LIFE INSURANCE ASSOCIATION
OF MASSACHUSETTS

July 26, 2019

The Honorable William Francis Galvin
Secretary of the Commonwealth
Attn: Proposed Regulations – Fiduciary Conduct 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 Life Insurance Association of Massachusetts ("LIAM") is a trade association representing 18 of the nation's leading life, long term care and disability income insurers. LIAM develops consensus on issues of importance to the industry and represents its members before the Massachusetts legislature and state government agencies.

The American Council of Life Insurers ("ACLI") is a national trade association representing 290 life insurers that hold over 95 percent of the industry's total assets. Our members serve 75 million American families that rely on life insurers' products for financial and retirement security. Our members offer life insurance, annuities, retirement plans, long-term care, disability income insurance, and reinsurance.

ACLI and LIAM greatly appreciate the opportunity to share their views on the proposed amendment of Massachusetts securities regulation that would establish a fiduciary duty for broker-dealers and investment advisers. The proposed initiative could affect broker-dealers and investment advisers that distribute financial and retirement products developed by our life insurance members.

We are concerned that a uniform fiduciary duty for broker-dealers and investment advisers, which does not consider retail customer choice and differing retail customer circumstances, will have unintended adverse effects, and may actually harm the Massachusetts individuals and families that it intends to protect.

We urge the Division to postpone further action on the proposed regulatory changes and carefully examine the implementation of the SEC Regulation Best Interest and Form CRS together with changes proposed by the National Association of Insurance Commissioners ("NAIC").

Summary of the Preliminary Proposal

On June 14, 2019, The Massachusetts Securities Division of the Office of the Secretary of the Commonwealth of Massachusetts (the "Securities Division") circulated for preliminary comment a regulation which would, among other things, impose a fiduciary conduct standard on broker-dealers, agents, investment advisers, and investment adviser representatives when providing investment advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the transferring of assets to any type of account.

According to the Division's announcement:

> 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.
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> 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 Proposed Regulation Would Harm the Very Consumers it Intends to Protect

To meet their diverse financial and retirement security needs, retirement savers deserve standards ensuring continued access to a wide variety of retirement products, retirement savings information and related financial guidance from financial professionals acting in their best interest. Life insurers create and market products and services that fulfill consumers' retirement and financial security. Life insurers also fill a unique and important role in providing financial and retirement services to the less affluent and the middle-income markets that are neglected by other financial service institutions. For example, life insurance agents tend to be more local than other financial service professionals, often serving consumers in small towns who would otherwise be beyond the scope of other financial service providers.

The proposed regulation will muddy the interpretive, compliance and regulatory waters resulting in a contraction in the delivery of financial and retirement products to Massachusetts individuals and families. As Americans address their often complex financial and retirement security needs, they need an effective federal and state regulatory framework that they can understand, that protects their interests as investors, and that affords them continued access to a wide variety of retirement and investment products and financial services they require to fulfill their changing needs.

Life insurers believe that regulation should provide consumer protections while ensuring that retail securities customers continue to have access to the quality products and services (advisory or brokerage) they need; receive advice at the frequency they choose (none, episodic, or ongoing); and have the choice to pay for those services in the manner that meets their needs (one-time, transaction-based, or fee-based).

Consumers rationally make choices about the products or services they purchase, and those choices are made by weighing differing needs, preferences, prices and purposes across a range of alternatives. Consumers of financial products and advice make similar choices about which factors they deem are their primary considerations when deciding among products, services, and service providers. Consumers also make important choices about the type of investment advice they want to receive, which will depend on their individual needs.

Retail customers should be able to choose different types of advice without sacrificing investor protection standards or receiving sub-standard advice, products, or services. Furthermore, by inflexibly applying the requirements of the proposed regulation in each of these circumstances and creating an ongoing obligation if any of these transactions are performed for a retail customer, the regulation will limit account choices and mandate services that the retail customers may not want and for which they do not wish to pay.

Limited Choices, Higher Fees

Rather than benefiting retail customers, the uniform fiduciary standard, as proposed by the Division, would strongly curtail access to lower-priced brokerage accounts that receive incidental advice, e.g."traditional brokerage accounts." Instead, the regulation will result in many retail customers having access only to self-directed online accounts, in which the desired advice is unavailable to them, or drive them into higher priced fee-based advisory accounts, for which many consumers fail to qualify.

Self-directed accounts are preferred by certain retail customers who choose to conduct their own research, are more confident of their decision-making, and wish to pay only for execution, settlement, and custodial services. Although this option generally is more economical, it is not ideal for all retail customers, particularly those with less time and investment experience. Such retail customers may want to have a conversation with a financial professional, weigh the pros and cons of different options, and receive what is traditionally viewed as "incidental" advice before making a purchase. Simply put, many retail customers are not inclined or equipped to go it alone, but also may not want to pay (or be able to qualify for or pay) an ongoing fee or receive advice over time. A reduction in the availability of traditional brokerage accounts would deprive many retail customers of the benefits of professional advice, in favor of other arrangements less suited to their needs.

Advisory accounts generally are chosen by retail customers who wish to delegate investment decisions to a professional manager. Such "full service" advice accounts may be, among other things, wrap accounts, or separately managed accounts, or digital wealth managers. Although they offer ongoing duties and monitoring, such accounts are not desirable for, or in the best interest of, many retail customers. Advisory accounts usually have entry points and asset-based fees that are much higher than the entry points and fees charged by traditional brokerage accounts.

Small and Moderate Investors Impacted Most

If financial firms are forced to move to a model where the only way a consumer can get financial advice is if that consumer pays a fee to a financial professional year after year out of their own pocket, then small and moderate retirement savers — everyday Americans — are far less likely to be able to consider all their options for their own retirement needs. It's also unfair to consumers who don't want a fee-based arrangement where the annual charges can become costly over time. Lastly, a fee-based arrangement is not always suitable or cost-effective for the investor, even if they qualify for it. For example, if a consumer is interested in a "buy and hold" strategy where they are not placing transactions or altering their portfolio on a regular basis, in many cases, that consumer would be better served with a traditional commission-based brokerage account.

Divergent regulatory approaches have proven detrimental to small and moderate retirement savers by driving away financial professionals and creating an advice gap for those most in need of sound guidance. The proposed regulation could provoke similar harm for Massachusetts individuals and families. If a uniform fiduciary standard is imposed in Massachusetts, firms that provide traditional brokerage accounts will have to evaluate whether they can continue to offer episodic, transaction-based advice to retail customers who hold small balances – the very ones who need that advice to help secure their financial stability and wellness. This is because the costs associated with the ongoing duties and monitoring required by the new standard may make such accounts cost-prohibitive for many broker-dealers and their customers. In contrast, the currently available traditional brokerage accounts offer retail customers the flexibility to seek help when needed, at price points acceptable to them, but without overburden them with services and monitoring they have neither requested nor want to pay for.

Market Impact of DOL Fiduciary Rule

Even well-intentioned, but ill-conceived rules can have an unforeseen, significant negative impact on life insurers' delivery of insurance and annuities to consumers, particularly those comprising moderate and middle-class households. During its operation, The United States Department of Labor's Fiduciary Rule (the "DOL Fiduciary Rule") caused a significant reduction in the sale of new insurance products. This was caused by increased operational costs and exposure to increased litigation risks under the DOL Fiduciary Rule. Variable annuity sales declined 21 percent in 2016 (from $133 billion in 2015 to $104.7 billion) and declined a further 8.7 percent in 2017 ($95.6 billion).

The findings of a study by Deloitte & Touche which reported the results of its survey of twenty-one financial institutions' implementation of the now-vacated DOL Fiduciary Rule, are particularly instructive. The Study found that implementation of the DOL Fiduciary Rule substantially limited access to brokerage services and increased the account or household minimums required to continue receiving advice. While the full effects of the DOL Rule were not realized, the SEC has confirmed that during the transition period, the Rule caused a significant reduction in retail investor access to brokerage services, caused a shift from commission-based brokerage accounts to self-directed accounts, and led to higher-priced products for retail customers. According to the research group LIMRA, if the Labor Department's regulation had remained in-force, 54 percent of advisors might have dropped or turned away small investors, resulting in as many as 4 million middle-class households losing access to information needed to ensure a secure retirement.

We are deeply concerned that the Securities Division proposal will have a similar effect on the Massachusetts marketplace. The proposal's duty of loyalty obligations are especially concerning, as firms would naturally limit or stop providing advice to brokerage clients given the impossible (and unknowable) requirement to recommend only "the best" products, account types, investment strategies and remuneration options. Additionally, broker-dealers would be incentivized to convert, where appropriate, brokerage clients to fee-based advisory accounts, as a result of the proposal's formulation of the ongoing fiduciary duty obligation. While certain clients might be appropriate for such an account, many others would lose access to the professional advice that is so critical for consumers facing the challenge of retirement and other key events.

The DOL Fiduciary Rule taught us some important lessons and led to a more effective way of regulating financial professionals, which achieves consumer protections while assuring consumer choice.

A Better Approach: SEC Regulation Best Interest

Shortly before the fiduciary duty initiative was proposed, the SEC adopted Regulation Best Interest ("Reg. BI") that establishes a standard of conduct for broker-dealers when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. This enhanced standard of conduct requires broker-dealers to act in the best interests of the retail customer at the time a recommendation is made without placing the financial or other interests of the broker-dealer or natural person who is an associated person making the recommendation ahead of the interests of the retail customer. This obligation is satisfied under Reg. BI, if the broker-dealer fulfills a disclosure obligation, a care obligation, a conflict of interest obligation, and a compliance obligation.

Regulation Best Interest is a sensible, principles-based rule governing broker-dealer conduct that properly implements the Dodd–Frank Act. Life insurers strongly support protections serving the best interests of customers, which can be meaningfully safeguarded with disclosure about services and material conflicts of interest. This approach provides an effective means to shield consumers and facilitate informed purchase decisions.

Coextensive with Regulation BI, the SEC adopted Form CRS, a streamlined, plain-English, user friendly document about services, fees, and consumers' relationship with broker-dealers and investment advisers, among other things. Form CRS dovetails neatly with the enhanced conduct standards in Reg. BI and significantly buttresses consumer protection and decision making. In a similar vein, the NAIC has coordinated with the SEC to develop parallel regulatory standards in the Suitability in Annuity Transactions Model Regulation. Likewise, the Department of Labor has docketed on its rulemaking agenda a standard of care rule, and has pledged to incorporate coordinated standards.

It is important to note that, contrary to the suggestion in the Securities Division notice and request for public comment, dated June 14, 2019 ("[i]n 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)."), Reg. BI cannot be satisfied by disclosure alone.

While disclosure is required under Reg. BI, it is only one of four obligations including a detailed, substantive care obligation, a conflict of interest obligation, and a compliance obligation. Indeed, on July 8, 2019, SEC Chair Jay Clayton dispelled the notion that disclosure alone satisfied Reg. BI in a public statement. He stated:

> *This claim [that disclosure alone fulfills Reg. BI] reflects a fundamental misunderstanding of how the independent component obligations of Reg. BI operate and a misconception of the investment adviser's fiduciary duty.*
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> *When making a recommendation, a broker-dealer has a general obligation to act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests. The general obligation is satisfied only if the broker-dealer complies with the four specified component obligations that I discussed—again, the Disclosure, Care, Conflict of Interest and Compliance Obligations.*
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> *Similarly, an investment adviser has an obligation to act in the best interest of its client—which is an overarching principle that encompasses both the adviser's duty of care and duty of loyalty. While an adviser may be able to satisfy the duty of loyalty by providing full and fair disclosure and obtaining informed consent, the adviser could not satisfy its duty of care solely through disclosure. Thus, the fiduciary duty cannot be satisfied by disclosure alone.*

Life Insurers Already Subject to Extensive Regulation

Life insurance companies and their associated persons currently fulfill a broad array of regulations administered by state insurance and securities departments, the SEC, DOL, and FINRA. Existing comprehensive regulations govern important aspects of the customer relationship, including suitability standards, disclosure, advertising, supervision, maintenance of customer account assets, data collection, training, compensation, and supervision of associated persons. In general, the federal securities laws and FINRA rules govern individual variable insurance contracts. In some cases, insurance products invoke both federal and state laws. Several additional consumer protections exist under the SEC's Regulation BI initiative and parallel developments in the NAIC's Suitability in Annuity Transactions Model Regulation. These important regulatory protections collectively provide important consumer protection and strong enforcement tools that buttress the purpose of the Massachusetts securities laws and the stated intent of the proposal.

As one example of regulatory protection, clarification on the scope of broker-dealer conflict management and mitigation under Reg. BI can be constructively drawn from the comprehensive FINRA Report on Conflicts of Interest. In its conflicts report, FINRA focused on broker-dealers' approaches to identifying and managing conflicts in three critical areas—broker-dealers':

- Enterprise-level frameworks to identify and manage conflicts of interest;
- Approaches to handling conflicts of interest in manufacturing and distributing new financial products; and,
- Approaches to compensating salespersons.

The report identified effective practices that FINRA observed or that, based on experience and analysis, FINRA believed could help broker-dealers improve their conflicts management practices. It also contained more general observations and commentary on firms' practices for enhanced conflicts management. The report encouraged the creation of a comprehensive framework to identify and manage conflicts of interest across and within broker-dealers' business lines that is scaled to the size and complexity of their business. The conduct under FINRA's conflicts position is just one of many complementary state and federal standards protecting consumers in the acquisition of financial and retirement products.

Improved Investor Understanding: 2018 RAND Study Modifies Form CRS

The Securities Division notice and request for public comment noted that investors may not be fully informed.:

> *"The empirical studies supporting the 2008 RAND Report found that investors were fundamentally confused about the differences between broker-dealers and investment advisers. 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. 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."*

Rand also conducted a much more recent study -- in 2018 -- evaluating proposed Form CRS through extensive consumer testing to assure it addressed the concerns highlighted in its 2008 study. The SEC carefully addressed the input that was elicited through the 2018 RAND study and modified the final form significantly in response. Again, SEC Chair Clayton addressed the incorrect assertion that Form CRS will not accomplish the goals of addressing investor confusion regarding the differences between brokers and adviser. He stated:

> *We have engaged in extensive and rigorous investor testing relating to the issues addressed by the relationship summary, not just for purposes of this rulemaking, but in connection with our long history in this space. The amount of feedback, investor testing and other information our staff considered in developing the final*

> *requirements for the relationship summary, leveraging their considerable experience and expertise with investor disclosures, was extensive—perhaps even unprecedented.*
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> *It is clear that retail investors are confused about the differences between brokers and investment advisers. The new Form CRS relationship summary is a substantial improvement over existing retail disclosures, which are often lengthy, framed in legal terminology and dispersed among many documents. No existing retail disclosure provides this level of transparency and comparability across SEC-registered investment advisers, broker-dealers, and dual registrants.*

Variable Annuities

As stated, we support the Securities Division's efforts to improve investor protection. Variable annuities and other variable insurance products are not within the jurisdictional mandate of the Massachusetts Securities Division, but rather, are regulated by the Massachusetts Division of Insurance. With the new Proposal on the table, this jurisdictional framework should remain unchanged.

Currently, because the Massachusetts Uniform Securities Act (the "Act") excludes variable insurance and annuity products from the definition of a security, these products cannot be regulated by the Massachusetts Securities Division or its rules governing securities, presumably including those in the Proposal. Under the Act, variable annuities are not included in the definition of a security, and they are exempt from registration and the Act. As a result, the Securities Division does not have jurisdiction to bring enforcement actions concerning variable annuities sales practices against life insurers and broker dealers.

Variable life insurance and variable annuities are appropriately regulated in the State of Massachusetts by the Division of Insurance, FINRA, and the SEC. Many states, including Massachusetts, have adopted rules that require insurance producers to have reasonable grounds for believing that, among other things, a recommendation is suitable for a customer based on the facts disclosed by the customer as to his or her investments or other insurance and his or her financial situation and needs, including information such as the customer's age, income, financial objectives, time horizon, liquidity needs, and risk tolerance. Many states, including Massachusetts, permit broker-dealers to meet state insurance suitability requirements for the sale of annuities by complying with FINRA rules pertaining to suitability and supervision of annuity transactions. The Massachusetts Division of Insurance has full authority to investigate and enforce consumer protection and suitability rules regarding these products. It is our strong expectation that, the Proposal notwithstanding, the Massachusetts Division of Insurance will continue to assume sole responsibility to regulate variable products in the State of Massachusetts.

Conclusion

Government studies reveal that many individuals and families are not adequately prepared for financial and retirement security. Each day, 10,000 Americans turn age 65 and many can expect to live 20 years or longer in retirement. Massachusetts has 1,071,418 million residents age 65 or older, which reflects 15.8% of the state's total population. Research shows that one-third of Americans approaching retirement have between nothing and $25,000 in savings to supplement Social Security income.

As society and work change, Americans need policy solutions that protect them and help them achieve financial security, regardless of where and how they work, their life stage, or the economic status of their household. People are living longer and financial security into retirement is a big challenge. Government policies that limit consumer choice ignore the fact that financial situations are varied and personal. Life insurers want to help people achieve retirement security with a choice of products that are available, accessible, and affordable for all.

The SEC's Regulation Best Interest is a sensible, principles-based rule governing broker-dealer conduct that properly implements the Dodd–Frank Act. The proposed Massachusetts regulation will conflict with the significant new SEC regulatory actions in Reg. BI and Form CRS and will harm the Massachusetts individuals and families it intends to protect.

ACLI and LIAM support reasonable regulations governing financial professionals that protect Americans in the acquisition of financial products. Efficient and effective best interest standards will broaden consumers' functional access to variable annuities and variable life insurance as financial and retirement solutions. Clarity, consistency and coordination across all regulatory platforms will best serve investors, and thwart regulatory arbitrage.

We urge the Division to postpone further action on the proposed regulatory changes and carefully examine the implementation of the SEC Regulation Best Interest and Form CRS together with changes proposed by the National Association of Insurance Commissioners.

Thank you for your attention to our views. Please let us know if you have any questions.

Sincerely,

Luke A. Dillon

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Life Insurance Association of Massachusetts

Carl B. Wilkerson

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