July 26, 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

Submitted Electronically – securitiesregs-comments@sec.state.ma.us

Re: **Preliminary Solicitation of Comments on a Fiduciary Standard of Conduct for Massachusetts Broker-Dealers, Agents, Investment Advisers and Investment Adviser Representatives**

Dear Secretary Gavin:

The Association for Advanced Life Underwriting ("AALU") appreciates the opportunity to respond to the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth's ("Division") preliminary solicitation of comments to the proposed amendments to 950 CMR 12.204, 12.205 and 12.207 (collectively, the "Proposal") establishing a uniform fiduciary standard for investment advisors and broker-dealers. We applaud your decision to seek input from the public on the Proposal, as it is vitally important that the Division understand the likely impacts the Proposal will have on the cost and availability of financial recommendations for investors in the Commonwealth. We write to offer our concerns specifically about the Proposal's likely impact on commission-based financial services, which are especially important to low-balance and beginning investors.

Who We Are

AALU is the leading organization of life insurance professionals—our more than 4,000 members are primarily producers engaged in providing life insurance planning and annuity solutions for individuals, families, and businesses nationwide. As life insurance professionals, we work in the best interest of our clients every day, enabling individuals and families to maintain independence in the face of potential financial catastrophe, and to build their savings and guarantee retirement income. We offer our comments on the Proposal on behalf of our many members that are registered representatives of broker-dealers, and we have significant concerns about the likely effect of the Proposal to restrict Massachusetts consumers' access to financial professionals using the commission-based business model.

Overview

The Division published the Proposal only a few days after the U.S. Securities and Exchange Commission ("SEC") issued final regulations materially changing the Federal conduct standards, required disclosures, and compensation standards for broker-dealers and registered investment advisors. We believe the Division should closely review the final Regulation Best Interest ("Reg BI"), Form CRS Relationship Summary (Form CRS"), and related guidance documents before proceeding with the Proposal, as the Division appears to discount the significance of these reforms without having had the opportunity to fully consider them. For example, while the notice accompanying the solicitation of comments referenced Reg BI, noting that it

prohibits certain sales contests, the notice expressed a lack of clarity regarding how Reg BI requires mitigation or elimination of conflicts. The notice stated that "…In many instances, it appears that the mitigation of conflicts required under the SEC Regulation Best Interest can be accomplished through disclosure,…" and also questioned how Reg BI's mitigation requirements would apply to "broader conflicts."[1]

As initially published, the SEC rules and explanatory materials are more than 1,500 pages of text with several thousand footnotes. We are still analyzing the final rule to determine the full impact on the marketplace, and encourage the Division to fully considered the impact of Reg BI in achieving the goals of the Proposal. Upon a more thorough review, we believe the Division should conclude that the Proposal is not necessary to achieve the goals of the Division, or at a minimum, that the Proposal must be materially changed to avoid unnecessary conflicts with federal law, and to avoid unintended harms to Massachusetts investors.

In the event the Division does proceed, we offer the following specific comments on the Proposal. These address our serious concerns that, as written, the Proposal will make it very difficult for commission-based recommendations to remain a market choice available to investors in the Commonwealth. Reducing investor choice in this way will be harmful to the investors the Proposal is intended to protect.

- The Proposal must be modified to remove the concept of a "best" recommendation or the "best" fee structure—this is not a fiduciary concept, and cannot be met in practice. Fiduciary recommendations regarding investments and fee structures inherently involve making subjective decisions after weighing often competing factors, such as risk and reward, or variables that cannot be known in advance. There often is no clear "best" answer. Fiduciary standards focus on procedural prudence, not the outcome of that process.

- The Division should recognize that adopting a final rule in the Commonwealth will contribute to a patchwork of different and conflicting State and federal rules that will not serve the best interests of investors, but likely will lead instead to litigation, increased costs, and reduced access for consumers.

- The Division should recognize that federal law is likely to preempt many of the requirements of the Proposal, and the ensuing litigation, delays, and confusion will not serve the interests of Massachusetts investors.

- The Division should provide for an 18-month implementation period in any final rule.

Commission-Based Models Are Very Important to Many Massachusetts Investors and the Proposal Should Be Modified to Preserve Investor Choice

Access to commission and transaction-based business models benefits investors in Massachusetts. Depending on the needs of the investor, such as the frequency with which they will make changes to their investments, or the type of investment product serving the consumer's best interest, a fee-based model of compensation may cost significantly more while providing no additional advice or assistance. That's why we are very concerned about the effect of the Proposal on commission-based compensation in three important areas.

First, in order to engage in transaction-based compensation, the new proposed Sec. 207(c)(3)(ii) requires that the broker-dealer or registered representative demonstrate that it is the "best" of the reasonably available fee options. As we discuss in more detail below, "best" is not a fiduciary concept, nor can it be applied in practice. There are a variety of subjective factors for each investor regarding whether fee or transaction-based business models are in their best interest, but it is simply not possible or realistic to demonstrate that one or the other is the "best" in all cases.

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1 "Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives," June 14, 2019, at https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/fiduciaryconductstandardidx.htm, last accessed on July 24, 2019.

Second, Sec. 207(c)(2) directs financial professionals to "avoid conflicts of interest and to make recommendations and provide investment advice without regard to the financial or any other interest" of anyone but the client. This vague language imposes a conduct standard that is at once too loose and too tight. It is unclear what the Division means in instructing financial professionals to "avoid conflicts." Does mean there can be no conflicts, or only that a good faith effort is made to avoid conflicts? At the other end of the spectrum, language requiring that recommendations must be made "without regard to" the financial or any other interest of any persons other than the client would preclude any consideration of any other factor, no matter how slight. This language invites legal challenges to transaction-based compensation models because there likely are some minor differences in compensation between different products that may be recommended. The "without regard to" language makes it too easy to suggest that a compensation factor was considered, which would be contrary to the standard outlawing any consideration of that factor whatsoever. It puts broker-dealers and their representatives in the position of proving a negative. By contrast, a standard where the advisor does not put his interest ahead of the client serves the same purpose without creating a legally untenable position for the financial professional.

Finally, the Proposal imposes an ongoing duty to monitor that is too broad, and does not permit many broker-dealers and representatives to act in that capacity. Under new proposed Sec. 207(b)(1)(ii), if there are "ongoing recommendations" or "ongoing compensation" or the "provi[sion of] investment advice, in any capacity," then the "… fiduciary duty shall be deemed an ongoing. [sic]" —in other words, the investor is not allowed the choice to use a dually registered advisor as a broker-dealer for some transactions and as an RIA for others. Rather than eliminating that choice, the investor should be able to make an informed choice based on clear disclosure.

"Best" Test Fails as a Legal Concept and in the Real World

The Division is attempting to insert a "best recommendation" and "best fee" concept into a fiduciary rule that is completely inapposite to fiduciary conduct. In the new proposed Sec. 207(c)(2)(i), the Proposal establishes a "presumption of a breach of the duty of loyalty for offering or receiving, direct or indirect compensation…" for making a recommendation "that is not the best of the reasonable available options..." It is not clear exactly how this provision interacts with a later provision in Sec. 207(c)(3)(ii) stating that, notwithstanding the prior language, there is not a presumed breach if the "renumeration represents the best of the reasonable available renumeration options for the customer or client…" While there is some ambiguity here, the common denominator is that only the "best" fee or recommendation can allow commission-based compensation. This is an impossible standard to meet.

Fiduciary standards are based on the "inputs," the process by which decisions are made. That is because basing standards on the outcome of the process effectively asks fiduciaries to guarantee outcomes. Fiduciary duties are designed to ensure that decisions are made for the benefit of the beneficiary of the obligation, not for the benefit of the fiduciary. That is very different than saying that the fiduciary's answer—which is often made in circumstances that are inherently subjective and based on weighing many different and sometimes conflicting factors—must be the best. There is rarely only one right answer.

Whether investment or fee recommendations, a "best" standard invites frivolous litigation and second-guessing of the ultimate decision. Fiduciary standards are designed to avoid such disputes. A legal challenge to the prudence of a decision is that it was made the wrong way, not that it was the wrong answer—the Proposal would turn this long-established fiduciary common law on its head.

Federal Preemption is Likely Absent Material Modifications

It appears that the intent behind the new Secs. 12.207(e) and (f) excluding ERISA plans and referencing the National Securities Markets Improvement Act of 1996 ("NSMIA")) was to avoid the Proposal's preemption by federal law, but we believe that significant portions of the Proposal would be preempted. In order to comply—such as showing that its recommendation is the best—a financial professional must keep records and take actions beyond those required by federal law. This includes the financial obligation of purchasing insurance coverage as a fiduciary that goes beyond the standard errors and omissions coverage required of a broker-dealer that is not a fiduciary. We also do not believe that this is a simple anti-fraud statute. Fraud is already illegal under Massachusetts law, and the Proposal addresses conduct that is not fraudulent.

The Division must anticipate litigation on this point, especially given the SEC's recent actions to fundamentally change Federal standards. Rather than conflict with the SEC, and increasing the cost and confusion facing investors, the Division should coordinate any final rule with the SEC final regulations.

Reasonable Implementation Deadline

Given the magnitude of the changes the Proposal would require, it will take some time for developing new policies and procedures and training personnel. We believe an eighteen-month implementation period would be reasonable.

Conclusion

Our members act in the best interest of the families they serve every day. We are very concerned, however, that the best interest of consumers will not be served by the Proposal as written. Rather than proceeding, the Division should review the SEC's new regulations. We believe these achieve the fundamental goals of the Proposal, and that the Commonwealth would be best served by not proceeding to a final regulation.

We appreciate the opportunity to comment, and appreciate your consideration of our concerns. We are always happy to answer any questions.

Sincerely,

Marc Cadin
President & CEO
AALU