FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL TO securitiesregs-comments@sec.state.ma.us

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

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

Dear Secretary Galvin:

On June 14, 2019, the Massachusetts Securities Division (the "Division") of the Office of the Secretary of the Commonwealth issued its *Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives*, which includes proposed amendments to 950 CMR 12.204 and 950 CMR 12.205 and newly proposed rule 950 CMR 12.207 (collectively, the "Proposal"). The Proposal would apply require broker-dealers, agents, investment advisers, and investment adviser representatives to adhere to a fiduciary conduct standard when dealing with their customers and clients, respectively.

The Financial Services Institute[1] (FSI) appreciates the opportunity to comment on this important proposal. We believe that any standard of care must require reasonable and streamlined disclosures to ensure industry participants effectively communicate any material conflicts of interest to their clients and prospective clients. Despite the Division's hesitation, we are confident that the U.S. Securities and Exchange Commission (the "SEC") has achieved this goal through its most recent rulemaking package, which includes Regulation Best Interest, Form CRS, interpretive guidance on the fiduciary duty applicable to investment advisers, and interpretive guidance on the solely incidental prong of the broker-dealer exclusion from the definition of investment adviser.[2] Regulation Best Interest achieves many of the goals set forth in the Division's Proposal, namely, a broker-dealer: (i) must provide a description of its applicable standard of conduct using prescribed wording; and (ii) must not place its own interests ahead of its customers'

[1] The **Financial Services Institute (FSI)** is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 100 independent financial services firm members and their 160,000+ affiliated financial advisors – which comprise over 60 percent of all producing registered representatives. We effect change through involvement in FINRA governance as well as constructive engagement in the regulatory and legislative processes, working to create a healthier regulatory environment for our members so they can provide affordable, objective advice to hard-working Main Street Americans. For more information, please click here.

[2] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 84 Fed. Reg. 33318 (July 12, 2019) (the "Reg BI Release"); *Form CRS Relationship Summary*, 84 Fed. Reg. 33492 (July 12, 2019) ("Form CRS"); *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, 84 Fed. Reg. (July 12, 2019) (the "Adviser Release"); *Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser*, 84 Fed. Reg. 33681 (July 12, 2019) (the "Solely Incidental Release").

interests. In addition, Regulation Best Interest provides a framework for disclosure which ensures that retail investors are informed of all material facts about: (i) the scope and terms of their relationship with a broker-dealer (i.e., that the firm or representative is acting in a broker-dealer capacity); (ii) fees and costs; and (iii) conflicts of interest.[3] Regulation Best Interest maintains the meaningful distinctions between brokerage services and advisory services, which preserve investor choice and access to investment products, services and advice. Regulation Best Interest generally imposes more specific obligations on broker-dealers than the principles-based requirements of investment advisers' common law fiduciary duty.[4] Additionally, Form CRS provides investors with meaningful and effective disclosures relating to broker-dealers and investment advisers. For these reasons, FSI members believe that the Proposal would unnecessarily duplicate and potentially conflict with the requirements of Regulation Best Interest.

FSI understands that the Division considered the standard of conduct under Regulation Best Interest to fall short. However, FSI believes that the investor protections provided under Regulation Best Interest and Form CRS align closely with the protections that would be provided under the Proposal while also preserving investor choice and access. In the event that the Division elects to proceed with its Proposal, FSI appreciates the opportunity to provide the following background and comments.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.[5] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).[6]

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $48.3 billion of economic activity.[7] This activity, in

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[3] Exchange Act Rule 15l-1(a)(2)(i).
[4] Reg BI Release at p. 60.
[5] Cerulli Associates, Advisor Headcount 2016, on file with author.
[6] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.
[7] Oxford Economics, The Economic Impact of FSI's Members at p. 23 (July 2016), https://financialservices.org/wp-content/uploads/2017/03/FSI-Impact-Report-Final.pdf.

turn, supports 482,100 jobs, including direct employees, those employed in the FSI supply chain, and those supported in the broader economy.[8]

Overview of the Proposal

The Proposal is comprised of two parts: amendments to 950 CMR 12.204 and 950 CMR 12.205 and newly proposed rule 950 CMR 12.207. Part One of the proposal would amend the existing suitability standard for broker-dealers to include recommending to a customer an investment strategy, the opening of any type of account, or the transferring of assets to any type of account.[9] Part One of the proposal would also amend the existing suitability standard for investment advisers to include recommending to a client whom investment supervisory, management or consulting services are provided an investment strategy, the opening of any type of account, or the transferring of assets to any type of account.[10]

Part Two of the Proposal would require broker-dealers and investment advisers to act as fiduciaries when providing investment advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the purchase, sale, or exchange of any security.[11] To satisfy the duty of care, broker-dealers and investment advisers would be required to use the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use taking into consideration all of the facts and circumstances. The broker-dealer or investment adviser would be required to make reasonable inquiry, including risks, costs and conflicts of interest related to the recommendation or investment advice, and the customer's investment objectives, financial situation and needs, as well as any other relevant information. To satisfy the duty of loyalty, the broker-dealer or investment adviser would be required to avoid conflicts of interest and make recommendations or provide investment advice without regard to the financial or any other interest of the broker-dealer or investment adviser, any affiliated or related entity, or any other third party.

Under the Proposal, a broker-dealer's or investment adviser's fiduciary obligation would extend through the execution of a "standalone" recommendation. However, if a broker-dealer or investment adviser makes ongoing recommendations or provides investment advice, in any capacity, or receives ongoing compensation in connection with the recommendation or advice, then the fiduciary duty would be an ongoing obligation to the client. In addition, if a broker-dealer or investment adviser exercises discretion over a customer's account or has a contractual fiduciary duty, then the broker-dealer or investment adviser would be a fiduciary when making a recommendation or providing investment advice.

The Proposal creates a presumption of a breach of the duty of loyalty for offering or receiving direct or indirect compensation to or from the broker-dealer or investment adviser for recommending an investment strategy, the opening of any specific type of account, the transfer of assets to any 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. The Proposal permits broker-dealers and investment advisers to receive transaction-based remuneration, so long as: (i) the remuneration is reasonable; (ii) the remuneration is the "best of the reasonably available remuneration options" for the customer; and (iii) the broker-dealer's or investment adviser's duty

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[8] Oxford Economics, The Economic Impact of FSI's Members at p. 23 (July 2016), https://financialservices.org/wp-content/uploads/2017/03/FSI-Impact-Report-Final.pdf.
[9] Proposed Rule 12.204(a)(4).
[10] Proposed Rule 12.205(c)(1).
[11] Proposed Rule 12.207.

of care is satisfied. Lastly, the Proposal requires broker-dealers and investment advisers to avoid conflicts of interest, as opposed to requiring broker-dealers and investment advisers to disclose conflicts of interest. The Proposal notes that there would be no presumption that disclosing a conflict of interest in and of itself would satisfy a broker-dealer's or investment adviser's duty of loyalty.

Discussion

FSI appreciates the opportunity to comment on the Proposal. Since 2009, FSI has publicly supported a carefully crafted standard of care that requires a duty of care and a duty of loyalty of all professionals providing personalized investment advice to retail clients.[12] FSI has been actively engaged in discussions surrounding the standard of care, including providing the SEC with detailed comments in response to requests for information and the original rule proposal for Regulation Best Interest. FSI believes that several key issues must be addressed in any standard of care rulemaking, including defining a standard of care and ensuring investors retain access to affordable investment products, services and advice.

In our view, the Proposal would impose a new regulatory structure that varies significantly from the current framework and would drastically alter the relationship between broker-dealers and their retail clients in the Commonwealth. Additionally, we believe the Proposal would result in more costly pricing structures for brokerage services, which limits access to advice, may be inconsistent with some investors' expectations and needs, and may not, in fact, be within their best interest. As noted above, FSI believes that the investor protections provided under Regulation Best Interest and Form CRS closely align with the protections that would be provided under the Proposal, while also preserving investor choice and access. Should the Division choose to move forward with the Proposal, FSI urges the Division to consider the burden that the Proposal will have on access to advice for many Main Street Americans, and the limitations that it will impose on products and services offered by financial advisors. Beyond these overriding concerns, we offer specific constructive feedback and suggestions below.

I. Inconsistencies with Federal and State Securities Laws

As noted above, FSI members have long supported a standard of care that requires a duty of care and a duty of loyalty of all professionals providing personalized investment advice to retail clients. We believe that such a standard should also require reasonable and streamlined disclosures to ensure industry participants effectively communicate their conflicts of interest to their clients and prospective clients. However, we have reservations about the Division's Proposal, which would establish a fiduciary duty for broker-dealers and in so doing would blur the meaningful distinctions between brokerage services and advisory services.

A broker-dealer's relationship with its customers is fundamentally different from that of an investment adviser's relationship with its clients. Broker-dealers play a critical role in helping retail investors achieve important long-term goals, such as accumulating retirement savings, buying a home or funding a child's college education.[13] "Specifically, the brokerage services provided to retail customers range from execution-only services to providing personalized investment advice in the form of recommendations of securities transactions or investment strategies involving securities

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[12] *See, e.g.*, Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Jay Clayton, Chairman, U.S. Securities and Exchange Commission (October 30, 2017) (responding to request for Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker Dealers), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2657870-161400.pdf.
[13] Reg BI Release at 6.

to customers."[14] Broker-dealers typically receive compensation based on the transactions executed for their retail customers. This type of arrangement is particularly useful to low- and middle-income retail investors who would otherwise be unable to afford advice and services under a fee-based advisory arrangement.

Investment advisers also play a similar but distinct role, offering a variety of advisory services, which are geared towards helping retail clients achieve the same long-term goals. Specifically, advisory services provided to retail clients range from financial planning and consulting to discretionary management of a client's assets, and are often hallmarked by ongoing advice and monitoring. Investment advisers are typically compensated based on a percentage of total assets managed for a client. This type of arrangement can be particularly useful for middle- and high-income retail investors who can afford to pay an ongoing fee for services.

Imposing a fiduciary duty on a customer's relationship with its broker-dealer is artificial and confuses the fundamental purpose of the brokerage relationship with that of an advisory relationship. The Proposal will serve to disadvantage the basic brokerage model, and result in harm to the Commonwealth's retail investors, with a predominant impact on those low- to middle-income retail investors who are residents of the Commonwealth. For these reasons, FSI urges the Division to adopt a standard of care that acknowledges the critical differences between brokerage and advisory relationships and services.

A. Broker-Dealer Exclusions for Solely Incidental Investment Advice

Many of FSI's IBD member firms are registered as both broker-dealers and investment advisers (i.e., dual registrants). As a dual registrant, an IBD member firm may provide brokerage services to retail customers in its capacity as a broker-dealer, advisory services to retail clients in its capacity as an investment adviser, or both brokerage and advisory services. The Proposal is especially harsh with respect to the dual-registrant model in that it contemplates holding a broker-dealer who makes ongoing recommendations or provides investment advice, in any capacity, or receives ongoing compensation in connection with the recommendation or advice, to an ongoing fiduciary standard.[15]

The Proposal takes a position that significantly differs from the position taken by the Massachusetts Uniform Securities Act (the "Act") and the SEC, both of which embrace the fundamental differences between brokerage services provided in a broker-dealer capacity and advisory services provided in an investment adviser capacity. For example, the Act explicitly excludes registered broker-dealers and broker-dealer agents from the definition of an investment adviser.[16] Unlike the Uniform Securities Act after which it was modeled, the Act's broker-dealer exclusion is not conditioned on the requirement that special compensation is not received.[17] This supports the conclusion that the Commonwealth's legislature acknowledges that broker-dealers may receive compensation for advice and still not trigger investment adviser registration requirements. In addition, the Official Comments to the Uniform Securities Act quote the SEC in agreeing that the exclusion for broker-dealers from the definition of an investment adviser recognizes "that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business."[18] The Official Comments note that the distinction may be drawn between investment advisers and

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[14] Reg BI Release at 6.
[15] Proposed Rule 12.207(b)(1)(ii).
[16] Mass. Gen. Laws ch. 110A, § 401(m).
[17] See Mass. Gen. Laws ch. 110A, § 401(m)(1)(F). *But see* Uniform Securities Act, § 102(f).
[18] See Uniform Securities Act of 1956, Section 401.01 (Official Code Comment) (quoting the SEC).

broker-dealers by noting when "compensation for advice itself" is received as compared to "compensation for services of another character."[19] Again, we note that the Commonwealth does not make such a distinction.

The Investment Advisers Act of 1940, as amended, provides an exclusion from its definition of an investment adviser for broker-dealers who provide advisory services that are "solely incidental to the conduct of their business as [brokers- dealers]," so long as they do not receive any special compensation for their advisory services.[20] The SEC recently confirmed and clarified the "solely incidental" exclusion in an interpretive release accompanying Regulation Best Interest.[21] In its release, the SEC acknowledges the congressional intent of the Advisers Act to specifically exclude persons "to the extent that such persons rendered investment advice incidental to their primary business."[22]

With its adoption of Regulation Best Interest, the SEC notes the key differences between broker-dealers and investment advisers, which generally include the nature of customer/client relationships, services offered and compensation models. FSI agrees that any advice provided by a broker-dealer that is not "solely incidental" and for which special compensation is received would likely subject a broker-dealer to adviser registration requirements. However, FSI believes that the Proposal goes against well-established law and guidance and would unnecessarily blur the meaningful distinction between brokerage and advisory services provided by dual registrants by holding them to a fiduciary standard even when they provide services in connection with brokerage services.[23] For these reasons, FSI urges the Division to reconsider its approach on dual registrants.

B. The Duration of a Broker-Dealer's Duty to a Customer

As noted above, the Proposal contemplates holding a broker-dealer who makes ongoing recommendations or provides investment advice, in any capacity, or receives ongoing compensation in connection with the recommendation or advice, to an ongoing fiduciary standard.[24] As noted above, imposing a fiduciary duty on a customer's relationship with its broker-dealer is artificial and confuses the fundamental purpose of the brokerage relationship with that of an advisory relationship.

The federal securities laws define "broker" and ""dealer" in the context of "effecting transactions" and "buying and selling securities," respectively.[25] Similarly, the Commonwealth defines a "broker-dealer" in the context of "effecting transactions in securities."[26] The Reg BI Release acknowledges that a broker-dealer who is a "dual registrant is an investment adviser solely with respect to accounts for which a dual-registrant provides advice and receives compensation that subjects it to the Advisers Act."[27]

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[19] See Uniform Securities Act of 1956, Section 401.01 (Official Code Comment) (quoting the SEC).
[20] 15 U.S.C. § 80b-2(a)(11)(C).
[21] Solely Incidental Release.
[22] See Solely Incidental Release.
[23] See, e.g., Certain Broker-Dealers Deemed Not To Be Investment Advisers, Investment Advisers Act Release No. 2376 (Apr. 12, 2005) ("Release 2376"), http://www.sec.gov/rules/final/34-51523.pdf; see also S. Rep. No. 76-1775 at 22; H.R. Rep. No. 76-2639 at 28 (the term "investment adviser" was "so defined as specifically to exclude . . . brokers (insofar as their advice is merely incidental to brokerage transactions for which they receive only brokerage commissions.")).
[24] Proposed Rule 12.207(b)(1)(ii).
[25] 15 U.S.C. § 78c(a)(4) and (a)(5).
[26] Mass. Gen. Laws ch. 110A, § 401(c).
[27] Reg BI Release at p. 34-35.

A broker-dealer who provides investment advice to a retail customer that otherwise fits squarely within the solely incidental exception should not be subject to an ongoing fiduciary duty. Such a requirement ignores the existing federal and state statutory definitions, exclusions, and guidance, all of which differentiate between broker-dealers and investment advisers. Furthermore, an ongoing fiduciary duty standard for a broker-dealer would deprive retail customers of the opportunity to choose the relationship, services, and fees and costs that suit their needs and investment objectives by: (i) placing them in an ongoing advice relationship with a broker-dealer whom they did not seek an advisory relationship with; and (ii) effectively pricing out customers from receiving investment advice in connection with their brokerage accounts. Additionally, FSI respectfully requests that the Division adhere to SEC and FINRA rules regarding the point in time duration of a broker-dealer's obligation to its customer and include an explicit exemption from the fiduciary duty for unsolicited transactions and self-directed accounts.

Conflicts of Interest

A. Satisfying the Duty of Loyalty

Under the Proposal, broker-dealers and investment advisers are required to satisfy a duty of loyalty to their clients and customers. One requirement of the duty of loyalty would be for broker-dealers and investment advisers to avoid conflicts of interest. The Proposal relies on a 2008 RAND Report to support its conclusion that the new disclosures required under Regulation Best Interest and Form CRS will not be effective in mitigating conflicts of interests for broker-dealers and investment advisers.[28] However, the SEC has provided a 2018 RAND Report, which suggests that Form CRS will be effective in mitigating conflicts of interest.[29] For example, the 2018 Report notes that "nearly 90 percent of survey respondents opined that [Form CRS] would help them make more informed decisions about investment accounts and services."[30]

Additionally, the SEC notes that the Dodd-Frank Act and 913 Study did not intend to require a broker-dealer to provide conflict-free recommendations.[31] Instead, Congress suggested that the SEC consider "prohibiting or restricting *certain* sales practices, conflicts of interest and compensation schemes . . ."[32] A standard of conduct that requires avoidance of all conflicts of interest does not align with the SEC's mandate pursuant to Dodd-Frank, nor does it necessarily result in a broker-dealer acting in the best interest of its customer. To promote consistency with current federal securities laws and Regulation Best Interest, we suggest striking this provision from the Proposal to instead require the disclosure of *material* conflicts of interest.[33] This amendment would also align the Proposal with the antifraud provisions under the Securities Exchange Act of 1934 (the "Exchange Act").[34] Lastly, FSI urges the Division to add a provision that explicitly states

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[28] Angela A. Hung et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers (2008).
[29] Angela A. Hung et al., Investor Testing of Form CRS Relationship Summary (2018).
[30] Angela A. Hung et al., Investor Testing of Form CRS Relationship Summary at p.50 (2018).
[31] *See* Section 913(g) of the Dodd-Frank Act (permitting the SEC to adopt a fiduciary duty for broker-dealers that requires "disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest.").
[32] Section 913(g) of the Dodd-Frank Act (emphasis added).
[33] *See Basic v. Levinson*, 485 U.S. 224, 230-32 (Mar. 7, 1988) (adopting a standard of materiality in the context of Exchange Act Rule 10b-5 that an omitted fact is material if there is a substantial likelihood that a reasonable investor would consider it significant).
[34] *See* Exchange Act Rule 10b-5 ("It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange . . . (b) To make any untrue statement of a *material* fact or to omit to state a *material* fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . .") (emphasis added).

that a broker-dealer's (or agent's) duty of loyalty is satisfied by disclosing "all material conflicts of interest that are associated with a recommendation."

B. "Without Regard To"

Under the Proposal, a broker-dealer's or investment adviser's duty of loyalty is satisfied when recommendations are made or investment advice is provided *without regard to* the financial or any other interest of the broker-dealer agent, investment adviser, or any other third-party.[35] This language originated with the Dodd-Frank Wall Street Reform and Consumer Protection Act[36] (the "Dodd-Frank Act") and the subsequent SEC study pursuant to section 913 of the Dodd-Frank Act.[37] However, the SEC provides sound reasoning for adopting alternative language in Regulation Best Interest.[38] Specifically, Regulation Best Interest requires a broker-dealer to "act in the best interest of the retail customer at the time the recommendation is made, *without placing* the financial or other interest of the [broker-dealer] . . . ahead of the interest of the retail customer."[39] The SEC acknowledges its change in course from the Dodd-Frank Act and the 913 Study, by noting that the best interest standard of conduct is intended to align with an investment adviser's fiduciary duty.[40] As noted above, the Dodd-Frank Act and 913 Study did not intend to require a broker-dealer to provide conflict-free recommendations.[41] The SEC substituted "without regard to" for fear that it 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 [the SEC believes] could ultimately harm retail investors by reducing their access to differing types of investment services and products and by increasing their costs."[42] For consistency and clarity, and to avoid potential harm to retail investors in the Commonwealth, we encourage the Division to adopt standard of care language that is similar to Regulation Best Interest.

C. Principal Transactions, Proprietary Products and Limited Product Offerings

The Proposal does not explicitly address whether it would prohibit a broker-dealer from recommending principal transactions, affiliated and proprietary products, or limited product offerings. However, the Division acknowledges the prohibition under Regulation Best Interest on sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.

Principal transactions represent a clear benefit to retail investors, as they provide retail investors with the ability to purchase municipal bonds in brokerage accounts and sell back to the

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[35] Proposed Rule 12.207(c)(2).
[36] Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5301 (2010).
[37] Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("913 Study"), www.sec.gov/news/studies/2011/913studyfinal.pdf.
[38] Reg BI Release at pp. 62-63.
[39] Exchange Act Rule 15l-1(a)(1) (emphasis added).
[40] Reg BI Release at p. 63. ("By replacing the "without regard to" language of Section 913(g) and the 913 Study with the "without placing the financial or other interest of the [broker-dealer] . . . ahead of the interest of the retail customer" phrasing, we did not intend to create a "lower" or "weaker" standard compared to the language of Section 913(g) and the 913 Study. Rather, we are adopting a standard that reflects that a broker-dealer should not put its interests ahead of the retail customer's interest, and thereby aligns with (and in certain areas imposes more specific obligations than) the investment adviser fiduciary duty, at the time a broker-dealer makes a recommendation to a retail customer.").
[41] *See* Section 913(g) of the Dodd-Frank Act (permitting the SEC to adopt a fiduciary duty for broker-dealers that requires "disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest.").
[42] Reg BI Release at p. 64.

broker-dealer those brokerage products that are often considered to be illiquid (i.e., less frequently traded). FSI requests clarification on the extent to which the Proposal permits principal transactions, affiliated and proprietary products, and limited product offerings. Specifically, FSI requests clarification as to whether a broker-dealer's duty of loyalty would prohibit principal transactions, the sale of affiliated and proprietary products or limited product offerings.

The Reg BI Release acknowledges that the Dodd-Frank Act does not require a prohibition on broker-dealers engaging in principal trades.[43] In addition, the SEC notes that a broker-dealer would be required to "disclose all material facts relating to conflicts of interest associated with the recommendation that might incline a broker-dealer to make a recommendation that is not disinterested, including, for example, proprietary products, payments from third parties, and compensation arrangements."[44] We urge the Division to align the Proposal with Regulation Best Interest by explicitly permitting principal transactions, the sale of affiliated and proprietary products and limited product offerings, and requiring disclosures of any material conflicts of interest such transactions and products create.[45]

D. Sales Contests, Sales Quotas, Bonuses and Non-Cash Compensation

The Proposal creates a presumption of a breach of the duty of loyalty for offering or receiving direct or indirect compensation to or from the broker-dealer or investment adviser for recommending, among other things, "the purchase, sale, or exchange of any security that is not *the best of the reasonably available options* for the customer or client."[46] FSI agrees with the Division's position[47] and recommends that the Division align with Regulation Best Interest by explicitly prohibiting sales contests, sales quotas, bonuses and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.[48]

II. Preserving Investor Access and Choice

Under the Proposal, a broker-dealer who is a dual registrant would be subject to an ongoing fiduciary standard if, in its capacity as a broker-dealer, it provides "solely incidental" investment advice to a customer. Under the Proposal, it appears that solely incidental investment advice would impose an obligation on a broker-dealer who is a dual registrant to monitor its customer's portfolios, investment strategies, and investments on an ongoing basis. In other words, a dual registrant who provides solely incidental advice in its capacity as a broker-dealer would be required to provide ongoing advisory services to its brokerage customers pursuant to a brokerage account agreement that likely provides for transaction-based compensation.

Obligating broker-dealers who are dual registrants to an ongoing fiduciary standard for solely incidental investment advice provided to a brokerage customer, as contemplated by the Proposal, could result in many of the Commonwealth's investors with a small or moderate amount of investable assets to lose access to their chosen financial professional. When faced with the increased costs associated with monitoring customers' accounts on an ongoing basis, a broker-dealer would be forced to either move their brokerage customers to fee-based advisory accounts (but only if it is the "best of the reasonably available options") or cease providing brokerage

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[43] Reg BI Release at p. 64 n. 128.
[44] Reg BI Release at p. 729.
[45] We note that this disclosure-based approach also aligns with an investment adviser's fiduciary duty of loyalty, which requires the adviser to "eliminate or make full and fair disclosure of all conflicts of interest which might incline an investment adviser— consciously or unconsciously—to render advice which is not disinterested such that a client can provide informed consent to the conflict." Adviser Release, supra note 2.
[46] Proposed Rule 12.207(c)(2)(i).
[47] *But see* infra Section V.B.
[48] See Exchange Act Rule 15l-1(a)(2)(iii)(D).

services to those customers' accounts altogether. Many negative unintended consequences will result if the Commonwealth investors lose access to financial professionals as a result of the Proposal. Financial advisors are instrumental in assisting retail investors with saving more for retirement and preparing retail investors for unexpected life events that would otherwise be financially devastating.[49] In addition, financial advisors guard retail investors against emotional financial decisions, such as reacting to volatility in the stock market, by keeping retail investors focused on their individual financial goals. Moreover, financial advisors are often the first line of defense against financial exploitation and this first line of defense will be lost for those the Commonwealth residents.

As noted above, FSI respectfully requests that the Division adhere to SEC and FINRA rules regarding the point in time duration of a broker-dealer's obligation to its customer and include an explicit exemption from the fiduciary duty for solely incidental investment advice for which special compensation is not received. As noted above, we recommend that the Division include an explicit exemption from the fiduciary duty for unsolicited transactions and self-directed accounts.

III. Interstate Application of Various Standards of Care

FSI urges the Division to also consider the Proposal's impact to retail investors with respect to interstate issues. For example, the Proposal does not address how a broker-dealer's fiduciary duty would apply to retail customer relationships when the customer is located or employed in, or moves to, other states where different (and potentially inconsistent) standards of care and related rules govern relationships between broker-dealers and their retail customers.

IV. Adapting and Defining Key Terms

FSI believes that the Proposal would benefit from the addition of definitions for certain key terms that are a central part of its proposed fiduciary duty standard.

A. "Recommendation;" "Investment Advice;" "Investment Strategy"

The Proposal uses the term "recommendation" or some variation thereof throughout.[50] Additionally, the terms "investment advice" and "investment strategy" are used throughout the Proposal.[51] To the extent possible, and for purposes of efficiency and transparency, FSI urges the Division to consider revising the Proposal to introduce key terms that are used by the SEC and FINRA, and drafting definitions for such key terms to align with SEC and FINRA rules and guidance.[52] For example, the Reg BI Release notes that "[f]actors considered in determining whether a recommendation has taken place include whether the communication 'reasonably could be viewed as a "call to action"' and 'reasonably would influence an investor to trade a particular security or group of securities'".[53] FSI also believes that the term "investment strategy" should clearly align with Regulation Best Interest's use of the term "investment strategy involving securities." The SEC notes that an "investment strategy involving securities" includes recommendations by broker-dealers of securities account types generally and recommendations to roll over or transfer assets from one type of account to another (e.g., 401(k) retirement plan to

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[49] Jamie Hopkins, *Not Enough People Have Financial Advisers and New Research Shows They Should*, Forbes (Aug. 28, 2014), https://www.forbes.com/sites/jamiehopkins/2014/08/28/not-enough-people-have-financial-advisers-and-new-research-shows-they-should/#749da13552e5.

[50] *See, e.g.*, Proposed Rule 12.204(a)(4); 12.205(c)(1); 12.207(b)(1) (emphasis added).

[51] *See, e.g.*, Proposed Rule 12.207(c)(1); 12.207(c)(2)(i) (emphasis added).

[52] *See, e.g.*, Financial Industry Regulatory Authority, Inc., FINRA Rule 2111 (Suitability) FAQ, (noting that "[a]lthough FINRA does not define the term "recommendation," it has offered several guiding principles that firms and brokers should consider when determining whether particular communications could be viewed as recommendations."), https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq#_edn1.

[53] Reg BI Release at pp. 79-80 (citing FINRA rules and guidance).

IRA).[54] Moreover, the SEC provides that the term "any securities transaction or investment strategy involving securities" includes explicit hold recommendations and implicit hold recommendations that are the result of agreed-upon account monitoring between the broker-dealer and retail customer.[55] While terms under Regulation Best Interest differ in some instances from current FINRA guidance, we encourage the Division to defer to Regulation Best Interest when defining or providing guidance on key terms, given that there may be forthcoming changes to FINRA rules and guidance.

B. "Best of the reasonably available options"

The Proposal creates a presumption of a breach of the duty of loyalty for offering or receiving direct or indirect compensation to or from the broker-dealer or investment adviser for recommending, among other things, "the purchase, sale, or exchange of any security that is not *the best of the reasonably available options*."[56] However, the Proposal permits a broker-dealer or agent to receive transaction-based remuneration so long as: (i) the remuneration is reasonable; (ii) the remuneration is the "*best of the reasonably available remuneration options*"; and (iii) the broker-dealer's duty of care is satisfied.[57]

FSI believes that any presumption of a breach of the duty of loyalty or any requirement for overcoming a presumption of a breach of the duty of loyalty should set forth clear and obvious standards for compliance. The "best of" standards set forth in the proposal do not set forth clear and obvious standards for broker-dealers and investment advisers to comply. FSI believes that the Proposal would benefit from clarification on how the Division would expect broker-dealers and investment advisers to determine and document for compliance, prior to making a recommendation to a retail customer to purchase, sell, or exchange a specific security, that the specific security is "the best of the reasonably available options." For example, does a "reasonably available option" include a product offered by a broker-dealer's clearing firm even if the broker-dealer does not offer the product through its agents? Does a "reasonably available option" include any product that is readily available on the market, but that a broker-dealer has not performed diligence on or signed a selling agreement to sell?

Similarly, FSI believes that the Proposal would also benefit from clarification on how the Division would expect broker-dealers to determine and document for compliance that transaction-based remuneration is the best of the reasonably available remuneration options for the customer. FSI does not believe that these provisions are intended to require a broker-dealer to determine whether a brokerage account that charges transaction-based remuneration is appropriate for a retail customer prior to every single transaction that is effected for the retail customer. To the extent that the Division does not agree that the "best of" standards should be eliminated altogether, FSI requests clarification on these provisions, including examples of the analysis that the Division would expect.

V. Preemption under the National Securities Markets Improvement Act

FSI believes that the Proposal has both preemption issues and legal deficiencies. Under the National Securities Markets Improvements Act ("NSMIA"), states are prohibited from requiring broker-dealers to among other things, make and keep records that differ from, or are in addition

[54] Reg BI Release at pp. 93-94.
[55] Reg BI Release at p. 94.
[56] Proposed Rule 12.207(c)(2)(i).
[57] Proposed 12.207(c)(3).

to, the records required under the federal rules.[58] In addition, states are preempted from imposing specific registration, licensing, and qualification requirements on SEC-registered investment advisers, with the exception of those provisions relating to enforcement of anti-fraud prohibitions.[59] .

As a practical matter, the Proposal would have the effect of imposing new recordkeeping requirements on broker-dealers, as they seek to develop, implement and document policies and procedures to demonstrate compliance with the Proposal's requirements. For example, broker-dealers who receive commissions for effecting securities transactions that result from their solely incidental investment advice would be required to overcome a presumption of a breach of the duty of loyalty. Specifically, broker-dealers and agents would be required to keep records that document and demonstrate why their recommendations are the "best of the reasonably available options." We believe the Proposal exceeds the Division's legal authority under NSMIA.

VI. The Economic Impact of a Fiduciary Standard in the Commonwealth

FSI members make significant contributions to local economies. FSI members generate $1.6 billion of economic activity in the Commonwealth.[60] This activity, in turn, supports 17,000 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy.[61] Furthermore, FSI members contribute nearly $72 million annually to Commonwealth and local government taxes.[62]

If FSI members are held to a unique standard of care in the Commonwealth, particularly if the requested clarification and exemptions are not provided, these financial advisors may have to cease doing business with or cut back on financial services provided to retail investors in the Commonwealth. This would undoubtedly have a negative impact on the Commonwealth's investors, specifically those low- to middle-income retail investors who are residents of the Commonwealth.

VII. Extension of the Effective Date

The Proposal affects many of the interactions broker-dealers and investment advisers have with retail investors. One particular challenge FSI members have identified is the substantial amount of time that is dedicated to properly educating and training representatives. This process of educating and training representatives on any new standard of care, procedures, and disclosures cannot commence until firms have made decisions about any changes that must be made to the products and services offered. This is especially critical if the procedures differ from Regulation Best Interest, current FINRA rules and other state standards of care. Specifically, FSI members will be challenged to implement the policies, procedures, forms and training required by Regulation Best Interest by June 2020. After that time, FSI members will be able to address the Division's final rule and any potentially inconsistent requirements among the Division's final rule,

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[58] 15 U.S.C. § 78o(i)(1) ("No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers that differ from, or are in addition to, the requirements in those areas established under this chapter.").
[59] 15 U.S.C. § 80b-3a(b)(1).
[60] Oxford Economics, The Economic Impact of FSI's Members at p. 30 (July 2016), https://financialservices.org/wp-content/uploads/2017/03/FSI-Impact-Report-Final.pdf.
[61] Oxford Economics, The Economic Impact of FSI's Members at p. 30 (July 2016), https://financialservices.org/wp-content/uploads/2017/03/FSI-Impact-Report-Final.pdf.
[62] Oxford Economics, The Economic Impact of FSI's Members at p. 30 (July 2016), https://financialservices.org/wp-content/uploads/2017/03/FSI-Impact-Report-Final.pdf.

new FINRA rules[63] and Regulation Best Interest. Moreover, these decisions cannot be made until firms' legal, compliance, and business units review and evaluate the final rule's impact on firms' business models. Therefore, we urge the Division to provide an 18-month implementation period between the Proposal's final adoption and its eventual effective date.

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In conclusion, FSI believes that the SEC's Regulation Best Interest strikes the right balance between the Division's stated goal of protecting investors against the abuses of conflicted recommendations and retail investors' interests in preserving access to investment advice and products. The Division's adoption of an additional and different standard of care with requirements that vary from federal and state laws and regulations only results in increased costs to and decreased access for the Commonwealth's retail investors. Thank you in advance for considering this request. If you have questions about anything in this letter, or if we can be of any further assistance in connection with this rulemaking, please feel free to contact me at robin.traxler@financialservices.org or (202) 393-0022.

Respectfully submitted,

Robin M. Traxler, Esq.
Senior Vice President, Policy & Deputy General Counsel

[63] See, e.g., Reg BI Release at p. 163 (noting that the SEC "anticipate[s] that FINRA will be reviewing the application of [its communication] rules in light of [Regulation Best Interest] disclosure obligations.").