The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

July 21, 2015

The Honorable Phyllis C. Borzi
Assistant Secretary for Employee Benefits Security
Office of Regulations and Interpretations
Attn: Conflict of Interest Rule
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Re: Proposed Conflict of Interest Rules: Definition of the Term "Fiduciary;" Conflict of Interest Rule-Retirement Investment Advice; and Related Prohibited Transaction Exemptions
29 CFR 2509, 2510, and 2550
RIN 1210-AB32; 1210-ZA25

Proposed Best Interest Contract Exemption
29 CFR Part 2550 [Application No D-11712]
ZRIN 1210-ZA25

Dear Assistant Secretary Borzi:

I write in my capacity as the chief securities regulator for Massachusetts. The Office of the Secretary of the Commonwealth administers and enforces the Massachusetts Securities Act, M.G.L. c.110A, through the Massachusetts Securities Division.

Through the regulatory and enforcement work conducted by my office, I have seen first-hand the harm that retail investors and savers have suffered as a result of conflicted investment advice. Conflicts of interest are built into the relationships between many financial professionals and their customers. Similarly, conflicts of interest are also built into many investment products, because high-risk and high-cost products often carry high selling commissions and ongoing fees.

We welcome the opportunity to comment on the U.S. Department of Labor's ("Labor") fiduciary rule proposal. The proposal to upgrade the standard for retirement investment advice to a fiduciary standard is a necessary step, which will significantly protect investors' savings. Most retail investors are not in a position to replace lost retirement funds, so those assets clearly warrant the protections provided by ERISA. Furthermore, improving the integrity of the

retirement savings market will benefit the economy overall; that benefit alone is a sufficient reason to strengthen the protection of these assets.

The need to make a fiduciary standard applicable to retirement advice is clear, and it has been for many years. I urge the Labor to promptly adopt the strong fiduciary standard it has proposed in order to protect investors who are now being poorly served, or suffering financial abuse, in the market for retirement advice.

I. Background: Most Investors Must Now Establish and Manage Their Own Retirement Plans

Labor correctly observes that investors are on their own in making retirement plans and seeking appropriate retirement advice. With the decline of traditional, professionally managed, defined benefit pensions and the rise of retirement savings vehicles such IRAs and 401(k) accounts, investors are forced to choose from a bewildering array of financial products and services. Very often, investors are poorly served, or are harmed, by the advice they are given and by the products that are sold to them.

The conflicted recommendations provided by the financial services industry for retirement savings too often saddle investors with complex, expensive, and unduly risky investments. Also, many alternative investments sold to retirement investors provide limited liquidity or none at all, so they are particularly ill suited to the needs of many senior citizens.

II. The Department of Labor's Proposals Are Realistic and Workable

With the fiduciary rule and related exemptions, particularly the Best Interest Contract Exemption, Labor has proposed a practical way to bring existing advisers and forms of compensation under a fiduciary standard.

A fiduciary standard has been actively discussed for many years, and it has gained significant support. Against this backdrop, Labor's fiduciary proposals should not come as a surprise to the financial services industry.

While a fiduciary standard will require financial firms to change how they do business, the challenges of adopting the standard are far from insurmountable. The financial services industry can be an innovative and dynamic industry, so we believe it can adjust to the requirements of Labor's proposed rules. Also, we note that investment advisers already operate under a fiduciary standard, so we believe other segments of the industry can adopt that standard as well.

We concur with the detailed findings in Labor's rule release that the current system of non-fiduciary retirement advice is very costly to investors, and that the compliance costs imposed by the proposals will be significantly less than the cost of conflicted advice.[1] When the costs and benefits of the proposal are evaluated, it becomes clear that the fiduciary standard will create significant savings. Those savings will benefit retirees.

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[1] *See,* Fiduciary Proposal, Part I.C. (*Gains to Investors and Compliance Costs*), Fed. Reg. Vol. 80, No. 75, pages 21930 - 21932.

We also understand that some criticize the fiduciary proposal as one that will bring disruptive and unnecessary change. These critics urge that a system of notice and disclosure will be sufficient to protect retirement investors. This is an argument for the *status quo*, and as such it should be rejected.

The securities laws currently impose a regime of full disclosure, along with obligations for brokers to deal fairly with their customers and make suitable recommendations. In practice, the current standards often fail to protect investors and their assets. Chronic problems range from overly expensive investment products to outright financial abuse. Retirement investors need the protection a fiduciary standard will provide, and they need it now.

III. IRAs Have Been an Area of Abuse

Many of the worst cases of abuse that my office has seen are instances where brokers have advised customers to roll over retirement assets into high-cost IRAs. In such cases, the investors' lack of expertise and their need for non-conflicted advice are tragically clear.

We have seen particular abuse in the category of so-called "self-directed IRAs." Self-directed IRAs were intended to provide a means for investors to put retirement assets into non-traditional investments within the IRA. There is a disturbing trend of sponsors of high-risk investments, as well as fraudsters, recommending that investors concentrate their IRA accounts in exotic and high cost investments.

a) Enforcement Action: Abuse in IRA Roll-Overs

We have seen repeated instances of abuse carried out by unscrupulous stockbrokers, investment advisers, and insurance agents in IRA roll-overs.

My office carried out an enforcement action against a major national brokerage firm relating to misconduct by one of its agents. This agent engaged in several abusive practices in handling the funds of Boston Edison utility employees who had been paid early retirement benefits.

The agent obtained a list of recent Boston Edison retirees and aggressively cold called them. His pitch included false promises and guarantees as well as misrepresentations about the safety of investing in the stock market and the returns he could generate. The agent convinced multiple Boston Edison employees to take their retirement distribution as a lump sum, and then roll that money into an IRA account at the brokerage where he worked.

The extent of the agent's calling created such a disturbance that the CEO of Boston Edison included a note in a statement-stuffer to Edison employees warning them against aggressive cold calling by this agent and the brokerage firm.

Despite attempts by Boston Edison's management to protect its employees in the face of such cold calling, the agent succeeded in opening large accounts with funds from Edison retirees. Bringing in these accounts made him a valuable agent at the firm.

This agent engaged in an array of abusive practices with these retirement accounts, including: excessive trading ("churning"); day trading mutual fund shares; placing customers in high-cost money market "B" shares --when a low-cost alternative was readily available; and recommending inappropriate, high risk securities.

The brokerage firm did not stop or even curtail the agent's misconduct. In fact, the firm ignored or stymied the efforts of supervisory personnel to stop the agent's misconduct.

After an investigation and the filing of an enforcement action by the Massachusetts Securities Division, the brokerage firm filed an offer of settlement. Under a Consent Order, the firm agreed to repay its customers for the losses they suffered due to their agent's misconduct.

b) Enforcement Action: Abuse in Self-Directed IRA Accounts

In 2011, a Quincy, Massachusetts man started offering shares for his fund via a private placement memorandum. The purpose of the fund was to take advantage of depressed real estate markets, buying homes, renovating, then either renting or selling the renovated homes. The Quincy man had attended house flipping seminars that included sessions on how to tap into dormant IRA/401K money and get investors to move their retirement funds into self-directed IRAs.

The Quincy man partnered with a self-directed IRA company, whose only requirement to hold the shares of the private placement as custodian was to receive a copy of the private placement memorandum.

The Quincy man promised 8% returns and requested the investors leave $500 in the self-directed IRA account to cover the first quarterly fee, and then returns would cover the fees for the remainder of the year. The self-directed IRA fee was fixed regardless of the amount invested. For example, based on $2,000 in fees ($500 charged quarterly), a $10,000 investment would have been assessed 20% in annual fees, while a $25,000 investment would have been assessed 8% in fees, and a $40,000 investment was assessed 5% in fees.

The promised 8% returns never materialized, and the Securities Division received complaints from investors. After an investigation, the Division settled the matter with the Quincy man by requiring him to return the investors' money along with the fees assessed by the self-directed IRA company.

c) Enforcement Action: Abuse in Sales of Alternative Products

My office carried out an extensive investigation of sales of speculative investment notes by a major independent brokerage firm. These notes were purportedly backed by medical accounts receivable. The notes were alternative investments that were sold under the rules for

non-public offerings. The brokerage firm sold the notes to retail investors, most of them at or close to retirement age, who were looking for a better return than money market accounts or CDs provided. A majority of the customers bought these notes for their IRA accounts.

The notes were issued by affiliates of a multi-million dollar financial company that had unaudited finacials statements and inadequate financial controls.

When several series of these notes collapsed, creating millions of dollars in losses for investors, the brokerage did not take steps to help make whole the customers to whom it had recommended those offerings. Instead, the brokerage firm and its legal team argued that the investors had agreed to purchase these risky and complex investments, and they were therefore responsible for the consequences when the offerings collapsed.

My office's investigation into this matter culminated in a lengthy administrative hearing. During that hearing, the brokerage's customers, many of them savers rather than investors, gave consistent accounts of how the notes were offered and sold.

Investors described their relationship with the brokerage firm and their individual brokers as a relationship built on trust. They expected the brokerage and the agent to make recommendations in their best interests and to look out for them. Investors believed the note investment was at least somewhat safe, particularly because their broker recommended it. Investors testified that written disclosures, including risk disclosures, were not emphasized at the point of sale (they were often downplayed or treated like mere paperwork).

The brokerage firm defended itself by blaming and trying to discredit its customers. Lawyers for the brokerage extensively questioned the customers about the long and technical disclosure materials they were given and the multiple complex subscription documents they had signed. In the hearing, the brokerage firm specifically disavowed any notion that it was obliged to act in the best interest of its customers. In fact, the firm turned on its customers by asserting that all of them were responsible for making the unsound investments that the firm had recommended.

The brokerage firm could not have raised those defenses at hearing if it had been legally and contractually required to serve its customers as a fiduciary.

After substantial customer testimony was entered into the record, the brokerage firm submitted an offer of settlement. Pursuant to a Consent Order, the firm agreed to repay the losses its customers suffered by investing in the notes.

We believe that a fiduciary standard for retirement advice will be an effective tool to prevent the kinds of misconduct and abuse we have described. While we stand ready to use our enforcement tools, a fiduciary standard is a pro-active measure that will help protect retirement investors before they suffer losses.

IV. Fiduciary Investment Advice under the Proposal

We strongly support Labor's initiative to eliminate the narrow "five part test" that determines when a person is an ERISA fiduciary. In particular, the requirements that the person must provide advice: (a) on a regular basis, (b) pursuant to an express or implied mutual agreement, arrangement, or understanding, and (c) that such advice will serve as the primary basis for investment decisions simply do not reflect how investment professionals provide advice to retirement investors and savers in the current market.

We also support the proposal's definition of fiduciary investment advice as including:

- Recommendations to take a distribution (with respect to an IRA or other plan) and recommendations as to the investment of securities or other property to be rolled over or otherwise distributed from an ERISA plan or IRA; and

- Recommendations on the selection of other fiduciary investment advisers or investment managers.

Enlarging the definition of "advice" to include the activities of solicitors and finders will help address a chronic source of problems in the current market for financial services.

The term "recommendation" is defined as any "communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action." This broad definition is appropriate, because it will capture the kinds of sales pitches and promotions that may be used to offer and sell investment products.

a) The "Best Interest Contract Exemption"

Labor's proposed Best Interest Contract Exemption (the "BIC") is a practical way to reconcile the high standards an ERISA fiduciary must meet with currently-existing adviser compensation structures. Without this exemption, such compensation might otherwise violate ERISA's prohibited transaction rules. We commend Labor for proposing a workable and principles-based approach.

The BIC includes requirements that advisers must enter into a written contract with the customer, and that the contract must specifically indicate that the adviser is a fiduciary and that the adviser will observe required impartial conduct standards.[2] We strongly support these safeguards.

We also support the requirement that a fiduciary wishing to use the Best Interest Contract Exemption must notify the Department of Labor of its intent to rely on that exemption prior to receiving any compensation in reliance on the exemption. The fiduciary would also be subject to additional recordkeeping requirements under the exemption. We ask that Labor set up a mechanism to share the notices and related information with financial regulators (including the states, the SEC, and FINRA) in order to promote investor protection.

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[2] This imposes by contract the prudence and loyalty requirements of ERISA Section 404(a).

We strongly agree with Labor's limitation of the BIC to certain categories of widely purchased investments.[3] We urge Labor to resist any pressure to enlarge the list of allowable investments under the exemption to include risky non-traded investments and illiquid alternative investment products.

b) Impartial Conduct Standards under the BIC

We support the requirement that a fiduciary using the BIC must contractually agree to, and comply with, designated impartial conduct standards. These standards include:

(a) Only providing advice that is in the best interest of the retirement investor;
(b) Avoiding misleading statements; and
(c) Receiving no more than reasonable compensation.

The adviser must also provide certain disclosures relating to material conflicts of interest, including informing the retirement investor of his/her right to obtain information about the adviser's direct and indirect fees; and the adviser must provide initial and annual financial/transaction disclosures, and comply with recordkeeping requirements.

We strongly support the requirement under the BIC that the adviser must warrant that it will comply with all applicable state and federal laws governing investment advice. This requirement will help to harmonize the work of state and federal financial regulators.

V. Waiver of Liability / Mandatory Arbitration

We support the prohibition under the BIC against any provision in the contract between the adviser and the retirement investor that provides for the retirement investor's waiver of his/her right to bring a class action lawsuit in court to resolve disputes, as well as the prohibition against including exculpatory provisions disclaiming or limiting the adviser's liability for violation of the contract. These prohibitions are consistent with the adviser's fiduciary duty to the customer, and they protect customers' ability to seek legal remedies under the contract.

We urge Labor to revise the BIC requirements to prohibit advisers from including mandatory pre-dispute arbitration provisions in their advisory contracts. Such mandatory arbitration language is fundamentally contrary to the fiduciary duty that an adviser owes to its customers. Securities industry mandatory pre-dispute arbitration is detrimental to customers because it requires customers to resolve disputes on the unequal playing field provided in FINRA arbitration. Fiduciary advisers should not take away their customers' right to resolve disputes in court.

VI. Confirm that ERISA Fiduciary Rules Do Not Preempt State Securities Law Jurisdiction

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[3] The listed investments are: bank deposits, CDs, shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement under the Securities Act of 1933, agency debt securities as defined in FINRA Rule 6710(l) or its successor, U.S. Treasury securities as defined in FINRA Rule 6710(p) or its successor, insurance and annuity contracts (both securities and non-securities), guaranteed investment contracts, and equity securities within the meaning of 17 CFR 230.405 that are exchange-traded securities within the meaning of 17 CFR 242.600.

Section 514(b) of the ERISA statute makes it clear that ERISA was not intended to, and does not, preempt state securities laws. We believe this language represents an appropriate recognition of the important role the states as financial regulators.[4]

Nonetheless, because of the wide-ranging changes that Labor's fiduciary duty rule and the accompanying revisions to the prohibited transaction exemptions will bring to existing relationships between customers and providers of financial advice, we ask Labor to confirm that there is no intention under the proposed rules to preempt state securities laws, and, in particular, no intention to preempt the enforcement authority of state financial regulators.

The Office of the Secretary of the Commonwealth, Massachusetts Securities Division shares with Labor the goal of protecting the retirement assets of retail investors. We commend you for this rulemaking. We stand ready to assist Labor in successfully adopting and implementing the fiduciary duty rules.

If you have any questions about this letter or if we can assist in any way, please contact me or Bryan Lantagne, Director of the Massachusetts Securities Division, at (617) 727-3548.

Sincerely,

William F. Galvin
Secretary of the Commonwealth
Commonwealth of Massachusetts

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[4] Section 514(a) states that ERISA shall supersede any and all State laws insofar as they may relate to any employee benefit plan; however, Section 514(b)(2)(A), (saving clause) preserves the states securities laws: "Except as provided in subparagraph (B), ***nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities***."

Section 514(b)(2)(B) states, "Neither an employee benefit plan . . . nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies."