

July 26, 2019

Via email to: securitiesregs-comments@sec.state.ma.us

Secretary William F. Galvin
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:

LPL Financial LLC (“LPL”) appreciates the opportunity to comment through the Massachusetts Securities Division’s (“Division’s”) preliminary solicitation of public comments (the “Solicitation”) on a proposed fiduciary conduct standard regulation for broker-dealers, agents, investment advisers, and investment adviser representatives (the “Regulation”).

We hope that the Division finds our comments constructive, and we look forward to continuing to work with you towards the shared goals of ensuring that Massachusetts retail investors are not only adequately protected, but also continue to have choices as to how they meet their financial needs, including access to transaction-based brokerage products and services. We are concerned that the Regulation could inadvertently and unnecessarily harm Massachusetts retail investors by limiting choice and unintentionally resulting in a reduction of financial services and product options available in The Commonwealth.

Moreover, given the breadth of the recent Securities and Exchange Commission (“SEC”) enhancements to the federal standards and disclosure requirements,¹ and that the industry is only in the early stages of reviewing and understanding their consequences, as well as implementing changes to comply with those requirements, we are concerned that it may not be possible to fully assess whether these significant changes fall short in protecting Massachusetts investors. Therefore, we respectfully request that the Division pause before adding to the overall regulatory framework under which financial institutions

¹ See Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (Jul. 12 2019) (to be codified at 17 CFR pt. 240), available <https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf> (hereinafter, “Regulation Best Interest Adopting Release”); Form Customer Relationship Summary (“CRS”); Amendments to Form ADV, 84 Fed. Reg. 33,492 (Jul. 12, 2019) (to be codified at 17 CFR pt. 200, 240, 249, 275, and 279), available at <https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12376.pdf> (hereinafter, “Form CRS Adopting Release”); Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669 (Jul. 12, 2019) (to be codified at 17 CFR pt. 276), available at <https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12208.pdf> (hereinafter, “IA Standard Interpretation”); Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer, 84 Fed. Reg. 33,681 (Jul. 12, 2019) (to be codified at 17 CFR pt. 276), available at <https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12209.pdf> (hereinafter, “Solely Incidental Interpretation”).

operate, at least until after the effective date of the SEC rules when the Division can better assess the changes resulting from these new rules and how they are implemented.

We believe that the SEC should have the chance to demonstrate its effectiveness in enforcing its rules before concluding that additional state-level regulations are necessary. In the meantime, of course, even without immediately moving forward with any new state-level regulations, Massachusetts would continue to protect its investors by enforcing Massachusetts's current securities laws—including fraud—in cases of unlawful activities by firms and their investment professionals.

I. Overview of LPL

LPL is a diversified financial services company and is dually registered with the SEC as a broker-dealer and investment adviser. We provide proprietary technology, comprehensive clearing and compliance services, practice management programs and training, and independent research to more than 16,000 independent financial professionals and over 800 banks and credit unions. LPL has been the nation's largest independent broker-dealer since 1996. Additionally, LPL supports approximately 3,500 financial professionals licensed with insurance companies and a network of over 400 independent investment advisers throughout the country by providing them with access to a range of products, platforms, and services.

Unlike typical financial professionals who are employees of large multinational financial institutions, LPL representatives are supported by LPL's platform and services, but operate as independent contractors and own their own businesses. As small business owners and entrepreneurs, our financial professionals seek to build personal and long-term relationships with their clients and the communities in which they work by educating and guiding their clients through the complexities of the investment decisions they must make to move towards their financial goals.

In Massachusetts, LPL has been registered as a broker-dealer since 1981 and has notice-filed as a federal covered adviser since 1994. Approximately 628 independent financial professionals and 38 banks and credit unions are associated with LPL in Massachusetts.

II. Impact of the Regulation on Financial Services in Massachusetts

LPL has consistently voiced its support for a regulatory regime that protects retail investors by ensuring that they receive investment advice and recommendations that are in their best interests,² but we are concerned that, as proposed, the Regulation will harm investors by significantly reducing access to, and choice of, investment products and services. With the goal of protecting investors while preserving

² See, e.g., Letter from Michelle B. Oroschakoff, Chief Legal Officer, LPL Financial LLC, to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 7, 2018) (commenting on proposed "Regulation Best Interest," proposed "Form CRS Relationship Summary," and "Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers"); Letter from Michelle B. Oroschakoff, Chief Legal Officer, LPL Financial LLC, to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (Dec. 18, 2018) (providing proposed clarifying language for the SEC to consider in its "best interest" rulemaking releases that would be issued in connection with the adoption of proposed Regulation Best Interest and the titling restrictions under proposed Rule 15l-2 under the Exchange Act). See also Exchange Act Release No. 83062 (Apr. 18, 2018), 83 Fed. Reg. 21,574 (May 9, 2018) ("Regulation Best Interest Proposing Release"); Exchange Act Release No. 83063 (Apr. 18, 2018), 83 Fed. Reg. 21,416 (May 9, 2018) ("Form CRS Proposing Release"); Advisers Act Release No. 4889 (Apr. 18, 2018), 83 Fed. Reg. 21,203 (May 9, 2018) ("Proposed IA Standard Interpretation").

choice, LPL has long supported a best interest standard of conduct for broker-dealers and investment advisers when its financial professionals provide personalized investment advice about securities to retail investors.³ We offer a unique perspective on the Regulation as a dually registered broker-dealer and investment adviser, headquartered in The Commonwealth, supporting independent financial professionals.

Our comments below are informed by over two years of practical experience preparing to implement the Department of Labor (“DOL”) Fiduciary Rule, and the changes we saw it bring to the distribution of financial services and products, including industry-wide reductions in the availability of brokerage services and the migration of assets from brokerage services and products to level-fee bundled advisory programs. Based on this experience, we are concerned that the Regulation could similarly result in a significant curtailment of access to brokerage services in Massachusetts, leading to further consolidations in the financial services industry. In particular, the Regulation would newly require broker-dealers to provide ongoing advice and monitoring services (similar to services offered through advisory programs for a fee), and includes standards that are impracticable to implement, including the “best of” and “without regard to” standards.

Brokerage services are appropriate for many retail investors because such services provide access to episodic investment assistance from a financial professional on a cost-effective basis. However, in light of the challenges associated with implementing the Regulation in brokerage arrangements and consistent with our experiences, and the experiences of others in the industry, with the DOL Fiduciary Rule, we believe that many dual-registrants may take the simplified approach and favor an advisory-only service model. This is because advisory services are, with a few exceptions, already structured to satisfy a fiduciary standard.

Loss of access to brokerage services would harm Massachusetts investors who:

- May not have sufficient assets to enroll in an advisory program;
- Prefer, and benefit financially from, a long-term buy-and-hold investing approach (particularly, in regard to mutual funds investors);
- Prefer to pay commissions on a transaction by transaction basis instead of an ongoing asset-based fee; and
- Benefit from maintaining both advisory and brokerage services.⁴

³ See, e.g., Letter from Stephanie L. Brown, Managing Director, General Counsel, LPL Financial LLC, to Elizabeth M. Murphy, Sec’y, U.S. Sec. & Exch. Comm’n (Aug. 30, 2010) (addressing comments on File No. 4-606: Study Regarding Obligations of Brokers, Dealers, and Investment Advisers) (stating, “Securities professionals providing the same service to retail customers should be held to the same standard of care and the same best practices. ... The focus ... should be consumer protection and enhanced transparency to the retail client.”); Letter from David P. Bergers, General Counsel, LPL Financial LLC, to U.S. Dep’t of Labor (Mar. 17, 2015) (addressing Proposed Extension of Fiduciary Rule Applicability Date); Letter from David P. Bergers, General Counsel, LPL Financial LLC, to U.S. Dep’t of Labor (Jul. 21, 2015) (addressing Proposed Definition of the Term “Fiduciary” and Related Proposed Prohibited Transaction Exemptions); see also n. 2 *supra*.

⁴ See K. Damato, “3 Reasons to Pay Commissions, Not Fees, to a Financial Adviser,” THE WALL STREET JOURNAL (Feb. 18, 2015), available at <http://blogs.wsj.com/totalreturn/2015/02/18/3-reasons-to-pay-commissions-not-fees-to-a-financial-adviser/>.

Because small savers and investors in Massachusetts may not have sufficient assets available to qualify or justify the use of an advisory program (which are generally subject to account minimums), they could be disproportionately harmed.

III. Comments on the Regulation

Recognizing that the Regulation is in the preliminary proposal phase, our comments are focused on key issues that could cause a reduction in access to brokerage services in Massachusetts.

- ***An Ongoing Obligation for Broker-Dealers Raises Significant Operational and Regulatory Issues.*** The Regulation would limit a broker-dealer's and its agent's fiduciary duty "through the execution of the recommendation," and this duty would "not be deemed an ongoing obligation unless the 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," in which case the duty is ongoing. An ongoing fiduciary duty could be broadly interpreted to require broker-dealers to monitor customer accounts on an ongoing basis and to impose an affirmative obligation to provide recommendations—services traditionally offered through investment advisory programs.

As such, imposing an ongoing fiduciary duty on dual registrants' brokerage services would require a complete overhaul of the transaction-based, episodic brokerage model, including compliance systems and processes, client agreements and disclosures, technology, and compensation structures. In short, this could require a dual registrant to effectively recreate the advisory model services on the brokerage platform. Many firms may not want, have the means to pay for, or have the organizational support to make the necessary changes to their brokerage platform to comply with this requirement, when it is simpler to offer only advisory programs and services where appropriate to do so.

We are also concerned that imposing an ongoing duty could directly conflict with federal law. Specifically, the Advisers Act does not require broker-dealers to register as investment advisers when they provide advisory services that are "solely incidental" to the conduct of the broker-dealer's business and when such services are provided for no "special compensation". The SEC recently clarified that a broker-dealer who provides "continuous monitoring" would be viewed as providing an advisory service that is not "solely incidental" to its brokerage business.⁵ It seems that many broker-dealers, as a result of the Regulation's obligations to comply with an ongoing duty, could be viewed as monitoring customer accounts "continuously"—triggering a loss of the "solely incidental" exception from the requirement to register as an investment adviser under federal law. As such, broker-dealers who are subject an ongoing fiduciary duty in Massachusetts would be required to register as investment advisers under federal law and could no longer act as broker-dealers with respect to services offered in Massachusetts—effectively bringing an end to the full-service brokerage model in Massachusetts.

Congress recognized the benefits of commission-based fees by showing its intent to preserve such arrangements under section 913 of the Dodd-Frank Act.

⁵ Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser, 84 Fed. Reg. 33681, 33687 (July 12, 2019).

Additionally, requiring firms to comply with the obligations of a fiduciary through the execution of a recommended transaction, which is completely in the investor's control, would require significant changes to the compliance systems, technology, and supervisory processes that support brokerage platforms. Moreover, we are concerned that this ongoing fiduciary obligation could conflict with the generally non-discretionary nature of brokerage services, potentially requiring firms to reject or cancel customer-directed trades in securities the firm previously recommended if the firm later determines that the trade is no longer in the customer's best interest at the time of the client's execution. This is a recipe for conflict between the firm and its non-discretionary client, as it could force the firm to both re-evaluate the previous recommendation (including getting updated client information) and potentially disregard the client's direction, which may also have the unintended consequence of forcing firms potentially to violate their "best execution" duties under federal law and regulation.

- ***The "Best Of," "Without Regard To," and "Avoid Conflicts" Standards Are Impracticable to Implement.*** The Regulation would impose a duty of loyalty that requires broker-dealers, agents, and advisers to act "without regard" to their financial or any other interest other than their clients' interests and to "avoid" conflicts of interest. Additionally, there is no presumption that disclosure satisfies the duty of loyalty, and the Regulation would presume a breach of fiduciary duty if a broker-dealer, agent, or adviser who offers or receives compensation in connection with recommending a specific account type or transaction in a specific security that "is not the *best of* the reasonably available options" (emphasis added).

While we understand that the Regulation is designed to address financial conflicts of interest, these standards leave firms open to after-the-fact second-guessing as to whether the duty of loyalty was satisfied in any particular instance and could even be broadly read to require broker-dealers and advisers to eliminate *all* conflicts of interest (i.e., all compensation) associated with their services.

Of particular concern here is how a firm can determine and substantiate that a recommendation was made "without regard to" interests other than the client's, and on what criteria (and at what point in time) a recommendation can be determined to be the "best of the reasonably available options." This is because the "without regard to" standard is susceptible to different interpretations and after-the-fact evaluation. For example, could an agent recommend a more expensive or more remunerative security if the agent has a reasonable basis to believe there are other factors about the security that make it in the best interest of the customer, based on that customer's investment profile?

The issue here is that broker-dealers and investment advisers often offer access to thousands of equity and debt securities, mutual funds, and other investment funds and products, all with different financial attributes, costs and uses in a comprehensive asset allocation or portfolio. Without being able to predict accurately future performance, it is impossible to operationalize a way for a firm to determine which option (or mix of options) will be the "best" at the time it is recommended to the investor. The concept of "best of" implies a singular solution, without appropriately recognizing and balancing the subjectivity inherent in the investment process and, more importantly, investor preferences.

Absent a dramatic reduction of product and service offerings, these standards are practically unworkable as they appear to expose firms to unmanageable regulatory risks and second-guessing. We believe that many firms will ultimately decide to again, as with their approaches under the DOL Fiduciary Rule, migrate away from the brokerage model to better avoid this subjective standard, which we believe will be an unintended and unfortunate consequence of the Regulation.

We are also concerned that the “best of” standard conflicts with FINRA rules prohibiting guarantees or implications that past performance will recur. Specifically, we are concerned that applying the “best of” standard will result in a hindsight review of actual performance against the performance of a different investment option that was available at the time of the recommendation and performed better. Such a hindsight review could be viewed as providing an investor a performance guarantee, as investors would be looking to the firm to make up investment losses as compared to the other “better” investment. This could be seen as an apparent violation of FINRA’s rules. While we do not believe the Division intended this result, we request that the Division eliminate the “best of” standard to alleviate this discrepancy.

In the end, our concern is that the Regulation will inadvertently and unnecessarily harm Massachusetts investors. Based on the substantial challenges, costs, and risks of implementing business and compliance solutions to comply with the Regulation, if adopted without changes, we believe that many in the industry may not maintain the full suite of brokerage services they currently offer in Massachusetts and view the advisory business as the preferred advice model for Massachusetts investors. Also, as happened in the wake of the DOL Fiduciary Rule, greater consolidation in the financial services industry may result because small local firms may not find a financially sustainable path to absorb increased costs and risks associated with complying with the Regulation.

Thank you for considering our comments on the Regulation. We very much appreciate and support Massachusetts’s goal of protecting investors and look forward to continuing to work with you towards achieving that goal while preserving choice and access to investment and financial services Massachusetts.

Sincerely,

A handwritten signature in cursive script, appearing to read "Michelle Bryan Oroschakoff".

Michelle Bryan Oroschakoff
Chief Legal Officer