



William Francis Galvin
Secretary of the Commonwealth of Massachusetts



Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives

June 14, 2019

The Massachusetts Securities Division (the "Division") of the Office of the Secretary of the Commonwealth is circulating for preliminary comment a regulation to apply a fiduciary conduct standard on broker-dealers, agents, investment advisers, and investment adviser representatives when dealing with their customers and clients, respectively.

This conduct standard is based on the common law fiduciary duties of care and loyalty. The fiduciary conduct standard requires that recommendations and advice be made in the best interest of customers and clients without regard to the interests of the broker-dealer or advisory firm or its personnel.

The proposed conduct standard allows for the payment of transaction-based remuneration if the remuneration is reasonable, it is the best of the reasonably available remuneration options, and the care obligation is satisfied.

The fiduciary obligation under the conduct standard applies to the provision of recommendations, advice, and to the selection of account types. Therefore, the conduct standard will apply to recommendations to open IRA roll-over accounts, as well as recommendations to open accounts involving asset-based or transaction based remuneration.

The Fiduciary Conduct Standard is Necessary in the Public Interest and for the Protection of Investors

The need for a conduct rule mandating that investment advice must be provided under a fiduciary standard has been recognized for many years.

Section 913 of the Dodd-Frank Wall Street Reform and Financial Protection Act ("Dodd-Frank") authorized the U.S. Securities and Exchange Commission (the "SEC") to establish a standard of conduct for broker-dealers providing investment advice about securities to retail investors that is "no less stringent than" the fiduciary duty standard under the Advisers Act. In 2011, the SEC's Section 913 Study, which was required under Dodd-Frank, specifically recommended that broker-dealers provide advice pursuant to the same fiduciary standard that applies to investment advisers.¹

In spite of the 2011 recommendation by the SEC staff, the SEC's final Regulation Best Interest release and rulemaking (June 5, 2019)² fails to establish a strong and uniform fiduciary standard.

The SEC's Regulation Best Interest fails to define the key term "best interest," and sets ambiguous requirements for how longstanding conflicts in the securities industry must be addressed under the new rule.

The SEC rule also fails to indicate whether some of the most problematic practices in the securities industry would be prohibited under the new rule. For instance, while the SEC's adopting release for Regulation Best Interest indicated that sales contests limited to specific products or product types would be contrary to that rule, it did not indicate that broader-based sales contests or quotas would be contrary to its requirements.

In many instances, it appears that the mitigation of conflicts required under the SEC Regulation Best Interest can be accomplished through disclosure, including disclosure via the new Customer Relationship Summary (Form CRS).³

This approach contradicts years of data gathered by studies and reports on disclosure and the conduct standards applicable to broker-dealers. The empirical studies supporting the 2008 RAND Report⁴ found that investors were fundamentally confused about the differences between broker-dealers and investment advisers.⁵ A key finding of the 2008 RAND Report is that most investors mistakenly believed the intermediary (whether it is a broker-dealer or an investment adviser) is acting in the investor's best interest.⁶ That report concluded that investors do not have the education and background to understand and effectively use disclosures such as the current Form ADV, Part 2.

While relationship and conflict disclosure is important for all investors, it cannot replace a clear fiduciary standard of conduct, which is the basis for the Division's proposal.

Massachusetts Securities Division Enforcement Actions Demonstrate the Need for a Uniform Fiduciary Standard

Retail investors have suffered severe financial harm under the current "suitability" conduct standard for broker-dealers, which does not do enough to eliminate conflicts of interest. The Division has repeatedly held firms accountable for the damage suffered by investors due to conflicts that would be avoided when the firms and individuals are held to a uniform fiduciary standard. The Division's enforcement cases include:

- **Sales Contests** at large broker-dealer firms involving cross-selling⁷ and involving sales in violation of internal policies and procedures.⁸
- **Churning** in senior citizen's brokerage account involving covered securities.⁹
- **Unsuitable sales of securities products** to a senior citizen by a representative working out of the offices of a large state chartered bank.¹⁰
- **Unsuitable sales of alternative investments**, including structured CDs, non-traded REITs, and BDCs, by representatives of a broker-dealer working out of state-chartered bank premises.¹¹
- **Sales of non-traded REITs** by representatives of a large, independent broker-dealer that failed to adequately supervise its agents' sales activities.¹²
- **Failure to Supervise** by a large, independent broker-dealer of its representative who made unsuitable recommendations involving sales of the exact same financial product, carrying a very high commission, to more than 80 customers.¹³

The preliminary comment period will remain open until **Friday, July 26, 2019 at 5:00 p.m.**

1 Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (January 2011) at page (v):

The Commission should exercise its rulemaking authority to implement the uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. Specifically, the Staff recommends that the uniform fiduciary standard of conduct established by the Commission should provide that: 'the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.' (Emphasis added.)

2 <https://www.sec.gov/rules/final/2019/34-86031.pdf>

3 <https://www.sec.gov/rules/final/2019/34-86032.pdf>

4 Investor and industry perspectives on investment advisers and broker-dealers / Angela K. Hung ... [et al.]. "RAND Report" (2008).

5 RAND Report at 19.

6 RAND Report at 19.

7 See Massachusetts Securities Division Docket No. E-2016-0055.

8 See Massachusetts Securities Division Docket No. E-2015-0103.

9 See Massachusetts Securities Division Docket No. E-2012-0118.

10 See Massachusetts Securities Division Docket No. E-2015-0103.

11 See Massachusetts Securities Division Docket No. E-2016-0060.

12 See Massachusetts Securities Division Docket No. E-2012-0036.

13 See Massachusetts Securities Division Docket No. E-2016-0039.

[Regulation, as amended \(redline\)](#) (PDF)

[Regulation, as amended \(clean\)](#) (PDF)

Request for Public Comment

The Division should receive written comments on the proposed amended regulations no later than **Friday, July 26, 2019 at 5:00 p.m.**

We will post comments on the Massachusetts Securities Division website and comments are subject to public records laws. We do not edit personal identifying information from submissions; submit only information that you wish to make available publicly.

Submission via Mail

Please mail any comments on the proposed amendments to:

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

Submission via Facsimile

Faxed comments may be sent to 617-248-0177. Comments sent via facsimile should include a cover sheet to the attention of "Proposed Regulations."

Submission via Email

Email comments or submissions of scanned comment letters attached to an email may be submitted to securitiesregs-comments@sec.state.ma.us.

Submit a Comment

If you have questions about either of the proposed amendments, please contact the Division at 617-727-3548.

William Francis Galvin, Secretary of the Commonwealth of Massachusetts

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