DAVIS & HARMAN LLP

ATTORNEYS AT LAW

THE WILLARD
1455 PENNSYLVANIA AVENUE, NW, SUITE 1200
WASHINGTON, DC 20004

TEL 202-347-2230
FAX 202-393-3310 WWW.DAVIS-HARMAN.COM

July 25, 2019

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: Comments on Proposed Fiduciary Conduct Standard

Dear Secretary Galvin:

On behalf of a group of firm clients, including brokerage firms, mutual funds, insurance companies, asset managers, and banks, we are writing to provide comments on the rule proposal published June 14, 2019, entitled "Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives."

In brief, our message is that there is documentary evidence, as provided below, that Massachusetts residents would be severely harmed by the proposed regulation if it is finalized in a manner similar to its current form. We accordingly urge a major re-write of the proposed regulation, followed by a re-proposal. We do not make this recommendation lightly. But as discussed below, the evidence is clear and the expected harm would be so significant that the proposal needs to be rewritten. In fact, there is a strong possibility that the proposed regulation could result in the cessation of most if not all broker-dealer services in Massachusetts and to Massachusetts residents (other than pure execution services).

SUMMARY

We have six main points, which are summarized here and discussed in more detail below.

I. **The best security standard is unique and unworkable.** The proposal provides: *"There shall be a presumption of a breach of the duty of loyalty for offering or receiving direct or indirect compensation to or from a broker-dealer, agent, or adviser for recommending an investment strategy, the opening of or transferring of assets to a specific type of account, or the purchase, sale, or exchange of any security that is not* ***the best*** *of the reasonably available options for the customer or client"* (emphasis added).

- **<u>Unique.</u>** The proposal's way of applying the duty of loyalty is dramatically different from any other rule or proposal that we are aware of (other than the recent New Jersey proposal on which the Massachusetts proposal appears to have been based). No other rule or proposal requires that a recommended security be the "best" security. In all other cases, including the Department of Labor's ("DOL") now-invalidated fiduciary rule, the duty of loyalty is applied to the ***process*** used to make a recommendation, not to the actual recommendation.

- **<u>Unworkable.</u>** ***It is simply not possible to develop any system that can determine the best security.*** So if Massachusetts were to effectively require recommendation of the best security, as it has proposed, there would be no way for broker-dealers, agents, or advisers to provide advice or recommendations at all without almost certain liability based on second guessing.
- **<u>Unworkable exception.</u>** Under the proposal, notwithstanding the above presumption, it appears not to be a breach of the duty of loyalty for broker-dealers, agents, or advisers to receive a transaction-based fee "as long as

  > i. the remuneration is reasonable,
  > ii. the remuneration represents ***the best*** of the reasonably available remuneration options for the customer or client, and
  > iii. the broker-dealer, agent, or adviser has otherwise satisfied its duty of care" (emphasis added).

  However, this exception is similarly unique and unworkable – i.e., it focuses on the "best" remuneration option, ignoring the subjective nature of the recommendation process, so it does not in fact provide relief.

II. <u>The proposal appears to require broker-dealers to provide ongoing advice, which would effectively disqualify them from broker-dealer status.</u> The proposal provides that:

> If a broker-dealer, agent, or adviser makes ongoing recommendations or provides investment advice, in any capacity, to a customer or client, or receives ongoing compensation in connection with the recommendation or advice, the fiduciary duty shall be deemed an ongoing.

Often, full service broker-dealers that have developed any degree of a relationship with their customers could be viewed as providing "ongoing recommendations" and receiving "ongoing compensation," as contrasted with "a standalone recommendation." Even more importantly, virtually all broker-dealers provide some type of "investment advice" in recommending a transaction to their customers. That is why there is an exception from investment adviser status for "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." If the provision of incidental investment advice were to trigger an ongoing fiduciary duty, broker-dealers would be effectively forced to become investment advisers. This would mean that broker-dealer services – other than pure execution services – would simply become unavailable in Massachusetts.

III. **<u>Great harm can be done by restricting broker-dealer services.</u>** The now-invalidated fiduciary rule issued by DOL strongly favored fee-based advice over broker-dealer services. Even in the short time that the rule was in effect, this aspect of the DOL rule caused massive harm to low- and middle-income individuals, as documented in the Appendices at the end of this letter. As discussed above and below, the Massachusetts proposal appears to go even further by actually banning broker-dealer services, which would result in even more harm to low- and middle-income individuals.

IV. **<u>Preemption.</u>** If the Massachusetts rule is not far narrower than the proposal, the rule will be substantially preempted by the Employee Retirement Income Security Act of 1974 ("ERISA") and federal securities laws, including the National Securities Markets Improvement Act of 1996 ("NSMIA"). The disruption and cost associated with invalid rules that are only in place until invalidated in court would be borne by everyone, but mostly by investors.

V. **<u>The Securities and Exchange Commission's ("SEC") Regulation Best Interest will protect investors in the most effective manner.</u>** We strongly support the application of the SEC-promulgated Regulation Best Interest to investment recommendations provided to retail investors by broker-dealers. This federal best interest standard for broker-dealers protects investors across the country in an efficient and effective manner. As discussed by SEC Chair Clayton in his June 5, 2019 statement, a patchwork of inconsistent and/or conflicting state rules adds cost and confusion to what is a national issue. Such cost and confusion is in turn borne by investors. In fact, if a state moves forward with its own fiduciary standard, such standard could actually result in a widespread prohibition ***in that state*** on broker-dealers' ability to help IRA owners, due to the Internal Revenue Code's prohibited transaction rules.

VI. **<u>Effective date.</u>** It is hard to evaluate the right type of effective date for the regulation, since the proposed regulation is simply unworkable and would result in the widespread elimination of broker-dealer services. The effective date issue deserves further attention in the context of a re-proposal, but at a minimum, there needs to be a transition period of at least 18 months after the publication of final regulations. Any shorter transition period would, independent of the substance of the regulations, likely result in brokerage services (other than execution-only services) for many, if not all, Massachusetts residents ceasing as of the effective date.

In addition, the proposal does not grandfather ongoing relationships from the new rule. In the context of the DOL rule, the absence of a grandfather rule for existing relationships resulted in many thousands of investors receiving letters informing them that they could no longer receive personalized assistance with respect to their account. Accordingly, investors were unable to obtain assistance on investments that may cease to be appropriate for them. In our view, existing relationships need to be grandfathered so as not to cut off investors from help in the middle of an investment strategy.

DISCUSSION

I. Unique and Unworkable Application of the Duty of Loyalty.

Best security standard: unique and not workable. The proposal provides: "There shall be a presumption of a breach of the duty of loyalty for offering or receiving direct or indirect compensation to or from a broker-dealer, agent, or adviser for recommending an investment strategy, the opening of or transferring of assets to a specific type of account, or the purchase, sale, or exchange of any security that is not the best of the reasonably available options for the customer or client." ***As explained below, this uniquely onerous approach will give rise to massive new potential liabilities for financial institutions. That in turn very likely will cause financial institutions to limit or eliminate the availability of their services to Massachusetts residents with small accounts.***

The proposal's way of applying the duty of loyalty is dramatically different from any other rule or proposal that we are aware of (other than the recent New Jersey proposal on which the Massachusetts proposal was apparently based). No other rules require in any way that a recommended security be the "best" security. In all other cases, including the Department of Labor's ("DOL's") now-invalidated fiduciary rule, the duty of loyalty is applied to the ***process*** used to make a recommendation, not to the actual recommendation. For example, the requirement in the DOL rule was that the recommendation be made "without regard to the financial or other interests of" the advice provider. This formulation, which itself is very problematic, is entirely different and far less problematic than the proposal's results-oriented test that effectively requires that the best security be recommended.

It is simply not possible to develop any system that can determine the best security. To be frank, if any such system existed, the person possessing that system would likely be long retired, not providing investment advice or working at all. So if Massachusetts were to effectively require recommendation of the best security, as it has proposed, there would be no way to provide advice or recommendations at all without almost certain liability based on second guessing. A hindsight standard regarding whether the security was the best option reasonably available is not workable.

We also note that there is a whole set of difficult issues regarding what securities are "reasonably available," especially in the case of broker-dealers who work primarily or exclusively with proprietary products or with a limited menu of products (such as products that they are most familiar with). In the context of the current proposal, we do not even get to that issue, because within any set of options, it is impossible to determine the "best" one. But if the "best" requirement is eliminated and the proposal is made workable in that regard, it would be important to clarify that broker-dealers may limit the menu of products that they recommend and that these limitations would determine what is reasonably available under the rule. A contrary rule would again be unworkable, forcing broker-dealers, for example, to consider tens of thousands of different products of varying complexities, many of which they are not familiar with.

<u>Unworkable exception from best securities rule.</u> Under the proposal, notwithstanding the above presumption, it is not a breach of the duty of loyalty for broker-dealers to receive a transaction-based fee, "as long as

> i. the remuneration is reasonable,
> ii. the remuneration represents the best of the reasonably available remuneration options for the customer or client, and
> iii. the broker-dealer, agent, or adviser has otherwise satisfied its duty of care."

The apparent intent underlying this exception is to provide relief with respect to the unworkable presumption of a violation if the "best security" is not recommended, though this is not clear. However, this exception is similarly unworkable, so it does not in fact provide relief. First, the exception is premised on providing the "best" remuneration option. Like the best security presumption, this exception is unlike any other rule we have seen, in that it is not based on the process used to make a recommendation regarding a fee option. On the contrary, the exception requires identifying ***the*** best reasonably available remuneration option, raising countless problems. For broker-dealers, these include, for example:

- **<u>In substantially all cases, some other broker-dealer will have a lower fee.</u>** If another broker-dealer has a lower transaction fee, a broker-dealer would seem to be ineligible for the exception. In substantially all cases, some other broker-dealer in the country will have lower fees, making the exception illusory.
    - If other broker-dealers' fees are not taken into account for determining what is reasonably available, that would need to be made clear.

- **<u>In substantially all cases, either the broker-dealer's own company or some other financial institution may be able to offer advisory services at a lower price than the transaction fees being charged.</u>** With the growth of robo advice, either the broker-dealer's own company or some other financial institution may be able to provide advice at a net lower cost than a broker-dealer may charge. If robo advice and all other advice services in the country are treated as reasonably available for purposes of the exception, virtually no broker-dealer will be able to get comfortable that they qualify for the exception. If these comparisons are not required, then what is required? The proposal does not address this question.

- **<u>In the absence of further guidance, the risk of not qualifying for the exception based on the above analysis is simply too great.</u>** At the very least, broker-dealers will limit or eliminate their services to small accounts because the fees that such accounts generate do not justify the risk posed by the unworkable presumption and exception.

<u>II. The Proposal Would Require Broker-Dealers to Provide Ongoing Advice, Which Would Effectively Disqualify Them from Broker-Dealer Status.</u>

The proposal provides that:

> If a broker-dealer, agent, or adviser makes ongoing recommendations or provides investment advice, in any capacity, to a customer or client, or receives ongoing compensation in connection with the recommendation or advice, the fiduciary duty shall be deemed an ongoing.

Often, full-service broker-dealers with good relationships with their customers could be viewed as providing "ongoing recommendations" and receiving "ongoing compensation," as contrasted with "a standalone recommendation," which is the alternative under the proposal. Even more importantly, virtually all broker-dealers provide some type of "investment advice" in recommending a transaction. That is why there is an exception from investment adviser status for "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." 15 U.S.C. §80b-2(a)(11). If the provision of incidental investment advice triggers an ongoing fiduciary duty, then broker-dealers have two choices: charge for taking on that very significant additional responsibility or not charge for it. The latter is commercially unworkable. But, if they charge for year-round fiduciary responsibility, which they would have to do, they are investment advisers and not broker-dealers. This would mean that broker-dealer services – other than pure execution services – would simply become unavailable in Massachusetts, as broker-dealers could be forced to become investment advisers.

The vast majority – estimated at 98% – of low- and middle-income individuals receiving personalized investment assistance obtain that assistance from broker-dealers.[1] Many of those individuals do not have sufficient savings to qualify for an advisory account. So by eliminating the brokerage model for Massachusetts residents, the proposal would effectively eliminate all personalized investment assistance for countless low- and middle-income individuals living in Massachusetts.

<u>III. The Specter of Harm to Low- and Middle-Income Massachusetts Residents is Very Real; There is Documentary Evidence.</u>

The risk of harm from an unworkable fiduciary rule is not hypothetical in any way. On the contrary, there is extensive data showing the very real harm that the DOL rule did to low- and middle-income individuals. Please see the Appendices for more complete data on this harm. But below, we provide some key examples:

- **<u>10.2 million accounts harmed.</u>** The national accounting firm Deloitte studied 21 financial institutions that represent 43% of U.S. financial advisors and 27% of the retirement savings assets in the market. The study found that as of the DOL rule's first applicability date on June 9th, ***53% of study participants reported limiting or eliminating access to brokerage advice for retirement accounts, which the firms estimate impact 10.2 million accounts and $900 billion AUM.***

[1] Oliver Wyman report: Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers (April 12, 2011).

- **68% report harm to small accounts.** In a Harper Polling survey of 600 financial professionals, 68% reported that they or their institutions would take on fewer small accounts.

- **75% report taking on fewer small clients.** A NAIFA survey of 1,093 members found that nearly 75% of financial professionals experienced or expected to experience an increase in the minimum account balances for the clients they serve.

- **Small employers and small accounts harmed.** A survey of Insured Retirement Institute ("IRI") members found that "more than 60 percent of the distribution firms that participated in the Survey have, are planning to, or are considering exiting or de-emphasizing target markets such as small IRA holders and small retirement plan sponsors."

- **Devastating effect on small accounts projected.** The consulting firm of A.T. Kearney projected that, by 2020, broker-dealer firms will collectively stop serving the majority of the $400 billion currently held in low-balance retirement accounts.

The DOL fiduciary rule made it much riskier and more expensive for broker-dealers to provide transactional assistance to small accounts. As a result, such assistance was reduced significantly. In this regard, the DOL framework was not nearly as draconian as the proposed Massachusetts regulation is. The Massachusetts proposal would effectively ban transactional assistance. As discussed briefly above, the DOL fiduciary rule resulted in dramatically reduced advice access for small retail investors. The consequences of the Massachusetts proposal would be far worse for Massachusetts residents, not just because it is more draconian but also because the proposal impacts all account types, not just retirement accounts.

IV. Preemption.

ERISA preemption in general. The proposal appears to attempt to avoid ERISA preemption by making the fiduciary rule inapplicable to persons acting as fiduciaries under ERISA. This does not avoid ERISA preemption because ERISA's preemptive power does not depend on whether the professionals that Massachusetts' proposal seeks to regulate are ERISA fiduciaries or not.[2] As discussed more fully below, the only relevant preemption question is whether Massachusetts' proposal "relates to" employee benefit plans, which it clearly does by attempting to impose fiduciary standards in the case of investment advice offered to ERISA-covered plans and participants.[3]

---

[2] *See Faulman v. Sec. Mut. Fin. Life Ins. Co.*, 353 Fed. Appx. 699, 702 (3d Cir. 2009) (explaining that ERISA fiduciary status is only one of several factors used to determine whether claims "relate to" an ERISA plan for preemption purposes); *Glaziers and Glassworkers Union Loc. No. 252 Annuity Fund v. Newbridge Securities, Inc.*, 93 F.3d 1171, 1185 (3d Cir. 1996) (even if a defendant is not an ERISA fiduciary, "state law claim[s] may 'relate to' an ERISA plan and be preempted").

[3] *See Kollman v. Hewitt Associates, LLC*, 487 F.3d 139 (3d Cir. 2007) (concluding that state law malpractice claims against a plan administrator who was not an ERISA fiduciary were preempted because the state law claims went to the "essence of the function of an ERISA plan").

As the Supreme Court has said, whether a state law "relates to" an employee benefit plan depends on the objectives of ERISA and the effect of state laws on ERISA plans.[4] In effect, the proposal attempts to override Congress' goal of establishing uniform standards for all matters central to plan administration, including fiduciary responsibility. ERISA carefully delineates who is a fiduciary and who is not. In the context of employee benefit plans, states cannot choose to treat as fiduciaries persons excepted from the ERISA definition. If this approach were successful in avoiding ERISA preemption, state laws could, contrary to the Congressional intent and case law described below, completely disrupt the national framework of laws applicable to ERISA plans by re-writing the duties of persons serving such plans.

ERISA broadly preempts state laws relating to employee benefit plans. ERISA is a comprehensive federal statute regulating employer-sponsored retirement and welfare benefit plans. When Congress passed ERISA, it included an explicit and far-reaching preemption provision. According to that provision, and except as otherwise provided by law, title I and title IV of ERISA "*shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan*" (emphasis added).[5] Importantly for purposes of this discussion, title I of ERISA defines who is a fiduciary with respect to an employee benefit plan and establishes a federal standard of care for fiduciaries. ***As one court put it, ERISA's preemption provision is "the most sweeping federal preemption statute ever enacted by Congress."***[6]

ERISA: exclusive enforcement mechanism for the regulation of plan fiduciaries. When drafting ERISA, Congress was clear that it wanted ERISA's preemption clause to apply broadly. In fact, ERISA's legislative history is full of commentary explaining how the law is intended to be the exclusive authority governing the entire field of employee benefit plans, including providing the exclusive enforcement mechanism regarding ERISA plans. For example, the text of ERISA itself states that ERISA is intended "to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by . . . establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans and by providing for appropriate remedies, sanctions, and ready access to the Federal courts."[7] As the Supreme Court has said, "any state-law cause of action that duplicates, supplements, or supplants the ERISA civil enforcement remedy conflicts with the clear congressional intent to make the ERISA remedy exclusive and is therefore pre-empted."[8]

Courts: state law fiduciary claims preempted. For purposes of this discussion, it is important to emphasize that courts considering ERISA's preemption provision have dismissed non-ERISA state law claims involving breaches of fiduciary duties, among other state law claims related to ERISA-covered retirement plans. For example, courts have consistently held that state claims

---

[4] *Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141, 147 (2001).

[5] ERISA § 514.

[6] *California Hospital Association v. Henning*, 569 F. Supp. 1544, 1546 (C.D. Cal.1983).

[7] ERISA § 2(b).

[8] *Aetna Health Inc. v. Davila*, 542 U.S. 200, 209 (2004).

arising out of the common law of trusts, including claims of breach of fiduciary duty, are preempted in the context of ERISA-covered retirement plans.[9]

Supreme Court: savings clause does not protect investment advice regulation from preemption. ERISA's preemption provisions also contain what is known as the "savings clause," which is a carve-out from preemption for state laws regulating *insurance, banking, or securities*. States attempting to develop their own fiduciary rules may try to argue that their efforts are not expressly preempted by ERISA because they are regulating "insurance, banking, or securities." This argument, however, is inconsistent with current case law interpreting ERISA's savings clause.

The case law on ERISA's savings clause interprets it very narrowly. In the case of insurance, the Supreme Court has explained that the savings clause is not applicable unless (1) the state law is "specifically directed towards entities engaged in insurance," and (2) the state law "substantially affect[s] the risk pooling arrangement between the insurer and the insured."[10] Thus, the insurance carve-out from ERISA preemption would not extend to protect state rules seeking to regulate advice regarding insurance products that relate to an ERISA-covered plan because any such regulation would not affect the risk pooling arrangement between the insured and the insurer.

Applying the Supreme Court's logic to the carve-out for securities and banking regulation, it is clear that ERISA's savings clause would not protect any state's fiduciary rule for broker-dealers from ERISA preemption. This is because states' efforts to create their own fiduciary rules, such as the effort described in the proposal, regulate the provision of investment advice, rather than regulating insurance, banking, or securities.

Supreme Court: savings clause inapplicable to state laws affecting enforcement issues. Moreover, any state fiduciary rule would also be preempted to the extent that it creates a legal remedy that duplicates, supplements, or supplants ERISA's civil enforcement provisions, which provide an exhaustive list of remedies. Again, by comparison to the reference to the state regulation of insurance under ERISA's savings clause, the Supreme Court has said, "even a state law that can arguably be characterized as 'regulating insurance' will be pre-empted if it provides a separate vehicle to assert a claim for benefits outside of, or in addition to, ERISA's remedial scheme."[11] Thus, by applying this principle to non-insurance matters described by ERISA's savings clause (i.e., banking and securities), state laws creating new legal remedies with respect to ERISA-covered plans would be preempted.

---

[9] *See, e.g.*, *Kramer v. Smith Barney*, 80 F.3d 1080, 1083 (5th Cir. 1996) ("[Plaintiff's] state law claims alleging that defendants violated their fiduciary duties to the plans and the beneficiaries relate to ERISA plans and are therefore preempted under section 514(a)."); *Nagy v. De Wese,* 705 F. Supp. 2d 456, 470 (E.D. Pa. 2010) (concluding that a state law fiduciary breach claim by a retirement plan participant was preempted by ERISA because the state law fiduciary claim relied on the defendant knowing that funds were held for the benefit of the participant under the plan).

[10] *Kentucky Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329, 334 (2003).

[11] *Davila*, 542 U.S. at 217–18; s*ee also McGuigan v. Reliance Stand. Life Ins. Co.*, 256 F. Supp. 2d 345, 348 (E.D. Pa. 2003); *Hawaii Mgt. All. Ass'n v. Ins. Com'r,* 100 P.3d 952, 965 (Haw. 2004).

In short, ERISA's powerful preemption provision expressly reflects Congress's unambiguous intent for the federal government to regulate all matters relating to employee benefit plans, including fiduciary responsibilities and the provision of investment advice. ERISA defines who is a fiduciary and creates its own enforcement mechanisms through DOL, the IRS, and federal courts. States may not add any new or additional requirements to that comprehensive system with respect to an employee benefit plan.

In sum, there is nothing unclear about the breadth of ERISA's preemption provision or the fact that it would clearly preempt any state fiduciary rule that attempts to apply to ERISA plans. ***For a real-life example of states' recognition of this clear fact, one has to look no further than the New York State Department of Financial Services' First Amendment to 11 NYCRR 224 (addressing "suitability and best interests in life insurance and annuity transactions"), which exempts all ERISA plans from its application.*** See 11 NYCRR section 224.2(b)(1). Because "insurance," like "securities," is covered by ERISA's savings clause, this is further evidence that the savings clause is clearly not applicable to state fiduciary rules.

The type of rule contemplated in the proposal would clearly be preempted with respect to ERISA plans and participants. As a result, any rule that is issued needs to be inapplicable with respect to ERISA plans.

<u>Preemption under NSMIA.</u> Similar to the ERISA preemption principles discussed above, Congress has also expressly indicated its intent to preempt certain state regulation of investment advisers and broker-dealers through its robust framework of federal securities law. For purposes of this discussion, we focus on two important provisions included in the National Securities Markets Improvement Act of 1996 ("NSMIA"), a federal law that clearly reflects Congress's intent to preempt the state regulation of securities, investment advisers, and broker-dealers. As the congressional managers of the Conference Committee for that law explained, NSMIA's preemption provisions are intended to "eliminate duplicative and unnecessary regulatory burdens [imposed by the states] while preserving important investor protections by reallocating responsibility over the regulation of the nation's securities markets in a more logical fashion between the Federal government and the states."[12]

NSMIA added a new provision to the Investment Advisers Act of 1940 that is specifically intended to reorganize the role of the states and the federal government with regard to the regulation of investment advisers. As a result of that change in 1996, ***section 203A of the Advisers Act now says that states are preempted from regulating investment advisers registered with the SEC, except in a few limited areas expressly permitted by Congress.*** Although section 203A permits states to bring enforcement actions with respect to fraud or deceit, to require notice filings, and to require state registration and licensing of individual representatives doing business in the state, all other matters regarding the regulation of SEC-registered investment advisers are "off limits" to the states. ***Moreover, the SEC's interpretation of section 203A clearly prevents states from indirectly regulating an SEC-registered investment adviser's business practices as a means of enforcing a state's anti-fraud rules in the absence of any fraudulent or dishonest***

[12] H.R. REP. NO. 104-864, at 39-40 (Conf. Rep.).

business practices.[13] As the SEC has previously explained, Congress created this division because it was concerned about the "cost imposed on investment advisers and their clients by overlapping, and in some cases, duplicative, regulation" by the states.[14] Accordingly, Congress chose to deny states "the ability to reinstitute the system of overlapping and duplicative regulation of investment advisers."[15]

As currently drafted, Massachusetts' fiduciary proposal conflicts with the portions of NSMIA that preempt the state regulation of federally-registered investment advisers. The proposed regulations would impose certain duties on "advisers," which are defined by the proposal to include federally-registered investment advisers.[16]

Finally, as noted above, the mere fact that the proposal deems fiduciary breaches to be "dishonest or unethical conduct or practices in the securities business" does not have any significance for preemption purposes. States may bring enforcement actions with respect to fraud or deceit. States cannot avoid this clear limitation by simply calling an action "fraud or deceit" if no such fraud or deceit is involved. Thus, the application of the proposal to representatives of federally-registered advisors is clearly preempted.

Through NSMIA, Congress also expressly indicated its intent to preempt certain state regulation of broker-dealers. Through the addition of section 15(i) of the Securities Exchange Act of 1934, Congress prohibited states from subjecting broker-dealers to any state requirement involving the "making and keeping [of] records," if such requirements "differ from, or are in addition to," the requirements already imposed by federal law.[17]

The express congressional directive on broker-dealer financial recordkeeping was clearly intended to preempt any state investment advice regulation that would, in effect, require broker-dealers to collect and keep records to document compliance with the law, which a fiduciary rule would clearly do. After all, any case brought by states or individual plaintiffs to enforce a fiduciary rule will be highly dependent on the broker's books and records regarding compliance steps, which have been declared "off limits" to the states by Congress.

The Bureau's proposed fiduciary rule attempts unsuccessfully to avoid the preemption issue described in the preceding two paragraphs by stating that it shall not "be construed to establish any requirements for capital, custody, margin, financial responsibility, making and keeping of records, bonding, or financial or operation reporting for any broker-dealer or agent that differ from, or are in addition to, the requirements established under [federal securities laws]." This part of the proposal is in irreconcilable conflict with the rest of the proposal, which requires extensive recordkeeping to demonstrate compliance. Thus, this purported limitation will not prevent preemption.

---

[13] 62 Fed. Reg. 28112, 28126 (May 22, 1997).

[14] 62 Fed. Reg. at 28113.

[15] 62 Fed. Reg. at 28126.

[16] Code of Massachusetts Regulations Title 950, proposed section 12.207(a).

[17] 15 U.S.C. § 78o.

Accordingly, any fiduciary rule issued by the Bureau with respect to broker-dealers would be preempted under NSMIA.

<u>The proposed rule would also be preempted based on "conflict preemption</u>." Federal law can preempt state laws in different ways. Congress can, for example, *expressly* say that certain issues, like the regulation of employee benefit plans or broker-dealer recordkeeping requirements, are "off limits" to the states. This is the kind of preemption discussed above, which is triggered by, for example, section 514 of ERISA and section 15(i) of the Securities Exchange Act of 1934.[18] Express preemption is not, however, the only way that federal law can preempt state law.

Even if Congress does not expressly preempt state law, it can impliedly preempt state law through a constitutional principle known as "conflict preemption." Federal law can preempt a state law under the doctrine of "conflict preemption" in one of two ways. First, a state law can be invalidated when it is impossible to comply with the federal and state laws at the same time.[19] ***Second, a state law can be invalidated when it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.***[20] This second type of conflict preemption, which is sometimes referred to as "obstacle preemption," provides a clear means of preempting Massachusetts' proposed fiduciary rule. This basis for preemption has been strengthened now that the SEC has finalized Regulation Best Interest – a rule that explicitly rejects a harmonized fiduciary standard for broker-dealers and investment advisers.

In the context of broker-dealer regulation, there is a significant body of case law indicating that the imposition of state fiduciary standards upon broker-dealers, especially as they relate to the forms of acceptable compensation and the disclosure of conflicts, is preempted under the doctrine of implied conflict preemption when they exceed the federal standards. For example, in the mid-1990s, plaintiffs brought a series of common law fiduciary claims against broker-dealers alleging that the brokers breached their state fiduciary duties by failing to disclose to their customers the receipt of "order flow" payments. Essentially, the plaintiffs argued that state fiduciary standards required detailed disclosure of those payments, notwithstanding the fact that the SEC imposed less strenuous standards at the federal level.

In a string of opinions considering those claims, the highest courts of four states concluded that federal law preempted the detailed disclosure of order flow payments as an outgrowth of state fiduciary principles. According to the courts, those state-based obligations were more stringent than the federal rules crafted by the SEC and would create an obstacle to the accomplishment and execution of the full purpose and objectives of Congress, namely Congress' objective of entrusting the SEC to comprehensively and uniformly regulate broker-dealers under a national market system.[21] In many respects, that string of cases closely parallels current efforts by states

---

[18] 15 U.S.C. § 78o.

[19] *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990).

[20] *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

[21] *See Guice v. Charles Schwab & Co., Inc.*, 674 N.E.2d 282 (N.Y. 1996) (concluding that federal law preempted state fiduciary standards requiring broker-dealers to disclose order flow payments because state-by-state fiduciary standards would defeat Congress's intent for the SEC to develop a national market system); *Orman v. Charles Schwab & Co., Inc.*, 688 N.E.2d 620 (Ill. 1997) (holding that federal disclosure rules for broker-dealers preempted

to impose new fiduciary standards for broker-dealers that exceed the federal standards. Accordingly, if Massachusetts finalizes its regulations as proposed, challengers seeking to invalidate the rule would prevail by applying similar logic – i.e., the Massachusetts proposal would create an obstacle to Congress' objective of entrusting the SEC to comprehensively and uniformly regulate broker-dealers under a national market system.

Now that the SEC has finalized its own broker-dealer standards through Regulation Best Interest, the case for conflict preemption is very strong. The Massachusetts proposal would directly conflict with many clear policy decisions made by the SEC, including the following:

> **Unlike the proposal, the SEC specifically rejected the idea of applying a fiduciary standard to broker-dealers.** "We have declined to subject broker-dealers to a wholesale and complete application of the existing fiduciary standard under the Advisers Act because it is not appropriately tailored to the structure and characteristics of the broker-dealer business model (i.e., transaction-specific recommendations and compensation), and would not properly take into account, and build upon, existing obligations that apply to broker-dealers, including under FINRA rules. Moreover, we believe (and our experience indicates), that this approach would significantly reduce retail investor access to differing types of investment services and products, reduce retail investor choice in how to pay for those products and services, and increase costs for retail investors of obtaining investment recommendations.
>
> "We have also declined to craft a new uniform standard that would apply equally and without differentiation to both broker-dealers and investment advisers. Adopting a "one size fits all" approach would risk reducing investor choice and access to existing products, services, service providers, and payment options, and would increase costs for firms and for retail investors in both broker-dealer and investment adviser relationships."

Preamble to Regulation Best Interest at pages 19-20.

> **Unlike the proposal, the SEC specifically rejected the requirement that advice be provided without regard to the broker-dealer's interest**. "[W]e are concerned that there is a risk that the "without regard to" language 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."

---

state fiduciary standards that would obstruct the national market system Congress intended to foster); *Shulick v. PaineWebber, Inc.*, 722 A.2d 148 (Pa. 1998) (concurring) (concluding that the disclosure of order flow payments under a state fiduciary standard was preempted because allowing states to impose more stringent requirements on broker-dealers would render the federal scheme "largely nugatory" and would require brokers "to craft their disclosures to meet potentially dozens of different state standards"); *see also Dahl v. Charles Schwab & Co., Inc.*, 545 N.W.2d 918 (Minn. 1996) (concluding that federal law preempted state fiduciary standards for broker-dealers because Congress intended the SEC to regulate the securities markets and state law would effectively eliminate a form of compensation permitted by federal law).

Id. at pages 63-64.

> **<u>Unlike the proposal, the SEC specifically rejected applying an ongoing duty to broker-dealers</u>**. "[T]he provision of recommendations in a broker-dealer relationship is generally transactional and episodic, and therefore the final rule requires that broker-dealers act in the best interest of their retail customers at the time a recommendation is made and imposes no duty to monitor a customer's account following a recommendation."

Id. at page 60.

Moreover, these SEC decisions were made pursuant to broad grants of authority by Congress.

> "The Commission is adopting Regulation Best Interest pursuant to the express and broad grant of rulemaking authority in Section 913(f) of the Dodd-Frank Act.... Section 913(f) of the Dodd-Frank Act provides the Commission discretionary authority to "commence a rulemaking, as necessary or appropriate to the public interest and for the protection of retail customers (and such other customers as the Commission may by rule provide), to address the legal or regulatory standards of care for brokers, dealers. . . [and] persons associated with brokers or dealers. . . for providing personalized investment advice about securities to such retail customers." In addition to Section 913(f), the Commission is promulgating Regulation Best Interest pursuant to other provisions of the Exchange Act, including Section 15(c)(6) and Section 17."

Id. at page 55.

The Massachusetts proposal would directly conflict with these and other core decisions made by the SEC pursuant to a Congressional grant of authority, and thus would fall squarely within the conflict preemption doctrine.

Moreover, as part of its recent regulatory package, the SEC reaffirmed that broker-dealers who provide advice that is "solely incidental" to their primary business of effecting securities transactions are exempt from the fiduciary standards imposed on investment advisers through the Investment Advisers Act of 1940. Under the doctrine of conflict preemption, this interpretation cannot be undone by state regulation subjecting broker-dealers to an ongoing fiduciary duty when they provide *any* level of investment advice to their customers, as the Massachusetts proposal would do.

Finally, the conflict preemption doctrine would also apply to the Massachusetts proposal with respect to investment advisers in light of, for example, the SEC's recently finalized "Interpretation Regarding Standard of Conduct for Investment Advisers."

<u>V. Support for Regulation Best Interest promulgated by the SEC in order to protect investors in the most effective manner.</u>

We strongly support the application of the SEC-promulgated Regulation Best Interest to investment recommendations provided to retail investors by broker-dealers. Investors are best served by having broker-dealers subject to this workable set of national rules promulgated by the

SEC. Inconsistent rules produce a variety of harms. As SEC Chair Clayton said in his June 5, 2019 statement:

> Recent examples of increases in . . . regulatory complexity include, among other things, (1) the Department of Labor's now vacated Fiduciary Rule, which would have imposed a standard of conduct different from both our existing standard of conduct for broker-dealers and the fiduciary standard applicable to investment advisers under the Advisers Act, and (2) the potential patchwork of inconsistent state-level standards. I and many others believe a patchwork approach to the regulation of the vast market for retail investment advice will increase costs, limit choice for retail investors and make oversight and enforcement more difficult. I am hopeful that our regulatory colleagues will continue to work with us to minimize inconsistencies and maximize the effectiveness of our collective efforts.

The harm attributable to a patchwork of inconsistent state rules would indeed be very significant:

- **Additional costs, depleting investor savings.** For broker-dealers operating in many or all states, the cost of designing, maintaining, training, and oversight with respect to different rules in different states is very material. And those costs will certainly be passed on to customers. This issue has not received the attention it deserves. There has been enormous scrutiny of fees, and the effect that they have on savings. Oddly, at the same time, there has been far too little scrutiny of rules that give rise to higher fees. Inconsistent rulemaking is certainly a huge creator of higher fees, as evidenced by the billions of dollars spent nationwide on the now-invalidated DOL rule.

- **Cross border issues.** There is no guidance on how to address cross border issues, such as the application of different state rules to broker-dealers providing assistance to investors in different states, leading to more confusion, uncertainty, and costs.

- **Great risk of errors and confusion.** We all know that our world is increasingly mobile. Broker-dealer representatives move between states, as do their customers. With multiple different rules in different jurisdictions, inadvertent errors by broker-dealers will likely increase, causing confusion and possibly undermining investor confidence. And mobile investors receiving different types of advice in different jurisdictions cannot help but be confused.

- **Gaps in advice due to inconsistencies.** All firms are developing systems to comply with the SEC's new rules. What happens if a state then develops different rules that are inconsistent with, and could possibly conflict with, the SEC rules? National firms will have no choice but to delay the provision of assistance in that state until systems are developed to deal with the differences, with the possibility that those differences cannot be dealt with and resolved easily, resulting in longer gaps in advice.

- **Inadvertent prohibition on advice regarding IRAs.** Without sufficient coordination with the federal agencies, there is a real possibility that the proposal could trigger fiduciary status under the Internal Revenue Code (though such treatment would be

inappropriate). For example, by treating broker-dealers as subject to a fiduciary duty, that could possibly result in the broker-dealer being treated as a fiduciary under the Code. That would mean in turn that almost all advice provided by broker-dealers with respect to IRAs would constitute a prohibited transaction under Code section 4975. [22] This is true because the advice provided by broker-dealers as fiduciaries can affect their own compensation, which runs afoul of Code section 4975(c)(1)(E). Although there are some prohibited transaction exemptions that could be helpful in some cases under the Code, the existing exemptions are not comprehensive, ***meaning that advice regarding IRAs would be widely prohibited in the state adopting the insufficiently coordinated fiduciary standard.***

In short, it is very important for there to be as much uniformity as possible in the protection of investors. Accordingly, we support the national standard promulgated by the SEC.

VI. Effective date.

It is hard to evaluate the right type of effective date for the regulation, since the proposed regulation is simply unworkable and would result in the widespread elimination of broker-dealer services. The effective date issue deserves further attention in the context of a re-proposal, but at a minimum, there needs to be a transition period of at least 18 months after the publication of final regulations. Any shorter transition period would, independent of the substance of the regulations, likely result in brokerage services (other than execution-only services) for many, if not all, Massachusetts residents ceasing as of the effective date.

In addition, the proposal does not grandfather ongoing relationships from the new rule. In the context of the DOL rule, the absence of a grandfather for existing relationships resulted in many thousands of investors receiving letters informing them that they could no longer receive personalized assistance with respect to their account. This was extremely harmful to small accounts across the country. Investors were unable to obtain assistance on investments that may cease to be appropriate for them, all attributable to a DOL failure to design a workable grandfather rule.

In our view, existing relationships need to be grandfathered so as not to cut off investors from help in the middle of an investment strategy.

Thank you for considering the comments provided above.

Sincerely,

Kent A. Mason

[22] As discussed above, it appears that the proposal would generally force broker-dealers to convert to investment adviser status. In that case, they would generally be ERISA fiduciaries, but by reason of the form of compensation charged by investment advisers, the prohibited transaction issues referenced in the text would generally not apply.

APPENDIX A: GENERAL HARM CREATED BY THE FIDUCIARY RULE

1. **Deloitte & Touche Study (August 9, 2017), as described in SIFMA's August 9, 2017 comment letter**
   a. *Description: a study of a cross-section of SIFMA's members, consisting of 21 financial institutions that represent 43% of U.S. financial advisors and 27% of the retirement savings assets in the market.*
   b. "[A]s of the Rule's first applicability date on June 9th, 53% of study participants reported limiting or eliminating access to brokerage advice for retirement accounts, which the firms estimate impact 10.2 million accounts and $900 billion AUM."
   c. "Roughly 95% of study participants indicated that they have reduced access to or choices within the products offered to retirement savers because of efforts to comply with the Rule. Products affected include mutual funds, annuities, structured products, fixed income, private offerings, and more, impacting an estimated 28.1 million accounts. Examples of the reduction in mutual fund availability include: 1) the elimination of no-load funds from brokerage platforms; 2) the elimination of mutual funds held directly at the mutual fund company; 3) reduced product offerings; and 4) elimination of other share classes."
   d. "Across the industry, broker-dealers will have spent more than $4.7 billion in start-up costs relating to the Rule, much of which has already been spent."
   e. "The ongoing costs to comply are estimated at over $700 million annually…."

2. **Harper Polling (July 2017), as described in the Financial Services Roundtable's August 10, 2017 comment letter (report and survey slides attached to letter)**
   a. *Description: a national survey of 600 financial professionals conducted by phone and through online interviews from July 7-12, 2017 (July 17, 2017).*
   b. A majority of respondents reported the Rule is restricting them from serving their clients' best interests.
   c. "Only 12% of respondents report the Rule is helping them to serve their clients best interest and 33% report there has been no impact, yet those respondents still report more complicated paperwork and fewer small accounts." "For those who reported the Rule is helping or has had no impact on their ability to serve their clients best interests, many reported negative changes to client services by (i) servicing fewer small accounts, (ii) offering fewer investment options, (iii) including fewer mutual fund options, and (iv) higher compliance costs, including additional fees for Retirement Investors."
   d. "Only 10% of Certified Financial Planners (CFP) report that the Rule is helping them to serve their clients best interests, and 55% report the Rule is restricting them from serving their clients best interests. This runs counter to the claim by the CFP Board of Standards that the Rule is workable for their members."
   e. 75% of respondents whose "typical clients have starting assets under $25,000 report that they will take on fewer small accounts due to increased compliance costs and legal risks."
   f. 63% reported that "the fiduciary standard will definitely/probably/or has already limited investment options/products they can provide to clients."

g. 56% said "their firms would offer fewer mutual fund products to consumers."
h. "…68% reported that they or their institutions will take on fewer small accounts."

3. <u>American Action Forum (AAF)</u> (March 16, 2017 <u>comment letter</u>)

a. *Description: AAF's comments are based on: (1) an AAF staff survey of the available literature in 2015 on the likely impact of the DOL rule, as discussed in an August 4, 2015 <u>article</u>; (2) a September 17, 2015 AAF <u>article</u>; and (3) AAF research as discussed in a February 22, 2017 <u>article</u>.*
b. Found reported compliance costs of at least $106 million in 2016, representing up-front costs from just four companies.
c. "[A]lmost all retail investors will see their costs increased by 73 to 196 percent due to a mass shift toward fee-based accounts."
d. "[F]irms providing investment advice will see an average of $21.5 million in initial compliance costs and $5.1 million in annual maintenance costs."
e. "[U]p to 7 million Individual Retirement Accounts (IRAs) would fail to qualify for an advisory account due to the balance too low to be sustainable for the advisor. In the shorter term, we found that the fiduciary rule, as written, will result in over $1500 of duplicative fees charged per household retirement account."
f. "…the fiduciary rule would cost $31.5 billion in total costs and $2 billion in annual burdens, making it the most expensive rule of 2016 and the second most expensive non-EPA rule since 2005."

4. <u>Meghan Milloy / American Action Forum (AAF) Research (April 2017)</u>, as stated on AAF's <u>website</u>

a. *Description: a research article by Meghan Milloy, Director of Financial Services Policy.*
b. The Rule will result in additional charges to retirement investors of approximately $816 annually per account or over $46 billion in aggregate.
c. "Although the rule has not yet become effective, AAF research has found that three major companies have left part of the brokerage business, and six more are drawing down their business or switching to a fee-based arrangement. From these companies alone, reported compliance costs have already topped $100 million, affecting 92,000 investment advisors, $190 billion in assets, and at least 2.3 million consumers."

5. <u>Chamber of Commerce's Monitoring of Rule's Impact</u>, as described in the Chamber's August 16, 2017 <u>comment letter</u>

a. *Description: outreach conducted by the Chamber to 14 firms that collectively manage $10 trillion in assets.*
b. "[N]early all of the institutions reported excluding some investment products from retirement investors in response to the rule, largely due to concerns about the pending 'level' fee requirements of the 'full' BIC Exemption."
c. "Most of the institutions also reported using the 'grandfathering' provisions included in the final rule, meaning that a substantial number of investors would be prevented from receiving new investment advice going forward, unless they

d. decide to change the type of account they have (e.g. change from a transaction-based account to a fee-based account).”

6. <u>NAIFA Survey of 1,093 Members (April 2017)</u>

a. Nearly 75% of financial professionals have experienced or expect to experience an increase in the minimum account balances for the clients they serve.
b. Nearly 90% of advisors believe consumers will need to pay more for their financial advice services.
c. More than 90% of financial professionals have already experienced or expect to experience restrictions of product offerings to their clients.
d. 68% of NAIFA’s members have been told that they cannot recommend certain mutual fund classes or types to clients, and almost 70% say they cannot recommend certain annuities.

7. <u>LIMRA Secure Retirement Institute’s *Second Quarter 2017 U.S. Retail Annuity Sales Survey*</u>, as described in an August 23, 2017 LIMRA <u>press release</u>

a. Total annuity sales for the first half of 2017 decreased 10% over the first half of 2016, the lowest first half sales since 2001.
b. Q2 2017 is the:
    i. 5th consecutive quarter of decline in overall annuity sales.
    ii. 6th consecutive quarter in which fixed annuity sales have been greater than variable annuity sales, which “hasn’t happened in almost 25 years.”
c. “A closer look at what’s driving the drop in VA sales reveals qualified VA sales have experienced a more significant decline than non-qualified VAs…. VA qualified sales were down 16 percent in the second quarter, while nonqualified sales were actually up 5 percent. This could be in reaction to the DOL fiduciary rule,” according to the director of annuity research.
d. Variable annuity sales are forecast to drop 10-15% in 2017, returning to levels not seen since 1998.

8. <u>LIMRA Secure Retirement Institute’s *First Quarter 2017 U.S. Retail Annuity Sales Survey*</u>, as described in a May 18, 2017 LIMRA <u>press release</u>

a. <u>Indexed annuity sales are forecast to decline 5-10% in 2017 and “another 15-20 percent in 2018 when the BICE goes into effect.”</u>

9. <u>LIMRA Secure Retirement Institute Study (2017), as described in NAIFA’s August 4, 2017 comment letter</u>

a. <u>“LIMRA estimates that access to guaranteed income products will decline 29% under the Rule/PTEs.”</u>

10. <u>Morningstar Report (2017)</u>, as described in the Insured Retirement Institute’s April 17, 2017 <u>comment letter</u>

a. Variable annuity sales declined nearly 22% from 2015 to 2016 despite a rising stock market.

11. **<u>Survey of Insured Retirement Institute (IRI) Member Firms (July 2017)</u>, as described in IRI's August 7, 2017 <u>comment letter</u>**
    a. *Description: IRI surveyed a representative sampling of its insurance company and distributor members from July 18-31, 2017.*
    b. "More than 60 percent of the distribution firms that participated in the Survey have, are planning to, or are considering exiting or de-emphasizing target markets such as small IRA holders and small retirement plan sponsors."
    c. A number of distributors reported that "approximately 155,000 of their clients have already been 'orphaned,' and a number of our insurer members told us that both the adviser and the firm have dissociated from the accounts of hundreds of their annuity contract owners. Far more accounts are expected to be impacted as implementation of the Rule proceeds."

12. **<u>CoreData Report, CoreData Research UK (2016)</u>, as described in <u>comment letter and attachment</u> submitted by Kent Mason (August 3, 2017)**
    a. *Description: a non-commissioned report based on an October 2016 survey of 552 U.S. financial advisors.*
    b. 71% of financial professionals will disengage from at least some retirement savers because of the Fiduciary Rule.
    c. 64% of financial professionals think the Fiduciary Rule will have a large negative impact on their mass-market clients (i.e., investors with less than $300,000 in net investable assets).
    d. On average, financial professionals estimate they will no longer work with 25% of their mass-market clients, creating an advice gap for low-balance investors.
    e. 39% of advisors believe the cost of personal financial advice will become too expensive for most investors.
    f. 32% of advisors believe that shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.
    g. 57% of advisors "believe increased paperwork stemming from reporting and disclosure requirements will be one of the top three challenges of the fiduciary rule**."**
    h. 18% of advisors "believe preparing for potential litigation will be one of the biggest challenges they must overcome."

13. **<u>A.T. Kearney Study (October 2016)</u>, as described in <u>comment letter and attachment</u> submitted by Kent Mason (August 3, 2017)**
    a. *Description: a study of the effects of the Fiduciary Rule published in connection with a discussion of how the global management consultant can help financial institutions adjust to the rule.*
    b. Concludes that "[a]s firms move toward fee-based advisory, many low-balance accounts will no longer be served, shifting many assets to formats such as robo-advice and self-directed."
    c. Recommends that broker/dealers should "[a]ccelerate the transition to fee-based services and advisory, and evaluate account thresholds to continue serving (for example, accounts greater than $200,000)."

d. States that “[c]ertain high-cost investment products (such as variable annuities) will be phased out as the business model is no longer viable under the new rule….”
e. By 2020, broker-dealer firms will collectively stop serving the majority of the $400 billion currently held in low-balance retirement accounts.
f. Implementing the DOL’s new fiduciary rule for retirement accounts will cost the brokerage industry $11 billion over the next four years.

14. Large Mutual Fund (2017 data), as described in the Chamber of Commerce’s April 17, 2017 comment letter

a. *Description: an interview the Chamber conducted with a large mutual fund provider.*
b. One mutual fund’s number of orphaned accounts (i.e., accounts without an advisor) nearly doubled in the first three months of 2017, and the average account balance in these orphan accounts is just $21,000. The fund projects that “ultimately 16% of the accounts it services will be orphaned this year because of the Fiduciary Rule.” “Extrapolating this prediction suggests that at least 1.6 million small retirement savers have already lost access to investment assistance since January 2017, and an additional 1.6 million are likely to lose access after the Rule becomes applicable.”

15. Fidelity Clearing & Custody Solutions Poll (August 2016), as described in September 28, 2016 ThinkAdvisor article

a. *Description: A blind online poll of 459 advisors conducted from August 18-26, 2016. Respondents consisted of 30% independent broker-dealer reps, 21% RIAs, 19% regional BD reps, 15% from wirehouse firms, 11% insurance BD reps, and 3% from banks.*
b. 10% of advisors responding to the survey reported they are planning to leave or retire from the field earlier than expected because of the rule, and another 18% said they are “reconsidering their careers as advisors.”

16. 2016 Global Survey of Financial Advisors commissioned by Natixis Global Asset Management, as described on Natixis website and in survey whitepaper

a. *Description: a survey of 2,550 advisors (including 300 in the U.S.) in 15 countries in Asia, Europe, the United Kingdom, and the Americas conducted in July 2016. The online quantitative survey was developed and hosted by CoreData Research.*
b. 38% of respondents said they will likely “disengage with smaller clients” as a result of new regulations.
c. Almost 80% of respondents are “concerned that more stringent regulations could limit access to financial advice for lower balance and mid-tier clients.”
d. More than 75% of advisors surveyed “believe increased regulations could even lead to higher costs for clients.”

17. **The Cerulli Report – U.S. Broker/Dealer Marketplace 2016, as described in Lincoln Financial Group's March 17, 2017 comment letter**
    a. *Description: an "in-depth analysis of broker/dealers (B/Ds) with financial advisors serving retail investors." Available for purchase.*
    b. 66% of advisors believe that small investors will have less access to professional financial advice as a result of the rule.

18. **NERA Economic Consulting's comment on the Department of Labor Proposal and Regulatory Impact Analysis (July 17, 2015)**
    a. *Description: SIFMA retained NERA Economic Consulting to review and comment on the proposed fiduciary rule. To conduct its cost study of the proposal, NERA gathered account-level data from several financial institutions, representing tens of thousands of IRA accounts that were observed from 2012 through Q1 2015.*
    b. "Using [a] conservative minimum account balance of $25,000, over 40% of commission-based accounts in our dataset would not be able to open fee-based accounts. Using a $50,000 threshold, over 57% of accounts would not meet minimum balance requirements for a fee-based account. If the effective threshold is $75,000, two-thirds of account holders would be left without any professional investment advice."

19. **Chamber of Commerce company interviews, as described in the Chamber's April 17, 2017 comment letter**
    a. *Description: In-depth, structured interviews of two to five persons with about 10 investment-advisory companies, broker-dealers, insurance companies, and others affected directly or indirectly by the Fiduciary Rule.*
    b. Interviewed companies "uniformly report that they have already restricted the choices of investment products available to retirement savers through their fee-based advisory channels, or they intend to do so when the Fiduciary Rule becomes applicable. The majority of companies interviewed have also either already raised the minimum account amounts to qualify for advisory services or have plans to do so upon applicability of the rule. Some firms have raised the minimum for advisory accounts to $100,000 or more, clearly excluding from their services small beginning savers."
    c. "[E]ven when the financial institution itself has not increased account minimums, individual brokers may implicitly discourage enrollment of smaller accounts and ration their time to larger accounts to earn better pay and to reduce time spent on compliance associated with smaller, transaction-based accounts."
    d. Insurance costs could exceed two to three times the cost estimated by the Department. Some respondents cited numbers as high as $10,000 per professional per year for Errors and Omissions coverage.
    e. The Chamber is unaware of any "robo-advisor" that recommends annuity products to generate retirement income, despite the clear need for these products and the Department's reliance on robo-advisors to alleviate the potential loss of access to retirement advice for small savers.

20. SIFMA survey, as described in document "New Data Shows DOL Fiduciary Rule Harming Small Retirement Savers" (available as attachment to Kent Mason's August 3, 2017 comment letter)

a. *Description: a survey of 25 member financial firms impacted by the Fiduciary Rule.*
b. "More than half the firms are considering moving IRA brokerage clients to call center services only."
c. "44% of the respondents anticipate that more than half of their clients could see a change in services (e.g., limitation of product choice, shift to fee-based account, or shift to online only, etc.). More than 50% of responding firms anticipate offering only advisory services to a subset of their current IRA brokerage customers."
d. "… more than 60% of the responding firms stated that they anticipate that some or all of the costs resulting from the potential increase in litigation and liability insurance may be passed on to clients."

21. Wall Street Journal Reports (February and April 2017), as described in the Financial Services Roundtable's April 17, 2017 comment letter

a. Firms have responded to the Rule by taking actions that include: (1) moving clients to fee-based accounts; (2) eliminating commission-based IRAs; (3) raising investment minimums for commission-based IRAs; (4) eliminating variable annuity products; and (5) excluding certain products from commission-based IRAs (e.g., annuities, mutual funds, and exchange-traded funds).

22. Jonathan Reuter updated analysis, as described in the American Bankers Association's (ABA) March 15, 2017 comment letter

a. *Description: ABA recommendations of key developments that an updated DOL analysis of the Fiduciary Rule should account for.*
b. The author of one of the academic studies cited by the Council of Economic Advisers (CEA), Jonathan Reuter, "issued an updated analysis that looked at more recent mutual fund performance (from 2003 to 2012) and concluded that broker-sold funds underperform no-load funds by an average of 18 basis points, significantly narrower than the 100-basis point difference cited by CEA."

APPENDIX B: HARM TO THE ANNUITY MARKET FROM THE FIDUCIARY RULE

1. **LIMRA Secure Retirement Institute's *Second Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in an August 23, 2017 LIMRA press release**
   a. Total annuity sales for the first half of 2017 decreased 10% over the first half of 2016, *the lowest first half sales since 2001*.
   b. Q2 2017 is the:
      i. 5th consecutive quarter of decline in overall annuity sales.
      ii. 6th consecutive quarter in which fixed annuity sales have been greater than variable annuity sales, which "hasn't happened in almost 25 years."
   c. "A closer look at what's driving the drop in VA sales reveals qualified VA sales have experienced a more significant decline than non-qualified VAs…. *VA qualified sales were down 16 percent in the second quarter, while nonqualified sales were actually up 5 percent. This could be in reaction to the DOL fiduciary rule*," (emphasis added) according to the director of annuity research.
   d. *Variable annuity sales are forecast to drop 10-15% in 2017, returning to levels not seen since 1998.*

2. **LIMRA Secure Retirement Institute's *First Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in May 18, 2017 LIMRA press release**
   a. Indexed annuity sales are forecast to decline 5-10% in 2017 and "another 15-20 percent in 2018 when the BICE goes into effect," referring to the "Best Interest Contract Exemption" under the DOL fiduciary rule.

3. **LIMRA Secure Retirement Institute Study (2017), as described in NAIFA's August 4, 2017 comment letter**
   a. "LIMRA estimates that access to guaranteed income products will decline 29% under the [DOL Fiduciary] Rule/PTEs." (The reference to "PTEs" is to the exemptions from the application of the Fiduciary Rule, which substantially all qualified annuities must use.)

4. **Morningstar Report (2017), as described in the Insured Retirement Institute's April 17, 2017 comment letter**
   a. Variable annuity sales declined nearly 22% from 2015 to 2016 despite a rising stock market, which "has traditionally led to increased sales" of VAs.

5. **Insured Retirement Institute (IRI) member survey (July 2017), as described in IRI's August 7, 2017 comment letter**
   a. "Half of the participating insurance companies reported that some of their distribution partners have already dropped the insurer's products from their shelf as part of their efforts to implement the [Fiduciary] Rule."
   b. "Nearly 60 percent of the participating insurance companies expect that fee-based annuities manufactured in response to the [Fiduciary] Rule will result in higher overall fees to the consumer."
   c. "[A] number of our distributor members reported that approximately 155,000 of their clients have already been 'orphaned,' and a number of our insurer members

told us that both the adviser and the firm have dissociated from the accounts of hundreds of their annuity contract owners. Far more accounts are expected to be impacted as implementation of the Rule proceeds."

6. **Independent Insurance Agents & Brokers of America, Inc. (IIABA) Member Survey (July 2017), as described in IIABA's August 3, 2017 comment letter**
    a. "38%, or 315 respondents, answered that they personally and/or the insurance agency they work for had stopped selling or giving advice related to products impacted by the fiduciary rule, or planned to do so on or before January 1, 2018 when the [fiduciary] rule takes full effect."
    b. "[M]ore than one third of independent insurance agents who responded to the survey will exit the market on or before January 1, 2018; and for those that remain some will offer more limited services to clients."

7. **ACLI (August 7, 2017 comment letter)**
    a. "One ACLI member informed us that it has reduced its proprietary insurance product offerings by 54 percent and its non-proprietary variable annuity offerings available through its broker-dealers by 76 percent."
    b. Consequences of the Fiduciary Rule as reported by ACLI members:
        i. "Some banks are no longer offering access to fixed and indexed annuities, even when they are used outside the context of an employee benefit plan or IRA."
        ii. "Some broker-dealers are no longer offering variable annuities even to savers and retirees with non-qualified assets not subject to the Regulation."
        iii. "Some broker dealers are reducing the number of insurers and annuity products available on their platforms."
        iv. "Some firms are inquiring how quickly they can be removed as the broker dealer of record from existing annuity business."
    c. "[T]he Regulation has already resulted in a dramatic increase of 'orphaned' accounts. Several ACLI member companies have already been notified by distribution partners that they will resign as agent of record to IRA and ERISA plan annuity holders. For example, one ACLI member has informed us that, since the Regulation's June 9, 2017 applicability date, it has received 'disassociation' requests for 84 annuity contracts, and the reason provided for each action was the Regulation. By comparison, this member received only 3 disassociation notices during 2016, none of which included the Regulation as the basis for the disassociation."
    d. One member reported that it has "identified over 250 small retirement plans that have lost access to guidance and advice as a result of the Regulation."

8. **NAIFA Survey of 1,093 Members (April 2017)**
    a. 70% of NAIFA's members say they cannot recommend certain annuities.

9. **<u>CoreData Report, CoreData Research UK (2016)</u>, as described in [comment letter and attachment] submitted by Kent Mason (August 3, 2017)**
    a. *Description: a non-commissioned report based on an October 2016 survey of 552 U.S. financial advisors.*
    b. 32% of advisors believe that shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.

10. **<u>A.T. Kearney Study (October 2016)</u>, as described in [comment letter and attachment] submitted by Kent Mason (August 3, 2017)**
    a. *Description: a study of the effects of the Fiduciary Rule published in connection with a discussion of how the global management consultant can help financial institutions adjust to the rule.*
    b. States that "[c]ertain high-cost investment products (such as variable annuities) will be phased out as the business model is no longer viable under the new rule…."

11. **<u>Chamber of Commerce</u> (April 17, 2017 [comment letter])**
    a. The Chamber is unaware of any "robo-advisor" that recommends annuity products to generate retirement income, despite the clear need for these products and the Department's reliance on robo-advisors to alleviate the potential loss of access to retirement advice for small savers.

12. **<u>Wall Street Journal Reports (February and April 2017)</u>, as described in the Financial Services Roundtable's April 17, 2017 [comment letter]**
    a. Firms have responded to the Rule by taking actions that include: (1) moving clients to fee-based accounts; (2) eliminating commission-based IRAs; (3) raising investment minimums for commission-based IRAs; (4) eliminating variable annuity products; and (5) excluding certain products from commission-based IRAs (e.g., annuities, mutual funds, and exchange-traded funds).

13. **<u>Cerulli Associates Research</u>, as reported in December 15, 2016 ThinkAdvisor [article]**
    a. "U.S. variable annuity and fixed indexed annuity sales are expected to decline by at least 10% through 2018 as the industry struggles to adapt to upcoming regulations put forth by the Department of Labor."
    b. Cerulli views insurers' "biggest challenge for the foreseeable future" as being the Fiduciary Rule.

14. **<u>Insured Retirement Institute (IRI) First-Quarter 2017 Annuity Sales Report</u>, as described in June 6, 2017 [press release]**
    a. *Description: sales results based on data reported by Beacon Research and Morningstar, Inc.*
    b. Industry-wide annuity sales declined 18% in the first quarter of 2017 as compared to the first quarter of 2016.

c. Fixed annuity sales during the first quarter of 2017 declined 13.9% as compared to the first quarter of 2016, and variable annuity sales declined 10.2% for the same period.

15. Insured Retirement Institute (IRI), as reported in December 15, 2016 ThinkAdvisor article

a. IRI "found that industrywide annuity sales in the third quarter totaled $51.3 billion, an 8.2% drop from sales of $55.9 billion during the second quarter of 2016, and a 12.3% decline from $58.5 billion in the third quarter of 2015."