VIA e-mail to: securitiesregs-comments@sec.state.ma.us

January 7, 2020

Office of the Secretary of the Commonwealth
Attn: Proposed Regulations – Fiduciary Conduct Standard
Massachusetts Securities Division
One Ashburton Place, Room 1701
Boston, MA 02108

Re: Fiduciary Duty of Broker-Dealers and Investment Advisers
950 CMR 12.204, 12.205, and 12.207

Ladies and Gentlemen:

Please allow this to serve as comments of Cetera Financial Group, Inc. ("Cetera") with regard to proposed amendments to 950 CMR 12.204 and 12.205 and proposed new 950 CMR 12.207 (collectively, the "Proposal"). The proposed amendments would establish and/or expand fiduciary obligations applicable to broker-dealers and others providing financial advice in the State of Massachusetts.

Cetera is the corporate parent of a group of ten broker-dealers and Registered Investment Advisers ("RIAs"), with more than 8,000 affiliated representatives. Our firms collectively serve more than 1 million retail investors, the large majority of whom are individuals, families, and small businesses. Through our representatives, we provide both transaction-based brokerage and fee-based investment advisory services. We have broad experience with both business models, the differing standards that are applicable to each, and the circumstances under which the interests and objectives of a client may be better served by one rather than the other.

The broker-dealer and RIA subsidiaries of Cetera currently have approximately 300 registered representatives and Investment Adviser Representatives ("IARs") who reside in Massachusetts. They collectively serve more than 35,000 client accounts and produce annual gross revenue in excess of $23 million. Considering a multiplier effect, Cetera representatives and their employees produce something on the order of $75 million of annual economic activity in Massachusetts.

Our representatives are independent contractors, not employees of Cetera. They operate small businesses that are focused on the communities in which they live and work. Their clients are often their friends, neighbors, and relatives, and they feel an obligation to act in the best interest of those clients in a way that transcends ordinary business relationships. The large majority of

our representatives offer both transaction-based brokerage services and fee-based investment advisory services, and many of their clients or households maintain both types of arrangements simultaneously. These clients have concluded that different types of arrangements best meet the totality of their needs, emphasizing the importance of maintaining customer choice regarding services and compensation models.

Cetera strongly supports implementation of a standard of care applicable to financial advisers providing advice to retail investors with respect to investments in securities. We have advocated publicly for this on numerous occasions, and we commend Secretary Galvin and the Massachusetts Securities Division (the "Division") for undertaking this effort to enhance investor protection. Massachusetts and other states play an important role in creating and enforcing standards applicable to the provision of investment advice. We welcome their participation in the discussion of how to strengthen investor protection while maintaining consumer choice and continued access to investment advice and products. Unfortunately, many aspects of the Proposal will produce negative and possibly unforeseen effects on investors, financial advisers, and the market for investment advice in Massachusetts. The Proposal creates unworkable standards that in many cases are not sufficiently defined to give advisers adequate notice of how they can comply with them. If adopted in its present form, the Proposal will make it much more difficult for advisers to provide transaction-based brokerage services to any client, especially those with whom they also have advisory relationships.

Adopting new regulations applicable to the provision of investment advice to retail customers must be viewed first through the prism of the existing regulatory structure. There have been a number of recent developments in this area, and they should be examined closely. Our comments below will cover a number of different topics, including the broader regulatory landscape applicable to the provision of investment advice, the findings and conclusions that the Division has relied on in formulating the current version of the Proposal, substantive issues with specific provisions of the Proposal, and collateral matters that may impact the enforceability or efficacy of the Proposal if it as adopted in its current form.

I. The Regulatory Landscape

The provision of investment advice to retail customers is governed by multiple jurisdictions, including the U.S Securities and Exchange Commission ("SEC"), Financial Industry National Regulatory Association ("FINRA"), state securities and insurance regulators, and the U.S. Department of Labor ("DOL"), among others. Many of these agencies have taken recent action in this area. The Division should take these into account.

SEC Regulation Best Interest

In June 2019, the U.S. Securities and Exchange Commission ("SEC") adopted Regulation Best Interest ("Reg. BI")[1] and a series of related regulations and interpretations regarding standards of conduct for broker-dealers and RIAs. Reg. BI establishes a comprehensive

[1] SEC Release No. 34 – 86031.

regime designed to enhance investor protection by requiring that broker-dealers and representatives not place their financial or other interests above those of their clients. A series of related regulations require extensive disclosure about the services broker-dealers and RIAs provide, the capacity in which they are acting, fees and expenses, and conflicts of interest that may exist between the adviser and the client. They also require development and implementation of a comprehensive regime to identify, disclose, and manage conflicts of interest. While the SEC does not refer to Reg. BI as a fiduciary standard, it draws extensively on common law fiduciary principles and will produce the same practical results for most investors. Importantly, Reg. BI provides a clear and straightforward compliance roadmap for broker-dealers and other financial professionals.

The DOL Fiduciary Rule

In 2013, the U.S Department of Labor (the "DOL") adopted what was referred to as the "Fiduciary Rule". It created standards applicable to the sale of securities and provision of investment advice to plans covered by the provisions of the Employee Retirement and Income Security Act of 1974 and Individual Retirement Accounts. The Fiduciary Rule was ultimately vacated by a decision of the U.S Court of Appeals for the 5th Circuit. However, the debate surrounding it provided a valuable learning experience to both the securities industry and regulatory agencies considering additional rulemaking. Broker-dealers and RIAs used it as an opportunity to look closely at many of their business practices, particularly with respect to compensation of individual advisers and the incentives that those practices may create. In many cases, broker-dealers made substantive changes to address these issues, increasing transparency and mitigating conflicts of interest. This has addressed many of the issues that the Proposal covers and led to better alignment between the interests of advisers and investors. For example, many broker-dealers have "levelized" compensation payable to representatives with respect to all products of a given type, substantially eliminating potential incentives to recommend one product over a similar one.

State Initiatives

In addition to the SEC and DOL, a few states in addition to Massachusetts have taken steps to establish their own conduct standards with respect to provision of investment advice. We have specific misgivings about each of those proposals, but our larger concern is that uncoordinated regulations enacted by individual states will create a patchwork of inconsistent, conflicting or duplicative rules that will significantly impair consumers' access to valuable financial products and professional assistance. Perhaps more than any other industry, the markets for securities and investments are national and global in nature. There are hundreds of millions of investors, hundreds of thousands of financial advisers, and tens of thousands of investment products, all operating in the same markets seeking investment returns. Like the proverbial pebble in the lake, the Proposal will create ripple effects both within and beyond the borders of Massachusetts.

The Division has stated that it is aware of all of these developments, but that its primary concern is the protection of Massachusetts residents. It does not believe that the actions

taken by other agencies are sufficient to protect the interests of Massachusetts investors, and does not wish to delay the adoption of additional rules. We believe that this view is not fully informed. In its present form, the Proposal will have immediate and negative effects on investors and the provision of investment advice in Massachusetts.

A close look at Reg. BI demonstrates that the substantive differences between it and the Proposal and the practical effects that they will produce are not as dramatic as the Division appears to believe. Even if Reg. BI does not address every issue in precisely the same way as the Proposal, it deals with the same substantive matters in a comprehensive way that strikes a much more appropriate balance between enhancing investor protection and maintaining consumer choice. As the Division deliberates how to move forward, we respectfully urge that it more closely consider how the Proposal fits into the broader scheme of regulations governing the conduct of financial professionals, and delay further action with respect to adoption of any new standards of conduct. Reg. BI will become fully effective less than six months from now. We appreciate the desire of the Division to move forward with its effort to enhance investor protection, but the standards set forth in the Proposal will be with us for a generation or more. A short delay is a small price to pay when balanced against the large potential for undesirable effects on investors.

We also believe that if the Proposal is adopted in its current form, it will come into direct conflict with federal law. We will offer additional comments relating to federal pre-emption below, but the Proposal creates an almost certain path to litigation regarding its scope and validity. We believe that the time and energy that would be expended on that would be better used by both the regulated community and the Division in addressing workable alternatives that will serve the interests of investors in a more balanced way.

The goal of adopting a fiduciary standard applicable to financial advisers is to enhance investor protection, an objective which we wholeheartedly support. However, all regulation must balance the benefits to the class of individuals it is designed to protect against the cost. In this instance, the costs would be both direct and indirect. The cost of compliance for financial advisers will increase, but the regulations embodied in the Proposal will also naturally tend to restrict business practices or limit availability of services that investors find valuable. There is no such thing as a free lunch. In virtually all cases, the cost of compliance with regulation is borne by the ultimate consumer of the goods or services. Increasing the cost of investment advice will ultimately reduce returns for investors. We urge the Division to consider both the direct costs involved in implementing any new regulations and the indirect cost to investors in the form of reduced availability of services or innovation by financial services providers.

Any state-by-state approach will also impose structural burdens and increase administrative and compliance costs to the point that some types of financial advice will no longer be available to a large segment of the investing public. In particular, the Division should consider the negative effects that adoption of the DOL Fiduciary Rule had on investor choice. In direct response to it, many broker-dealers announced that they would no longer offer brokerage accounts that featured transaction-based compensation

for Individual Retirement Accounts ("IRAs").[2] This effectively meant that IRA owners who wished to have access to investment advice would be forced to establish fee-based investment advisory accounts. This was problematic for at least two reasons: First, many investors would have been forced to pay for services that they did not need or want. In addition, most RIAs have a minimum account size for advisory accounts, often $100,000 or more. This would have the effect of depriving customers with limited means access to services that they need and desire.

As we have noted, one of the primary goals of any regulation of financial advice should be to preserve customer choice with respect to the types of services investors wish to receive and how they choose to pay for them. The Proposal nominally allows brokerage arrangements with transaction-based compensation. However, it creates a number of circumstances under which broker-dealers will have a duty to monitor brokerage accounts on an ongoing basis. This fundamentally changes the nature of the traditional brokerage relationship and creates conditions that are so restrictive that such services may well cease to be economically viable to provide. When faced with similar regulations proposed by the State of Nevada, many broker-dealers have stated that they would discontinue offering transaction-based brokerage services in that state.[3]

Transaction-based compensation models present conflicts of interest. However, the Proposal appears to start with the assumption that other compensation models such as fee-based advisory arrangements are free from conflicts. That is simply not the case. Any provider of professional advice who is compensated for their services has a conflict of interest in that they need to convince clients to utilize their services in order to generate revenue. This is true of financial advisers, physicians, attorneys, and all other professionals. Fee-based advisory relationships present different types of conflicts that must be managed, but they are not conflict-free. The conditions established by the Proposal are so burdensome that providing transaction-based brokerage services much more difficult and expensive to provide.

Transaction-based compensation models predate the enactment of the federal securities laws and have been widely used for more than 100 years. The conflicts of interest they present can be effectively disclosed and managed, and the Division should reconsider the extent to which provision of brokerage services with transaction-based compensation models can realistically be maintained under the terms of the Proposal. As an example, in Reg. BI the SEC identified certain types of activity (for example, sales contests that were focused on sales of a single product or service in a limited period of time) as being likely to create conflicts of interest so severe that they cannot be effectively mitigated and required broker-dealers to adopt policies and procedures to eliminate them.

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[2] https://www.investmentnews.com/article/20161024/FREE/161029956/commonwealth-financial-eliminates-commission-based-retirement;
https://www.investmentnews.com/article/20161006/FREE/161009942/merrill-lynch-eliminates-commission-ira-business-in-response-to-dol

[3] https://www.investmentnews.com/article/20190313/FREE/190319968/morgan-stanley-threatens-to-pull-out-of-nevada-over-states-fiduciary

We would also note that compensation models with asset-based advisory fees are best for some investors but not for all of them. Many investors have adopted "buy and hold" investment strategies. They invest in assets that will be held for long periods of time, regardless of their short-term performance. Examples include diversified mutual fund portfolios and "bond ladders", strategies in which the investor assembles a group of fixed income investments with staggered maturities. The intention is that once these portfolios are created, they will not require substantial attention or transaction activity for long periods of time. Advisory models generally include ongoing monitoring by the adviser, which is a service that must be paid for. Elimination of transaction-based compensation models will inevitably force many investors to either pay for services that they do not want or need or lose access to professional investment advice. While the Proposal may be well-intentioned in this regard, we do not believe it serves the interests of most investors.

II. The Preliminary Proposal and Conclusions of the Division

Prior to publishing the Proposal, the Division issued a Preliminary Solicitation for Comments in June 2019 (the "Preproposal"). In its Request for Comment on the Proposal dated December 13, 2019 (the "Notice") the Division addresses a number of issues raised by commenters in response to the Preproposal. We do not believe that the many of the findings and conclusions set forth in the Notice give due consideration to the views of the commenters. Several of the findings are brief, largely conclusory, and lacking in detail regarding the rationale that the Division employed in reaching them. The Notice contains several findings that we believe are either inaccurate or not supported, including the following:

A. Section 913 of the Dodd-Frank Act expressly authorizes the SEC to establish a fiduciary standard for broker-dealers. A study conducted by the SEC staff (the "Section 913 Study") recommended adoption of a fiduciary standard applicable to broker-dealers that would be functionally equivalent to that applicable to RIAs, and the Notice cites the findings of the Section 913 Study as justification for proceeding with the Proposal in its current form. However, the Notice does not mention the fact that in adopting Reg. BI, the SEC took extensive notice of the Section 913 Study and specifically concluded that applying the same standard to broker-dealers and RIAs was not in the best interest of many investors. The Commissioners carefully weighed the attributes of alternative regimes and concluded that the approach recommended by the Section 913 Study did not strike the correct balance between enhancing investor protection and maintaining customer choice. They found that a single fiduciary standard applicable to broker-dealers and RIAs would produce greater uniformity between broker-dealers and investment advisers, but also noted that such a uniform standard would be detrimental to investor choice, cost, and consumer access in the market for financial advice. (See for example, the comments of SEC Chairman Jay Clayton during the SEC meeting at which Reg. BI was adopted.)[4] Given its role

[4] https://www.sec.gov/video/webcast-archive-player.shtml?document_id=060519openmeeting

as the only regulatory agency with jurisdiction over all broker-dealers and RIAs in the United States, the conclusions reached by the SEC are entitled to a high degree of deference. With all due respect for the findings of the Section 913 Study, the conclusions of the Commission itself are far more compelling on this point.

B. Many harmful practices such as sales contests and quotas will continue to be permissible under the provisions of Reg. BI. This is at best an oversimplification. Reg. BI specifically mandates elimination of sales contests or other similar incentives for agents to recommend a specific product or products in a specified period of time. In addition, it requires broker-dealers to review all conflicts of interest, including all compensation arrangements and incentives that result from their business models and implement processes to manage and mitigate them.

C. Reg. BI places too much reliance on disclosure as a method of managing conflicts. This conclusion is not well substantiated and appears to assume that investors are incapable of evaluating information relating to their investments and financial circumstances. It is unsupported by rigorous academic or other research, and summarily dismisses the fact that disclosure is the bedrock principle on which securities law and regulation in the United States are founded. Perhaps more importantly, Reg. BI requires broker-dealers to identify, manage, and mitigate all material conflicts of interest, and disclosure is clearly one method of doing so. Reg. BI establishes a regime under which broker-dealers must take specific action based on the nature of the conflict. We submit that this approach is better designed to protect investors while also maintaining consumer choice.

D. The Proposal would "enhance the quality of advice in the transactional, episodic brokerage model without imposing any new ongoing obligations on those providing it". Perhaps we misunderstand the import of this conclusion, but the Proposal clearly imposes new obligations on advisers providing traditional brokerage services under many if not the majority of circumstances, particularly with regard to requirements to provide ongoing monitoring of recommendations in brokerage arrangements.

E. The Notice states that "Given the overlap of securities and non-securities related advice, the Division has a strong interest in regulating the conduct of its registrants regardless of the presence or absence of securities." We do not believe that the Division has statutory authority to regulate provision of advice with respect to anything other than securities, but even if it does, this creates a regime in which advice provided by a broker-dealer with respect to the value of any type of property could form the basis of an unethical trade practice claim. For example, if a customer of a broker-dealer solicits an opinion regarding the value of artwork or antiques, the Division's formulation could create liability on the part of the adviser with respect to that advice. This is an unwise and unwarranted adventure into territory far beyond the mandate of the Division or the ability of the securities industry to monitor and manage.

III. Initial Small Business Impact Statement

In connection with the Proposal, the Division has published an Initial Small Business Impact Statement (the "Statement"). It's primary findings are that adoption of the Proposal would have little or no impact on access to, provision of, or the cost of investment advice in the State of Massachusetts. The Statement itself is relatively brief and does not offer much other than conclusions that are not supported by any substantial evidence.

We will not attempt to address all of the individual matters set forth in the Statement here, although we believe it is in the interest of the Division, financial advisers, and investors that more rigorous research on the economic impact of the Proposal be undertaken before it is adopted, and would welcome an opportunity to engage with the Division on that point. We can say with certainty, however, that if adopted in its current form, the regulations set forth in the Proposal will drastically increase the cost of compliance for broker-dealers, which will have a direct effect on the willingness and ability of new firms to organize and conduct that business in Massachusetts.

IV. Substantive Aspects of the Proposal

A. Scope of covered activities

i. Definitions of "advice" and "recommendations" and coverage of non-customers

The Proposal creates standards of conduct relating to the provision of advice and recommendations made to clients, but does not specifically define the terms "advice" or "recommendation". The Notice states that the Division received numerous comments on the Preproposal addressing this point, but declined to go further in addressing this very large and substantive concern. In addition, 950 CMR 12.207(3) includes "prospective" customers and clients within its coverage. This creates the possibility of legal obligations to individuals with whom broker-dealers have no business or contractual relationship.

We repeat and re-emphasize our earlier comments: Any new regulation should make clear that the fiduciary obligation applies only to personalized recommendations that are intended to be acted upon by the individual to whom they are conveyed, and should be modeled on the "call to action" concept embodied in FINRA Rule 2111. Individuals who do not meet these criteria should be expressly excluded from its coverage.

ii. Advice that is "solely incidental" to the execution of securities transactions

The Proposal should also make clear that the rendering of advice with respect to securities that is solely incidental to the execution of securities transactions does not, in and of itself, create any duty to monitor investment recommendations absent the existence of an advisory relationship that is explicitly agreed to between the parties. We will offer additional comments regarding the scope of the obligation to provide ongoing monitoring of investment recommendations in brokerage accounts below, but we believe that the Division should be guided by the interpretation of the SEC regarding investment advice that is solely incidental to the execution of securities transactions and recognize that not all advice should create such an ongoing duty.[5]

iii. Investment strategies

The Proposal covers recommendations with respect to purchases and sales of securities, investment strategies, and the opening of any type of account, including transaction-based brokerage or fee-based investment advisory arrangements. Subject to our comments above regarding the definition of the terms advice, recommendations, and prospective clients, we believe that the Proposal takes the correct approach on this issue. We would also reiterate our comments above relating to the terms of any regulation covering advice with respect to any property other than securities. The Proposal as currently drafted covers advice relating to fixed insurance products and commodities. Even assuming that the Division has statutory authority to do this, it represents a significant departure from existing regulation in Massachusetts and most other jurisdictions. The potential for negative impacts and unforeseen consequences should be studied further before proceeding.

iv. Discretionary trading authority in brokerage accounts

950 CMR12-207(b)(2) provides that a broker-dealer or agent has an ongoing fiduciary duty if they exercise discretionary authority over a customer's account. Exercise of discretionary authority is a hallmark of an advisory relationship. We agree that brokerage arrangements that include unlimited investment discretion (not those limited in scope, such as arrangements covering only "time and price") should be subject to an ongoing obligation similar to that applicable to RIAs.

v. Non-exclusive list of violative conduct or activities

950 CMR 12-207(1) lists several activities that would be deemed to violate the fiduciary obligation, but specifically states that this list is "non-exclusive". As we noted in our comments on the Preproposal, this formulation does not provide reasonable notice to broker-dealers regarding acceptable conduct or standards for how to determine it, and creates a potentially endless number of activities that

[5] SEC Release No. IA-5249.

may be alleged to constitute breaches of the fiduciary obligation. Broker-dealers and customers need to know what conduct is acceptable prior to entering into a relationship. This provision will produce exactly the opposite effect.

B. Scope of the Fiduciary Obligation

950 CMR 12.207(1) describes the scope of the fiduciary obligation and conduct that would be deemed to violate it. Subsections (b) and (c) list specific activities that would give rise to an ongoing fiduciary obligation on the part of the adviser. Certain of these criteria are appropriate, but others are not.

In connection with the adoption of Reg. BI, the SEC issued interpretive guidance regarding activities that would subject a financial adviser to registration as an RIA. (See Release IA-5249, noted above.) The Investment Advisers Act of 1940 provides that, in general, any entity or individual that provides advice with respect to securities for compensation is deemed to be acting as an RIA and therefore subject to the fiduciary obligations which it includes There is an exception for broker-dealers if the broker-dealer provides advice that is "solely incidental" to the execution of transactions in securities. This recognizes that broker-dealers commonly provide advice with respect to securities as part of their activities, and so long as they do not receive "special compensation" such as ongoing advisory fees, they would not be deemed to be acting an RIA.

In Release IA-5249, the SEC states that there are two primary indicia of an investment advisory relationship: Exercise of discretionary transaction authority and ongoing monitoring of investment recommendations. Thus, if a broker-dealer provides either of these services, it generally could not satisfy the "solely incidental" exception in the Investment Advisers Act and would be forced to register as an RIA. Applying the SEC guidance to the provisions of 950 CMR 12.207, we note the following:

i. 950 CMR 12.207(1)(b)(1) creates an ongoing monitoring obligation if the adviser exercises discretion over the client's account, unless the discretionary authority is limited to time and price of section of a transaction. As noted by the SEC, exercise of discretionary authority has generally been viewed as indicative of an ongoing advisory relationship. We agree that this should give rise to a fiduciary obligation and ongoing monitoring obligation.

ii. 950 CMR 12.207(1)(b)(2) and (3) provide that if the adviser has a contractual fiduciary duty or other contractual obligation to monitor the client's account on a regular or periodic basis, an ongoing fiduciary obligation should apply. The SEC has stated that agreements to perform ongoing monitoring of client accounts are indicia of advisory relationships that have traditionally been subject to a fiduciary obligation, and we agree with this formulation.

iii. 950 CMR 12.207(1)(b)(4) provides that if the adviser receives ongoing compensation or charges ongoing fees, a fiduciary duty and ongoing monitoring obligation are created. If the adviser has a specific agreement with the client to perform ongoing monitoring or other services and receives fees in exchange for doing so, our comments regarding Sections (b)(2) and (b)(3) apply and we agree that imposition of a fiduciary obligation are appropriate. However, there are many circumstances in which a broker-dealer receives ongoing compensation with respect to securities purchased by a client but without an agreement that the compensation is in return for providing ongoing monitoring or any other specific services. Examples of this include compensation paid to broker-dealers pursuant to SEC Rule 12b-1[6] and to ongoing "trail" compensation with respect to certain variable annuity contracts. 950 CMR 12.207(1)(b)(4) should be amended to state that unless any ongoing compensation received by the broker-dealer is specifically intended (by contract or other express agreement) to be in return for providing ongoing monitoring of the account, receipt of ongoing compensation would not, in and of itself, create a fiduciary obligation or an obligation to perform ongoing monitoring.

iv. 950 CMR 12.207(1)(b)(4) also provides that if the adviser receives compensation "as an integral component of other financially related services", the fiduciary and ongoing monitoring obligations would apply. The scope of the term "integral component" is not further defined, and the parameters are extremely unclear. The Division should clarify this term to provide that the fiduciary obligation and any ongoing monitoring obligation attaches only if the broker-dealer has a specific agreement with the client to provide such services.

v. 950 CMR 12.207(1)(b)(5) covers circumstances in which the adviser "engages in any act, practice, or course of business that results in a customer or client ***having a reasonable expectation*** (emphasis added) that the broker-dealer, agent, investment adviser, or investment adviser representative will monitor the customer's or client's account on a regular or periodic basis." This appears to be a well-intentioned attempt to provide a "catch-all" provision under which the existence of a fiduciary obligation could be inferred from the surrounding circumstances. Unfortunately, any standard that relies on a "reasonable expectation" is too inherently subjective to be reliably interpreted. It does not provide broker-dealers with sufficient clarity about the scope of their obligations to allow them to create processes or systems to manage and mitigate this risk. If the Division believes it is important to have a catch-all provision such as this, it should explicitly provide that if a broker-dealer discloses to a client or customer that it will not provide ongoing monitoring services to them, such a disclosure would be determinative of the issue and the customer could not raise a claim that they had a "reasonable expectation" based on other circumstances or facts.

[6] 17 CFR Section 270.12b-1

vi. 950 CMR 12.207(1)(c) provides that if the adviser identifies themselves using certain descriptive titles including such terms as "financial adviser", it would be presumed that the customer has a reasonable expectation that the broker-dealer will provide ongoing monitoring services and be subject to the fiduciary obligation. We have a number of concerns about this provision, including the following:

- Terms such as "financial adviser" are widely used by broker-dealer agents to describe themselves and the services they provide. Their use is so widespread that these terms should be considered generic. It should not be assumed that clients will equate the use of a descriptive term such as this with an ongoing monitoring obligation. Perhaps more importantly, the scope and terms of the relationship between the client and adviser should be defined by the agreement of the parties rather than superficial descriptions. This provision should either be deleted from the Proposal or amended to provide that, if the broker-dealer or agent discloses to the client that that they are not providing ongoing monitoring services, their use of any of the specified titles or descriptive terms would not create such an obligation.

- It is common for agents of broker-dealers to be simultaneously registered as agents of an RIA, and to provide services as both broker-dealers and IARs. (This is often referred to as dual registration, or "switching hats".) A substantial percentage of Cetera advisers are registered as both IARs and agents of a broker-dealer. This allows them to offer both types of services to clients, and allows clients to select the advice and compensation model that makes the most sense for them with respect to each of their accounts. In many cases, a client maintains both a transaction-based brokerage arrangement and a fee-based advisory relationship with the same adviser.

  Investors often have different objectives for different accounts or investments. Some accounts may seek to achieve shorter-term goals such as saving for the purchase of a home. Some may be longer-term, such as saving for retirement. Some accounts may have objectives such as seeking tax-efficiency through minimum portfolio turnover. Each of these account types require differing levels of service from the adviser, and lend themselves to different compensation models.

  In its current form, 950 CMR 12.207(1)(c) would make it far more complicated and difficult for an adviser to provide both transaction-based brokerage services and fee-based advisory services to the same client without assuming an ongoing obligation to monitor all of the customer's accounts. For example, if the adviser identifies themselves using the term "Wealth Manager" in reference to their investment advisory activities, they would automatically be required to provide ongoing monitoring with respect to all accounts.

We understand that the Division's basis for including this provision in the Proposal arises out of a concern about confusion on the part of investors regarding the capacity in which the agent is acting. This concern is understandable, but without clarification, the approach taken in the Proposal produces a solution that is far more draconian than warranted. The SEC considered the issue of dually-registered advisers when it adopted Reg. BI and concluded that the more appropriate solution was to require explicit disclosure of the capacity in which the adviser is acting and requiring that any adviser who offers both brokerage and advisory services provide a written disclosure (Form CRS) that compares the two options.[7] This approach appropriately balances the need to ensure that investors understand the nature of their relationship with the adviser and the continued availability of investment-related services.

The elimination of the ability to maintain both advisory and brokerage accounts for the same client at the same time also creates a practical problem: What happens to all of the investors who currently have both brokerage and advisory relationships with the same adviser? On the effective date of any new regulations in Massachusetts, they will be forced to either convert one or more of their accounts to a different model, move one or more accounts to another adviser, or reconsider the model that they have previously utilized with the adviser. None of these options are appealing.

Fortunately, this problem is relatively easy to address. Any final regulation should specifically state that the obligation to provide ongoing monitoring would apply only to accounts where a contractual or other express obligation exists. Clients and broker-dealers should be free to define the terms of their relationship on an account-by-account basis if they choose, regardless of any title the advisor uses or if they provide other services to the client. If the regulation does not make this clarification, one of two things is likely to happen: Either broker-dealers will cease offering brokerage services in Massachusetts and force all clients to utilize a fee-based advisory model, or they will raise the price of transaction-based arrangements to compensate for the increased effort and risk that they assume. This reduces the availability of products and services to customers without a concomitant benefit.

vii. Conflict with Federal law and pre-emption

In Release IA 5429, the SEC set forth its interpretation of the "solely incidental" exception. As noted above, that interpretation states that exercise of investment discretion or provision of ongoing monitoring of brokerage accounts are indicia of an advisory relationship. Thus, if a broker-dealer performs either of these services under any circumstances, they would presumably be required to register as an RIA and conduct themselves in accordance with the provisions of the

[7] SEC Release No. 34-86032

Investment Advisers Act. 950 CMR 12.207 creates several circumstances in which a broker-dealer would be required to provide ongoing monitoring of brokerage accounts (receipt of ongoing compensation and use of certain titles, among other things). If this version of the Proposal is adopted, many advisers that are not otherwise subject to the provisions of the Investment Advisers Act suddenly will be. There is no effective means by which a broker-dealer that meets the conditions in 950 CMR 12.207 could avoid regulation as an RIA. This creates a direct and immediate conflict between the Proposal and federal law which we do not believe can be reconciled. The Proposal should explicitly recognize this conflict and eliminate the provisions of 950 CMR 12.207 (1)(b)(4) and (5).

C. The Duty of Care

i. The framework that the Division has established for the duty of care generally represents an appropriate set of factors that are important to investors, and one with which broker-dealers are familiar. It is similar to FINRA Rule 2111, which creates "Know Your Customer" and "Due Diligence" obligations. These require broker-dealers to review the characteristics, risks, and potential benefits of securities that they recommend to customers to determine if they are suitable for any investor, and to understand and take into account the attributes of the investor to whom the recommendation is made to ascertain that it is appropriate for them individually. However, 950 CMR12-207(2)(a)(3) would also require broker-dealers to take into account "any other relevant information" when making recommendations. As we stated in our comments on the Preproposal, the term "any other relevant information' is overly broad, imprecise, and not reasonably calculated to give broker-dealers sufficient notice regarding the factors that they are required to consider in meeting the duty of care. It is also likely to spawn a large number of disputes without any realistic standards by which to decide them. The Notice recites that one or more commenters on the original fiduciary proposal pointed this out, but the Division nonetheless declined to either refine this broad and amorphous concept or provide any explanation as to why not. We find this failure perplexing.

A comprehensive and well-understood template for factors that must be considered by a broker-dealer making a recommendation already exists in FINRA Rule 2111. In the interest of regulatory consistency and minimizing administrative and compliance costs, we repeat our request that the Proposal include a safe harbor provision confirming that broker-dealers that comply with the provisions of FINRA Rule 2111 satisfy the duty of care established by the Proposal. We also reiterate our earlier suggesting that compliance with FINRA Rule 2111 should create a presumption that the duty of care is satisfied with respect to the matters it covers.

ii. 950 CMR 12.207(2) provides that, in order to meet the fiduciary duty, a financial adviser must adhere to duties of "***utmost care and loyalty***" (emphasis added) to

the customer or client. We note that the Preproposal required that any recommendation to a customer represent the "best of the reasonably available options". The Proposal eliminated this requirement, apparently due to the Division having concluded that the requirement that a recommendation comprise the "best" of anything establishes a standard which cannot realistically be met. Formulation of investment recommendations is a process, not a single result. Any regulation should specify that financial advisers must adhere to specific standards of conduct rather than terms that are not capable of precise definition. The term "utmost" carries much of the same baggage that "best" had in the Preproposal. The Proposal wisely eliminated "best", and should do likewise with "utmost".

D. The Duty of Loyalty

In its present form, the duty of loyalty set forth in the Proposal is unworkable. It creates a number of issues, including the following:

i. "Without regard to the financial interest of the broker-dealer."

950 CMR12-207(2)(b)(3) requires that any recommendation by a broker-dealer or agent must be made "…***without regard to*** the financial or any other interest of the broker-dealer, agent …" (Emphasis added.) Not only is the concept of "without regard to" difficult to define, it is virtually impossible for any provider of professional services to meet because all professionals who are compensated by their clients do so with the objective of generating revenue to and earning a profit. Largely for this reason, the SEC provided in Reg. BI that a broker-dealer may not place their interest ***above*** that of the client when providing advice or recommendations. Reg. BI establishes a specific framework of conditions that must be satisfied in order to meet this standard. It is much more realistic and comprehensible than the standard embodied in the Proposal. The formulation that the Division has adopted is capable of such a wide range of interpretations that it will lead to endless litigation about how it should be applied. This provision should be deleted or modified to be consistent with the provisions of Reg. BI.

ii. Disclosure and Conflict Mitigation

CMR 950 12-207(2)(b) establishes a framework for dealing with conflicts of interest. It provides that broker-dealers must disclose all material conflicts of interest, make all reasonably practicable efforts to avoid them, eliminate conflicts that cannot be avoided, and mitigate conflicts that cannot be avoided or eliminated. This creates a standard that is not only ambiguous but will be extremely difficult to navigate in practice. As discussed above, all professionals have conflicts of interest in their relationships with clients, and every compensation model creates one or more conflicts.

The requirement that any adviser avoid conflicts is noble but not realistic. The more appropriate way to view management of conflicts of interest is that all of them fall somewhere on a continuum. Some present issues that are so severe that they must be eliminated, such as sales contests or quotas involving single products over a limited period of time. Others, such as whether a client should choose a fee-based advisory or transaction-based brokerage account are so inherently subjective that they are best managed though disclosure. The key to dealing with any conflict is to require that it be managed based upon its own characteristics and where it lies on the continuum. Reg. BI establishes a specific regime under which disclosure and management of conflicts must occur. The Proposal should take a similar approach.

950 CMR 12.207(1)(c) also provides that disclosing or mitigating conflicts of interest will not satisfy the duty of loyalty, but does not offer any further guidance regarding how financial advisers should determine what would. If neither disclosure nor mitigation are sufficient, one must ask: What is? In the absence of certainty, broker-dealers will mitigate the risk of violating this provision by reducing their product and service offerings for investors in Massachusetts. This is not in anyone's interest. At a minimum, the Division should set forth standards which will make clear how conflicts of interest, especially those arising out of adviser compensation practices, can be managed. Reg. BI provides a specific template for the Division to consider. We propose that as a starting point.

iii. Materiality of matters requiring disclosure

950 CMR 12.207(2)(b)(1) requires that financial advisers disclose all material conflicts of interest. However, 950 CMR 12.207(2)(b)(2) and (3) do not limit the obligation to avoid, manage, and mitigate conflicts of interest to those that are material. We believe that this may have been an oversight in the drafting process. If so, the Division should clarify that all obligations with respect to conflicts of interest are limited to those that would be considered material.

We would also reiterate our comments in connection with the Preproposal with respect to materiality. The legal standard for this concept is set forth by the U.S. Supreme Court in ***TSC Industries v. Northway***[8] and subsequently affirmed in ***Basic, Inc. v. Levinson*** [9], which has become the accepted standard for materiality in connection with recommendations to execute securities transactions. The Proposal should incorporate the well-established definition of materiality set forth in ***Basic****:* The significance that a reasonable investor would place on the withheld or misrepresented information. As discussed above, the current version of the Proposal would adopt an overbroad standard that would require disclosure and management of conflicts that may not be relevant or useful to an average investor.

[8] 426 U.S 438 (1976).
[9] 485 U.S. 224 (1988).

Defining material conflicts of interest as the Supreme Court did in ***Basic*** would have numerous benefits for investors. It would provide them with information pertinent to their investment decisions while avoiding the problem of over-disclosure. For the securities industry, using the ***Basic*** definition would achieve a greater degree of legal certainty by employing a standard with which it is already familiar, and for which an existing legal framework exists.

iv. Disclosure and management of conflicts of interest should be limited to persons or entities for whom they actually exist

Standards of conduct and obligations to identify and mitigate conflicts of interest should generally apply in the same way to both broker-dealers and their associated persons. However, it should be recognized that there are conflicts of interest that exist for the firm (for example, with respect to certain revenue-sharing arrangements and principal transactions), but do not also apply to the individual adviser. Representatives of most broker-dealers do not receive any portion of these revenues, and these practices do not create adverse incentives for the representative who actually makes investment recommendations to the client. Identification and mitigation of conflicts of interest, especially regarding compensation, should recognize this and limit application to those individuals or entities that have actual conflicts rather than adopting a blanket standard for all members of an affiliated group.

V. Pre-emption of state conduct standards for broker-dealers

950 CMR 12-207(5) provides that "…nothing in this section shall be construed to establish any capital, custody, margin, financial responsibility, making and keeping of records, bonding, or financial or operation reporting requirements for any broker-dealer of any agent of any broker-dealer that differ from, or are in addition to, the requirement established under 15 U.S.C. Section 78o(i)."

We believe that this is a well-intentioned effort by the Division to avoid the provisions of The National Securities Markets Improvement Act of 1996 ("NSMIA"). NSMIA precludes states from enacting regulations relating to the making and keeping of records "***that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act]***" (Emphasis added). Exchange Act Rule 17(a)-4 requires broker-dealers to keep a record of "all communications … by the member … relating to its business as such….". [10] We submit that it would be extremely difficult if not impossible for broker-dealers to establish compliance with the standards embodied in the Proposal without creating and maintaining a significant amount of documentation in addition to that which is currently required by Rule 17a-4.

950 CMR 12.207(1)(b) creates obligations for broker-dealers to provide ongoing monitoring of accounts or recommendations under certain circumstances. In order to

[10] 17 CFR §§ 240.17a-4(b)(4).

demonstrate that such monitoring was done, it would be necessary to create written records memorializing as much. There is no requirement in SEC Rule 17a-4 or elsewhere under federal law to create such records in connection with recommendations or transactions in brokerage accounts.

The recitation in 950 CMR 12.207 that it will not create any new recordkeeping requirements directly contradicts any realistic interpretation of its other provisions. The only way to cure this contradiction while retaining the other provisions of the Proposal would be to provide that, notwithstanding any new obligations it creates, broker-dealers and other financial advisers would not be required to create records documenting any actions they took to comply. This would be unorthodox at best, and not likely to accomplish the Division's desired result.

As discussed above, by crafting the Proposal to limit "hat-switching," the Proposal is also in direct conflict with the federal securities laws, which expressly authorize and permit dual registrants to simultaneously provide transaction-based brokerage and investment advisory services to the same clients. The ability to maintain multiple relationships is a core principle of Reg. BI. It implicitly recognizes that broker-dealers are not required to provide ongoing monitoring by requiring disclosure of limitations on the scope of services they offer.

VI. Creation of private rights of action

The Proposal should explicitly state that it is not intended to confer or create any private rights of action for alleged violations of the fiduciary duty. We understand that the intent of the Proposal is to enhance protection for investors and affirm the right of the state to take action against individuals or entities that violate applicable rules. While we disagree with the substance of many of the provisions in the Proposal, we acknowledge and accept the role of the state in creating standards that the Division itself may enforce. That being said, allowing customers of broker-dealers and RIAs to predicate civil actions on alleged violation of these regulations creates numerous adverse consequences. If the Proposal creates private rights of action, enforcement of these regulations will effectively be outsourced to the claimant's bar. This will create financial and other incentives to bring frivolous claims, ultimately increasing the cost of doing business for financial advisers in providing services to their clients. It is an axiom of economics that there is no free lunch. The cost of providing any service will ultimately be passed on to the consumer of those services. In this case, that is the investing public.

VII. Dishonest or unethical business practices

950 CMR 12-204 deems failure to conform to the fiduciary obligation a dishonest or unethical business practice. We share the Division's desire to ensure that investors are adequately protected and that bad actors are appropriately punished, but any regulation as new, different, and difficult to interpret as this will almost certainly produce inadvertent or de minimis breaches that do not result in harm to investors. Unfair trade practice laws throughout the United States generally recognize this concern, and therefore require

evidence of a pattern or practice of bad behavior before imposing penalties. We respectfully urge the Division to adopt a similar requirement by revising Section 12-204 to provide as follows:

A. "Dishonest or unethical business practices"…shall include providing investment advice or recommending to a customer, an investment strategy, the opening of, or transfer of assets to, any type of account, or the purchase, sale, or exchange of any security when:

i. A broker-dealer, or its agent, <u>engages in a pattern or practice of failing</u> to act in accordance with a fiduciary duty to a customer when making a recommendation or providing investment advice.

VIII. <u>Effective dates and timing for implementation</u>

As noted above, the Proposal represents a substantial departure from the current regulatory regime. The experience of broker-dealers with the DOL Fiduciary rule has demonstrated that compliance with any such new framework involves a long process of review to understand what activities may be impacted and how compliance may be achieved. In addition, there are numerous dependencies and parties that need to be included in implementation of any new processes that must be developed. They include broker-dealers, product sponsors, clearing firms, and other service providers. Until the final version of any new regulations is published, most firms cannot begin preparing for implementation, and necessary adjustments are not within the control of any one party. We suggest that the Division provide for a period of at least 24 months from the time that any new regulations are adopted until they become effective.

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We appreciate the opportunity to provide these comments, and look forward to working with the Division as it considers further action. If we any offer any additional information or assistance, please let me know.

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