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January 7, 2020

VIA Email

Office of the Secretary of the Commonwealth
Massachusetts Securities Division

Re: **Proposed Fiduciary Conduct Standard for Broker-Dealers, Agents,
Investment Advisers and Investment Adviser Representatives**

Dear Sir or Madam:

We are writing to provide comments to the Massachusetts Securities Division (the "Division") on proposed revisions to 950 CRM 12.200, which would deem it an unethical or dishonest conduct or practice for a broker-dealer, agent, investment adviser, or investment adviser representative registered or required to be registered in Massachusetts to fail to act in accordance with a fiduciary standard.

Capital Group is one of the oldest and largest asset managers in the nation. Through our investment advisory subsidiaries, we manage approximately \$2 trillion in assets in separate accounts and various collective investment vehicles. Most of the assets we manage are in the American Funds family of mutual funds. As of November 30, 2019, more than 435,000 Massachusetts residents held \$62 billion in American Funds assets. Most of these assets are held in A share mutual funds which were purchased through the payment of a commission to a broker.

I. The final rule should broadly facilitate access to commissionable investment advice

At Capital Group, we believe strongly in the value of professional investment advice. There is a significant gap between market returns and the returns actually realized by investors. Because of untimely buying and selling, the average investor captures only a fraction of market gains. However, investors who work with an investment adviser representative or a registered representative of a broker-dealer are more diversified and do better by staying invested in market downturns and avoiding the traps of market timing.

We also believe in the importance of investor choice. For many investors, the lowest-cost option is paying for investment advice through commissionable mutual funds (the investor pays an upfront fee -- on average, 2.5% of the initial investment -- and then bears an expense for ongoing service from the broker that is typically 0.25% annually). Commissionable investments are buy-

and-hold investments. The average holding period for a commissionable investment in the American Funds is nearly twice as long as the average holding period for a fee-based investment in the American Funds (in this model the client pays no upfront fee and then typically pays 1-1.5% annually thereafter). For long-term investors, commissions are a cost-efficient way of paying for ongoing investment advice. The exact point at which a buy-and-hold investor pays less than a comparable fee-based arrangement depends on a variety of factors, including the cost of the fee-based program and investment returns, but there is no question that compensating a financial advisor for investment advice through commissions is a reasonable choice for many. This is not to suggest that fee-based arrangements are problematic or that commissionable investments are always preferable, but it is to say that the manner in which investors pay for advice should be a matter of investor choice.

We are concerned that the proposed Massachusetts fiduciary rule will inadvertently reduce access to professional investment advice and eliminate investor choice. The Massachusetts rule will fundamentally re-write the standard of care applicable to brokers in at least two ways. First, it will impose an ongoing duty of care, including an ongoing duty to monitor, on most broker-dealers and their registered representatives. The vast majority of full-service broker-dealers use titles like “financial advisor” or “wealth manager” and receive ongoing compensation, such as 12b-1 fees, in connection with A share mutual funds, both of which would result in an ongoing duty to monitor accounts. Second, the proposed rule would impose a duty to “[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”. This duty to avoid or eliminate conflicts will call into question many of the traditional forms of broker-dealer compensation paid in connection with commissionable mutual funds, like commission schedules defined by the mutual fund family, 12b-1 fees, subtransfer agency fees, rights of exchange and rights of accumulation.

We believe that an ongoing duty to monitor is inconsistent with the brokerage business model. Broker-dealer firms offer fee-based advisory programs for investors who want ongoing monitoring and advisory programs are priced accordingly. We also believe that commissionable mutual funds have been an effective and affordable means of accessing advice for buy-and-hold and smaller balance investors for many years. Yet the proposed regulation would appear to force broker-dealer firms to eliminate A share mutual funds. For these reasons, we believe the Division should revise the proposal to accommodate transactional investment advice and traditional commissionable mutual funds.

II. The final rule should include a grandfather rule for legacy mutual funds

If, however, the Division decides to move forward with a final rule that is substantially similar to the proposal, the Division should include a grandfather rule for existing investors in

commissionable mutual funds. The proposal does not provide any exception, carveout or other grandfather provision that would allow existing investors in commissionable mutual funds to continue to receive transactional advice from their broker's registered representative. Instead, every brokerage relationship would have to comply with the new rule's ongoing duty to monitor after its effective date. A grandfather rule for legacy mutual fund investments – one that allows for ongoing advice (including recommendations to stay invested), does not impose an ongoing duty to monitor, and facilitates traditional forms of brokerage compensation – would go a long way towards minimizing unnecessary disruption.

Unless the final rule includes a grandfather clause, many investors who currently rely on a broker for advice will be moved to fee-based advisory programs and other investors will simply lose access to their broker, *after the investors already paid a commission*. Many of these investors are retired and elderly investors who may find a forced change in their brokerage relationship challenging. Others are middle-class savers who will be worse off for losing access to professional investment advice. For these reasons, the Department of Labor fiduciary rule included a grandfather rule¹ as did the U.K. when the Financial Services Authority re-wrote the rules for retail investment advice.² We believe a grandfather rule in the Massachusetts fiduciary rule is essential to protect existing investors in traditional commissionable mutual funds.

There are sound policy arguments for a grandfather rule. First, without a grandfather provision, it is likely that the new rule will result in a substantial immediate increase in the cost of investment advice for many savers. Many brokers will encourage eligible investors to transition to fee-based advisory programs in order to satisfy the Massachusetts' duty to monitor.³ Advisory programs are priced and designed to provide ongoing monitoring and generally charge average asset-based fees of 1% to 1.5%.⁴ In contrast, investors in A share funds bear an annual ongoing expense of no more than 0.25% for service and access to a broker. Thus, without a

¹ Prohibited Transaction Exemption 2016-01, Section VII (Best Interest Contract Exemption providing relief for pre-existing transactions).

² PS 12/3 *Distribution of retail investments: RDR Advisor Charging – treatment of legacy assets* (February 2012).

³ We applaud the Division for treating the recommendation of an account type – such as the recommendation of an advisory account – as advice subject to a fiduciary standard. We are, however, concerned that many broker-dealer firms will only offer advisory programs to Massachusetts residents or will stress the broader range of services associated with advisory programs, such as rebalancing, financial planning and tax-loss harvesting. Put simply, the fact that recommendations of account type would be subject to a fiduciary standard does not obviate the need for a grandfather rule.

⁴ Average advisory fees depend on the platform type, for example, unified management account or mutual fund only. Actual client fees can be higher or lower and are negotiated by the investment adviser representative and their client with the size of the relationship being a major factor in determining the actual fee charged.

grandfather rule, we expect that many Massachusetts investors will see costs that are four to five times the cost the investors currently bear.⁵

Second, as mentioned above, without a grandfather rule, we believe that other A share mutual fund investors will lose access to professional investment advice. Fee-based advisory arrangements are simply not viable for many smaller balance investors. The current minimum investment requirements for participation in an advisory program that charges asset-based fees are simply too high for many investors. And hard dollar fees, such as per hour fees or project-based fees, are both uncommon and prohibitively expensive for smaller balance investors. It is possible (even likely) that over time new business models for providing advice to smaller balance investors will arise but the current landscape does not easily accommodate these savers.⁶

Third, as an economic matter, investors who transition to an advisory program or lose access to their broker will lose the benefit of the bargain they struck when they purchased a mutual fund through the payment of a commission. The commission paid in connection with the sale of a mutual fund is compensation for the transaction as well as a prepayment for ongoing investment advice, for example, hold recommendations in times of turmoil, investment reviews, reallocation decisions, etc. The investor pays a commission equal to a percentage of the initial investment and then the mutual fund pays the advisor an annual amount equal to up to 0.25% of the value of the account. These payments entitle the shareholder to ongoing service. Without a grandfather rule, shareholders will forfeit their pre-paid right to ongoing advice at very modest cost when they are transitioned to an advisory program or their broker resigns.

Fourth, from a public policy perspective, allowing advisors to receive an asset-based fee from existing mutual fund brokerage accounts does not raise the types of conflicts of interest issues underlying the fiduciary proposal. Ongoing compensation of one-quarter of one percent (0.25%), typically for fairly small balance investors is very modest, for example, \$125 per year on a \$50,000 investment. Such a small amount should not raise the conflicts of interest concerns driving the Division's proposal. A financial advisor is not going to recommend that a client stay invested in a mutual fund to receive what is a very modest revenue stream.

We believe that a grandfather rule could be appropriately crafted so that it does not swallow the general rule or lock investors into inappropriate investments. First, the grandfather rule need not cover existing relationships; it could be limited to existing investments. That is, new purchases could be covered by the new rules. Second, grandfathered investments could be subject to a transactional fiduciary standard. The grandfather merely needs to provide relief from the

⁵ Appendix A includes an illustration of the sharp cost increase an average investor with \$50,000 would experience if moved from A share mutual funds to a typical advisory program.

⁶ Our concern is not hypothetical. In the run up to the Department of Labor fiduciary rule, many investors in our Class A share mutual funds had their brokers resign.

affirmative duty to monitor and any implied prohibition on ongoing compensation in the form of 12b-1 fees.

A few other considerations are worth mentioning. The Division should extend the grandfather to investment exchanges as long as an exchange did not trigger a new commission. In this regard, mutual fund families typically provide rights of exchange within the fund family that allow investors to exchange mutual fund investments without paying a new commission. Such an approach would accommodate rebalancing programs while ensuring that brokers did not have inappropriate incentives to recommend exchanges. Further, the Division should extend the grandfather to periodic payment programs and dividend reinvestment programs that were established before the effective date of the new rules. It would be a shame if previously established financial plans are disrupted by the new rules. Finally, the Division should consider grandfathering additional purchases that do not involve the payment by the investor of a new commission. Many investors have earned the right to purchase mutual fund shares without a commission through rights of accumulation or other fund policies, such as policies that permit rollovers into IRAs at net asset value. This is a cost-effective way to purchase shares and it would be ironic if the Massachusetts rule eliminated this investor benefit.

The grandfather rule we recommend is very similar to the grandfather rule adopted by the Department of Labor. It also closely tracks the grandfather rule adopted in the U.K.

We believe a grandfather rule along these lines will be effectively limited in both duration and scope. Financial advisors will shift larger accounts from commissionable investments to fee-based programs, which offer a different suite of services. Moreover, investors who are making ongoing contributions will be motivated to aggregate all of their investments in one account -- they will not want grandfathered and non-grandfathered accounts.

The grandfather rule will, however, be critical to facilitating an orderly transition to the new regime, especially if the Division adopts an accelerated time line for compliance, like the June 30, 2020 implementation date for Regulation Best Interest. Broker-dealer firms will need time to determine how they will adapt to the Massachusetts rule, whether an advisory solution is appropriate for each affected brokerage client, and what the tax implications are of liquidating shares. An accelerated time line without a grandfather has the potential to put Massachusetts investors at risk of hasty decisions and put their hard-earned savings into motion at significant potential costs. A grandfather rule will help ease the transition to an accelerated time line for compliance and avoid the risks of widespread disruption for Massachusetts investors.

We also believe that a grandfather rule along the lines we recommend will facilitate the development of new business models. In 2017, we requested and received the “clean shares”

letter from the SEC.⁷ The clean shares letter allows broker-dealer firms to set their own commission schedules on mutual funds and therefore eliminate conflicts of interest between funds, fund families and between different product types, such as ETFs and individual securities. Significantly, the clean shares letter would prohibit a broker-dealer from receiving payments for distribution in connection with clean shares assets. To the extent that firms adopt a clean shares approach as a compliance strategy, we believe that firms will want to grandfather existing investments.⁸

Although the focus of our comments is understandably on mutual funds, we also note that there are other types of existing investments for which advice was provided on a commissionable basis, for example, variable annuity contracts, where a grandfather rule seems entirely appropriate. Without such a rule, investors in IRA annuities could incur surrender charges in connection with liquidations as they move to fee-based arrangements, not to mention the loss of potential retirement income and other benefits.

We appreciate your consideration and would be happy to answer any questions. Please call the undersigned if we can be helpful at 213-615-4007.

Sincerely,

Jason Bortz
Senior Counsel

⁷ See <https://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm>.

⁸ A large broker-dealer recently announced implementation of a clean shares brokerage program and utilized the grandfather approach we recommend. See <https://onwallstreet.financial-planning.com/news/ahead-of-sec-regulation-best-interest-ubs-to-offer-single-mutual-fund-share-class-in-brokerage>.

Appendix A:

	Brokerage Model (A shares)		Advisory Model (Varies - Eligible Fee Based Share Class)	
	Existing Investor (Grandfathering-Recommended)	New Investor	New or Existing Investor (Same)	
Initial Investment	\$ 50,000	\$ 50,000	\$	50,000
Fees paid to Broker Dealer (Brokerage Model)				
Upfront Sales Charge (4.50%) ¹	Previously Paid	\$ 2,250		
Typical Annual Sub-Transfer Agent Fee (0.12%)	\$ 60	\$ 60		
Typical Annual 12b-1 Distribution Fee (0.25%)	\$ 125	\$ 125		
Fees paid to Investment Advisor (Fee Based Model)				
Annual Advisory Fee (1.30%) ²			\$	650
Typical Annual Sub-Transfer Agent Fee (0.12%)			\$	60
Manager Fee (Same Regardless of Share Class)				
Hypothetical Annual Management Fee (0.40%)	\$ 200	\$ 200	\$	200
Total Recurring Annual Client Fees & Expenses	\$ 385	\$ 385	\$	910
Cummulative Client Fees & Expenses Over ...				
...3 years	\$ 1,205	\$ 3,419	\$	2,818
...5 years	\$ 2,095	\$ 4,271	\$	4,849
...7 years	\$ 3,062	\$ 5,197	\$	7,011
...10 years	\$ 4,672	\$ 6,737	\$	10,519
Client Account Value After ³ ...				
...3 years	\$ 56,617	\$ 54,173	\$	54,923
...5 years	\$ 61,508	\$ 58,853	\$	58,472
...7 years	\$ 66,822	\$ 63,937	\$	62,250
...10 years	\$ 75,665	\$ 72,399	\$	68,379

¹ Based on the \$50,000 American Funds sales charge breakpoint. Sales charges decline based on cumulative client investment.

² Sources: Cerulli Associates, in partnership with the Investments & Wealth Institute (formerly IMCA) and The Financial Planning Association® (FPA®), Avg. Fee for \$100,000 client size.

³ Assumes a 5% annualized account appreciation.