Institute for Portfolio Alternatives

January 6, 2020

Via electronic submission to: securitiesregs-comments@sec.state.ma.us

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 Institute for Portfolio Alternatives ("IPA")[1] submits the following comments on the Massachusetts Securities Division's ("Division") Proposed Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives ("Proposal"), dated December 13, 2019.[2]

The IPA has an immediate interest in applicable standards of conduct for financial professionals in Massachusetts as our members include both regulated broker-dealer firms and their investment professionals in your state and nationwide. IPA member firms support individual investor access to a wide variety of asset classes with low correlation to the traded markets and historically available only to institutional investors. These investment products have been held in the accounts of more than 3 million individual investors. With over $135 billion in capital investments, they remain a critical component of an effectively balanced investment portfolio and serve an essential capital formation function for national, state and local economies.[3]

The IPA appreciates your consideration of comments in response to the preliminary solicitation on the proposed fiduciary conduct standard and recognize certain modifications that were made in the

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1 On Monday, April 9, 2018, the Investment Program Association became the Institute for Portfolio Alternatives. The change reflects our organization's continued commitment to champion the portfolio diversifying investment industry.

2 Request for Comment, December 13, 2019, *at* https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf.

3 For over 30 years the IPA has raised awareness of portfolio diversifying investment (PDI) products among stakeholders and market participants, including investment professionals, policymakers and the investing public. We support increased access to investment strategies with low correlation to the equity markets: lifecycle real estate investment trusts (Lifecycle REITs), net asset value REITs (NAV REITs), business development companies (BDCs), interval funds and direct participation programs (DPPs). Through advocacy and industry-leading education, the IPA is committed to ensuring that all investors have access to real assets and the opportunity to effectively diversify their investment portfolios.

current Proposal.[4] However, we strongly believe that other modifications lack clarity in application and contain ambiguity in substantive interpretation. We remain concerned that these changes will negatively impact the availability of broker-dealer services to retail customers in Massachusetts. We, along with our broker-dealer members and other associations, strongly urge your consideration of the comments expressed below:

1. Before addressing the substantive provisions of the Proposal, we strongly encourage that the Division, before promulgating any final rule, allow firms to fully implement the new federal standard promulgated by the Securities and Exchange Commission ("SEC") in Regulation Best Interest and Form CRS (collectively, "Reg BI").[5] Re. BI requires federal and state regulators, broker-dealers and investment advisers to adopt significant new requirements, procedures and policies to address, examine for, and enforce compliance under the new rule. While we understand that the Division does not support the SEC's new federal standard, we are concerned by its dismissiveness of the real compliance and operational costs of implementing the new standard.[6] We also believe that Reg BI significantly improves the broker-dealer standard of conduct owed to investors.[7] There are substantial practical challenges that your registrants face in complying with Reg BI, associated FINRA rule changes, and similar changes necessitated under state securities laws by the June 30, 2020 compliance deadline. This concern is elevated by conflicting state requirements that create confusion and uncertainty for firms, financial professionals and their customers/clients, and therefore do not further the goals of investor protection.

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[4] We appreciate that the Division recognized our concerns about the effect of the "best of" standard used in the preliminary solicitation, and removed this language in the current Proposal. See IPA Letter to Secretary William Francis Galvin, July 26, 2019, *at* https://www.ipa.com/wp-content/uploads/2019/07/IPA-Letter-to-MA-Securities-Bureau-FINAL-7.26.19.pdf.

[5] Regulation Best Interest, 17 CFR Part 240, Release No. 34-86031; File No. S7-07-18 (June 5, 2019).

[6] For example, the Division states "[t]he time to establish a true uniform fiduciary standard to protect Massachusetts investors is now, before industry habit and practices harden around Reg BI and form a barrier to further improvements." Request for Comment, at 5.

[7] For example, unlike the previous FINRA suitability rule, Reg BI requires a customer's best interest to be placed *before* the financial or other interest of the broker-dealer firm or its individual agents. "Cost" must be explicitly considered as part of the recommendation. Firms must mitigate conflicts that create an incentive for the broker-dealer to place his or her own interest ahead of the investor, and must eliminate sales contests, quotas, bonuses, and non-cash compensation based on sale of specific securities or types of securities within a limited period of time. Reg BI also establishes a new duty of care for broker-dealers and requires firms to demonstrate compliance with the rule as a whole. For firms, this entails new policies, processes, methodology, training, testing, continuous improvement, escalation, and other factors. Firms must develop and distribute the new Form CRS both to new clients but also to existing or legacy clients. This involves consideration of investors' locations, age and demographics, and new methods of communication. Form CRS requires disclosures about the broker's compensation, legal disciplinary history, conflicts of interest and a summary of services. A broker must also disclose the capacity in which they are acting at the outset of the relationship, and cannot use the terms "advisor" or "adviser" unless they are a registered investment adviser or their representative.

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2. We believe the increased costs will directly impact the availability and cost of financial advice for Massachusetts investors, particularly those with small dollar accounts or "buy-and-hold" strategies. As an example of the impact of the loss of episodic brokerage services for Massachusetts investors, suppose Mr. and Mrs. Smith, 55 and 57 years old, respectively, inherit $50,000, which they intend to keep invested for at least 7 years until their retirement. They want to invest in a diversified portfolio of mutual funds with a combination of stocks and bonds, and have two options: (1) a brokerage account paying a one-time average commission of 5%, or (2) a fee based account where they will pay 1.5% per year as the standard rate for smaller accounts. Mr. and Mrs. Smith will pay a one-time commission of approximately $2,500 to invest through a brokerage account at the time the investment is made versus an annual fee of approximately $750 per year for a total of $5,250 (more than double the one-time brokerage fee) in an advisory account over the next seven years. If the account increases in value over the seven years, then the annual fees paid will increase as well. Preserving the option of transaction-based brokerage services is critical for investors in Massachusetts with smaller accounts or with specific circumstances where a one-time commission may be better for the investor.

3. The IPA is concerned about the duty of loyalty requirements regarding avoidance, elimination and mitigation. We appreciate that the Proposal adds the addition of the word "material" in its requirement to disclose conflicts of interest, but we are deeply concerned about the lack of clarity and ambiguity that "disclosing or mitigating conflicts alone does not meet or demonstrate the duty of loyalty." Read in combination with the requirement that financial professionals must "[m]ake all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts that cannot be avoided, and mitigate conflicts that cannot be avoided or eliminated," it is unclear how the duty can be met if mitigation is insufficient to meet the duty. In other words, after all reasonably practicable efforts are made to avoid and/or eliminate conflicts, how could a broker-dealer demonstrate compliance if mitigation is its only option. Because certain conflicts are inherent in any fee-for-service based business, the Division should provide guidance on how mitigation can achieve compliance where avoidance and elimination is not an option. Moreover, the Proposal is unclear whether *all* conflicts must be avoided, and it is also unclear if mitigation is required *only after* avoidance and/or elimination of conflicts. Similar to our comments in the preliminary solicitation regarding the "best of" standard, it is unclear what "all" requires, or how it qualifies "reasonably practicable efforts," and therefore creates uncertainty and liability for financial firms seeking to ensure compliance.

4. The IPA is also concerned about the broad application of an ongoing duty, requiring ongoing monitoring and thus an ongoing duty if a financial professional receives "ongoing compensation or charges ongoing fees," uses common titles such as "consultant" or "manager," or the customer has a "reasonable expectation" that an account is being monitored. If a broker-dealer makes more than one recommendation, or receives a trailing commission or compensation over time for an episodic-only recommendation, then they would owe an ongoing fiduciary duty. This would require broker-dealers and registered representatives to monitor a customer's account after a trade is executed, which is contrary to the episodic nature and intent of the brokerage relationship. This

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would have the unintended consequence of substantially reducing the availability of episodic brokerage services for Massachusetts investors.

Further, in connection with the adoption of Reg BI, the SEC issued interpretive guidance regarding activities that would subject a financial professional to register as an investment adviser ("RIA"). The SEC stated that because ongoing monitoring of investment recommendations is often a hallmark of an investment advisory relationship, if a broker-dealer performed ongoing monitoring services for a customer, it generally could not satisfy the "solely incidental" exception in the Investment Advisers Act of 1940 ("Advisers Act") and thus must register under the Act as an RIA. The ongoing monitoring provisions in the Proposal are in direct conflict with the provisions of the Advisers Act, Reg. BI and SEC guidance. In other words, due to the broad application of the ongoing monitoring requirements in the Proposal, broker-dealers could not rely on the "solely incidental" exception, and thus could not meet the requirements of the Proposal without registering as RIAs. We believe that the Division should limit the ongoing monitoring requirement to circumstances where the customer and the broker-dealer have established an investment advisory relationship (by written agreement or otherwise) that includes a specific obligation on the part of the broker-dealer to provide ongoing monitoring of either the investment recommendations made by the broker-dealer or the other circumstances of the customer. In other words, if the broker-dealer has agreed to provide ongoing monitoring that would otherwise subject them to the provisions of the Adviser's Act, they would have an ongoing (post-execution of the recommendation) fiduciary duty. Absent that there would be no such obligation. We also recommend that the Proposal provide that clear notice be provided regarding the capacity in which the financial professional is acting, and that the duty for broker-dealers, whenever acting in such capacity, apply only through the execution of the recommendation. We also suggest that the Division delay adoption of a final rule until the SEC provides further guidance on the scope of the term "solely incidental" and how it relates to the ongoing duty established by the Proposal.

5. With regard to the use of titles, the IPA supports the goal of reducing investor confusion by restricting the use of certain titles closely aligned to the statutory term "investment adviser." However, we believe that the Proposal should limit use only to the terms "adviser" or "advisor" rather than the broad and generic list of titles included in the Proposal. This will more closely align with similar changes being undertaken to comply with Reg BI, and the Division also has antifraud authority to monitor and enforce the use of misleading names and titles, which necessarily change over time. Should the Division include any title changes in its final rule, the IPA requests that the change apply prospectively as any retroactive change may result in uncertainty, potential liability and a disproportionate compliance burden on broker-dealer firms not commensurate with the corresponding investor benefit.

6. The IPA also suggests that the "without regard to" language in the Proposal's duty of loyalty be replaced with a standard that requires the financial professional to put the client's interest first, or that is consistent with the language in Reg BI that provides, "without placing the financial or other interest . . . ahead of the interest of the retail customer." This change provides greater

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clarity for addressing broker-dealer conflicts. Servicing a customer *without regard to* one's financial interest is antithetical to any fee-for-service industry, including attorneys, physicians, or other professionals. We believe the current language will unnecessarily increase the litigation risk and the likelihood that the post-sale outcome for a customer/client of a recommendation will be used to assert that the duty of loyalty was not met.

7. The IPA again suggests that the regulation expressly apply only to retail customers that are legal residents of or reside in Massachusetts. The fiduciary duty should not be owed by Massachusetts registrants to out of state clients or entities, and may be inconsistent with the duties owed to those clients in their state of domicile or residence. Given the approaching implementation date of Reg BI, we also strongly encourage the Division to provide for an 18-month implementation period in order to comply with both Reg BI and an additional state standard.

8. Finally, the IPA continues to assert that the Division's rulemaking will run counter to federal standards for broker-dealers and require the making and keeping of records that are different or in addition to those required to be made and kept under the federal securities laws, which would be preempted. In other words, in order to comply with the Proposal, broker-dealers will have to take actions and keep new records beyond those required under federal law. As stated above, in addition to preemption concerns, this additional cost of compliance could cause broker-dealers to decide not to provide advice to Massachusetts investors.

We respectfully request that the Division consider all of the points discussed above. We believe the unintended consequence will be significant increased compliance costs for Massachusetts registrants and decreased options for Massachusetts investors. If the IPA may be of any assistance, please do not hesitate to contact me or Anya Coverman, IPA's Senior Vice President, Government Affairs and General Counsel, at (202) 548-7190.

Sincerely,

Anthony Chereso
President & CEO, Institute for Portfolio Alternatives

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