

January 7, 2020

Submission Via Email: securitiesregs-comments@sec.state.ma.us

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

Raymond J. Manista

Executive Vice President
Chief Legal Officer and Secretary

raymanista@northwesternmutual.com
720 East Wisconsin Avenue
Milwaukee, WI 53202-4797
P 414.665.2214 | F 414.665.2214

Dear Secretary Galvin:

The Northwestern Mutual Life Insurance Company (“Northwestern Mutual”) appreciates the opportunity to comment on the Massachusetts Securities Division’s (“Division”) Proposed Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives dated December 13, 2019 (the “Proposal”).

Northwestern Mutual has long supported a uniform best interest standard of care when providing investment advice to retail consumers so long as it is business-model neutral, preserves consumer choice, ensures consumers have continued access to investor education, planning services and affordable investment options, and provides reasonable guidance and certainty for the firm and its financial representatives in its implementation. These are the same principles that guided us in commenting on the Department of Labor’s (“DOL”) investment advice rulemaking for the retirement market and the Securities and Exchange Commission’s (“SEC”) more recent Regulation Best Interest and Form CRS rulemaking package.

While Northwestern Mutual respects the Division’s objective of enhancing the standard of care in the investment space for Massachusetts consumers, we believe the Proposal significantly misses the mark on the principles noted above and would likely lead to increased client cost, greater client confusion, and reduced client access to high-quality investment and insurance products for Massachusetts consumers as compared to consumers in neighboring states and across the rest of the country.

Since it appears, much to our disappointment, that the Division is unwilling to defer or delay this regulatory effort in order to align or harmonize it with other adopted or pending federal and state regulatory efforts such as the SEC’s Regulation Best Interest or the National Association of Insurance Commissioners’ amendments to its model regulation on annuities,¹ we submit this comment letter to suggest ways in which this Proposal could be improved to better address the principles mentioned above. After providing below some additional information about Northwestern Mutual and the

¹ The Commonwealth of Massachusetts Securities Division, Request for Comment (December 13, 2019) at pp. 3-5 (the “Request for Comment”), available at <https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf>.

Massachusetts consumers that we currently protect and advise, we affirm certain industry comment letters on the Proposal and highlight several issues of significant importance to us.

About Northwestern Mutual. For more than 160 years, Northwestern Mutual has been helping families and businesses achieve financial security. Our financial representatives build lifelong relationships with clients through a distinctive, whole-picture planning approach that integrates risk management with wealth accumulation, preservation and distribution. Northwestern Mutual delivers financial security to more than 4.5 million clients who rely on us for insurance and investment solutions, including life, disability income and long-term care insurance; annuities; trust services; mutual funds and general securities; and investment advisory products and services.

Our financial strength and ability to meet our clients' needs is demonstrated by \$285 billion in assets, \$28 billion in annual revenue, \$157 billion in client assets held or managed in investment products and services, and \$1.9 trillion worth of life insurance protection in force. We have the highest financial strength ratings awarded to any life insurer by all four of the major rating agencies. In 2019, Northwestern Mutual was once again recognized by FORTUNE magazine as one of the "World's Most Admired" life insurance companies.

We have a sales force of approximately 6,700 full-time financial representatives and 5,000 associate financial representatives, most of whom are also registered representatives of our broker-dealer, Northwestern Mutual Investment Services, LLC ("NMIS"), which is among the top five independent broker-dealers in the United States according to Financial Advisor Magazine. A majority of our full-time representatives are also advisors of Northwestern Mutual Wealth Management Company ("WMC"), a limited purpose federal savings bank regulated by the Office of the Comptroller of the Currency ("OCC") providing investment advisory programs and services to our clients.

Northwestern Mutual has a significant footprint in Massachusetts on any number of measures. The potential impact of the Proposal on our business and the residents of the Commonwealth can be sized with a few illustrative data points:

- More than 87,000 Northwestern Mutual life insurance policyowners are located in Massachusetts with a face amount of insurance protection of more than \$55 billion
- We have approximately 17,000 investment products and services accounts in Massachusetts, with \$2.8 billion in client assets held or under management
- Our annuity contracts total 9,000 in the Commonwealth, representing a value of about \$475 million for Massachusetts residents
- More than 2,300 of our representatives are securities licensed in Massachusetts
- More than 15 Northwestern Mutual offices (e.g., offices of supervisory jurisdiction, branch offices, etc.) are located in the Commonwealth
- Approximately 250 of our financial representatives are residents of Massachusetts and they employ a staff of 180 additional associates

As our name indicates, Northwestern Mutual is organized as a mutual company, which allows us to manage the company in the best interests of our clients rather than splitting our focus between

clients and shareholders. As a mutual, after setting aside a safe margin for reserves and surplus each year, Northwestern Mutual returns gains from its operations, that would otherwise be profits, to its participating policyowners in the form of dividends, which, in turn, lowers the net cost of products to our clients over time. In other words, our mutual advantage brings into alignment the interests of both clients and the company, which is amply demonstrated by our persistency rate for life insurance in force of more than 96 percent, a key indicator of client satisfaction.

We believe that Northwestern Mutual's substantial investment in the training of our financial representatives and the development of high-quality insurance and investment products allows us to deliver a combination of exceptional guidance and investment solutions to help our Massachusetts clients (and the rest of the investing public) achieve financial security. Doing so while living by mutual values and delivering long-term product value (in the form of low net cost over time) through our exclusive distribution system is something that the Division should continue to foster, not hinder, in this rulemaking.

Industry Trade Comment Letters. Northwestern Mutual legal staff, along with many others in the industry, participated in the development of comment letters on the Proposal from the American Council of Life Insurers ("ACLI"), the Committee of Annuity Insurers ("CAI") and the Securities Industry and Financial Markets Association ("SIFMA"). In lieu of providing our own detailed and lengthy comment letter on the Proposal, we wish to commend to the Division the matters identified in those comment letters. While understandably not identical in content given the varied memberships of the organizations and the diversity of business models within the financial services industry, we believe the matters identified in the ACLI, CAI and SIFMA letters should be addressed by the Division in order to ensure the Division's objective of enhanced investor protection while preserving investor access and choice associated with the brokerage transaction-based model.

Application to Insurance Products. In the Proposal, the Division inserted new language as compared to its preliminary proposal issued June 14, 2019 (the "Preliminary Proposal") explicitly applying fiduciary obligations to "insurance products." While acknowledging in the Request for Comment that insurance products such as annuities are not securities under Massachusetts securities law, the Division reasoned that it had a strong interest in regulating the conduct of its registrants notwithstanding the absence of a security in the transaction. It contended that advice about insurance products and other non-securities is in most cases provided in conjunction with a brokerage or investment advisory relationship, "which imparts a degree of trust and confidence in the recommendations."² While stating that it did not take any position on annuities generally in the Request for Comment, it went on to note that it had seen numerous abusive practices with annuity sales, which it said were exacerbated by "the complexity of these products, the often-high cost and fees, and the high commissions for selling them."³ The Division therefore concluded that the addition of insurance products to the Proposal was consistent with M.G.L. ch. 110A, Section 204(a)(2)(G).⁴ We find

² *Id.* at pp. 5-6.

³ *Id.* at p. 5.

⁴ This section provides in relevant part "(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that

this development quite troubling and urge the Division to reconsider its inclusion of the references to insurance products in the final rule.

First, it appears the Division is leveraging a reference to “insurance business” in a Massachusetts securities enforcement statute to create a wholly new standard of care for insurance products it does not have direct authority to regulate. For example, the below relevant portion of the Massachusetts insurance statutes appears to preclude the regulation of insurance products under the Massachusetts securities laws:

No company shall make a contract of insurance or annuity, including any such insurance or annuity contract which is a contract on a variable basis, upon or relative to any property or interests or lives in the commonwealth, or with any resident thereof, and no person shall negotiate, solicit, sell or in any manner aid in the transaction of such contracts, or of their continuance or renewal, except as authorized by this chapter or chapter one hundred and seventy-six, or except as otherwise expressly authorized by law; **and any such contract and the negotiation, solicitation, sale or transaction thereof by any person shall not be subject to the provisions of chapter one hundred and ten A.** M.G.L. ch. 175, § 3 (emphasis added).

It is the Massachusetts Commissioner of Insurance who is granted authority to establish insurance regulations for recommendations and sales of insurance products within the Commonwealth.⁵ The Division points to no authority in its Request for Comment that specifically authorizes it to effectively adopt a new body of regulation applicable to insurance products.

Second, the Division has provided no definition of the term “insurance product.” Thus, the term could conceivably be read to cover not only annuities, but also life insurance products such as term insurance and permanent life insurance, disability income insurance and long term-care insurance, none of the latter of which are treated as securities under federal or Massachusetts law and are not commonly associated with the provision of investment advice. On the basis of its jurisdictional analysis and reasoning in the Request for Comment, it would appear that the Division could also take the position that it has the right to create a fiduciary obligation for, and that this Proposal then also applies to, recommendations of property-casualty insurance, and even health insurance, if made by a person who holds either a Massachusetts securities agent or investment adviser representative license.

If the Division remains convinced of its authority to regulate insurance products in this manner, we then urge it to (i) define in any final rule exactly which types or categories of insurance products it is asserting jurisdiction over so that the financial services industry and Massachusetts residents have clarity as to which insurance products the fiduciary obligations apply to, (ii) only include within the definition those insurance products that are closely related to investments and that could arise under

the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser: ... (G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business.”

⁵ See M.G.L. ch. 175, § 3A.

investment relationships and thus potentially the Division's jurisdiction, and (iii) limit its application to those particular circumstances where the insurance products recommended or sold needed the Massachusetts brokerage or investment advisory licensing which the Division has authority to regulate (e.g., a fee-based variable annuity recommended to a Massachusetts consumer by a licensed Massachusetts investment adviser representative through an investment advisory program offered by a Massachusetts registered investment adviser firm).

Imposition of a Continuous Fiduciary Duty in Brokerage. The Proposal creates an ongoing fiduciary duty for Massachusetts brokerage accounts if, among other circumstances, a broker-dealer or its agent (i) receives ongoing compensation for advising a customer or client as to the advisability of purchasing or selling securities, (ii) engages in any act, practice or course of business that results in the customer or client having a reasonable expectation that their brokerage account will be monitored on a regular or periodic basis, or (iii) certain titles, credentials or professional designations are used when engaging with the customer or client. Thus, the Proposal seeks to fundamentally change the historical nature of a brokerage relationship, and the related monitoring structures, from transaction-based where incidental investment advice is provided, to a relationship effectively the equivalent of investment advisory, where there is completely different client pricing to account for the provision of ongoing investment advice and account monitoring.

We have significant concerns that this aspect of the Proposal will result in reduced access of Massachusetts consumers to high quality investment and insurance products, jeopardizing their ability to protect what they have and plan for their retirement. For example, unlike many if not most broker-dealers, NMIS does not require a minimum investment amount to open or maintain a brokerage account. More than 6,000 of NMIS' brokerage accounts in Massachusetts hold less than \$25,000 in assets. We want to be able to help new investors protect and grow their assets over their lifetime in order to achieve their financial goals and objectives. With the imposition of a continuous fiduciary duty it may be necessary for NMIS to establish brokerage account minimums for Massachusetts residents only because the cost of creating a system of ongoing account monitoring for small accounts would not be financially feasible. Furthermore, NMIS would have to consider instituting a new more expensive client pricing structure for Massachusetts brokerage accounts only as the current pricing structure is designed to support supervision of point in time recommendations rather than an obligation to provide ongoing advice. We fear that these potential measures, replicated across the financial services industry within Massachusetts, will result in a significant segment of Massachusetts consumers being priced out of high-quality products and advice, at a time when their needs are only growing for appropriate investment solutions and retirement planning.

To avoid this detrimental impact to Massachusetts investors, we suggest several changes be made in this section of the Proposal as part of any final rule. While the Division made some changes in the ongoing compensation provision in the Proposal as compared to the Preliminary Proposal, we urge the Division to further clarify that this provision is only intended to apply to ongoing fees/compensation charged/received for the provision of ongoing investment advice (e.g., annual advisory fees as a percentage of AUM), and is not intended to impose an ongoing fiduciary duty by virtue of ongoing commissions for transaction-based recommendations commonly known as "trails" in the

brokerage/insurance setting (e.g., mutual fund ongoing asset-based sales charges such as 12b-1s or C shares, insurance renewal commissions or persistency fees, etc.).

We further appeal to the Division to delete the new act, practice or course of business trigger for the continuous fiduciary duty because it provides no certainty as to when and on what basis a “reasonable expectation” of the customer or client has been formed and actually works counter to the best interests of Massachusetts consumers. Northwestern Mutual and its representatives believe the needs and objectives of our clients are best met by building lifetime relationships to help them achieve financial security but the very nature of those relationships the Department could contend create an ongoing fiduciary obligation for both brokerage and insurance product recommendations.

Since the new titling, credentials and professional designations language in the Proposal is derivative to the act, practice and course of business language, we strongly believe that language should also be eliminated in any final rule. Among other reasons, it effectively discourages representatives from obtaining quality investment and financial planning education such as through the CFP Board, as a CFP® professional who is also Massachusetts securities registrant using that designation in the Commonwealth would be subject to an ongoing fiduciary duty in brokerage. It also does not consider the ability to use such titles or credentials in settings for which the Division does not have jurisdiction, such as the provision of investment advisory services through our federal savings bank, WMC, which is subject to the rules of the OCC.

If the Division is insistent upon maintaining a titling, credentials and designations provision in any final rule, we would highly encourage the Division to limit its applicability to situations where the representative or firm has not disclosed to the client the capacity it is acting in when making a recommendation or providing investment advice. For example, a representative who uses the title Wealth Management Advisor should not be subject to an ongoing fiduciary duty in brokerage if when making a brokerage recommendation, she makes clear that her titling is derived from her relationship with a federal bank providing investment advisory services and that in this case she is providing brokerage services as a representative of a broker-dealer rather than the bank.

Requirement to Avoid/Eliminate/Mitigate Conflicts of Interest. The Division has established a construct in the Proposal whereby registrants are to first make all reasonably practicable efforts to avoid all conflicts of interest, second to eliminate all conflicts of interest that cannot be avoided, and third to mitigate all conflicts that cannot be avoided or eliminated. In all cases, all material conflicts of interest must be disclosed to the customer or client and we are informed that disclosing or mitigating conflicts alone does not meet the duty of loyalty under the Proposal. This approach creates substantial uncertainty for registrants, and ultimately will lead to confusion for Massachusetts consumers, as to what exactly must be done to meet the Division’s expectations relative to conflicts of interest.

For example, it is unclear as to what constitutes “all reasonably practicable efforts” to address conflicts in the manner described in the Proposal. On the one hand, as discussed below, the Division is effectively prohibiting all sales contests, quotas and special incentive programs connected to securities, commodities or insurance product recommendations as conflicts so great that they breach the duty of loyalty. On the other hand, in the Request for Comment the Division indicates that conflicts such as

transaction-based compensation, principal trading and proprietary products are not prohibited by the Proposal, but each must be addressed and managed in accordance with the Proposal and are subject to Division enforcement action when it deems such conflicts a breach of the duty of loyalty.⁶ This suggests that registrants are going to be subject to hindsight judgment by the Division as to which conflicts should have been avoided, which eliminated and which mitigated without any clear guidance from the Division.

This appears to us to be a place where the Division should strive for greater uniformity with other regulatory bodies. It is our belief that the SEC's Regulation Best Interest approach to the management of conflicts of interest, which requires identification and disclosure of conflicts of interest, and mitigation and elimination of certain specified conflicts of interest at the representative and firm level, offers substantial enhanced investor protections and much greater clarity on the steps a brokerage firm and its representatives must take in order to satisfy the duty of loyalty. We urge the Division to adopt a comparable framework for the management of conflicts in any final rule.

Prohibition of Sales Contests, Quotas and Special Incentive Programs. The Proposal introduced new language as compared to the Preliminary Proposal that establishes a presumptive breach of the duty of loyalty when a Massachusetts securities registrant makes a recommendation "in connection with any sales contest, implied or express quota requirement, or other special incentive program." In the Request for Comment the Division further asserts that these contests, quotas and incentive programs provide no benefit to Massachusetts consumers, are repugnant to the principle of loyalty, and that "recommendations and advice that are truly best for the customer or client should not require any extra incentive."⁷

In our view, the fatal flaw in this provision is the failure to (i) provide any definitions of the key terms and (ii) recognize that context is essential in assessing these various incentive structures. For example, company-sponsored recognition trips held in the U.S., which generally are used to provide significant education and training to representatives on products and services, redounding to the ultimate benefit of Massachusetts consumers, could in theory violate this provision if any Massachusetts investment or insurance production was considered in determining the attendees. The SEC recognized the value of these training and education meetings, including attendance at company-sponsored annual meetings, indicating that they were not prohibited under Regulation Best Interest provided that they were not based on the sale of specific securities or type of securities within a limited period of time.⁸ We believe the Division should make similar clarifications.

This terminology also calls into question other ubiquitous compensation structures in the brokerage industry. For example, payment of representative compensation on an escalating grid appears now to be subject to uncertainty by the Division's reference to special incentive programs without more and the Division's statements in the Request for Comment regarding the payment of any

⁶ See Request for Comment at pp. 10-11.

⁷ *Id.* at p. 9.

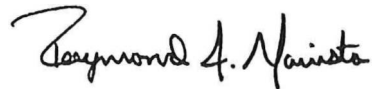
⁸ SEC Regulation Best Interest Adopting Release (June 15, 2019) at p. 356, available at <https://www.sec.gov/rules/final/2019/34-86031.pdf>.

“extra incentive.” The SEC observed in the Regulation Best Interest adopting release that conflicts associated with total products sold or asset accumulation and growth present less risk that the incentive would compromise compliance with the care or conflict of interest obligation owed under the rule.⁹ Even the DOL under its fiduciary rule, which was later vacated in federal court, permitted appropriately designed grid compensation structures.¹⁰ In any final rule, the Division should make clear that it is not seeking to dismantle common industry structures and practices to compensate representatives through use of these terms.

Providing for a Reasonable Compliance Period. Although we understand that final regulations in Massachusetts are generally effective upon publication in the Massachusetts Register, we urge the Division to use its authority to specify a later effective date or, failing that, a delayed enforcement date. The SEC provided broker-dealers one year to come into compliance with Regulation Best Interest. The New York Department of Financial Services, in adopting a best interest standard of care for life insurance in its state in 2018, provided the industry with 18 months to comply with the new requirements for those products. Neither of these regulators created a continuous fiduciary obligation. Substantial time and resources will be needed to build the requisite infrastructure, systems, monitoring, oversight, training and policies and procedures necessary to comply with any final rule. While work being done to come into compliance with Regulation Best Interest by June 30, 2020 will be helpful in responding to any final rule, it will obviously not be sufficient as the Proposal is in direct response to the perceived inadequacies of Regulation Best Interest by the Division. We believe a reasonable effective date or non-enforcement period given the above is 18 months from the point of publication.

Once again, we appreciate the opportunity to provide input on the Proposal. If you have any questions regarding our comments or if we can be of any assistance in your consideration of the issues summarized above, please contact the undersigned or John Dunn at 414-665-5443 or johndunn@northwesternmutual.com.

Very truly yours,



Raymond J. Manista
Executive Vice President, Chief Legal &
Compliance Officer and Secretary

5669611-2

⁹ *Id.* at p. 355.

¹⁰ DOL Conflict of Interest Exemptions FAQs (October 27, 2016) at pp. 7-9, available at <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf>.