Testimony of Dale E. Brown, CAE

On Behalf of the Financial Services Institute

Before the Massachusetts Securities Division

of the Office of the Secretary of the Commonwealth

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I. Introduction

Hello, my name is Dale Brown, President and CEO of the Financial Services Institute (FSI). Thank you for the opportunity to provide testimony today on the Division's Fiduciary Proposal. This is an important rule proposal with a direct impact the Main Street investors that FSI members serve every day.

I want to thank Secretary Galvin, Diane Young-Spitzer, Peter Cassidy and the Securities Division staff this opportunity to share our thoughts on the Proposal.

I will first provide some background on our members and our mission before focusing on three of our areas of concern regarding the Proposal: investor choice, conflict with existing federal and Commonwealth law, and preemption. We have also filed a more extensive comment letter addressing all of our concerns. We recommend that the Division either more closely align its Proposal with the SEC's Regulation Best Interest, or delay the Proposal to assess Reg BI once it is fully implemented.

II. Background on FSI Members

First, I would like to share some background on FSI, our members and the clients they serve because this informs our perspective on the proposal. FSI is the only trade association representing independent financial advisors and independent financial services firms. The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. Our almost 90 member firms provide business support, supervision,

execution and clearing services to the 160,000 independent financial advisors affiliated with them and the clients these advisors serve. Independent financial advisors account for more than half of all producing registered representatives. These financial advisors are self-employed independent business owners, not employees of the firm through which they are licensed. They are small-business owners and job creators with strong ties to their communities. Independent financial advisors provide comprehensive and affordable financial services, including financial education, planning, implementation, and investment monitoring to middle-class and mass-affluent investors who want to ensure a dignified retirement, provide for the education of their children and achieve other Main Street financial goals.

FSI members make a significant contribution to the economy of the Commonwealth by generating $1.6 billion dollars of economic activity, supporting over 17,000 jobs and contributing more than $72 million annually in state and local taxes.

III. The Proposal Will Limit Investors' Choices.

One of the core tenets of FSI's mission since we were founded in 2004 is to ensure that all individuals have access to competent and affordable financial advice, products and services. We remain concerned that the Proposal, while updated to attempt to align to Reg BI, will limit investor choice and access to advice, products and services.

We appreciate the helpful changes to the Proposal, as well as the Division's time and effort; however, we respectfully note that the Proposal does not adequately complement Reg BI. We appreciate that the Proposal contemplates both an episodic and an ongoing fiduciary duty requirement. But the structure and requirements of the Proposal will result in the vast majority of broker-dealer relationships becoming subject to an ongoing fiduciary duty requirement. The Proposal has numerous triggers for an ongoing fiduciary duty relationship, including the new titling provision, contractual provisions for any monitoring, and the highly subjective criteria of customer expectations of regular or

periodic monitoring. Under the Proposal, and because of these triggers leading to an ongoing fiduciary relationship, a broker-dealer would often be unable to provide one-time or occasional investment advice to its brokerage clients even if such advice is in the clients' best interest. Broker-dealers seeking to comply with the new ongoing duty would face significant increased costs associated with demonstrating compliance with the Proposal.

The Proposal will deprive investors of the opportunity to choose the services and account type that best suits their needs and investment objectives. It will discourage broker-dealers from serving Massachusetts clients - whether because of cost or because of the narrow availability of episodic, rather than ongoing, fiduciary duty. The Proposal will also result in more costly pricing structures for brokerage services, which limits access to advice and may be inconsistent with investor expectations. Massachusetts investors with a smaller amount of investable assets may be especially vulnerable to losing access to their chosen financial professional who can no longer afford to serve them.

These outcomes are contrary to the best interest of Massachusetts investors.

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 (usually compensated on a percentage of total assets managed for a client) can be most appropriate for middle- and high-income retail investors who can afford to pay an ongoing fee for services. The Proposal removes these distinctions, resulting in a marked decrease of investor choice and access. We recommend that you consider aligning the Proposal much closer to Reg BI, which acknowledges the differences in broker-dealer and investment adviser business models and maintains the balance of investor choice and access.

IV. The Proposal is contrary to the congressional intent of the Investment Advisers Act of 1940, the position of the U.S. Securities and Exchange Commission, and the Massachusetts Uniform Securities Act.

Like the Pre-Proposal, the Proposal continues to have inconsistencies with federal securities law, as well as with the Commonwealth's securities statute. The Investment Advisers Act of 1940, the SEC, and the Massachusetts Uniform Securities Act all recognize the fundamental differences between brokerage services provided in a broker-dealer capacity and advisory services provided in an investment adviser capacity. The Proposal's requirement of, in many instances, an ongoing fiduciary duty, in turn conflicts with these well-established federal and state laws.

The Advisers Act excludes from its registration requirements broker-dealers who provide advisory services that are “solely incidental to the conduct of their business as [brokers-dealers],” so long as they do not receive any special compensation for their advisory services. The

SEC reiterated this position in recent guidance that was issued as part of Reg BI. The Massachusetts Act explicitly excludes registered broker-dealers and broker-dealer agents from the definition of an investment adviser. 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.

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. We recommend the Division further examine the inconsistencies between federal law and the Proposal, as well as between Massachusetts law and the Proposal.

V. The Proposal imposes books and records requirements on broker-dealers that differ from, or are in addition to, federal requirements in violation of the National Securities Markets Improvement Act.

Avoiding confusing and duplicative regulatory burdens, such as the ones this Proposal presents, was Congress' intent when it passed the National Securities Markets Improvement Act (NSMIA) in 1996. Section 103 of NSMIA expressly preempts states from enacting regulations that impose new or different recordkeeping requirements than those established under the Securities and Exchange Act of 1934. However, creating a state-specific fiduciary duty would require broker-dealers to create and maintain new records to demonstrate compliance with the state's unique fiduciary obligations. Therefore, the Proposal is preempted by NSMIA.

I note that we also address other areas of preemption in our more extensive comment letter, including the Advisers Act with respect to investment adviser representatives, other federal securities laws, ERISA and additional statutes.

VII. Closing

In closing, FSI cannot support the proposal because:

• It reduces investor choice, raises the cost of investing, and deprives some investors of access to a financial advisor;
• It is in conflict with the congressional intent expressed in the Advisers Act, the position of SEC, and the Massachusetts Uniform Securities Act; and
• It is preempted by NSMIA, as well as other statutes.

As a result, we recommend the Division either more closely align its Proposal with Reg BI, or delay the Proposal to Reg BI once implemented. Thank you again for the opportunity to testify today.