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Via e-mail: 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: Proposed Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives (950 CMR 12.200)

Dear Secretary Galvin:

On behalf of our members, the Insured Retirement Institute (“IRI”)¹ appreciates the opportunity to provide comments to the Massachusetts Securities Division (the “Division”) on the Division’s proposal to impose a fiduciary duty on broker-dealers, agents, investment advisers, and investment adviser representatives through proposed amendments to 950 CMR 12.200 (the “Proposal”).

In 2016, our members had combined fixed and variable annuity sales of over \$5.86 billion in Massachusetts, representing 2.8% of US annuity sales and making it the 11th largest annuity market in the U.S. We count among our members several large financial institutions headquartered in and around Massachusetts, as well as over 20,000 financial advisors across the state who are affiliated with more than 400 different broker-dealer firms.

As we noted in our July 2019 comment letter (the “July 2019 Letter”) in response to the Division’s June 2019 preliminary proposal (the “Preliminary Proposal”), IRI and our members have long supported the establishment of workable and meaningful enhancements to the standards of conduct to which financial professionals are held. We believe the Securities and Exchange Commissions (“SEC”) has accomplished this objective with the adoption of rules in June 2019 that establish a best interest standard for

¹ IRI is the leading association for the entire supply chain of insured retirement strategies, including life insurers, asset managers, and distributors such as broker-dealers, banks and marketing organizations. IRI members account for more than 95 percent of annuity assets in the U.S., include the top 10 distributors of annuities ranked by assets under management, and are represented by financial professionals serving millions of Americans. IRI champions retirement security for all through leadership in advocacy, awareness, research, and the advancement of digital solutions within a collaborative industry community.

federally-registered broker-dealers and registered representatives (“BDs”) under the federal securities laws (collectively, the “Final SEC Rules”).² On a related note, the National Association of Insurance Commissioners (“NAIC”) has nearly completed its work on similar enhancements to the standards applicable to state insurance producers under its model regulation governing annuity sales practices (the “NAIC Model”). We anticipate final approval of these modifications in early 2020, followed by prompt action across the states to adopt the enhanced NAIC Model.

In the pages that follow, we will explain why and how we believe the Final SEC Rules and the enhanced NAIC Model will effectively accomplish the Division’s goals without the need for further regulation as contemplated by the Proposal, and will do so recognizing important legal and practical differences between “best interest” standards for broker-dealers and “fiduciary” standards for investment advisers. We recognize, however, that the Division may be unpersuaded by these arguments. Therefore, we will also provide specific recommendations intended to make the Proposal more workable and reduce the potential unintended consequences we believe would follow if the Proposal is adopted in its current form.

1. The Division Should Objectively Evaluate the Actual Effectiveness of the Final SEC Rules and the Enhanced NAIC Model Before Determining Whether to Take Final Action on the Proposal.

In our July 2019 Letter, we contended that the Final SEC Rules, and in particular, Regulation Best Interest (“Reg BI”), would substantially strengthen investor protection compared to existing law in a manner that is consistent with the principle that financial professionals should be required to act in their clients’ best interest when providing personalized investment advice, while also preserving investor choice and access to the products and services they need to achieve their financial goals. Six months later, our view remains unchanged and, in fact, has been validated by our industry’s comprehensive response to the Final SEC Rules.

Over the past six months, we have worked closely with our members to support their efforts to prepare for implementation of the Final SEC Rules on June 30, 2020. Our broker-dealer members have diligently analyzed the Final SEC Rules; assessed their existing policies, procedures, and systems in light of the Final SEC Rules; and undertaken extensive efforts to develop and implement changes needed to comply with the letter and spirit of the Final SEC Rules. For their part, our insurance company and asset manager members have worked closely with their broker-dealer partners in support of these efforts. In addition, the SEC and the Financial Industry Regulatory Authority (“FINRA”) have issued guidance and developed tools and resources to help firms prepare for implementation,³ and FINRA is conducting

² Regulation Best Interest, Exchange Act Release No. 34-86031, 84 FR 33318 (June 5, 2019) (“Reg BI Adopting Release”); Form CRS Relationship Summary; Amendments to Form ADV, Exchange Act Release No. 34-86032, Investment Advisers Act Release No. 5247, 84 FR 33492 (June 5, 2019); Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, Investment Advisers Act Release No. 5249, 84 FR 33669 (June 5, 2019); and Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 5248, 84 FR 33681 (June 5, 2019).

³ A list of resources and tools created by the SEC and FINRA to support firms’ implementation efforts has been posted on FINRA’s website at: <https://www.finra.org/rules-guidance/key-topics/regulation-best-interest>.

preparedness reviews to help firms evaluate and understand how much more work must be done before June 30.

For example, our broker-dealer members are:

- Developing training and tools to ensure that their registered representatives act in their clients' best interest and are equipped to do so;
- Modifying their policies and procedures to clearly require their registered representatives to act in their clients' best interest when making recommendations about securities, including recommendations about the type of account a client should open;
- Incorporating consideration of upfront and future costs, as well as reasonably available alternatives, into the process for determining whether a particular product or account type is in the client's best interest;
- Updating their monitoring and supervision systems to identify recommendations that might not be in the client's best interest, and to carefully scrutinize such recommendations to determine whether corrective action is needed;
- Preparing new, user-friendly disclosure materials to ensure that investors have the information they need to make informed decisions about the type of financial professional to work with, and to fully and fairly evaluate recommendations made by their chosen financial professional (including information about costs, conflicts of interest, and limitations on the products they can recommend);
- Developing enhanced policies and procedures to identify and eliminate or mitigate conflicts of interest at both the firm and financial professional levels; and
- Eliminating sales contests, bonuses, non-cash compensation and quotas based on the sale of specific securities or specific types of securities within a limited time.

We and our members are confident that these changes will result in significantly greater investor protections, and we anticipate similar efforts by insurance distribution firms as states adopt the enhanced NAIC Model.

In the Request for Comments on the Proposal, the Division claims that "Reg BI fails to provide investors the protection they need from harmful conflicts of interest [because] "best interest" is not defined...and the rule focuses far too heavily on disclosure..." The Division further asserts that "[a] fiduciary standard is necessary to ensure that financial advice be based on what is best for investors." In our view, the Division's posture is untenable in light of the extensive work being done by broker-dealers and their registered representatives to ensure that investors get advice that is in their best interest, as described above, and is inconsistent with the relationship characteristics necessary and important for imposing a true "fiduciary" standard.

Proponents of a fiduciary standard often present it as a panacea, as if a person with bad intentions can be wrapped in a fiduciary tunic and somehow be transformed into a beacon of truth and honesty. This sort of blind devotion to a word has driven otherwise intelligent and well-meaning individuals to

disregard the fact that, as SEC Chairman Jay Clayton has stated on numerous occasions, there is very little daylight between a fiduciary rule and a best interest rule. Both types of rules expressly require financial professionals to act in their clients' best interest, but neither can guarantee, with 100% certainty, that investors will never get bad advice or be victimized by bad actors.

Nonetheless, these are important differences. Under longstanding legal standards, the fiduciary relationship requires a transfer of some decision making power from the client to the fiduciary. In the context of this rulemaking, this transfer of decision making results in a key difference – namely that a fiduciary rule applies this standard on an ongoing basis to the entire relationship between the financial professional and the client, while a best interest rule applies the standard on a transaction-by-transaction basis, with no requirement to monitor the client's account in between individual transactions.

Given this significant alignment between fiduciary and best interest rules, we believe the Division has mistakenly characterized the Final SEC Rules as inadequate and ineffective. While we clearly disagree with this view, we do not expect the Division to simply take our word for it. Instead, we respectfully ask the Division to take the time to carefully and objectively assess whether the Final SEC Rules and the enhanced NAIC Model effectively protect investors before deciding whether additional regulatory action is needed. If the Division determines, after the Final SEC Rules and the enhanced NAIC Model have been in effect for a reasonable period of time, that more stringent rules are needed to adequately protect investors, we will work with you to achieve this shared goal.

II. The Proposal Must Either Expressly Exclude Annuities from its Scope or Harmonize with the Enhanced NAIC Model to Reflect the Unique Nature of Annuity Products.

From the perspective of IRI and our members, one of the most significant and problematic differences between the Proposal and the Preliminary Proposal is the fact that the Proposal expressly applies when a broker-dealer, agent, investment adviser, or investment adviser representative recommends “the purchase, sale, or exchange of any...insurance product.” However, the Massachusetts Uniform Securities Act (the “Act”) excludes any insurance products, including annuity contracts, from the Division’s jurisdiction.⁴ This represents a clear acknowledgement by the Massachusetts legislature that annuities and other insurance products are already subject to extensive regulation by the Massachusetts Division of Insurance (“MA DOI”)⁵, the SEC, and FINRA, and that additional regulation under the Act would be unnecessary, redundant, and potentially result in conflicting standards.

Section 204(a)(2)(G) of the Act does authorize the Division to deny, revoke, suspend, cancel or withdraw the registration of any broker-dealer or investment adviser who, among other things, “(G) has engaged

⁴ See 110A MGL 401(k) (“‘Security’ does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period.”). See also, 110A MGL 402(5) (providing an exemption for “[a]ny security issued by and representing an interest in or a debt of, or guaranteed by, any insurance company organized under the laws of any state and authorized to do business in this State”).

⁵ See Consumer Protection and Suitability in Annuity Transactions, 211 CMR 96.00, available at <https://www.mass.gov/files/documents/2017/10/20/211cmr96.pdf>.

in any unethical or dishonest conduct or practices in the securities, commodities or insurance business.” However, nothing in that statutory provision gives the Division authority to adopt regulations imposing a fiduciary duty on broker-dealers or investment advisers. Moreover, the MA DOI, as the primary regulator of the insurance industry, is best suited to enforce standards of conduct with regard to recommendations of insurance products. Jurisdictional regulatory boundaries should be observed so that state laws are not inconsistent with respect to the standard of conduct applicable to these products. Absent such consistency, two insurance producers who are regulated by the MA DOI could be held to different standards simply because one of them is also subject to regulation by the Division.

Based on the foregoing, we respectfully assert that the Division must strike the references to insurance products from the Proposal. If, however, the Division disagrees with our interpretation of the Act and insists on expressly applying the Proposal to insurance products, we respectfully urge the Division to carefully consider the views expressed by the MA DOI in its July 26, 2019, comment letter to the Division regarding the Preliminary Proposal. In particular, the MA DOI expressed concern about potential inconsistencies between the Division’s approach and the enhanced NAIC Model. We share this concern, and we echo Commissioner Anderson’s request that, if the Division intends to apply the Proposal to annuities (despite its lack of jurisdiction, as explained above), it should modify the Proposal to “harmonize its requirements with [the enhanced NAIC Model and] to reflect the unique nature of annuity products.” Furthermore, the Division should more clearly specify the types of annuities it is intended to cover.

*III. If the Division Moves Ahead with the Proposal, Several Important Changes Are Necessary to Minimize Unintended Investor Harm.*⁶

In the event the Division does not wait to adopt the Proposal until Reg BI and the enhanced NAIC Model have been in effect long enough to assess their effectiveness, we offer the following comments to help the Division craft a more workable rule that will have less adverse impact on Massachusetts investors. To be clear, however, even if the Division were to accept all the changes recommended below, we would still have significant concerns about the creation of a patchwork of inconsistent and incompatible regulations. In particular, we believe the Proposal will cause many Massachusetts residents to lose access to the wide variety of products and services available to other Americans to help them achieve their financial goals. Economic realities could drive firms to charge more for services, increase minimum account size thresholds, significantly scale back the products and services offered, or potentially even discontinue operating in Massachusetts if the cost of doing business becomes prohibitive.⁷

⁶ The only way to fully avoid the unintended consequence of harming investors would be to delay finalization of the Proposal for the reasons outlined above. IRI’s recommendations, as described in this section, are important and helpful but can only go so far to minimize the harm to investors.

⁷ A detailed discussion of this concern was included in Section I of our July 2019 Letter, which is hereby incorporated by reference into this letter.

A. *The Circumstances Under Which the Fiduciary Standard Would Apply Are Overly Broad and Insufficiently Defined.*

Section 12.207(1) of the Proposal provides a “non-exclusive list of practices by a broker-dealer, agent, investment adviser, or investment adviser representative which shall be deemed ‘unethical or dishonest conduct or practices.’” We have significant concerns about several aspects of this provision.

First, by characterizing this as a “non-exclusive list,” the Proposal fails to clearly define the types of conduct it intends to prohibit. Even the most honest and well-meaning financial professionals will be left to cross their fingers and hope the Division will not decide that their actions somehow violated their regulatory duties. While this approach may provide the Division with greater latitude to pursue bad actors, we fear it will also drive trustworthy and reliable individuals out of the business. Obviously, this would not be a positive outcome.

Second, subsection (a) refers to “providing investment advice or recommending” certain investment activities. However, the Proposal fails to define these terms. We believe the Division intended these terms to refer to the types of conduct that would give rise to an obligation to register with the SEC as an investment adviser under the Investment Advisers Act of 1940 (the “Advisers Act”). We would support such an interpretation, and we would urge the Division to revise the Proposal to be more explicit on this important point.

Third, subsection (b)4 would require broker-dealers, agents, investment advisers, and investment adviser representatives to meet a fiduciary duty whenever they receive “ongoing compensation or charge[] ongoing fees” for advice about the advisability of certain investment activities. Commission-based compensation arrangements frequently include both an upfront commission and a trailing commission. For many investors, this structure is the most financially beneficial. In practice, however, imposing a fiduciary duty on such arrangements would effectively impose a corresponding duty to provide ongoing monitoring.

Clearly, ongoing monitoring of a client’s account and investments is a significant and valuable service. It is not, however, a service that is universally needed or wanted by all investors. Like nearly all other services, ongoing monitoring is not free; it requires additional time, effort, and training, and exposes firms and financial professionals to risks and potential liabilities that would not otherwise exist. As such, ongoing monitoring comes with a cost, and that cost outweighs the value for many investors. For example, a buy-and-hold investor could go multiple years without making any changes to his or her portfolio, and therefore, would derive little to no benefit from ongoing monitoring. Unfortunately, the Proposal would effectively prevent such investors from purchasing and paying for only those services they actually want or need.

Fourth, subsection (b)4 would also impose a fiduciary duty whenever broker-dealers, agents, investment advisers, and investment adviser representatives provide advice about the advisability of certain investment activities “as an integral component of other financially related services.” Similar to the concerns expressed above, the Proposal provides no definition of this phrase, thereby preventing firms and financial professionals from knowing whether they have engaged in conduct that will trigger fiduciary obligations under this subsection.

Lastly, subsection (b)5 provides that a fiduciary duty can arise as a result of the “reasonable expectation” of the customer or client. Again, the Proposal offers no clarity or certainty as to the types of situations or conduct that would be sufficient to create a “reasonable expectation” that ongoing monitoring will be provided (except for the use of certain titles, which we will discuss in the next section).

Based on the foregoing, we respectfully urge the Division to revise Section 12.207(1)(a) and (b) to more clearly define the circumstances under which broker-dealers, agents, investment advisers, and investment adviser representatives will be required to satisfy a fiduciary duty. Clarity and certainty are critical for any regulation to effectively achieve its intended objectives, and as written, the Proposal fails to meet these standards.

B. *The Presumption that the Use of Certain Titles, Credentials, or Designations Would Result in a Reasonable Expectation that Ongoing Monitoring Will Be Provided is Inconsistent and Incompatible with Reg BI and Should be Stricken from the Proposal.*

In the Reg BI Adopting Release, the SEC states that “the use of the term ‘adviser’ and ‘advisor’ in a name or title by (1) a broker-dealer that is not also registered as an investment adviser or (2) an associated person that is not also a supervised person of an investment adviser” would violate Reg BI’s capacity disclosure requirement.⁸ This reflects the SEC’s policy choice to allow firms and financial professionals to use those terms in their names or titles as long as they are properly registered and regulated under the Advisers Act, even if they do not operate solely as investment advisers or investment adviser representatives.

By contrast, the Proposal would impose a fiduciary duty on broker-dealers and agents who use those terms in their names or titles. As a result, dual registrants who use those terms as expressly permitted under Reg BI, or who use other terms that are not referenced in Reg BI, would be forced to either discontinue the use of those terms (at potentially significant expense) or operate as fiduciaries with respect to all of their customers or clients.

C. *The Reference to Duties of “Utmost” Care and Loyalty Suggest That Fiduciaries Under the Proposal Must Meet a Higher Standard Than Traditional Duties of Care and Loyalty, But the Proposal Fails to Clearly Define “Utmost” Care and Loyalty.*

Fiduciary obligations are imposed under a variety of different legal regimes, including the Advisers Act, ERISA, the Uniform Trust Code, state corporate laws, state common law,⁹ and more. In different contexts, fiduciary duties can sometimes have different meanings. However, the notion that fiduciaries must act in accordance with duties of care and loyalty is universal. As such, it is unclear what is intended

⁸ See Reg BI Adopting Release at 33351.

⁹ Under state common law, fiduciary duties arise in the context of a principal/agent relationship, where one person (the principal) expressly delegates particular responsibilities to another (the agent), and the agent expressly accepts those responsibilities. Common law fiduciary duties cannot be imposed on an agent unless and until he or she agrees to accept a fiduciary position. See Restatement (Third) of Agency, § 8.08 (“Subject to any agreement with the principal, an agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances.”).

by the inclusion of the word “utmost” in Section 12.207(2) of the Proposal. Firms and financial professionals who are held to a fiduciary standard under the Advisers Act, for example, can look to the extensive SEC guidance and case law to understand their duties of care and loyalty. The Division has offered no such guidance as to the distinction between traditional “care and loyalty” and this seemingly higher standard of “utmost care and loyalty.” As such, we respectfully urge the Division to strike the word “utmost” from the Proposal to avoid any potential confusion or uncertainty as to its expectations for firms and financial professionals who would be treated as fiduciaries if the Proposal is adopted.

D. The Proposal’s Approach to Conflicts of Interest Should Be More Thoroughly Developed.

The conflicts of interest provision in Section 12.207(2)(b)2 of the Proposal represents a significant improvement over the Preliminary Proposal, and we appreciate the Division’s willingness to make changes to this important provision. However, the current approach still leaves IRI and our members with a few difficult questions:

1. What types of circumstances or conduct would constitute a “conflict of interest” under the Proposal?
2. How are firms and financial professionals expected to distinguish between conflicts that must be avoided, conflicts that must be eliminated, and conflicts that can be managed through mitigation?
3. What would constitute effective avoidance, elimination, or mitigation of a conflict?

We respectfully submit that the most efficient and effective solution to these questions would be for the Division to further revise this provision to align with the approach taken in Reg BI, including its definition of “conflicts of interest.”

Similarly, we respectfully urge the Division to more clearly and narrowly define the prohibition on “sales contest[s], implied or express quota requirement[s], [and] other special incentive program[s]” in Section 12.207(2)(d). As written, this provision’s terms are so vague and so broad that they could conceivably apply to almost any kind of compensation based on a representative’s performance. Without a more clear definition, it would be impossible for firms to know what constitutes either a “special incentive program”, or an “implied quota.” We urge the Division to harmonize this section with the approach taken by Reg BI, which we believe would effectively address the Division’s concerns with sales contests.

E. The Duty of Loyalty Formulation Creates an Impossible Standard and Should be Revised to Follow the Approach Taken in the Final SEC Rules.

As we explained in our July 2019 Letter, we oppose the formulation of the duty of loyalty as a requirement to make recommendations “without regard to the financial or any other interest of any party other than the customer or client.” This language comes directly from the now-vacated DOL Rule¹⁰

¹⁰ As used in this letter, the term “DOL Rule” means, collectively, the final regulation defining the term “fiduciary” under the Employee Retirement Income Security Act of 1974, as amended, the Best Interest Contract Exemption, and the amendments to prohibited transaction exemption 84-24, each of which was issued by the DOL on April 8, 2016 and vacated *in toto* by the United States Circuit Court of Appeals for the Fifth Circuit on March 15, 2018.

and would require a complete disregard of any financial interest of the fiduciary and its affiliates. In reality, and as we and numerous other commenters explained to the Department of Labor, this formulation wholly ignores the business and economic reality that firms and financial professionals must generate enough revenue to cover their costs and earn a reasonable profit in order to stay in business.¹¹

We do not believe the Division intended to require BDs to completely disregard their own business interests. Rather, we believe the Division's intent – consistent with that of the SEC in adopting Reg BI – was to require that the investor's interests are always considered first and foremost. Accordingly, we respectfully urge the Division to modify the Proposal to more clearly reflect this intent by aligning with the approach taken in the Reg BI.

Moreover, based on the discussion of this issue in the Reg BI Adopting Release, the use of the “without regard to” phrasing in the Proposal would be in direct conflict with Reg BI, thereby increasing the likelihood that the Division's rule would be preempted.

Specifically, we recommend that the Division revise section 12.207(2)(b)3 as follows:

“Make recommendations and provide investment advice without ~~regard to the financial or any other interest of any party other than~~ placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the customer or client.”

F. *Additional Comments.*

We have additional comments and concerns regarding the Proposal. We previously expressed these points in our July 2019 Letter on the Preliminary Proposal, but the changes made by the Division to the Preliminary Proposal did not address them. As such, we hereby incorporate by reference into this letter the comments and concerns described under the following headings in our July 2019 Letter:

1. The information gathering aspect of the duty of care is ill-defined and overbroad and should be revised to align with the comprehensive list of relevant factors included in FINRA's suitability rule (the retail customer's investment profile).
2. The Proposal fails to address the permissibility of common brokerage activities (such as sales of proprietary products) and should be revised to expressly clarify that such activities are not inconsistent with the fiduciary duty.

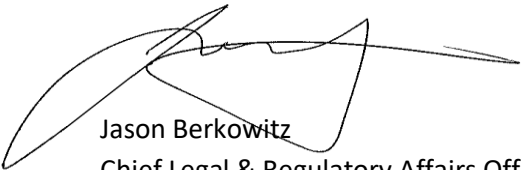
¹¹ Reg BI Adopting Release, at 49-51 (describing comments received in support of and in opposition to the use of the “without regard to” phrasing), and at 62-67 (expressing the SEC's concern that the “without regard to” phrasing “would be inappropriately construed to require a broker-dealer to eliminate 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 their costs;” and explaining the decision to instead use the “without placing the financial or other interest...ahead of the interest of the retail customer” phrasing, which “recognizes that while a broker-dealer will inevitably have some financial interest in a recommendation—the nature and magnitude of which will vary—the broker-dealer's interests cannot be placed ahead of the retail customer's interest.”)

3. A pattern or practice of fiduciary breaches should be required to demonstrate that a firm or financial professional has engaged in “dishonest or unethical business practices.”
4. The Proposal should not apply to entities that are already subject to fiduciary obligations under existing law.
5. The Proposal fails to effectively avoid federal preemption.
6. A final rule must provide sufficient time to develop and implement the policies, procedures, and systems changes necessary to achieve compliance.

* * *

Thank you again for the opportunity to share our views on this important subject. If you have questions about anything in this letter, or if we can be of any further assistance in connection with this important regulatory effort, please contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Jason Berkowitz", with a long horizontal stroke extending to the right.

Jason Berkowitz
Chief Legal & Regulatory Affairs Officer
Insured Retirement Institute (IRI)