

## **ADOPTING RELEASE**

DATE: June 19, 2019

RE: Amendments to State-Registered Investment Adviser Disclosure Regulations - 950 MASS. CODE REGS. 12.205(8)

The Massachusetts Securities Division (the “Division”) is adopting the following amendments to 950 MASS. CODE REGS. 12.205(8) regarding disclosure requirements for investment advisers that are registered in Massachusetts (the “Regulations”). The adopted amendments to the Regulations would (1) require each investment adviser registered in Massachusetts to provide clients and prospective clients with a one-page, stand-alone Table of Fees for Services (the “Fee Table”) indicating the fees charged for services offered by the investment adviser, and (2) revise paragraphs (a) and (d) of the Regulations to remove redundancy and potential ambiguity in those paragraphs as currently drafted.

The Division gave notice of the proposed amendments, the public hearing on the proposed amendments, and the public comment period on April 3, 2019 via the Division’s website and a published notice in The Boston Globe. On its website, the Division provided a summary of the basis for and development of the Fee Table, as well as copies of the proposed amendments, the Fee Table and instructions, and the Division’s initial small business impact statement. Notice of the public hearing and comment period was published in the Massachusetts Register as of April 19, 2019. The Division held a public hearing on the proposed amendments on May 2, 2019 and the public comment period ended on May 3, 2019. The Division received and reviewed thirty-one written comments regarding the proposed amendments.

The adopted amendments shall become effective upon publication in the Massachusetts Register. The next publication of the Massachusetts Register is scheduled for June 14, 2019. Notwithstanding the amendments becoming effective upon publication in the Massachusetts Register, 950 MASS. CODE REGS. 12.205(8), as amended, shall be enforced as of January 1, 2020.

The following is a summary of the amendments being adopted, an analysis of public comments received and reviewed by the Division, and, where applicable, modifications made to the proposal prior to adoption.

### **1. 950 MASS. CODE REGS. 12.205(8)(a)2., 12.205(8)(f)-(h): Requiring Investment Advisers Registered in Massachusetts to Provide Clients and Prospective Clients With a Stand-Alone Fee Table**

Investment advisers currently disclose information about the services that they offer and the associated fees and costs in a narrative format in Form ADV Part 2A (the “Brochure”). The adopted amendments will require investment advisers who are registered in Massachusetts to distill this information into a Fee Table, in accordance with

the instructions and parameters prescribed by the Division. The Fee Table will be a one-page, stand-alone document. The Fee Table will be updated and delivered consistent with the existing requirements for Form ADV (including the Brochure). If the investment adviser has a website, the Fee Table must be available and easily accessible on the website. If the investment adviser's website has an internal search feature, a search for the term "fee" or "fees" should return a link to the Fee Table as one of the top results.

The Fee Table is intended to provide a simplified and more accessible overview of the investment adviser's fees and services, consistent with the more detailed descriptions in Form ADV Part 1A and the Brochure. The Fee Table is intended to supplement, not replace, the more detailed disclosure of fees and services in the Brochure.

### **A. Analysis and Response to Public Comments Regarding Fee Table Proposal**

Of the written comments received, fifteen comments were generally in favor of the Fee Table proposal, fourteen were generally against, and two were neutral but sought clarification on specific issues. Many of the comments raised similar issues and concerns, and the Division will address those collectively.

#### **i. Information Disclosed in Form ADV**

Several commenters contend that the Fee Table is unnecessary because investment advisers already describe their fees and services in their Brochure. The Division does not find this argument persuasive.

As the Division noted in its April 3, 2019 Request for Public Comment, recent academic research has shown that as fees and services have become more complex and varied, the disclosures in Brochures have generally followed suit.<sup>1</sup> This has often resulted in Brochures that are difficult for many investors to understand, which may represent a barrier to those most in need of clear financial advice.<sup>2</sup> In addition, other commenters have noted their experience that investors and clients often do not read the Brochure or know where to find fee information in their account statements, contracts, or the Brochure. Although changes to Form ADV might prove helpful in these regards, it is not within the Division's unilateral authority to effect such changes.

Accordingly, the Division believes that requiring investment advisers to distill this information into a simple, easy-to-read Fee Table will ultimately benefit investors by increasing awareness and encouraging discussion with their advisers.

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<sup>1</sup> See Kyre Dane Lahtinen, Stephan Shipe, *Readability of financial advisor disclosures*, 44 J. Empirical Fin. 36-42 (2017) (analyzing readability of Form ADV Part 2 disclosures). Professor Shipe was a participant in the Division's Fee Table working group.

<sup>2</sup> *Id.*

## **ii. Varying Scope and Quality of Services Among Investment Advisers**

A number of commenters believe that the Fee Table does not provide enough space or flexibility in format and terminology for them to adequately detail the scope and quality of their services for the fees charged. The Division is not persuaded by this concern because of the independent purposes of the Fee Table and the Form ADV. The Fee Table does not replace the Brochure and specifically directs the reader to “carefully review Item 4 and Item 5” of the investment adviser’s Brochure. Limiting the terminology in the “Services” column to that used in the investment adviser’s Form ADV Part 1A, Item 5G, is intended to ease the burden of preparing the Fee Table. It will also keep the Fee Table uncluttered and ensure that all investment advisers are using uniform terminology.

## **iii. Tailoring Fees and Services to Individual Clients**

A number of commenters expressed concern that the Fee Table would restrict their ability to tailor their fees and services to the needs of individual clients. The Division does not agree. The Fee Table should be consistent with what is already disclosed in Form ADV Part 1A and the Brochure, neither of which prohibit investment advisers from tailoring or negotiating fees and services with individual clients. The Fee Table itself also expressly provides investment advisers the opportunity to say whether their fees may be or are not negotiable.

## **iv. Comparison Based Primarily on Price for Services**

Several commenters voiced concerns that the Fee Table would cause investors to focus primarily on price when comparing investment advisers. The Brochure requires fee disclosure precisely because it is an important part of a client’s or prospective client’s decision to retain an investment adviser. This information should be readily accessible. The Division believes that investors will benefit from immediate, accessible information about fees with the caveat that they should seek additional information from the investment adviser and the Brochure. With the simplified disclosure provided by the Fee Table, investors can, and are encouraged to, ask more informed questions about the value provided by different investment advisers.<sup>3</sup>

## **v. One-on-One Cognitive Investor Testing**

One commenter recommended that the Division conduct “one-on-one cognitive testing” of the Fee Table, based on recent research and legislation at the federal level regarding

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<sup>3</sup> One commenter stated that prospective clients will not initiate such discussions or may give up because the whole subject is too complicated or confusing. This is contrary to the stated experience of at least one other commenter, who completed the Fee Table and received useful feedback from clients and prospective clients. Specifically, the feedback received indicated that the Fee Table prompted questions, that it was easier to use than the Brochure, and that the prospective client was interested in seeing the disclosed fee arrangements applied to an account like the client’s own before hiring the commenter.

the SEC's Form CRS.<sup>4</sup> The Division does not believe that qualitative cognitive testing of the Fee Table is necessary at this time.

The Fee Table is a one-page, stand-alone document that is intended to distill and present information about the investment adviser's fees and services in a more visually accessible format than the often dense narrative found in the Brochure. The concise form and content of the Fee Table contrasts with Form CRS, which contains four pages of substantive disclosures regarding legal obligations and operational distinctions between different categories of industry actors. To the extent the Fee Table contains technical terminology, that terminology is commonly used and understood in the industry and comes from the Brochure, which investors are currently expected to read.

The commenter also acknowledges the valuable feedback already obtained from current and prospective clients by investment adviser members of the Division's Fee Table working group. Generally, the clients and prospective clients surveyed found the Fee Table easier to use than the narrative disclosure in the Brochure and indicated that the Fee Table prompted questions for the investment adviser. Some clients and prospective clients indicated that they were not fully aware of all fees charged by third parties in connection with implementing their investment adviser's advice, despite having received the Brochure. The yes/no "Discussion Box" indicates third-party charges that might apply to a client, encouraging further questions and discussion.

Accordingly, the Division does not believe that "one-on-one cognitive testing" in the nature of what has been proposed for Form CRS is necessary because of the simplicity of the Fee Table and the positive feedback already obtained from investors.

#### **vi. Competition with Investment Advisers Not Required to Provide a Fee Table**

Multiple commenters were concerned that the Fee Table would put Massachusetts-registered investment advisers at a competitive disadvantage relative to investment advisers that would not be required to provide a Fee Table because they are not registered in Massachusetts. The Division does not find these concerns persuasive.<sup>5</sup> The Fee Table distills information that is already publicly available into a more accessible, user-friendly format.

#### **vii. Comments Seeking Clarification on What Should be Included in Fee Table and its Delivery**

A number of commenters sought clarification on what should be included in the Fee Table and how to account for irregularities or exceptions. Another commenter asked for

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<sup>4</sup> Comments from the Financial Planning Association ("FPA"). Two FPA representatives participated in the development of the Fee Table as members of the Division's Fee Table working group.

<sup>5</sup> This information is required to be disclosed in the Brochure because it is important for investors to have this information. To the extent that making this information more accessible and user-friendly may create a competitive disadvantage, the Division believes that the benefit to investors outweighs this concern.

clarification as to whether the delivery requirement for the Fee Table would be satisfied by sending a link to the page of the investment adviser's website containing the Fee Table, a link to a virtual document, or the Fee Table itself via email.

In response to these concerns, the Division intends to provide training on the Fee Table prior to enforcement of the requirement on January 1, 2020. However, as a general rule, the Fee Table should contain the same fee arrangements for services that are disclosed in an investment adviser's Brochure and can be delivered in the same manner as the Brochure and other disclosures.

For example, if a fee arrangement is described in the Brochure using percentages, it should be included in the Fee Table the same way. If an investment adviser has clients with negotiated, atypical, or "legacy" fee arrangements but does not disclose these fee arrangements in the Brochure as part of its normal business, they do not need to be in the Fee Table.

#### **viii. State-by-State Requirements**

One commenter expressed concern that compliance would become difficult if other states adopt their own, different versions of the Fee Table in the future. The Division is not aware of any other jurisdiction that has proposed an investment adviser fee table. In the event that other states adopt their own versions of the Fee Table, or efforts are made to develop a uniform model fee table for all jurisdictions, the Division will consider those developments at the appropriate time.

#### **ix. Fee Table Available on the Investment Adviser's Website**

One commenter found the requirement that investment advisers publish the fee table on their website to be unreasonable. The commenter cited its "simple website" and stated that adding the Fee Table would require a "substantial overhaul" to the website. The Division does not find this persuasive. The Fee Table must be available on the investment adviser's website, but the Regulations do not prescribe the manner in which this is to be done. A link to a PDF document would be sufficient, as would embedding the Fee Table within the page itself. The Division does not believe that this requirement would necessitate a "substantial overhaul" to any website.

#### **x. Concerns About Potential Investor Confusion**

Two commenters believe that the "Additional fees and costs to discuss with your Adviser" section of the Fee Table ("Part 3: Discussion Box" in the instructions) will be confusing or misleading to clients. The Division disagrees. Feedback obtained by members of the Fee Table working group suggests that clients do not know they may have to pay additional costs to implement advice from their investment adviser. Further, the feedback suggests that even if aware, clients do not know where to find more information about these costs. The Division believes that by indicating whether and which additional costs might apply, the Fee Table will enable investors to ask informed

questions and a gain better understanding of the total costs associated with implementing the investment adviser's recommendations.

## **B. Modifications to Fee Table**

The Division is adopting the amendments to the Regulations as proposed, without further amendment. However, after considering the comments received, the Division has modified certain aspects of the Fee Table.

First, two commenters were concerned that the words "Fee Total" in the bottom row of the Fee Table might lead the reader to expect an individualized estimate or numerical total rather than the intended general disclosure consistent with the Brochure, and that the absence of that estimate or numerical total might cause unnecessary suspicion of the investment adviser. Accordingly, the Division has removed the words "Fee Total" from the bottom row of the Fee Table.

Second, one commenter addressing the perceived lack of flexibility to describe the scope and value of listed services (*see* 1(A)(ii), above) in the Fee Table pointed out a difficulty faced by investment advisers that offer alternative fee arrangements for the same service(s), as listed on Form ADV Part 1A. Specifically, the commenter noted that when the investment adviser's Fee Table is compared to that of an investment adviser who only charges one type of fee for the same service(s), the reader might assume that that the former is significantly more expensive and charging fees on multiple levels. As stated above in item 1(A)(ii), the limited terminology in the "Services" column is necessary in order to keep the Fee Table uncluttered and to ensure comparability between Fee Tables of different investment advisers. Accordingly, rather than modify the manner in which Services are indicated in the Fee Table, the Division has modified the preamble as shown in the attached Fee Table template and instructions. The Division believes that the changes address this concern by clarifying when fees are not cumulative and encouraging the reader to initiate a dialog with the investment adviser for more details.

## **2. 950 MASS. CODE REGS. 12.205(8)(a), (d): Revisions to Existing Provisions to Consolidate Affirmative Requirements and Eliminate Redundancy**

Paragraphs (a) and (d) of the Regulations as currently drafted require similar disclosures by investment advisers to clients, but are potentially ambiguous with respect to the timing of the disclosures.

The amendments being adopted consolidate the affirmative disclosure requirements, including the Fee Table, into the same paragraph. In addition to simplifying the Regulations for the reader, this also harmonizes the required timing of the existing disclosure requirements.

The Division received no substantive comments on the proposed revisions to paragraphs (a) and (d), and the Division is adopting the amendments to the Regulations as proposed, without amendment.