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Office of the Secretary of the Commonwealth  
Massachusetts Securities Division  
One Ashburton Place, Room 1701  
Boston, MA 02108

**Re: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment  
Advisers, and Investment Adviser Representatives**

Dear Secretary Galvin:

The Attorney General of the Commonwealth of Massachusetts appreciates the opportunity to comment on the Massachusetts Securities Division's (the "Division") proposed regulation that would enhance the fiduciary conduct standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives (the "Rule Proposal").

As you know, we were part of a coalition of 17 State Attorneys General that filed comments with the Securities and Exchange Commission ("Commission"), urging the Commission to strengthen Regulation Best Interest ("Reg. BI") to ensure that brokers place the interests of the client above their interests when recommending an investment product. Our coalition believed that broker-dealers should be subject to the same fiduciary standard as investment advisers when making recommendations to customers.

For years, broker-dealers have been offering investment advisory services without being held to the same fiduciary standard as investment advisers. Taking full advantage of the "Solely Incidental" exclusion under the Investment Advisers Act of 1940 (the "Advisers Act"),<sup>1</sup> many broker-dealers have steered their clients towards products and services with higher fees and commissions that were not in their clients' best interest. These conflicted financial professionals have been able, in some circumstances, to successfully argue that they had fulfilled their duty to their clients under the Exchange Act and FINRA rules by simply having a reasonable belief that a recommendation was suitable for a client based on information provided to them by that client.

After investigating and resolving numerous complaints relating to the activities of broker-dealers, we have learned that many consumers:

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<sup>1</sup> See Investment Advisers Act of 1940 § 202(a)(11)(C), 15 U.S.C. § 80b-3(a)(11)(C).



- were recommended unsuitable products;
- did not understand the features and risks associated with the product(s) they purchased;
- were not aware that in addition to transaction-based fees, third-party fees and other miscellaneous fees would be periodically deducted from their accounts;
- did not understand how their financial professional is being compensated and/or how long that compensation would last;
- believed the broker-dealer representative was their adviser, and expected the representative to act in their best interest;
- were not aware of material conflicts of interests that may have influenced the recommendation of a particular product by their broker-dealer or adviser;
- were not aware that the product(s) they had purchased were not FDIC insured; and
- did not know the difference between a broker-dealer and an investment adviser.

We also learned that in many instances the broker-dealer had failed to adequately supervise its financial advisors who made the unsuitable recommendations. In light of the above information, like the Secretary, we find that while the Commission's Reg. BI attempts to strengthen the standard of conduct for broker-dealers and reduce customer confusion, its failure to: (1) adopt a uniform standard for broker-dealers and investment advisers; (2) define "Best Interest"; (3) prohibit conflicted compensation incentives such as sales contests; and (4) adequately address conflicts, ensures that the current suitability standard remains unchanged.

Like the Secretary, we are particularly concerned that under Reg. BI, broker-dealers operating under conflicts and motivated by self-interest would try to avoid liability by simply disclosing the potential conflicts to investors who are unlikely to understand the impact of the conflicts at the point of sale. For these reasons, we support the Rule Proposal.

### **Comment on the Rule Proposal**

Below we provide comments on certain provisions of the Rule Proposal.

#### *1. Proposed Fiduciary Standard*

We agree with the Secretary that the Commission should have adopted a clear and uniform fiduciary standard for investment advisers and broker-dealers pursuant to Section 913(g) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. We believe that while it is important to maintain the broker-dealer model separate and distinct from the investment adviser model, to the extent that broker-dealers are performing the same services as investment advisers, they should be treated the same.

The Division's Rule Proposal ensures that all persons who provide financial advice for a fee are held to the same fiduciary standard regardless of their titles. Under the Advisers Act, an investment adviser owes a fiduciary duty to its clients. Broker-dealers are excluded from the definition of investment advisers if the advice they provide is "solely incidental" to their brokerage services. Accordingly, they do not owe their clients a fiduciary duty even when they provide basically the same advice as an investment adviser. Currently, many broker-dealers are also registered as investment advisers, further eroding the distinction between the investment advisory and brokerage services business models. In the absence of a strong uniform standard for both broker-dealers and investment advisers, dual registrants may avoid liability simply by switching titles. For this reason, we support the uniform standard put forth by the Division in the Rule Proposal.

## *2. The Applicability of the Rule Proposal*

The Division's Rule Proposal makes it dishonest and unethical to fail to act in accordance with a fiduciary duty when, among other things, providing investment advice or recommending an investment strategy. For purposes of the Rule Proposal, an "adviser" means "any person, including persons registered or excluded from registration under M.G.L. c. 110A, who receives any consideration from another person primarily for advising the other person as to the value of securities or their purchase and sale, whether through the issuance of analyses or reports or otherwise." The Proposal also states, "[i]t is a rebuttable presumption that such term includes all investment advisers and investment adviser representatives, as well as other persons who charge fees based on assets under management or portfolio performance for rendering investment advice."

We want to commend the Division for focusing on the conduct of making a recommendation and not the title of the "advising" individual. We agree that to the extent that a broker-dealer acts like an "adviser" within the meaning of the Advisers Act, the broker-dealer should be held to a strong fiduciary standard to ensure that it puts clients' interests above its own.

## *3. Fiduciary Duty and Standalone Recommendation*

Under the Division's Rule Proposal, the fiduciary duty would apply to a "standalone recommendation" and "extend through the execution of the recommendation and shall not be deemed an ongoing obligation." If the broker-dealer, agent or adviser (1) makes ongoing recommendations, (2) provides investment advice in any capacity to the customer/client, or (3) receives ongoing compensation in connection with the recommendation or advice, the fiduciary duty is deemed to be ongoing.

We agree with the Secretary's viewpoint that any new rule should accommodate episodic advice. However, for clarity purposes, we would like to suggest that the Division define "standalone recommendation," and provide guidance on what would constitute a "standalone recommendation" and "through the execution of the recommendation." We believe that without clarification, customers with non-discretionary accounts may not be adequately protected.

As you know, while in theory a non-discretionary account means the financial advisor recommends and the customer determines, in practice there is often little difference in the expectations of owners of discretionary accounts versus owners of non-discretionary accounts. Many customers with non-discretionary accounts rely heavily on the judgment of their advisers, and many have informally delegated discretionary trading authority to their brokers. Therefore, we recommend the Rule Proposal adopt a case-by-case approach in determining whether a broker-dealer or adviser would be subject to an ongoing fiduciary obligation in non-discretionary accounts, and not restrict the ongoing obligation to discretionary accounts.

4. *Avoidance and Elimination of Conflicts*

We support the Division's Rule Proposal that to satisfy the duty of loyalty, a broker-dealer must avoid conflicts of interest and make recommendations without regard to cash or non-cash incentives. We agree that there should be a presumption of a breach of the duty of loyalty for offering or receiving compensation for advice that is not "the best of the reasonably available options," and that disclosing a conflict should not automatically satisfy the duty of loyalty.

Taken together, the above language addresses material conflicts that arise from conflicted compensation incentives such as sales contests, prizes and other sales-based compensation schemes. The language closes a familiar loophole that allows broker-dealers and investment advisers to avoid liability by simply disclosing the conflict to the client.

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In conclusion, we appreciate the opportunity to comment on the Rule Proposal, and believe that this effort will help to address a number of the issues we have identified through our investigatory and enforcement work. Please contact us if you have any questions relating to our comments.

Sincerely,



Elizabeth Nsahlai  
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Insurance and Financial Services Division