. Laws ch. 110A, § 401(m); *see also* Advisers Act 203(A) ("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

representatives in the Proposal and consider carving out investment adviser representatives of federal covered advisers from the 12 CMR 207 requirements. We appreciate and understand that the Commonwealth has jurisdiction to license, register or qualify investment adviser representatives, but reiterate that, other than license, register or qualify, the state reach towards investment adviser representatives is circumscribed to solely conduct that triggers the Commonwealth's anti-fraud authority. The Commonwealth does not have the authority to mandate conduct for investment adviser representatives of federal covered advisers (Please refer to IV.C. for addition discussion on this topic).

E. The Addition of Commodity and Insurance Products to the Proposal Further Highlights Inconsistencies between the Proposal and the Commonwealth's laws.

We respectfully request that the Proposal be amended to expressly exempt commodities and insurance products. We agree with the Division's "acknowledge[ment] that annuities are not considered securities"[27] and note that the Massachusetts Division of Insurance is the primary regulator of the insurance business in the Commonwealth. The Massachusetts Division of Insurance is not contemplating a fiduciary standard. We note that maintaining insurance products within the Proposal is another example of inconsistencies within the Commonwealth's laws, and also that inclusion of the insurance products could require some broker-dealer registrants who are also selling insurance to be at a disadvantage based solely on their broker-dealer registration.

II. Conflicts of Interest

As we noted above, FSI has long supported a carefully crafted standard of care that requires both a duty of care and a duty of loyalty of all professionals providing personalized investment advice to retail clients. We appreciate the changes the Division has made to the duty of loyalty and conflicts of interest sections of the Proposal, particularly with the addition of materiality as a standard for disclosure of conflicts of interest. However, we note below several areas in the Proposal's conflicts of interest requirements that are challenging from a compliance standpoint. We also note that these requirements are largely in conflict with Regulation Best Interest, and recommend the proposal be more closely aligned to Regulation Best Interest.

A. Satisfying the Duty of Loyalty Under the Proposal Would Require Broker-Dealers to Abandon Practices and Products to the Detriment of Investors

Under the Proposal, the duty of loyalty would require that "all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts that cannot be avoided, and mitigate conflicts that cannot be avoided"[28] be made, as well as the disclosure of all materials conflicts of interest. We note that the Proposal has improved upon the Pre-Proposal's "avoid conflicts" construction, though these improvements are undermined by the language that "disclosing or mitigating conflicts alone does not meet or demonstrate the duty of loyalty."[29]

We note that this new language conflicts with Regulation Best Interest's Conflict of Interest Obligation, which requires that all materials conflicts must be disclosed, conflicts that created an incentive for a financial professional to place its interest ahead of the customer must be mitigated and select conflicts must be eliminated. We reiterate our comments on the Pre-Proposal regarding the importance of considering the 2018 RAND Report in addition to the 2008 RAND Report, as

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that is a supervised person of such person, except that a State may license, register, or otherwise qualify any investment adviser representative who has a place of business located within that State").

[27] Request for Comment at p. 6.

[28] Proposed 950 CMR 12.207(2)(b). We address the remainder of this section, particularly the "without regard to" construction, in II. B.

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

well as the fact that the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") did not intend to create a conflict-free environment for broker-dealers.[30] We also note that federal covered advisers may rely on disclosure and the customer's consent to satisfy fiduciary duty requirements;[31] in turn, these obligations flow down to the associated persons of federal covered advisers, including those registered as investment adviser representatives. For consistency and clarity, we encourage the Division to amend the Proposal to align more closely to Regulation Best Interest.

B. "Without Regard to" Should be Replaced with "Without Placing the Financial or Other Interest…. Ahead of the Interest of the Retail Customer"

Under the Proposal, satisfying the duty of loyalty requires that recommendations are made or investment advice is provided without regard to the financial or any other interest of any party other than the client.[32] While we understand the origin of this language, we recommend that the Division undertake the same analysis as the SEC with regard to this language and substitute "without placing the financial or other interest…ahead of the interest of the retail customer"[33] in replacement of "without regard to."

We note that the "without regard to" language originated in the Dodd-Frank Act and the subsequent SEC study pursuant to section 913 of the Dodd-Frank.[34] However, the SEC provided sound reasoning for adopting the alternative "without placing the financial or other interest…" language in Regulation Best Interest.[35] The SEC acknowledges its change in course from the Dodd-Frank Act and the 913 Study, by noting that the best interest standard of conduct is intended to align with an investment adviser's fiduciary duty.[36] The SEC substituted "without regard to" for fear that it would be "inappropriately construed to require a broker-dealer to eliminate all of its conflicts when making a recommendation (i.e., require recommendations that are conflict free), which [the SEC believes] could ultimately harm retail investors by reducing their access to differing types of investment services and products and by increasing their costs."[37] For consistency and clarity, and to avoid potential harm to retail investors in the Commonwealth, we reiterate our request that the Division amend the Proposal to align more closely to Regulation Best Interest.

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[30] *See* Section 913(g) of the Dodd-Frank Act (permitting the SEC to adopt a fiduciary duty for broker-dealers that requires "disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest.").

[31] *See* Adviser Release; *see also* Amendments to Form ADV, Release No. IA-3060 (March 3, 2008).

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

[33] Reg BI Release at p. 33326; Reg BI Adopting Release at 208.

[34] Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("913 Study"), www.sec.gov/news/studies/2011/913studyfinal.pdf.

[35] Reg BI Release at p. 33319.

[36] Reg BI Release at p. 33331 ("By replacing the "without regard to" language of Section 913(g) and the 913 Study with the "without placing the financial or other interest of the [broker-dealer] . . . ahead of the interest of the retail customer" phrasing, we did not intend to create a "lower" or "weaker" standard compared to the language of Section 913(g) and the 913 Study. Rather, we are adopting a standard that reflects that a broker-dealer should not put its interests ahead of the retail customer's interest, and thereby aligns with (and in certain areas imposes more specific obligations than) the investment adviser fiduciary duty, at the time a broker-dealer makes a recommendation to a retail customer.").

[37] Reg BI Release at p. 33332.

C. Principal Transactions, Proprietary Products and Limited Product Offerings: The Proposal's Silence on These Common Brokerage Activities Creates Further Uncertainty Regarding the Proposal's Application of Fiduciary Duty to Broker-Dealers

Principal transactions represent a clear benefit to retail investors, as they provide retail investors with the ability to purchase municipal bonds in brokerage accounts and sell back to the broker-dealer those brokerage products that are often considered to be illiquid (i.e., less frequently traded). FSI requests clarification on the extent to which the Proposal permits principal transactions, affiliated and proprietary products, and limited product offerings. Specifically, FSI requests clarification as to whether a broker-dealer's duty of loyalty would prohibit principal transactions, the sale of affiliated and proprietary products or limited product offerings.

The Reg BI Release acknowledges that the Dodd-Frank Act does not require a prohibition on broker-dealers engaging in principal trades.[38] In addition, the SEC notes that a broker-dealer would be required to "disclose all material facts relating to conflicts of interest associated with the recommendation that might incline a broker-dealer to make a recommendation that is not disinterested, including, for example, proprietary products, payments from third parties, and compensation arrangements."[39] We urge the Division to align the Proposal with Regulation Best Interest by explicitly permitting principal transactions, the sale of affiliated and proprietary products, and limited product offerings, and requiring disclosures of any material conflicts of interest such transactions and products create.

D. Sales Contests, Sales Quotas, Bonuses and Non-Cash Compensation: The Proposal's Expansive Approach to These Types of Compensation is Overly Broad and Could Hamper Firms' Productivity Management.

We recommend that the Division adopt the same sales contest language as Regulation Best Interest, which 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."[40] We agree with Regulation Best Interest's distinction between reasonable and neutral measures of performance and productivity as opposed to sales contests improperly favoring certain investment products. We reiterate our request that the Proposal be amended to expressly exempt commodities and insurance products.

FSI makes this recommendation as we are concerned with the broad language in the Proposal creating a presumption that virtually all sales contests, quotas, and other special incentive programs violate the duty of loyalty. Specifically, we are concerned about the broadness of and lack of definition within the language, as well as this provision becoming a barrier for FSI members to manage productivity. We note that the Proposal does not define implied quota requirements, express quota requirements, and special incentive programs. We are also concerned that the restrictions on sales contests, quotas or other special incentive programs apply to commodities and insurance products as well as securities. Adopting Regulation Best Interest's language would remediate these concerns

III. Interstate Application of Various Standards of Care: The Proposal's Application Will Disadvantage Broker-Dealers with Offices or Clients in Massachusetts

[38] Reg BI Release at p. 33331 n. 126.
[39] Reg BI Release at p. 33483.
[40] Reg BI Release at p. 33321.

FSI remains concerned about the Proposal's lack of clarity surrounding interstate application, as there is no explicit limitation of application of the Proposal to Massachusetts clients. In response to the Pre-Proposal, FSI urged the Division to also consider the impact to retail investors with respect to interstate issues. We reiterate our concerns from the Pre-Proposal, noting that the Proposal has not provided additional details regarding how a broker-dealer's fiduciary duty would apply to retail customer relationships when the customer is located or employed in, or moves to, or spends a significant portion of the year in other states where different (and potentially inconsistent) standards of care and related rules govern relationships between broker-dealers and their retail customers. We expect firms to seek to limit the application of the Proposal to just Massachusetts clients and therefore recommend that the Proposal be revised to explicitly limit its application to retail investors who are residents of Massachusetts or who reside in that state.

We also recommend that the Division consider incorporating a de minimis structure for out-of-state firms with Massachusetts clients, and applying the Proposal only when the firm or advisors are registered or required to be registered in the Commonwealth. We encourage the Division to explore ways of reducing the compliance burden on firms and advisors who may not have a presence in the Commonwealth, but have an occasional client move to the Commonwealth. One approach could be to draw from the long-held principles in the state-registered investment adviser regulatory structure[41] and including a similar threshold (of number of clients) for the Proposal to apply to out-of-state firms.

IV. The Proposal is Subject to Preemption under Federal Law

Despite the changes to the Proposal as compared to the Pre-Proposal, FSI believes that the Proposal continues to present both legal and policy weaknesses, including significant preemption issues for both broker-dealers (and their representatives) and for investment adviser representatives of federal covered advisers notice filed in Massachusetts. In addition to the specific preemption concerns outlined below, we also note several additional preemption concerns, including parts of the securities laws and beyond.[42] We also note that the Proposal should explicitly clarify that it does not create a private right of action; if the Proposal implicitly created a private right of action, the Federal Arbitration Act would expressly preempt it as the FAA restricts the enforcement of arbitration agreements.

A. Preemption Under NSMIA Applies with Regard to Broker-Dealer Books and Records

Under the National Securities Markets Improvements Act ("NSMIA"), states are prohibited from requiring broker-dealers to, among other things, make and keep records that differ from, or are in addition to, the records required under the federal rules. As a practical matter, the Proposal would have the effect of imposing new recordkeeping requirements on broker-dealers, as broker-dealers seek to develop, implement and document policies and procedures to demonstrate compliance with the Proposal's requirements.

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[41] *See* Mass. Gen. Laws ch. 110A, §202(c)(3)(e); *see also* 950 CMR 12.205(10(b); *see also* Advisers Act 222(d)(2) ("… during the preceding 12-month period, has had fewer than 6 clients who are residents of that State").

[42] These concerns include additions such as: preemption language in the Advisers Act, the Exchange Act and the Securities Act, express preemption issues, conflict preemption, the Constitution's Commerce Clause, the Employee Retirement Income Security Act of 1974 (ERISA) preemption, and the Massachusetts Administrative Procedure Act

B. The Proposal Does Not Have the Authority to Impose a Uniform Standard of Care on Broker-Dealers under Dodd Frank Section 913 and Also Conflicts with Regulation Best Interest and federal law

We note that Section 913 of Dodd-Frank did not require the SEC to establish a uniform standard; instead, Section 913 called for an SEC study on the topic, as well as follow-up steps towards rulemaking. The SEC has completed this rulemaking. Therefore, the Division has no void to fill, nor did Dodd-Frank contemplate anything other than a federal solution to raising the standard of care for applicants.

Furthermore, as discussed earlier, the ongoing nature of the Proposal's obligations is in direct conflict with the Regulation Best Interest ruleset, including the solely incidental release.

C. The Proposal's Attempt to Regulate the Conduct of Investment Adviser Representatives of Federal Covered Advisers Conflicts with Federal Law

State securities regulators, such as the Division, are solely allowed to impose specific registration, licensing and qualification requirements on investment adviser representatives of federal covered advisers; beyond that, NSMIA preempts regulation of investment adviser representatives with the exception of those provisions relating to enforcement of anti-fraud prohibitions.[43] The Investment Advisers Act Section 203A grant of partial authority over investment adviser representatives is focused solely on registration, licensing and qualification. None of these three concepts include a conduct standard; the qualification concept includes solely qualification by examinations (e.g. Series 65 or 66), as described by several regulators and quasi regulatory entities.[44] The Commonwealth retains anti-fraud authority over federal covered advisers as well as investment adviser representatives, but otherwise solely has the authority to register, license and qualify investment adviser representatives of federal covered advisers.

We note that application of the Proposal to IARs of federal covered advisers would be indirect substantive regulation of SEC-registered investment advisers and would be contrary to NSMIA. We recommend the Proposal be amended to exempt investment adviser representatives of federal covered advisers from the Proposal.

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[43] Advisors Act 203(A).

[44] SEC, *Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("The states also regulate the activities of many investment advisers. Most smaller investment advisers are registered and regulated at the state level. Investment adviser representatives of state- and federally-registered advisers commonly are subject to state registration, licensing or qualification requirements."), available at https://www.sec.gov/news/studies/2011/913studyfinal.pdf; *see also* Letter from Thomas M. Selman, Executive Vice President, FINRA, to Jennifer B. McHugh, Senior Advisor to the Chairman, U.S. Securities and Exchange Commission (Nov. 16 2010), (Regarding Investment Adviser Qualification Examination Program (Nov. 16, 2010) ("In creating a qualifications program for investment advisers (IAs), the Commission should consider a program that is tailored to the law, regulations, services and products offered by investment advisers. This structure would provide for the qualification and registration of investment adviser representatives (IARs) and supervisory personnel. FINRA recognizes that many states currently require investment adviser personnel to pass the Uniform Investment Adviser Law (Series 65) Examination in order to register with such states as an investment adviser representative.") available at https://www.sec.gov/comments/4-606/4606-2850.pdf; *see also* Letter from David Massey, President, NASAA, to Jennifer B. McHugh, Senior Advisor to the Chairman, U.S. Securities and Exchange Commission (Dec. 13, 2010) (Regarding Investment Adviser Qualification Examination Program) ("As explained in the report submitted to the Commission by NASAA pursuant to the Section 913 Study, to register as an investment adviser representative individuals must satisfy certain competency requirements. Generally individuals can meet the state competency requirements by obtaining a passing score on the Series 65 examination, the Series 7 and 66 examinations, or otherwise be qualified by virtue of holding one or more recognized credentials.") available at https://www.sec.gov/comments/4-606/4606-2859.pdf.

V. The Proposal Will Significantly Reduce, or Eliminate, FSI Members' Services to Massachusetts Investors and Negatively Impact Economic Activity

FSI members make significant contributions to local economies. FSI members generate $1.6 billion of economic activity in the Commonwealth.[45] This activity, in turn, supports 17,000 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy.[46] Furthermore, FSI members contribute nearly $72 million annually to Commonwealth and local government taxes.[47] If FSI members are held to a unique standard of care in the Commonwealth, particularly if the requested clarification and exemptions are not provided, these financial advisors may have to cease doing business with or cut back on financial services provided to retail investors in the Commonwealth. This would undoubtedly have a negative impact on the Commonwealth's advisors, specifically those serving low- to middle-income retail investors who are residents of the Commonwealth.

VI. Extension of the Effective Date

In light of the ongoing implementation phase of Regulation Best Interest, we recommend the Division delay effective date of the Proposal until Regulation Best Interest has been effective for a sufficient period of time. We however also reiterate our recommendation that the Division either more closely align its Proposal with Regulation Best Interest, or delay adopting the Proposal to assess Regulation Best Interest once it is implemented and been effective for a sufficient period of time. Should the Division decide to proceed, we would encourage the Proposal to have an effective date of on or after June 30, 2020 and to include an implementation period of at least 18 months. Alternatively, we would urge that the Division delay the enforcement date for at least 18 months

Thank you in advance for considering this request. If you have questions about anything in this letter, or if we can be of any further assistance in connection with this rulemaking, please feel free to contact Robin Traxler, FSI's Senior Vice President, Policy and Deputy General Counsel, at robin.traxler@financialservices.org or (202) 393-0022.

Respectfully submitted,

David Bellaire
Executive Vice President & General Counsel

[45] Oxford Economics, The Economic Impact of FSI's Members at p. 30 (July 2016), https://financialservices.org/wpcontent/uploads/2017/03/FSI-Impact-Report-Final.pdf.
[46] Oxford Economics, The Economic Impact of FSI's Members at p. 30 (July 2016), https://financialservices.org/wpcontent/uploads/2017/03/FSI-Impact-Report-Final.pdf.
[47] Oxford Economics, The Economic Impact of FSI's Members at p. 30 (July 2016), https://financialservices.org/wpcontent/uploads/2017/03/FSI-Impact-Report-Final.pdf.