July 26, 2019

Office of the Secretary of the Commonwealth
Attn: Proposed Regulations – Fiduciary Conduct of 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:

The undersigned organizations write in response to the Securities Division's preliminary proposal to apply a state-based common law fiduciary standard to broker-dealers' and investment advisers' advisory activities. Given the unfortunate demise of the Department of Labor (DOL) Fiduciary Rule and the glaring deficiencies in the Securities and Exchange Commission's (SEC's) Regulation Best Interest (Reg BI),[1] we greatly appreciate states such as Massachusetts that are willing to step in to fill the regulatory void by providing the protections investors reasonably expect and desperately need. Contrary to arguments from industry groups, Massachusetts is well within its authority in proposing a fiduciary rule.

I. Broker-dealers hold themselves out and function as investment advice providers who are in positions of trust and confidence with their customers. Applying a common law fiduciary duty to these relationships is entirely appropriate.

There are myriad ways in which broker-dealers seek to persuade the investing public that they are providing objective, trustworthy investment advice rather than mere sales pitches.[2] For example, brokerage firms and their registered representatives routinely market themselves as "financial advisors," "financial consultants," or "wealth managers," giving the impression of specialized advisory expertise. They commonly describe their services as "investment advice" or "retirement planning" and market those services as designed to serve customers' best interests. In holding themselves out as impartial experts, they seek to occupy positions of trust and confidence with their customers. The clear intent of this marketing is to convince investors that they should trust that their "advisor" will be looking out for their best interests and to encourage them to rely on their expertise and recommendations. And investors place their trust in their financial professionals to provide them advice that is genuinely in their best interests and will maximize the value of their investments.[3]

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[1] *See, e.g.,* SEC Commissioner Robert J. Jackson Jr., Statement on Final Rules Governing Investment Advice, June 5, 2019, https://bit.ly/2XJsaSp.

[2] *See* Micah Hauptman and Barbara Roper, *Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways,* CONSUMER FEDERATION OF AMERICA, January 18, 2017, http://bit.ly/2jKUbFD.

[3] *See* Regulation Best Interest, Section III.B.4.a, 496-500, https://bit.ly/2Xfudkq ("In seeking financial advice, a retail investor places not only money but also trust in a financial professional….one industry study of over 800 investors notes that '96% of U.S. investors report that they trust their financial professional and 97% believe their financial professional has their best interest in mind.'").

Here are just a few examples of firms' marketing materials supporting the conclusion they function as "trusted advisors."

- D.A. Davidson states: "**Trust** is the cornerstone of the relationship between you, as an investor, and the D.A. Davidson & Co. financial professionals working for you. Your needs should **always come first**."[4]
- Mass Mutual states: "Join millions of people who place their **confidence and trust** in us."[5]
- Raymond James states: "[I]t's developing a long-term relationship built on understanding and **trust**. Your **advisor** is there for you throughout the **planning** and investing process, giving you **objective and unbiased advice** along the way."[6]
- Schwab states: "A relationship you can **trust**, close to home."[7]
- UBS states: "The UBS Wealth Management Americas approach is based on the **trusted relationship** of our Financial **Advisors** and their clients. Our experienced **Advisors** are committed to understanding clients' needs and delivering insightful, informed **advice** to help them realize their dreams."[8]

The harm to investors is immense when they reasonably, but mistakenly believe they are getting advice that's in their best interest based on a trusted relationship with their financial professional. In addition to paying higher costs, investors who rely on biased sales recommendations as if they constituted unbiased advice can end up facing unnecessary risks or receiving substandard returns. Cumulatively, these industry practices drain tens of billions of dollars every year out of investors' pockets and into the pockets of firms and their financial professionals. According to one study, Massachusetts IRA investors alone lose approximately $491 million a year as a result of conflicted advice.[9] The losses are even larger when considering all types of accounts (retirement and non-retirement) and the full range of products sold within these accounts.

Given how broker-dealers advertise and function as advisers in position of trust and confidence with their customers, it is entirely appropriate to apply a common law fiduciary duty to their advisory activities.

II. Reg BI will not meaningfully change harmful industry practices or improve protections for investors.

Because Reg BI is based on the misconception that the investment advice market already functions well, it doesn't seriously address the problem of conflicted investment advice. In other words, it was a political solution, rather than a policy solution, designed to *seem* like it was

[4] D.A. DAVIDSON, Your Rights, https://bit.ly/2ADEM4B (last visited August 21, 2016) (emphasis added).
[5] MASS MUTUAL, https://bit.ly/1LKF5YF (last visited August 21, 2016) (emphasis added).
[6] RAYMOND JAMES, Why a Raymond James Advisor, https://bit.ly/2qheDme (last visited April 4, 2018) (emphasis added).
[7] SCHWAB, Find a Branch, https://bit.ly/2yIk81Y (last visited August 21, 2016) (emphasis added)
[8] UBS, About Us, https://bit.ly/2caSp1Q (last visited August 21, 2016) (emphasis added).
[9] Heidi Shierholz and Ben Zipperer, *Here is what's at stake with the conflict of interest ('fiduciary') rule*, ECONOMIC POLICY INSTITUTE, May 30, 2017, https://bit.ly/2EQJ9gE.

enhancing investor protections without actually doing so in any meaningful way. Among our many concerns:

- Reg BI is decidedly not a true fiduciary standard.
- While it uses the phrase "best interest" ubiquitously, Reg BI doesn't define what best interest means, and the discussion it does provide of this topic suggests it largely reflects existing FINRA policy.
- Reg BI doesn't require brokers to recommend what they reasonably believe to be the best of the reasonably available options. In a recent speech, SEC Chairman Clayton made clear that the failure to include any obligation to do what is "best" for the investor in their "best interest" standard was intentional.[10]
- While Reg BI says that brokers have to "consider" costs when making recommendations, the SEC provided no guidance on whether or how this "consideration" would be any different than the existing requirement under FINRA rules to consider costs. The clear implication is that, as long as a broker can come up with some other reason why they recommended an investment that costs more and just so happens to pay them more, they can satisfy the care obligation under Reg BI.
- Reg BI allows firms to continue to artificially create harmful incentives that encourage and reward brokers for making recommendations that are profitable to the firm rather than those that are best for the investor. It requires only that they "mitigate" in some undefined way the harmful incentives they themselves created. Far from making clear that mitigation must be sufficient to prevent the conflict from tainting the recommendation, the release suggests that policies and procedures that are required under existing FINRA rules could constitute sufficient mitigation.
- The conflict of interest provisions, which were already weak in the proposal, actually got weaker in the final rule. They are more reliant on disclosure for firm-level conflicts, despite the fact that research clearly shows that conflict disclosure doesn't work.
- Reg BI prohibits only a very narrow set of harmful incentives – "high pressure," time-limited, product-specific sales contests, sales quotas, bonuses, and non-cash compensation. Incentives that lack any one of those features, e.g., an ongoing product-specific sales quota, do not appear to be covered by this ban. The rule appears to expand somewhat on existing FINRA rules in this area, but it wouldn't curtail the broader set of sales contests, quotas, bonuses, non-cash compensation, and other incentives that are harmful to investors, including the practices that were at issue in the Division's recent Scottrade enforcement action.[11]
- Reg BI allows dual registrants to engage in hat-switching with impunity, addressing it through meaningless disclosure. Because important differences in the standards for broker-dealers and investment advisers remain, this bifurcated approach will perpetuate investor confusion and harm.

In our view, investors will be worse off under Reg BI than they would have been had the Commission failed to act. Now, broker-dealers will be allowed to claim that they are legally

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[10] SEC Chairman Jay Clayton, "Regulation Best Interest and Investment Adviser Fiduciary Duty: Two Strong Standards that Protect and Provide Choice for Main Street Investors," Boston, Massachusetts, July 8, 2019, https://bit.ly/32UdIKo.

[11] *In re Scottrade, Inc*., Administrative Complaint, No. E-2017-0045 (Feb. 15, 2018) http://bit.ly/2By4rMW.

required to serve investors' best interests, but nothing in the rule will actually require them to do so. As a result, investors will be misled into trusting that their brokers are providing higher quality advice than they're legally required to provide, and investors will continue to lose billions of dollars every year because of it. Some investors, who otherwise wouldn't use a broker, might choose to use one, based on the claim that the broker is legally required to serve their best interest. These investors could be harmed in ways they otherwise wouldn't be.

III. Massachusetts should apply a broad fiduciary standard of conduct to all advisory activities. Moreover, the specific formulation of the fiduciary standard is critical.

Given Reg BI's clear deficiencies and the harm that Reg BI is likely to cause, it's entirely appropriate that Massachusetts step in to protect its citizens by requiring all financial professionals to comply with a meaningful fiduciary duty. This fiduciary duty must apply across the broad range of activities that reasonably can be considered advisory in nature, including when a broker or adviser recommends to a customer an investment strategy, the opening of, or transfer of assets to, any type of account, or the purchase, sale, exchange, or hold of a security.

Next, the specific formulation of the fiduciary duty is critical. At common law, a fiduciary duty includes both a duty of care to act with prudence and a duty of loyalty to refrain from engaging in self-dealing. Under this standard, brokers and advisers must be required to recommend, from among those investments they have reasonably available to recommend, the investment or investments that they reasonably believe are the best option or options for the investor. In doing so, they must be required to act "without regard to" their own financial or other interests. To achieve this, the uniform fiduciary standard should be backed by requirements for firms to rein in the use of harmful incentives that encourage and reward bad advice. This includes cracking down on the use of sales contests, trips, bonuses, and quotas for meeting certain production requirements, for example, that are designed to encourage the sale of products and services that are most profitable for them, rather than those that are best for the customer. Importantly, the standard must not allow firms and financial professionals to rely on disclosure alone to satisfy their duty of loyalty. There is simply no evidence that disclosure is effective in protecting investors from the harmful impact of conflicts.

In addition, the Division should apply a fiduciary duty that follows the contours of the relationship to fully protect investors and match their reasonable expectations. One of Reg BI's most glaring shortcomings is that it applies different requirements on brokerage and advisory accounts with regard to account monitoring, treatment of conflicts, and the scope of services to which the duty applies that aren't based on actual differences in the business models. Specifically, Reg BI applies on a transaction-by-transaction basis, irrespective of the nature of the relationship between the broker and the customer or the other accounts the investor has with the financial professional. This can increase the likelihood that investors will be harmed in multiple ways. First, Reg BI would continue to allow dual registrants to engage in hat switching so long as the dual registrant provides disclosures about the capacity in which they are acting. Research, including previous testing conducted by the SEC, indicates such disclosures are likely to be meaningless to investors who do not understand basic differences between brokers and advisers or why those differences matter.

Second, Reg BI applies a transaction-by-transaction obligation, even in ongoing, long term relationships of trust and confidence, which defeats investors' reasonable expectations. This is inconsistent with how courts have applied the common law fiduciary duty. According to Professor Jill Gross, who is Associate Dean for Academic Affairs and Professor of Law at the Elisabeth Haub School of Law at Pace University and who is a coauthor of the Broker-Dealer Law and Regulation Handbook, state common law typically recognizes that brokers have a fiduciary duty to their customers under certain circumstances, including where the broker has de facto control over an account.[12] This includes circumstances in which the investor routinely approves the broker's recommendations because the investor lacks the experience or sophistication necessary to exercise her own judgment. In such cases, courts have held that the broker has a duty to manage the account in a manner directly comporting with the needs and objectives of the customer, to keep informed regarding changes in the market which affect the client's interests, and to act responsively to protect those interests, among other things.

Applying a transaction-by-transaction obligation is also inconsistent with how firms routinely market their services, as ongoing and long-term relationships of trust and confidence. The following are a few typical examples:[13]

- Janney states: "Selecting a financial advisor and firm when seeking a long-term financial relationship built on trust and experience is one of the greatest decisions you will make."
- Ameriprise: "The ongoing relationship between you and your advisor is at the heart of what we do, to help you track your progress and adapt to changes in your life." / "We regularly reach out to you with meaningful information and ideas."
- Stephens: "We are committed to establishing and maintaining long-term relationships based on integrity and trust and delivering long-term results based on deep research and independent thinking."
- Voya: "You'll build an ongoing, one-on-one relationship as your advisor gets to know you and your situation, and you can work together to tailor financial advice specifically to meet your needs."
- Raymond James: "[I]t's developing a long-term relationship built on understanding and trust. Your advisor is there for you throughout the planning and investing process, giving you objective and unbiased advice along the way."
- Securian Financial: "If this sounds to you like a fairly close relationship, you're right. Many people develop lifelong friendships with their financial advisors. After all, these are people that you entrust with your financial future."

Given the generally low levels of financial literacy and the high degree of dependence investors place on their brokers, we believe that the circumstances that give rise to a common law

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[12] Letter from Jill I Gross, to the SEC, Regulation Best Interest, March 11, 2019, https://bit.ly/31v15os ("Many retail investors are incapable of evaluating recommendations on their own, rely on those individuals as "trusted advisors" (in fact they are told by broker-dealers' marketing materials to rely on them), and follow their advice without questioning what is best for them. They reasonably believe they are in long-term relationships of trust and confidence and that their "advisor" will monitor their account and keep them apprised of any changes that should be made. Based on how these relationships are marketed and work in practice, it is entirely understandable why investors expect that they will receive ongoing services from broker-dealers.").

[13] *See* Micah Hauptman and Barbara Roper, Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways, Consumer Federation of America, January 18, 2017, https://bit.ly/2qKIhmO.

fiduciary duty, including a duty to monitor the account, are quite common. We therefore urge the Division to apply a fiduciary duty that follows the contours of the relationship.

Under such an approach, brokers who truly do offer a one-time recommendation to a customer with no suggestion that the recommendation is being offered as part of an ongoing relationship would have no ongoing duty. In such circumstances, however, the broker should not be permitted to recommend investments that the customer is not capable of monitoring on her own. On the other hand, a broker that has an ongoing relationship with the customer that includes periodic recommendations should have an ongoing duty appropriate to that role. This might include an obligation to review the customer account once or twice a year, for example, to make sure that everything continues to perform as expected, to ascertain whether the customer's circumstances have changed, and to ensure that the investments continue to be in the best interests of the customer based on that evaluation. This approach is consistent with both the transaction-based broker-dealer business model and investors' reasonable expectations based on brokerage firms' marketing of their services as ongoing relationships of trust and confidence.

IV. Arguments that this proposal would be preempted if it were enacted have no merit.

We expect that members of the industry will argue that the proposal would be preempted by federal law. However, the National Securities Markets Improvement Act (NSMIA) preempts states only in specifically enumerated areas, none of which is implicated here.[14]

The Securities Industry and Financial Markets Association (SIFMA), the Financial Services Institute (FSI), and other industry groups incorrectly argue that the reference to recordkeeping in NSMIA precludes states from promulgating a fiduciary duty for brokers' advice. They erroneously claim that any heightened state-based standard of conduct that might cause a firm to *voluntarily* keep a record that isn't also required under federal law would be preempted. This is clearly wrong. Merely because a firm may *voluntarily* choose to adopt more rigorous recordkeeping practices for their own business purposes does not mean that the firm is legally required to do so. So long as your proposal does not impose an affirmative obligation on broker-dealers to keep new or additional records and only focuses on the firm's and financial professional's conduct, it should not run afoul of NSMIA.

And the simple fact is that existing recordkeeping requirements under federal law should provide more than an adequate basis to determine whether a firm complied with or violated this fiduciary proposal. Moreover, states can and often do impose fiduciary duties on brokers in specific circumstances, despite the fact that there is no federal fiduciary duty for brokers.[15] This

[14] *See, e.g.*, Letter from A. Valerie Mirko, Esq., General Counsel, North American Securities Administrators Association, Inc., to Honorable Herbert Lemelman, Presiding Officer Office of the Secretary of the Commonwealth of Massachusetts, March 30, 2017, https://bit.ly/2GC1Wg5.

[15] The SEC acknowledges this in its proposed Regulation Best Interest, stating, "[A] broker-dealer may have a fiduciary duty under certain circumstances. This duty may arise under state common law, which varies by state." Proposed Regulation Best Interest footnote 15 at 14. It reiterates this in its final rule, stating, "[W]e emphasize that Regulation Best Interest is separate from any common law analysis of whether a broker-dealer has fiduciary duties." Final Regulation Best interest at 68. *See also* footnote 137, stating, "Generally, courts have found that broker-dealers that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, owe customers a fiduciary duty."

further demonstrates that the industry's interpretation of NSMIA's preemptive effect is misguided.

Similarly the proposal is crafted narrowly to avoid ERISA preemption concerns. The ERISA case law makes clear the purpose of ERISA's preemption provisions are to ensure plans and plan sponsors are subject to a uniform body of benefits law. It has nothing to do, however, with ensuring third parties that are not subject to ERISA's mandates escape state-based regulation of general applicability. So long as your proposal makes clear that it would not apply to any person "acting in the capacity of a fiduciary to an employee benefit plan, its participants or beneficiaries, as those terms are defined in the Employee Retirement Income Security Act (ERISA)," we believe it would not be preempted by ERISA.

V. Conclusion

If Massachusetts adopts a new standard based on these principles, it can lead the way for other states that are considering how to step in where federal regulators have failed and provide badly needed strengthened protections for investors who rely on financial professionals for advice. Thank you for your leadership and for your consideration of our views. In the absence of a strong, uniform federal standard, the need for state action is stronger than ever.

Thank you for your consideration of our views.

Alliance for Retired Americans
Americans for Financial Reform Education Fund
Better Markets
Center for American Progress
Center for Economic Justice
Consumer Action
Consumer Federation of America
Committee for the Fiduciary Standard
EPI Policy Center
Fund Democracy
Greater Boston Legal Services
Massachusetts Budget and Policy Center
MASSPIRG
Massachusetts Communities Action Network (MCAN)
National Employment Law Project
Woodstock Institute