INSTITUTE FOR
THE FIDUCIARY STANDARD

July 25, 2019

Office of the Secretary of the Commonwealth
Attn Proposed Regulations – Fee Table
Massachusetts Securities Division
One Ashburton Place, Room 1701
Boston, MA 02108

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

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

Dear Secretary Galvin:

I write on behalf of the Institute for the Fiduciary Standard to express strong support for your proposal, "Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives Preliminary Solicitation of Public Comments: Fiduciary Conduct."

Your 'Standard for … Fiduciary Conduct' reflects the common law duties of loyalty and care. The most important provision in your standard restores the importance of avoiding or eliminating conflicts as opposed to disclosing conflicts. The explicit provision stating that conflict disclosure alone is presumed insufficient to meet the duty of loyalty is important. Avoiding conflicts is as important in 2019 to investors and the markets as it was to the framers of the Investment Advisers Act of 1940.

In your June 14 request for preliminary comment, some short falls of the SEC's Reg BI are noted. "The SEC's Regulation Best Interest fails to define the key term "best interest," and sets ambiguous requirements for how longstanding conflicts in the securities industry must be addressed under the new rule. Further, "the SEC rule also fails to indicate whether some of the most problematic practices in the securities industry would be prohibited under the new rule."

You also note, importantly, how, "In many instances, it appears that the mitigation of conflicts required under the SEC Regulation Best Interest can be accomplished through disclosure, including disclosure via the new Customer Relationship Summary (Form CRS) (even though) this approach contradicts years of data gathered by studies and reports on disclosure and the conduct standards applicable to broker-dealers."

Reg BI falls way short of requiring the necessary provisions to protect investors

To underscore the importance of these points, I add the following:

Reg BI is widely opposed outside Wall Street and Washington. This is no surprise. Investor and fiduciary advocates, advisor groups, independent experts, state securities administrators and investors themselves have expressed major concerns. A review of letters for the Reg BI proposal raises a basic

question: Are there any independent and credible experts who support the rule and also address critics' concerns about the rule? There is not one that we can find.

There is a divide between Reg BI adherents and fiduciary advocates and investors that is real and deep. It puts the sides on different planets, relying on different data and analysis, speaking different languages. It makes meaningful discussion all but impossible. This lack of meaningful discussion endangers the body politic of the country.

Reg BI falls way short of requiring the necessary provisions to protect investors

With sadness I note that the dialogue between rulemaking adherents and fiduciary advocates and investors got even worse July 8, when the chairman of the SEC spoke in Boston. In defending his rulemaking he criticizes his critics. He seems to sound dismissive. He calls much criticism of the rulemaking, "false, misleading, misguided." This language is not good for the rulemaking process. Neither is it good for the country.

Alternatively, imagine if the chairman had invited critics, along with neutral scholars, to a meeting in his office? There are significant issues that could actually have been discussed. Here are four.

One, Reg BI clearly appears to impose a suitability-like standard.

First, Reg BI language on 'best interest' is from FINRA's suitability rule. Cases cited by the SEC state, "A brokers recommendation must be consistent with a customers' best interest." The point is FINRA already says broker recommendations must meet a best interest standard. If so, changes brokers must make to meet a best interest standard are?

If a BD recommendation is in a customer's best interest under FINRA current rules, when BDs define *disclosure, care* and *compliance policies*, why is the same transaction under Reg BI NOT also in the best interest?

<u>The bottom line</u>. The foundation of Reg BI is BDs' current FINRA obligations.

Two, Reg BI does not define best interest. So BD's will.

The cornerstone of Reg BI is firm compliance. BDs are granted great flexibility to write, interpret and enforce their policies and procedures. Including if mitigation of a conflict is called for. This will be decided by BD compliance staff, whether a recommendation creates an incentive that places the interest of the broker or firm ahead of the customer. (Regulation Best Interest, 2iii(B)).

It raises the question of who is the regulated and who is the regulator. The Reg BI release explains, "We proposed a principles-based approach to provide flexibility to firms to develop and; tailor policies and procedures that include conflict mitigation measures based on each firms circumstances." (Release, page 322)

"Flexibility" means BDs get lots of discretion. Reg BI claims this beats "mandating specific mitigation measures" (331) because, "broker-dealers are most capable of identifying and addressing the conflicts that may affect the obligations of their associated persons with respect to the recommendations they make." (326) It appears that BDs are the deciders and the SEC has just sent BDs a vote of confidence that the SEC believes they will decide well – as the SEC might.

The SEC explains, "This approach appropriately balances our goal of reducing the potential harm that conflicts of interest have on broker dealers' recommendations to retail customers (through mitigation) and preserving retail access (in terms of choice and access) to brokerage products and services." (328) This candid admission appears to justify an explicit and conscious tradeoff between greater mitigation and greater investor harms. It appears to approve such greater investor harms for the sole purpose to preserve the BDs' business model.

The bottom line. Reg BI does not "define" 'best interest', so BD's will effectively define it. They will write, interpret and then enforce their own policies and procedures. They will do so believing, and understandably so, they already serve customers best interest. They will do so confidently because, as Reg BI asserts, "they are most capable" to do so. The clear message: BDs will enforce their policies and procedures just as the SEC might.

Three, rule-making ambiguity is seen in confusing or misleading messages. The SEC June 5 Fact Statement states Reg BI "Cannot be satisfied through disclosure alone." Misleading messages about conflict disclosure and mitigation abound. Ambiguity muddles language and causes confusion –even among professionals.

John Taft is vice chairman of Baird and former chair of the Securities Industry and Financial Markets Association (Sifma). He is one of the most experienced BD lobbyists in Washington. He recently wrote that conflict mitigation is required by the rule. This is not true, but an initial reading of the SEC's own fact sheet was confusing. Mr. Taft appears to have misinterpreted it.

Ken Bentsen is CEO of Sifma. In a June 13 op-ed, Bentsen writes, "Disclosure of a financial conflict alone also is not considered adequate, effectively holding BDs to a higher standard than the one applicable to RIAs today." This assertion is also not true. It's grossly misleading. But it is a main argument of Reg BI adherents.

The bottom line. Ambiguous and confusing language is misleading and it appears to be the norm.

Four, the SEC criticizes commenters who disagree with the rulemaking.

As noted above, in Boston SEC Chairman Jay Clayton defended his June 5th broker and adviser rulemaking. Instead of explaining to investors in plain language the actual meaning of the rulemaking and how it meets "reasonable investor expectations", and why he believes critics are wrong, the chairman uses much of the speech to criticize rulemaking critics.

According to the speech, much criticism is "false, misleading, misguided." So bad, in fact, that this criticism provides even more proof that … the rulemaking is right:

"Some of this commentary has, in my view, shown a lack of understanding of the law and legal obligations of financial professionals, both before and after adoption of our rulemaking package. This has only further solidified my view that our actions were timely and appropriate, and will ultimately benefit retail investors and our markets."

The speech seems to dismiss critics of the rulemaking. Commenters, perhaps, like AARP, Consumer Federation of America, the Investment Advisers Association, CFA Institute, NASAA and the Institute for the Fiduciary Standard that have expressed serious concerns with the proposal and, or final rule. The question of course is do each of these organizations show a "lack of understanding" of the law?

Conclusion

The Reg BI release shows how Reg BI is a suitability-like rule and why it seems it will be enforced as one. Yet, it's branded a "higher standard" than RIA's fiduciary standard. This dis-function between what Reg BI is and what Reg BI advocates say it is has created a divide that separates Reg BI adherents and fiduciary advocates into opposing camps that seem to not hear, acknowledge, and comprehend almost any substantive points alike. Basic words or terms such as "fee disclosure," and "mitigation" have different meanings. Make no mistake. This divide mirrors our national politics. It ought to worry everyone.

Industry and regulatory leadership that is based on a real fiduciary standard, as opposed to a vague and undefined standard that will be defined by BDs, is essential to mending divisions and restoring trust and confidence in the markets and the finance industry. The Massachusetts 'Standard for … Fiduciary Conduct' is an important step to do so.

Sincerely,

Knut A. Rostad
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President