

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 American Securities Association (ASA)¹ welcomes the opportunity to comment on the Massachusetts Securities Division (Division) proposed regulation to apply a fiduciary conduct standard on broker-dealers, agents, investment advisers, and investment adviser representatives (Proposal). The ASA's comments are derived from the diversity of our membership, the different business models of our membership, and the vast experience our members have providing every type of wealth management service to our customers across Massachusetts.

We strongly support holding those who work in the securities markets to a high standard in their dealings with the public. This is why the ASA strongly supported the adoption of Regulation Best Interest "Reg BI" by the Securities and Exchange Commission (SEC) in 2019.² We are concerned, however, that real world evidence suggests the Proposal, as written, will unintentionally hurt the very consumers it is designed to help. There is overwhelming evidence that similar proposals enacted at the federal level and in Great Britain resulted in higher costs and fewer choices for consumers. Even more concerning, these proposals made it much more difficult, if not impossible, for savers of modest means to access face-to-face financial services and advice. In short, the proposals exacerbated economic inequality at a time when policymakers like you and others are working to reduce it.

Fortunately, Massachusetts has an opportunity to learn from the real-world impact of similar regulations and avoid these unintended consequences.

¹ The ASA is a trade association that represents the retail and institutional capital markets interest of middle market financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors and support efficient and competitively balanced capital markets that advance financial independence, stimulate job creation, and increase prosperity. The ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.
www.americansecurities.org.

² SEC Regulation Best Interest, RIN 3235-AM35 (Release No. 34-86031; File No. S7-07-18) (June 5, 2019); SEC Form CRS Relationship Summary; Amendments to Form ADV, RIN 3235-AL27 (Release Nos. 34-86032; IA-5247; File No. S7-08-18) (June 5, 2019).

I. The Standard Proposed in Massachusetts Uses the Same “Without Regard To” Standard as the U.S. Department of Labor

The Proposal requires investment recommendations to be made “without regard to” the financial interest of the firm and its representatives or advisers. The “without regard to” standard reflects an approach to consumer protection that has been proven to hurt the very people it attempts to help. Evidence from the U.S. Department of Labor’s (DOL) fiduciary rule and the United Kingdom demonstrate this fact.

Despite the Division’s statement that it is basing the proposal on the common law duty of loyalty, the phrase “without regard to” is not found in regulations governing the standard of conduct for broker-dealers or investment advisers. The SEC’s own interpretation of the common law duty of loyalty under the Investment Advisers Act of 1940 (’40 Act) states, “The duty of loyalty requires that an adviser not subordinate its clients’ interests to its own. In other words, an investment adviser must not place its own interest ahead of its client’s interest.”³ The phrase “without regard to” is nowhere to be found in the SEC’s interpretation of the ’40 Act as defined by common law.

When adopting Reg BI, the SEC specifically rejected including the “without regard to” language for these reasons and instead made it clear that financial professionals could not put their interests ahead of their customers. By contrast, the now vacated DOL’s “Best Interest Contract (BIC) Exemption” expressly used “without regard to” as its standard. The BIC Exemption stated, “The phrase ‘without regard to’ is a concise expression of ERISA’s duty of loyalty.”⁴

II. The “Without Regard To” Standard Proposed in Massachusetts Has Caused Harm Where It’s Been Used in Other Jurisdictions.

While “without regard to” may work for workplace retirement plans that are controlled by employers, it has proven problematic when attempting to apply it to individual securities accounts controlled by retail investors. This is precisely why we believe that the Proposal’s use of the “without regard to” phrase will introduce the same problems for consumers as the DOL Fiduciary Rule.

Our concerns of consumer harm are “not theoretical.”⁵ The SEC found that “there was a **significant reduction in retail investor access** to brokerage services, and ... available alternative sources **were higher priced** in many circumstances” once firms began implementing the DOL’s Fiduciary Rule (emphasis added).⁶ This unfortunate result can be attributed, at least in part, to the DOL’s use of the phrase “without regard to.” Experts at the SEC stated,

³ SEC Commission Interpretation Regarding Standard of Conduct for Investment Advisers, RIN 3235-AM36 (Release No. IA-5248; File No. S7-07-18) (June 5, 2019).

⁴ DOL Best Interest Contract Exemption, ZRIN 1210-ZA25, 81 FR 21002 (April 8, 2016).

⁵ SEC Regulation Best Interest, *supra* note 2; Statement at the Open Meeting on Commission Actions to Enhance and Clarify the Obligations Financial Professionals Owe to our Main Street Investors, Chairman Jay Clayton, June 5, 2019.

⁶ SEC Regulation Best Interest, *supra* note 2

Nevertheless, we are concerned that there is risk that the “without regard to” language 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 we believe could ultimately harm retail investors by reducing their access to differing types of investment services and products and by increasing costs.⁷

The SEC’s concerns of reduced access and increased costs are well-documented in the public record.

| Public Announcements in Response to the Rule Before it Was Delayed and Vacated⁸ | |
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| <i><u>No Commission Brokerage for IRAs</u></i> | <i><u>High Minimums for Brokerage Accounts</u></i> |
| <ul style="list-style-type: none"> • Merrill Lynch | <ul style="list-style-type: none"> • Edward Jones (\$100,000) |
| <ul style="list-style-type: none"> • JP Morgan | <ul style="list-style-type: none"> • Stifel |
| <ul style="list-style-type: none"> • Capital One | |
| <ul style="list-style-type: none"> • Commonwealth Financial | |
| | <i><u>Selling its Brokerage Business</u></i> |
| <i><u>Robo-Advice Only or No Face-to-Face Service for Small Accounts</u></i> | <ul style="list-style-type: none"> • MetLife • AIG |
| <ul style="list-style-type: none"> • Merrill Lynch | <ul style="list-style-type: none"> • Stifel (Selling its Indpt. Brokerage Business) |

⁷ *Id.*

⁸Curci, Gia, *Merrill Lynch Eliminates Commission IRA Business in Response to DOL Fiduciary Rule*, InvestmentNews (October 6, 2016) available at: <https://www.investmentnews.com/article/20161006/FREE/161009942/merrill-lynch-eliminates-commission-ira-business-in-response-to-dol>; Ann Marsh, *JPMorgan nixes Commissions on Retirement Accounts*, Financial Planning (November 10, 2016) available at: <https://www.financial-planning.com/news/jp-morgan-nixes-commissions-on-retirement-accounts-possibly-signaling-fiduciary-rules-staying-power>; *Capital One will Eliminate Commissions on IRAs*, InvestmentNews (November 14, 2016) available at: <https://www.investmentnews.com/article/20161116/FREE/161119951/capital-one-will-eliminate-commissions-on-iras>; *Commonwealth to Ditch IRA Commissions*, Barrons (October 26, 2016) available at: https://www.barrons.com/articles/commonwealth-to-ditch-ira-commissions1477454904?mod=WSJ_article_EditorsPicks_1; Michael Wursthorn, *Edward Jones Shakes Up Retirement Offerings Ahead of Fiduciary Rule*, WSJ (August 17, 2016) available at: <https://www.wsj.com/articles/edward-jones-shakes-up-retirement-offerings-ahead-of-fiduciary-rule-1471469692>; Kenneth Corbin, *Stife’s Fiduciary Solution for Commissions*, Financial Planning (November 13, 2016) available at: <https://www.financial-planning.com/news/stifels-fiduciary-solution-for-commissions>; Gia Curci, *State Farm, Citing DOL Fiduciary Rule, Cuts Agents from Mutual Fund and Variable Annuity Sales*, Investment News (September 13, 2016) available at: <https://www.investmentnews.com/article/20160912/FREE/160919992/state-farm-citing-dol-fiduciary-rule-cuts-agents-from-mutual-fund?AID=%2F20160912%2FFREE%2F160919992>; Katherine Chigliński, Margaret Collins, *AIG Advisor Group Sale Fueled by DOL Fiduciary Rule, CEO Says* (ThinkAdvisor) (January 28, 2016) available at: <https://www.thinkadvisor.com/2016/01/28/aig-advisor-group-sale-fueled-by-dol-fiduciary-rul/?slreturn=20191119142547>; Cidzelis, *MetLife is Second Major Insurer to Exit the Brokerage Business*, Investment News (June 23, 2016) available at: <https://www.investmentnews.com/article/20160229/FREE/160229937/metlife-is-second-major-insurer-to-exit-the-brokerage-business-in>; Andrew Welsch, *Fiduciary Rule Forced Stife’s Hand to Sell IBD, CEO Says*, OnWallStreet (August 3, 2016) available at: <https://onwallstreet.financial-planning.com/news/fiduciary-rule-forced-stifels-hand-to-sell-ibd-ceo-says>.

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J.D. Power surveyed more than 1,000 full-service investors in February 2017 about the Rule. It found that “more than half (59%) of investors who pay commissions say they either ‘probably will not’ (40%) or ‘definitely will not’ (19%) be willing to stay with their current firm if it meant being forced to move to a fee-based retirement account.”⁹

According to the research firm, Cerulli Associates, small firms will likely “be unable to support [the Rule’s] new regulatory costs, resulting in an increase in firm consolidations.”¹⁰

The Proposal’s use of the “without regard to” phrase will lead to the same result as occurred following the implementation of the DOL Rule – less choice and higher prices for consumers. While the Proposal ostensibly allows for commission-based compensation, the liability it imposes would effectively prohibit the brokerage model in Massachusetts. Notwithstanding the stated intent of the DOL’s BIC Exemption to allow commissions, less choices and higher prices still resulted before it was ultimately vacated. Like the DOL Fiduciary Rule, the “without regard to” phrase in the Proposal effectively eliminates what the Division says is permitted.

The United Kingdom’s Retail Distribution Review (RDR) provides another example of how this will hurt Massachusetts consumers. The RDR imposed a ban on commissions in January 2013. Three years later the U.K. Government published a report on the RDR. It found that **advice is “primarily accessible and affordable for the more affluent in society”** (emphasis added).¹¹ In other words, the U.K. Government admitted that its rule created an advice gap that hurt less affluent consumers.¹² Another study released in 2019 found the advice gap caused by the RDR has widened since 2015.¹³ While the RDR was intended to improve standards, the evidence shows it has resulted in a market where those with smaller amounts to save have “struggled” to find help.¹⁴

Rather than tying its Proposal to a standard that has proven to hurt consumers, we recommend the Division recognize the SEC’s approach of aligning the broker-dealer standard of conduct with the investment adviser’s standard to “serve the best interest of its clients and not subordinate its client’s interest to its own.”¹⁵ In other words, Massachusetts should accept the national standard that

⁹ Michael Foy, *Fiduciary Roulette*, available at: <https://www.jdpower.com/business/resource/wealth-management-fiduciary-roulette>

¹⁰ Warren Hersch, *DOL Rule Will Force Consolidation of Broker-Dealers*, ThinkAdvisor (December 20, 2016) available at: <https://www.thinkadvisor.com/2016/12/20/dol-rule-will-force-consolidation-of-broker-dealer/>

¹¹ HM Treasury-Financial Conduct Authority, *Financial Advice Market Review (Final Report)* (March 2016), available at <https://www.fca.org.uk/publication/corporate/famr-final-report.pdf>.

¹² Emma Ann Hughes, *FCA Admits RDR Contributed to Advice Gap*, FT Adviser (July 19, 2016), available at <https://www.ftadviser.com/2016/07/19/regulation/rdr/fca-admits-rdr-contributed-to-advice-gap-chujPxa8fmBkivLaaAxxfN/article.html>.

¹³ Kate Beioley, *Financial Advice Gap Has Widened Since 2015*, Financial Times (May 21, 2019), available at <https://www.ft.com/content/1b931788-7be1-11e9-81d2-f785092ab560>.

¹⁴ *Id.*

¹⁵ SEC Regulation Best Interest, *supra* note 2.

requires a financial professional “cannot place its own interest ahead of the interests of its clients.”¹⁶ The SEC Reg BI already accomplishes the Division’s goals without importing the harm the “without regard to” phrase has caused in other instances.

III. The Proposals Will Make Inequality Worse in Massachusetts.

Brookings Institution (Brookings) experts, Martin Neil Baily and Sarah Holmes, have stated “regulations that push savers into accounts with [ongoing fees] instead of [commissions] may not be in their best interest.”¹⁷ The account options available today generally allow all investors, regardless of income, the opportunity to affordably access the resources they need to save. The Proposal will disrupt this balance. Specifically, the vagueness and legal ambiguities it contains incent firms to shift services and products from commission-based accounts into advisory accounts. The Brookings experts highlight what this means for consumers when they state, “High net worth clients can afford to pay for advice but a low-income family does not have a lot of money to put to work even though teaching them about investment options and good investment decisions may be quite time-consuming.”¹⁸

Massachusetts must address this problem before it adopts a standard that differs from the national standard. Our suggestion is that Massachusetts recognize that the SEC’s Reg BI national standard is the most effective way to ensure uniformity and equality under the law. This will produce a better outcome for Massachusetts investors and avoided the creation of a balkanized system where state-level rules conflict with federal regulation.

Preserving financial advice for the wealthy, while leaving the middle class to fend for itself or unnecessarily use more expensive account options, is a bad outcome for Massachusetts. It unfairly disadvantages those in the state who are most vulnerable to our nation’s savings crisis. As discussed earlier, the Proposal makes this result more likely because these exact inequalities occurred when similar regulations were imposed.

IV. Independent Expertise at the SEC Should be Prioritized Over Political Motivations.

Unlike other federal agencies, the SEC is a federal independent agency whose mission requires it to “protect investors” and promote capital formation.¹⁹ The Division appropriately recognizes the SEC Staff’s expertise by citing a study they conducted eight years ago (Section 913 Study). The SEC Staff has examined this issue for more than a decade. But rather than aligning itself with the national best interest standard, the Division discounts the SEC’s years of expertise and sides with

¹⁶ *Id.* at 66.

¹⁷ Martin Neil Baily and Sarah E. Holmes, *Serving the Best Interests of Retirement Savers: Framing the Issues*, The Brookings Institution (July 2015) (stating ongoing fees “may seem to take less of the investor’s funds, but that is not usually the case”), available at <https://www.brookings.edu/wp-content/uploads/2016/06/Download-the-full-paper-1.pdf>.

¹⁸ *Id.*

¹⁹ U.S. Securities and Exchange Commission, About the SEC, available at <https://www.sec.gov/about.shtml>.

a partisan recommendation from 2011 that received a well-reasoned statement of dissent from two Presidentially appointed SEC Commissioners.²⁰

The Proposal fails to fully account for the overall public record the SEC developed during the eight years since the Section 913 Study was developed (e.g. DOL Fiduciary Rule, U.K. RDR, etc.). The SEC's final actions make clear on numerous occasions that it did not sit idly by while time passed. Rather, the SEC expressly points out its concerns with regulatory approaches adopted since the release of the Section 913 Study recommendation, such as the DOL's Fiduciary Rule.

Discounting the work done by the independent experts at the SEC and elsewhere will cause real harm to Massachusetts investors.

V. The Proposals Put Massachusetts at a Disadvantage.

Additional protections at the state level are inconsistent, incompatible, and unnecessary. The Proposal would adopt a standard that conflicts with the federal standard in order to prohibit the same activity. This ultimately disadvantages Massachusetts as businesses and consumers across the state will see their costs rise. Different standards will also create confusion instead of clarity for investors as they will struggle to determine what rules apply and when. We agree with SEC Chair Clayton's view that "a patchwork approach to the regulation of the vast market for retail investment advice will increase costs, limit choice for retail investors, and make oversight and enforcement more difficult."²¹ The Division ignores this advice at its own peril.

VI. Reg BI Protects Consumers & Preserves Access to Financial Advice for All Savers

The SEC's new regulations establish a national standard prohibiting firms and all financial professionals from putting their interests ahead of the client. All investors will now have a consistent standard across financial service providers, greater clarity on their service options, and choice when selecting the resources that best meet their needs. In short, the SEC's new regulations bring certainty to Massachusetts investors and working families saving and investing for a better future.

We believe the standards laid out in the Proposal directly undermine the consumer protections set forth in Reg BIs national best interest standard. The Proposal will apply a standard that: (1) has been proven to harm consumers, (2) exacerbates income and wealth inequalities, (3) ignores over a decade of work by independent experts at the SEC, and (4) threatens Massachusetts economic competitiveness relative to other states. Adopting a different approach from the national standard will confuse residents, financial professionals, and firms in Massachusetts.

²⁰ Statement Regarding Study On Investment Advisers And Broker-Dealers. Troy Paredes and Kathleen Casey, January 22, 2011.

²¹ *Supra* note 5.

The Division should be fair to Massachusetts residents and its economy and refrain from imposing a standard that is inconsistent and incompatible with the national standard.

VII. Conclusion.

For all the reasons detailed above, we recommend the Division refrain from adopting the standard set forth in the Proposal, and instead, recognize the effectiveness of the SEC's national best interest standard. The SEC's national best interest standard greatly strengthens consumer protections without disenfranchising Massachusetts consumers, and it maintains access to the affordable services and products residents use to save and invest for a better future.

If you have any further questions, please contact me at 202-621-1785.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer
American Securities Association