Institute for Portfolio Alternatives

July 26, 2019

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

Office of the Secretary of the Commonwealth
Attn: Proposed Regulations – Fiduciary Conduct Standards
Massachusetts Securities Division
One Ashburton Place, Room 1701
Boston, MA 02108

Dear Secretary Galvin:

The Institute for Portfolio Alternatives ("IPA")[1] appreciates the opportunity to comment on the Massachusetts Securities Division's ("Division") preliminary solicitation of public comments on a proposed regulation "to apply a fiduciary conduct standard on broker-dealers, agents, investment advisers, and investment adviser representatives when dealing with their customers and clients" ("Proposal").

The IPA has an immediate interest in applicable standards of conduct for financial professionals in Massachusetts as our members include both regulated broker-dealer firms and their investment professionals in your state and nationwide. IPA member firms support individual investor access to a wide variety of asset classes with low correlation to the traded markets and historically available only to institutional investors. These investment products have been held in the accounts of more than 3 million individual investors. With over $135 billion in capital investments, they remain a critical component of an effectively balanced investment portfolio and serve an essential capital formation function for national, state and local economies.[2]

The IPA is concerned about the Proposal for the reasons detailed below. We appreciate the Division's consideration of public comments and are willing to assist the Division as it considers this important issue:

1. As you are aware, the U.S. Securities and Exchange Commission ("SEC"), shortly before the release of the Proposal, adopted and published Regulation Best Interest ("Reg BI"). Reg BI is a significant heightened standard that requires both regulators—federal and state—and firms to

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[1] On Monday, April 9, 2018, the Investment Program Association became the Institute for Portfolio Alternatives. The change reflects our organization's continued commitment to champion the portfolio diversifying investment industry.

[2] For over 30 years the IPA has raised awareness of portfolio diversifying investment (PDI) products among stakeholders and market participants, including investment professionals, policymakers and the investing public. We support increased access to investment strategies with low correlation to the equity markets: lifecycle real estate investment trusts (Lifecycle REITs), net asset value REITs (NAV REITs), business development companies (BDCs), interval funds and direct participation programs (DPPs). Through advocacy and industry-leading education, the IPA is committed to ensuring that all investors have access to real assets and the opportunity to effectively diversify their investment portfolios.

adopt new requirements, procedures and policies to address, examine for, and enforce compliance under the new rule. Reg BI includes important investor protections; for example, unlike the previous FINRA suitability rule, it requires a customer's best interest to be placed *before* the financial or other interest of the broker-dealer firm or its individual agents. "Cost" must be explicitly considered as part of the recommendation. Firms must mitigate conflicts that create an incentive for the broker-dealer to place his or her own interest ahead of the investor, and must eliminate sales contests, quotas, bonuses, and non-cash compensation based on sale of specific securities or types of securities within a limited period of time. Reg BI also establishes a new duty of care for broker-dealers and requires firms to demonstrate compliance with the rule as a whole. For firms, this entails new policies, processes, methodology, training, testing, continuous improvement, escalation, and other factors. Firms must develop and distribute the new Form CRS both to new clients but also to existing or legacy clients. This will involve consideration of investors' locations, age and demographics, and different methods of communication. Form CRS requires disclosures about the broker's compensation, legal disciplinary history, conflicts of interest and a summary of services. A broker must also disclose the capacity in which they are acting at the outset of the relationship, and cannot use the terms "advisor" or "adviser" unless they are a registered investment adviser or their representative.

We strongly urge the Division not to pursue a formal rulemaking at this time, and to discuss with financial firms in your state the changes being undertaken to comply with Reg BI and further the goal of greater investor protection. The IPA is concerned about the significant compliance and operational costs of implementing both the new federal standard along with additional state standards. There are substantial practical challenges that your registrants face in complying with Reg BI, associated FINRA rule changes, and similar changes necessitated under state securities laws by the June 30, 2020 compliance deadline. We are similarly concerned about conflicting federal and state requirements that create confusion and uncertainty among firms, advisors and clients, and therefore do not further the goals of investor protection. Increased costs in providing quality investment advice will have a direct impact on the availability and cost of financial advice for Massachusetts investors, particularly those with small dollar accounts or "buy-and-hold" strategies.

2. The IPA is concerned about the effect of the "best of" standard used in the Proposal, requiring that the recommended strategy, security or account type be the "best of the reasonably available options" and that the broker-dealer or agent may receive a transaction-based fee only if it "represents the best of the reasonably available remuneration options." The Division does not explain how a broker-dealer can demonstrate that the recommended strategy, security, account type or fee is the "best" of reasonably available options. The term "best" is an unattainable standard, and creates uncertainty and liability for financial firms given the universe of available and comparable investments. We are deeply concerned that the post-sale outcome of a recommendation or investment strategy, as opposed to the process or procedures undertaken prior to a sale, will be used to justify whether the "best" standard was met. The IPA believes that the practical effect of the "best of" standard will be to reduce or even eliminate transaction-based fee

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arrangements for Massachusetts investors. This will have a detrimental effect on investors who may not have sufficient account minimums to maintain fee-based accounts or who will not receive personalized advice on self-directed accounts. We urge the Division to remove the term "best" from the Proposal.

3. The IPA is also concerned that an ongoing fiduciary duty applies to the broker-dealer or agent that "provides, *in any capacity*, investment advice" to the customer (emphasis added). This broad application would effectively prohibit dual registrants from acting in a broker-dealer capacity. In other words, if the customer receives investment advice through an affiliated investment adviser or a dual registered broker-dealer/investment adviser or registered representative/investment adviser representative, then the fiduciary duty applies on an ongoing basis and across all accounts of the customer. Similarly, if the broker-dealer makes "ongoing recommendations" or receives "ongoing compensation", then the fiduciary duty would apply on an ongoing basis. Thus, if a registrant makes more than one recommendation, or receives a trailing commission, then they would owe an ongoing fiduciary duty. This would require broker-dealers and registered representatives to monitor a customer's account after a trade is executed, which is contrary to the episodic nature and intent of the brokerage relationship. This would have the unintended consequence of limiting episodic brokerage services for Massachusetts investors. We recommend that the proposed regulation instead provide that clear notice be provided regarding the capacity in which the financial professional is acting, and that the duty for broker-dealers, whenever acting in such capacity, apply only though the execution of the recommendation.

   As an example of the impact of the loss of episodic brokerage services for Massachusetts investors, suppose Mr. and Mrs. Smith, 55 and 57 years old, respectively, inherit $50,000, which they intend to keep invested for at least 7 years until their retirement. They want to invest in a diversified portfolio of mutual funds with a combination of stocks and bonds, and have two options: (1) a brokerage account paying a one-time average commission of 5%, or (2) a fee based account where they will pay 1.5% per year as the standard rate for smaller accounts. Mr. and Mrs. Smith will pay a one-time commission of approximately $2,500 to invest through a brokerage account at the time the investment is made versus an annual fee of approximately $750 per year for a total of $5,250 (more than double the one-time brokerage fee) in an advisory account over the next seven years. If the account increases in value over the seven years, then the annual fees paid will increase as well. Preserving the option of transaction-based brokerage services is critical for many investors in Massachusetts with smaller accounts or with specific circumstances where a one-time commission may be better for the investor.

4. We are concerned with the Proposal's duty of loyalty that requires a broker-dealer, agent, or adviser "to avoid conflicts of interest." Conflicts are inherent in any service-based business. We do not believe that it is possible to avoid all conflicts; thus, we encourage the Division to remove this language and consider treatment of conflicts consistent with Reg BI, which includes mitigation of certain conflicts and elimination of other conflicts. Similarly, we suggest that the "without regard to" language in the Proposal's duty of loyalty be replaced with "without placing

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the financial or other interest . . . ahead of the interest of the retail customer."[3] This change is consistent with Reg BI, and provides greater clarity for addressing broker-dealer conflicts. In other words, it clarifies that a broker-dealer may not place their interest above that of the client when providing advice or recommendations. As stated previously, servicing a customer "without regard" to one's financial interest is antithetical to any fee-for-service industry, including attorneys, physicians, or other professionals.

5. The IPA suggests that the regulation expressly apply only to retail customers that are legal residents of or reside in Massachusetts. The fiduciary duty should not be owed by Massachusetts registrants to out of state clients or entities, and may be inconsistent with the duties owed to those clients in their state of domicile or residence. We also encourage the Division to provide for an 18-month implementation period in order to comply with both Reg BI and this additional state standard.

6. Finally, the IPA is concerned that the Division's rulemaking will run counter to federal standards for broker-dealers and require the making and keeping of records that are different or in addition to those required to be made and kept under the federal securities laws, which would be preempted. In other words, in order to comply with the Proposal, broker-dealers will have to take actions and keep new records beyond those required under federal law. In addition to preemption concerns, this additional cost of compliance could cause broker-dealers to decide not to provide advice to Massachusetts investors.

We respectfully request that the Division consider all of the points discussed above. We believe the unintended consequence will be significant increased compliance costs for Massachusetts registrants and decreased options for Massachusetts investors. If the IPA may be of any assistance, please do not hesitate to contact me or Anya Coverman, IPA's Senior Vice President, Government Affairs and General Counsel, at (202) 548-7190.

Sincerely,

Anthony Chereso
President & CEO, Institute for Portfolio Alternatives

[3] Regulation Best Interest, 17 CFR Part 240, Release No. 34-86031; File No. S7-07-18 (June 5, 2019).

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