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July 22, 2019

William F. Galvin
Secretary of the Commonwealth of Massachusetts
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: Proposed Amendments to 950 CMR Sections 12.204, 12.205 & 12.207

Dear Mr. Galvin:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations and in state and federal courts. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules which govern the conduct of those who provide advice to investors.

On June 14, 2019, the Office of the Secretary of the Commonwealth of Massachusetts ("the Secretary") issued a Notice soliciting comments regarding amendments to its regulations to require that broker-dealers, agents, investment advisers, and investment adviser representatives be subject to a fiduciary duty when dealing with their customers and clients ("the Proposed Amendments"). The Secretary recognized in its Notice that a uniform fiduciary standard is in the public interest and is necessary to protect investors from the abuses that can result when financial professionals place their own financial interests ahead of their customers. The Secretary also recognized that the Securities and Exchange Commission's ("SEC") Regulation Best Interest failed to establish a strong and uniform fiduciary standard.

PIABA has long advocated for a true fiduciary standard for all persons who provide investment advice to their clients, and fully supports the Proposed Amendments. Consistent with numerous studies, including the SEC's findings in 2011 which are cited in the Notice, we believe that a uniform fiduciary duty applicable to all financial intermediaries who provide investment advice would eliminate confusion and best protect customers.[1] We therefore believe that the fiduciary duty should apply to all forms of financial

[1] SEC, *Study on Investment Advisers and Broker-Dealers* ("SEC Study") (Jan. 2011), available at http://www.sec.gov/news/studies/2011/913studyfinal.pdf. The SEC reviewed two studies which it sponsored (the "Seigel & Gale Study" and the "RAND Report"), and a study conducted by Consumer Federation of America. The

advice, and to all customers. We also believe that the fiduciary duty should arise whenever a financial or investment recommendation is made, and that it should last throughout the duration of the advisor-customer relationship. Finally, we believe the Proposed Amendments should explicitly provide for a private right of action. PIABA's position is discussed in further detail below.

I. PIABA Supports the Proposed Amendments' Provision of a Uniform Fiduciary Duty on All Broker-Dealers, Agents and Advisers who Provide Investment Advice

A. Application of a Fiduciary Duty to Financial Professionals Who Provide Investment Advice

The Proposed Amendments protect Massachusetts investors by imposing a fiduciary duty on all financial professionals who render investment advice, and by broadly defining the types of investment recommendations and advice which trigger that obligation. The proposed statewide uniform fiduciary standard make it clear that financial professionals owe a fiduciary duty whenever they provide financial recommendations and advice for financial renumeration, rather than putting the burden upon customers to prove that there was a relationship of trust and reliance.[2] PIABA supports the Secretary's approach of requiring all financial professionals, regardless of title or license, to adhere to a uniform fiduciary duty when providing investment advice.

The Proposed Amendments are consistent with what most retail customers believe about their financial advisor – that he or she is a fiduciary.[3] Indeed, brokerage firms give their "registered representatives" titles that sound trustworthy, like "Financial Advisor," "Wealth Consultant," and "Wealth Manager."[4] Brokers also pay millions of dollars every year in advertising to tell investors that they put the interests of customers ahead of their own. Brokers encourage investors to *trust* them, saying they will provide *advice* and *guidance.* As a result, when a customer meets with a broker, she reasonably expects that she is being given advice that is for her benefit. This is particularly true as to broker-dealers and financial professionals who are dually registered as investment advisors. As the Proposed Amendments recognize, professionals who provide investment advice to a customer should not be allowed to "switch hats" to a lower standard of care depending on the particular type of investment they have recommended to a customer and/or how they are being compensated for that recommendation.

SEC Study found that, based on the comments, studies and surveys it had reviewed, investors did not understand the differences between investment advisers and broker-dealers. The SEC determined that this misunderstanding is compounded by the fact that many retail investors may not have the "sophistication, information, or access needed to represent themselves effectively in today's market and to pursue their financial goals." *Id.* at 101.

[2] *See, e.g., Hays v. Ellrich,* 471 Mass. 592 (Mass. 2015); *Genovesi v. Nelson,* 85 Mass. App. Ct. 43 (Mass. App. 2014); *Patsos v. First Albany Corp.,* 433 Mass. 323 (Mass. 2000).

[3] *See* Spectrum Group, *Fiduciary – Do Investors Know What it Means* (2015), available at http://spectrum.com/Content_Whitepaper/fiduciary.aspx.

[4] Peiffer, Joseph C. and Christine Lazaro, Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty, Misleading Ads Fuel Confusion, Underscore Need for Fiduciary Standard (March 25, 2015), available at https://piaba.org/sites/default/files/newsroom/2015-03/PIABA%20Conflicted%20Advice%20Report.pdf.

The Proposed Amendments will finally align the duty that financial professionals owe to customers in rendering investment advice with the representations made by such professionals and with the customers' reasonable expectations.

PIABA also strongly supports the Proposed Amendments' broad definition of the types of investment advice that trigger a fiduciary duty. The Secretary correctly recognizes that brokers do not merely pick investments or devise investment strategies. Specifically, brokers sometimes recommend other financial courses of action preceding the recommendation of a particular security or investment strategy, in order to earn the client's trust and cause the client to entrust their assets to the broker for management. Prime examples of such scenarios include a recommendation to roll over an employer-based retirement account into a new IRA account, or when a broker recommends to a prospective client that they retire early and/or elect a lump sum payment in lieu of a defined benefit pension and turn the lump sum over to the broker for investment. Obviously, the broker has a financial incentive to recommend these courses of action. The Proposed Amendments appropriately hold financial professionals to a fiduciary duty for all types of investment advice, including, but not limited to, the situations described above.

B. Incorporating the Duty of Care and Duty of Loyalty

PIABA supports the Proposed Amendments' incorporation and definition of the two primary duties of a fiduciary: the duty of care and the duty of loyalty, which are set forth in the Proposed Amendments.[5]

We believe that the Secretary's approach to fiduciary duties and the definitions it has utilized in the Proposed Amendments strike an appropriate balance between accommodating the traditional, compensation-based model of many broker-dealers and other sales agents, with the interests of protecting investors from the financial harm caused by conflicted advice.

II. PIABA's Proposed Modifications to the Draft Regulations Will Further Strengthen Investor Protection

As discussed above, PIABA strongly supports the approach and language of the Proposed Amendments. There are a few suggestions we wish to propose which we believe are consistent with the Proposed Amendments and will provide important protections to investors.

A. The Proposed Amendments Should Include Sales Incentives Offered by Third Parties in the Definition of Conduct that Gives Rise to a Presumption of Breach of the Duty of Loyalty

The Proposed Amendments provide that the duty of loyalty requires a broker-dealer, agent or advisor to make recommendations and provide investment advice without regard to the financial or any other interest of the broker-dealer, agent, adviser, any affiliated or related entity or its officers, directors, agents, employees, contractors, or any other third party. However, the following section, which sets forth the circumstances which give rise to a presumption of the breach of fiduciary duty, does not include third parties. Therefore, under the proposed amendments as currently written, the offer or receipt of direct or

[5] Proposed Amendment to 950 CMR 12.207(c).

indirect compensation from a *third party* (such as an issuer of a variable annuity or other investment product) would not give rise to a presumption of a breach of duty of loyalty.

In its Notice, the Secretary cited its concern with harmful incentives such as sales contests that encourage or reward conflicted advice as being one of its basis for the Proposed Amendments. Sales incentives are often offered by third party issuers of annuity products, mutual funds and other investments, including vacations to exotic locales, golf packages, marketing support, and other incentives. The conflicts that arise from these types of incentives are significant. PIABA therefore recommends that the Secretary add the words "or any third party" after the word "adviser" in Section 950 CMR 12.207(c)(2)(i).

B. The Proposed Amendments Should Provide Protection for Institutional Investors

The Proposed Amendments exclude all institutional buyers, as defined in 950 CMR 12.205(1)(a)(6), from the protections of the Proposed Amendments. PIABA believes that the Proposed Amendments should protect all investors, regardless of their wealth, sophistication or status as an individual versus a legal entity. Brokers frequently disclaim any fiduciary duties to pension funds and institutional investors. However, pension funds and institutional investors manage pools of capital which hold the retirement savings for millions of individuals.[6] The individual beneficiaries of pension funds and institutions are often unsophisticated people of modest means who have minimal outside assets and no control over how their retirement assets are managed. As such, a broker who misleads a pension fund or institutional investor can do substantial damage, without the impacted individuals ever knowing or having control over what was done.[7]

Additionally, brokerage firms regularly disclaim their duties to customers whose retirement accounts or income may qualify them as "accredited investors" under federal securities laws. An "accredited investor" is a natural person with assets worth more than one million dollars.[8] Many retirees, having saved their entire lives or purchased property that has substantially appreciated in value over time, meet the definition of accredited investor. However, those retirees often have only a limited understanding of investments. Moreover, those retirees are often not able to recover from significant losses from risky investments. Simply put, all customers deserve unconflicted investment advice that is in their best interest, regardless of their accumulated wealth or the manner in which they have invested.

C. The Proposed Amendments Should Clarify that Harmed Investors Have a Private Right of Action

The Proposed Amendments do not explicitly include a private right of action for investors who have suffered losses resulting from their broker's violation of his or her fiduciary obligation.

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[6] Tamar Frankel, *The Regulation of Brokers, Dealers, Advisers and Financial Planners*, 30 Rev. Banking & Fin. L. 123, 129-30 (2011). Professor Frankel also observes that institutional investors are "not much better off than individuals with respect to understanding some complex investments." *Id*. at 130.

[7] *Id*. at 130.

[8] Rule 501 under Regulation D defines accredited investor as "[a]ny natural person whose individual net worth, or joint net worth with that person's spouse, exceeds $1,000,000" (excluding primary residence), or whose income exceeds $200,000 per year, or joint income with that person's spouse exceeds $300,000 per year. 17 C.F.R. §230.501 (a)(5) and (a)(6).

There are several important reasons why an express provision within the Proposed Amendments which provides for a private right of action would better protect investors.

First, allowing for a private right of action is consistent with the overarching goal of state and federal securities laws and regulations --which is to protect the investing public. A private right of action would provide firms with a strong incentive to adopt and implement policies and procedures to ensure that financial professionals are adhering to a fiduciary duty and to carefully police conflicts of interest. Private actions can and regularly do supplement the state and federal agencies' public enforcement efforts, including in States which hold brokers to a fiduciary standard.[9] Similarly here, a private right of action can serve as a powerful tool to encourage compliance with the Proposed Amendments and, when violated, supplement the state's enforcement efforts.[10]

Finally, a fiduciary relationship is that of the highest trust and confidence as between a financial advisor and an investor. Whenever that trust is broken, investors should have their own ability to pursue a private right of action in order to prevent the uniform fiduciary standard from becoming meaningless.

III. The Proposed Amendments Are Necessary and Appropriate Because They Provide Greater Protection for Massachusett's Investors than the Securities and Exchange Commission's "Regulation Best Interest"

As the Notice explicitly recognizes, Regulation Best Interest ("Reg BI") "does not provide sufficient protections for Massachusetts investors."[11] We agree.

A. Reg BI Does Not Sufficiently Protect Investors

Despite its title, Reg BI does not impose a true fiduciary standard upon broker-dealers and affiliated persons who provide investment advice. Reg BI essentially builds upon and codifies FINRA's interpretation of its suitability rule.[12] Reg BI does not define best interest, but rather, creates a checklist

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[9] *See* Richard B. Stewart and Cass R. Sunstein, *Public Programs and Private Rights*, 95 Harv. L. Rev. 1193, 1214 (1982).

[10] Private remedies are a necessary adjunct to the basic legal structure of the securities laws. Customers may bring an action under Sections 11(civil liability for false registration statement) and 12 (civil liability for false statements in prospectuses and communications) of the Securities Act of 1933, 15 U.S.C. §§ 77k and 77l, respectively; and under Sections 21D (private securities litigation), 21F (securities whistleblower incentives and protection), and 29 (manipulative and deceptive devices) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78u-4, 78u-6 and 78j, respectively. Additionally, investors can arbitrate a broad range of state, federal and regulatory securities violations under the rules promulgated by the FINRA if the underlying contract so provides or the customer demands it. FINRA Rule 10300 *et seq.* The Proposed Amendments should recognize these well-established means of protection for private investors.

[11] Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, at 1 (June 14, 2019).

[12] Securities and Exchange Commission, Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release No. 34-86031, 17 C.F.R. pt 240 (June 5, 2019) ("Final Rule").

of four obligations a firm must discharge to meet the standard – disclosure, care, conflict of interest, and compliance obligations – none of which actually obligates the firm to place the customer's interests ahead of the firm's.

Reg BI substantially relies on disclosure rather than meaningful investor protection. While theoretically an enhancement of FINRA rules, the Customer Relationship Summary form ("the CRS") that Reg BI requires and relies upon will not provide investors with timely, useable information. This is not merely PIABA's opinion. In fact, the SEC's own commissioned study by the RAND Corporation confirmed that the CRS was largely ineffective in helping investors understand the different duties of financial professionals, and that many individuals still remained confused about when firms and their agents owed them fiduciary duties and when they did not, even after reading the CRS.[13] Further, in an attempt to provide greater "flexibility for firms to tailor the wording" of the CRS disclosures,[14] Reg BI does not require firms to disclose every material conflict, but instead, gives firms wide discretion on what to disclose.[15] Reg BI still allows brokers to satisfy their purported disclosure obligations regarding costs by providing percentages or ranges, rather than the dollar amounts likely to be understood by investors. In short, under Reg BI, firms will be able to satisfy their disclosure obligation through boilerplate disclosures, and withhold actual cost and conflict of interest information until after the sale of the product at issue has been made.

In contrast to the Proposed Amendments, Reg BI will not require brokers to weigh the relative risks, costs and benefits of different strategies or types of investments available to achieve the customer's goals. Instead a broker will only be required to consider costs when deciding among two otherwise identical securities. Reg BI also limits the purported "best interest" obligation to the beginning and end of a transaction, rather than for the duration of the customer-broker relationship. In addition, Reg BI continues differing standards of conduct for dually registered investment advisors and brokers.

Lastly, Reg BI's conflict obligation does not prohibit firms from creating conflicts that would reasonably be expected to encourage and reward advice that is not in the customer's best interests. Reg BI simply requires firms to develop and enforce policies and procedures to "mitigate" most conflicts and, to the extent not mitigated or eliminated, the firm may satisfy this obligation through disclosure. However, providing greater disclosure does not appropriately mitigate the conflicts of interest inherent in the relationship between financial advisors and customers. Instead, it places the burden on the customers to fully understand the impact of those conflicts on the future of their retirement savings.

The weak and ineffective provisons of Reg BI stand in sharp contrast to the Proposed Amendments. As discussed in Section I above, the Proposed Amendments hold all financial professionals who render investment advice to a fiduciary standard. The Proposed Amendments provide that conflicts of interest are presumed to be a breach of the duty of loyalty. The Proposed Amendments require that financial

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[13] Investor Testing of Form CRS Relationship Summary, SEC 46 (Nov. 2018), available at https://www.sec.gov/about/offices/investorad/investor-testing-form-crs-relationshipsummary.pdf. In fact, the written responses to specific questions about the disclosures reveal that a significant number of participants did not understand important sections of the form, and still had a general misunderstanding of the different standards governing investment accounts and financial professionals. The RAND report also reflects that many of the participants were unable to synthesize and apply the information. *Id.* at 47-48.

[14] Final Rule, *supra* note 12, at 81.

[15] "Firms are not expected to disclose every material conflict of interest, and should instead consider what would be most relevant for retail investors to know in deciding whether to select or retain the particular firm. *Id.* at 161.

professionals adhere to a duty of care and a duty of loyalty, which cannot be discharged solely through purported disclosures. The Proposed Amendments define what the fiduciary duty requires, and what is meant by the duty of care and the duty of loyalty. The Proposed Amendments recognize that the fiduciary duty should endure for the duration of the relationship. Lastly, the Proposed Amendments eliminate the false distinction between investment advisors and brokers by treating both as the financial professionals which they hold themselves out to be, and by requiring both to adhere to the same standard of conduct.

Simply put, the differences between Reg BI and the fiduciary standard proposed in the Proposed Amendments are significant. Consequently, as the Notice states, the Proposed Amendments are necessary and appropriate in order to sufficiently protect Massachusetts investors.

B. Reg BI Does Not Preempt the Secretary from Enacting the Proposed Amendments

We believe that some in the financial services industry may argue that the SEC's anticipated Reg BI preempts States from enacting a fiduciary standard. Such an argument is not supported by Reg BI, nor by the Dodd-Frank Act under which Reg BI has been promulgated. The exact opposite is true.

Specifically, there is no express language in Reg BI which alters or supersedes any existing obligations applicable to brokers and broker-dealers with respect to the circumstances under which brokers may owe customers a fiduciary duty under state law. To the contrary, the SEC explained in its Release that "the preemptive effect of [Reg BI] on any state law governing the relationship between regulated entities and their customers [will] be determined in future judicial proceedings."[16]

Further, Reg BI was promulgated pursuant to Section 913 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). This provision required the SEC to conduct a study to evaluate the effectiveness of existing legal or regulatory standards of care (imposed by the Commission, a national securities association, and other federal or state authorities) for providing personalized investment advice and recommendations about securities to retail customers; and whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.[17] It is clear from the foregoing that the SEC's task was to determine whether a rule establishing a baseline standard for investment advice was warranted based on gaps in the existing regulatory scheme. Indeed, the Dodd-Frank Act does not provide that rulemaking by the SEC in this area would preempt state law. Likewise, Reg BI does not indicate that it is intended to preempt state law. In fact, doing so would be unconstitutional.

Under the Tenth Amendment to the Constitution, powers not enumerated to the Federal government are reserved to the States or the people. As a result, although the SEC may create a best-interest rule for the financial industry, it cannot, as an administrative agency of the federal executive branch, create a rule that interferes with a State's interest in protecting its citizens from tortious conduct. Simply put,

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[16] Final Rule, *supra* note 12 at 43.

[17] *See* "Study on Investment Advisers and Broker-Dealers," Executive Summary, p. i, January 2011, available at http://www.sec.gov/news/studies/2011/913studyfinal.pdf.

Massachusetts retains the right to enact more stringent rules than the SEC if its legislators or judiciary conclude that an enhanced level of investor protection is warranted based on the needs of the State.

Finally, the only potential challenge to the Draft Regulations would be under the National Securities Markets Improvement Act of 1996 ("NSMIA"). Section 103 of NSMIA limits states from enacting any rule or regulation that imposes upon broker-dealers any "[c]apital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements" that are greater than those imposed under federal law, rules or regulations.[18] The Proposed Amendments expressly address this concern.[19]

IV. Conclusion

PIABA supports the Secretary's efforts to heighten the duty of brokers who provide investment advice to their customers. PIABA urges the Secretary to adopt its Proposed Amendments, along with the suggestions which are discussed in Section II above. PIABA thanks the Secretary for the opportunity to comment on this important issue.

Sincerely,

Christine Lazaro
PIABA President

[18] 15 U.S.C. §780(i).

[19] 950 CMR 12.207(f)