



UBS Group AG

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

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: Comments on Proposed Fiduciary Conduct Standard

Dear Secretary Galvin:

Thank you for the opportunity to provide comments on the Massachusetts Securities Division's (the "Division") rule proposal on fiduciary conduct for broker-dealers, agents, investment advisers, and investment adviser representatives when dealing with their customers and clients (the "Proposal"). UBS AG supports the Division's efforts to protect Massachusetts's investing public through meaningful standards for broker-dealers and investment advisors, and believes that recommendations and advice should be made in the best interest of customers.

However, UBS AG strongly believes that the Proposal as drafted will significantly and negatively impact many Massachusetts residents. Specifically, we believe that rather than strengthen financial protections for Massachusetts residents, adopting a "best of" standard that is unworkable, requiring an ongoing fiduciary duty on broker-dealers for providing incidental advice, and imposing a fiduciary duty on solely incidental advice will result in harm to many Massachusetts investors.

We believe it to be critical that the Securities and Exchange Commission (the "SEC") in its June 5, 2019 release of its final version of Regulation Best Interest preserves investor choice to select a "pay as you go" brokerage model while enhancing protections for retail clients. Without such choice, we believe that Massachusetts investors may have (1) less information to make sound investment decisions, and (2) fewer investment options to meet their financial goals. In addition, low and middle-income investors may have less access to advice from market professionals.

UBS AG, therefore, respectfully requests that the Division consider revising the Proposal as the current draft will result for many in the opposite of safeguarding investments and instilling public confidence in the financial markets. The Division should eliminate or revise the imposition of a fiduciary duty on solely incidental advice, eliminate or rewrite the unworkable "best of" standard, and revise the language so that broker-dealers are not subject to an ongoing fiduciary duty on a brokerage account for providing incidental advice.

Background

UBS AG, a subsidiary of UBS Group AG, operates three main business lines in the United States—its wealth management business primarily operated through its dually registered broker-dealer and investment advisor UBS Financial Services Inc., its investment banking business primarily operated through UBS Securities LLC, and its global asset management business primarily operated through UBS Asset Management (Americas) Inc. ("UBS" is used throughout in reference to the UBS business in the United States). UBS is one of the largest securities firms in the United States, employing more than 20,000 people. Our firm has a long history serving investors in Massachusetts, dating back to the founding in the 1880s of the Boston brokerage firm PaineWebber & Co.

Comments

A. UBS believes that the "best of" standard imposed in the Proposal would be impossible to meet and should be removed.

We believe that the Proposal's requirement that recommendations of securities or account types be "the best of the reasonably available options" imposes a standard that would be impossible to meet and would create unrealistic expectations on the part of investors looking at investment results with the benefit of 20/20 hindsight. This "best of" requirement would result in almost certain liability based on second guessing, and there would therefore be no way to provide a recommendation of a security without becoming exposed to such potential liability.

Both the SEC and FINRA have long recognized that there is no single "best" security recommendation. The broadness of this standard leaves open whether a given recommendation should have been the one with the lowest cost, highest return, lowest risk, or the one that was most liquid. The standard also fails to consider that not all securities or account types are offered by all firms and leaves open whether the recommendation in fact must consider the entire universe of securities which in all likelihood is not what the Division intended.

Similarly, the Proposal further provides a transaction-based fee exception for a recommendation as long as it's the best of those reasonably available. We do not believe this is a workable standard that can be met. When applied to fees, the standard raises questions about whether discounting is permitted or even required, and whether a particular analysis is required of each recommended transaction as to whether the cost would be higher or lower in a brokerage account or an investment advisory account. The second guessing risk described above would also apply here.

We believe that the SEC's articulation of a best interest standard is the right one; "best interest without putting the financial or other interests of the broker before those of the customer" and respectfully request that should the Division decide to move forward with the Proposal that it revises the standard to use the language from the SEC's Best Interest Regulation.

B. The Proposal should be revised so that broker-dealers are not subject to an ongoing fiduciary duty on a brokerage account by virtue of providing solely incidental advice.

The Proposal provides that "if a broker-dealer ... provides investment advice, in any capacity ... the fiduciary duty shall be deemed an ongoing." This concept raises a myriad of problems.

With the fiduciary duty comes an ongoing duty to monitor the client's brokerage account; a duty that brokerage accounts are not priced for and are not set up with the type of supervision that would be required with this type of fiduciary duty. Additionally, as written the fiduciary obligation would extend even to a brokerage account completely self-directed by the client with no input from a broker. Any fiduciary obligation imposed should at most be limited to recommendations and only at the point in time in which a recommendation is made. Because brokerage firms do not have the operational capacity to provide ongoing fiduciary advice to brokerage clients, firms may limit the availability of brokerage services to Massachusetts clients.

We therefore believe that the Proposal should eliminate this provision.

C. The Division should carefully digest the views of the SEC and its recent adoption of Regulation Best Interest before moving forward with its Proposal

Regulators and lawmakers have for good reason long recognized the distinction and value of the broker-dealer model for investors. The SEC – the chief regulator of investment advisers and broker-dealers – with its unparalleled expertise in regulating the securities industry and the capital markets has confirmed the value of this model for investors. While the SEC has adopted a materially heightened standard of conduct for broker-dealers in its June 6, 2019 adoption of Regulation Best Interest, it has nonetheless preserved investors' access and choice regarding investment advice and products.

Although it will clearly take some time to digest the full implications of Regulation Best Interest's final version, the Division should carefully consider the SEC's views and positions when regulating this area. As SEC Chairman Clayton noted in his June 5, 2019 open meeting remarks, the obligations of financial professionals when they provide investment advice and services to retail customers "is a vast, multifaceted, complex and critically important facet of our economy and our society. It directly affects 43 million American households. "Broker-dealers and investment advisers "play important roles in helping retail investors achieve their long-term financial goals" and "they do so in significantly different ways – offering different types of relationships, different services, and different fee models."

The differences highlighted by the SEC are why a "one size fits all" approach is problematic as they would, among other things, likely "reduce investor choice and access to products and services and increase costs." We share Chairman Clayton's and the industry's concerns about a potential patchwork of conflicting state requirements and its impact on the industry. As Chairman Clayton noted in his open meeting remarks, "I and many others believe a patchwork approach to the regulation of the vast market for retail investment advice will increase costs, limit choice for retail investors and make oversight and enforcement more difficult."

UBS, therefore, believes that the Division should revise its Proposal, and in doing so carefully digest the SEC's views and interpretations to ensure that investor choice and costs to the variety of investment services and products remains. In fact, we believe that the Division should hold off on finalizing the Proposal until the markets have had an opportunity to see how Regulation Best Interest is working in practice for a period of time. Upon seeing this experience and upon further reflection, it may well be determined that the Proposal is not necessary, and the Division would thereby avoid the negative effects of the Proposal on Massachusetts investors that we describe below.

D. The Proposal will harm many Massachusetts investors with brokerage accounts by leaving them with less information to make sound investment decisions

The Proposal as drafted will provide many Massachusetts brokerage clients with less market information. Imposing a fiduciary duty on broker-dealers for providing solely incidental advice will accelerate the move from brokerage to fee-based accounts. In doing this, the Proposal ignores the reality that for Massachusetts investors who do not opt for a potentially more costly fee-based advisory program, they will no longer have access to the expertise of a broker-dealer to assist in evaluating their investments. Additionally, the Proposal's unworkable requirement of determining the "best of" and particularly the "best" security may very well discourage some broker-dealers from assisting a brokerage customer for fear of the consequences of not meeting the fiduciary standard.

In today's volatile environment and rapidly changing world, investors need education from market professionals more than ever. An open conversation with broker-dealers adds value and is in the best interests of investors. Many investors would prefer to speak to a broker-dealer and receive incidental advice than to be forced to go it alone and navigate the maze of investing. These investors will lose the ability to speak to a real, live person about investment strategy, relying instead on no-advice call centers or generic information found on the internet.

Broker-dealers often provide assistance as to the wisdom of engaging in a particular transaction, whether it is refraining from entering into the market to preserve principal and having liquidity or staying the course with an investment to fund their children's college educations and their own retirement. The Division cites in its Proposal the 913 Study reflecting "that retail investors do not understand the difference between investment advisers and broker-dealers." Yet, the Proposal may force many of these same investors to evaluate investments and strategies on their own. With only one way to obtain financial assistance from broker-dealers, many Massachusetts residents may be unable to make sound investment decisions regarding their investment objectives, risk tolerance, financial circumstances, and short and long-term needs.

E. The Proposal will harm many Massachusetts investors with brokerage accounts by leaving them with fewer investment options to meet their financial goals

The Proposal as drafted will provide Massachusetts brokerage clients with fewer investment options. The imposition of a fiduciary duty on solely incidental advice and adopting an unworkable "best of" standard will reduce the availability of certain brokerage services and the range of investment products that are made available in them. Some broker-dealers may limit or do away with services to small accounts because the fees would not be worth the risk of offering them. This would eliminate the choice of Massachusetts residents to select the oftentimes more appropriate investment product and/or transaction-based commission brokerage account to meet their financial objectives.

FINRA has noted that commission-based accounts are often the best choice for investors who desire to purchase and hold a particular asset for a long period of time.¹ However, the Proposal will cause the availability of these products to decrease and their prices to rise. As CoreData Research UK found with the similar DOL fiduciary rule, 71% of financial representatives will "disengage with" some investors with

¹ FINRA, *Report on Conflicts of Interest*, 29 (Oct. 2013), available at <https://www.finra.org/sites/default/files/Industry/p359971.pdf>

smaller accounts as a result of that rule, and “the cost of advice is expected to increase and be passed on to investors,” but “will become too expensive for most investors.”²

A study by the management consultant A.T. Kearney found that because of the DOL's fiduciary rule “many low-balance accounts will no longer be served, shifting many assets to formats such as robo-advice and self-directed.”³ Further, the DOL's fiduciary rule “played a big role” in drastically decreasing the sales of variable annuities,⁴ although for many investors they are the only guarantee against outliving their income. Similarly, the Proposal will have the same impact on the options for Massachusetts retirees and other investors.

The current brokerage arrangement offers significant benefits to Massachusetts investors (overlooked by the Proposal) by allowing investors access to securities that are only or primarily available through broker-dealers acting as principal. Customers not only benefit from the range of products available in UBS's inventory, but they also benefit from the more efficient execution of these principal trades in a brokerage account where the services may be provided at an overall lower cost than under an asset-based fee arrangement.

F. The Proposal will harm low and middle-income Massachusetts investors by leaving them with less access to market professionals to help maintain and build wealth

The Proposal as drafted will reduce access to market professionals for low and middle-income Massachusetts investors. The consequences of imposing a fiduciary duty on solely incidental advice and adopting an unworkable “best of” standard will be borne disproportionately by people with fewer investable assets, as firms will be forced to raise the minimum thresholds for these accounts.⁵ This in turn will lead to low and middle-income residents having lower levels of savings and investing,⁶ and limit their ability to maintain and build wealth.

² CoreData, *Sailing Through the Fiduciary Fog*, 3, 15 (Nov. 2016), available at https://www.sifma.org/uploadedfiles/correspondence/comment_letters/2017/sifma%20letter%20-%20in1210-ab79%20-%20appendix%20ii.pdf; see CoreData, *Fiduciary Rule to Leave US Mass-Market Investors Stranded, Study Shows*, available at <http://www.valuewalk.com/wp-content/uploads/2016/11/Fiduciary-rule-Press-Release-%E2%80%93-CoreData-Research.pdf>

³ A.T. Kearney, *The \$20 Billion Impact of the New Fiduciary Rule on the U.S. Wealth Management Industry*, 8 (Oct. 2016), available at <https://www.atkearney.com/documents/10192/7041991/DOL+Perspective++August+2016.pdf/b2a2176b-c821-41d9-b12ed3d2b0807d69>.

⁴ Greg Iacurci, *Department of Labor's Fiduciary Rule Blamed for Insurers' Massive Hit on Variable Annuity Sales*, *Investment News* (Mar. 28, 2017), available at <http://www.investmentnews.com/article/20170328/FREE/170329922/departments-of-labors-fiduciaryruleblamed-for-insurers-massive-hit>.

⁵ See Comment Letter Submitted by SIFMA at 8–9 (Apr. 17, 2017), available at http://www.sifma.org/uploadedfiles/correspondence/comment_letters/2017/sifma%20letter%20-%20in1210-ab79%20wo%20appendix.pdf?n=24493.

⁶ See Michael Wursthorn, *A Complete List of Brokers and Their Approach to “The Fiduciary Rule,”* *Wall St. J.* (Feb. 6, 2017), available at <https://www.wsj.com/articles/a-complete-list-of-brokers-and-their-approach-to-the-fiduciary-rule-1486413491>

Individuals are motivated to save more when they have access to a financial representative.⁷ Similar to the impact of the DOL's fiduciary rule, the Proposal would reduce such assistance for those with lower incomes, who tend to save and invest less when they are not advised. Research studies, for instance, have tended to show that when clients do not receive financial representation, they end up holding fewer equities than investors who do receive financial recommendations.⁸

Additionally, those individuals who lose access to assistance of this kind on average lose asset value.⁹ Studies indicate that asset allocation, not mutual fund performance, explains, on average, 100% of performance.¹⁰ Most brokerage investors do not have a clear understanding of the best way to build and manage a portfolio. They often lack the time and resources to do the requisite diligence. Market professionals help bridge this knowledge gap and make the markets more accessible and less of an exclusive club only for those investors who can afford to pay advisory fees.

Conclusion

UBS wholeheartedly supports the Division's efforts in providing additional protections to Massachusetts investors. However, we do not believe that the Proposal fully takes into account the adverse potential consequences to the investors it seeks to protect. The Proposal upends the long-standing role of assistance that broker-dealers provide to investors and will limit investor information, choice and access. As we support added protections in our industry, most market professionals serve the purpose of educating investors by offering sound guidance, access to market intelligence, and assisting investors with achieving their short and long-term financial objectives. We, therefore, believe that the Division's Proposal requires revisions such as those set forth above and in the comment letters of our industry colleagues and relevant industry trade associations to best serve the interests of Massachusetts investors.



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⁷ See Charles Schwab & Co., *Communicating Retirement Plan Benefits in a World of Skeptics*, available at <http://www.schwab.com/pubhclf1le/P-8557214>; Claude Montmarquette, et al., *The Gamma Factor and the Value of Financial Advice* (Aug. 2016), available at <https://cirano.qc.ca/files/publications/2016s-35.pdf>; Francis M. Kinniry, Jr., *Putting a Value on Your Advice: Quantifying Vanguard's Advisor Alpha*, Vanguard Research (Sept. 2015), available at <https://static.vgcontent.info/crp/intl/auw/docs/literature/research/quantifying-advisers-alpha.pdf>.

⁸ See, e.g., S.R. Foerster, et al., *Retail Financial Advice: Does One Size Fit All?*, J. of Fin. (2017).

⁹ See Claude Montmarquette et al., *Econometric Models on the Value of Advice of a Financial Advisor*, available at <http://econpapers.repec.org/paper/circirpro/2012rp-17.htm>.

¹⁰ Roger Ibbotson, et al., *Does Asset Allocation Policy Explain 40, 90, 100 Percent of Performance?*, 56 Fin. Analysts J. (2000), available at <https://ssrn.com/abstract=279096>.