EVERSHEDS SUTHERLAND

THE Committee OF Annuity Insurers
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July 26, 2019

Via E-Mail to securitiesregs-comments@sec.state.ma.us

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

Dear Secretary Galvin:

On behalf of the Committee of Annuity Insurers (the "Committee")[1] and its 32 member insurance companies that represent over 80% of the annuity business in the United States, we are submitting this letter in response to the *Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives* (the "Proposal"), issued by the Massachusetts Securities Division (the "Securities Division") of the Office of the Secretary of the Commonwealth of Massachusetts on June 14, 2019.[2] The Proposal solicits comment on proposed amendments to 950 CMR 12.204 and 12.205 and newly proposed rule 950 CMR 12.207 (collectively, the "Proposal"). Our comments below begin with an overview of the Committee and then turn to the Committee's specific comments on the Proposal.

Overview of the Committee

The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of federal and state policy with respect to securities, regulatory, and tax issues affecting annuities. Most of the Committee's members also have affiliated broker-dealers and/or investment advisers that distribute and/or sell registered insurance products or provide advice in connection with such products as well as other securities. For over 35 years, the Committee has been actively involved in shaping and commenting upon many elements of the federal securities regulatory framework as it applies to annuity products. In particular, as relevant to the Proposal, the Committee over many years has been actively involved in standard of conduct and suitability-related initiatives of the U.S. Department of Labor, the Financial Industry Regulatory Authority, Inc., and the U.S. Securities and Exchange Commission ("SEC"). The Committee appreciates the opportunity to submit comments in response to the Proposal.

Overview of the Proposed Rule

As noted above, the Proposal is comprised of two parts: amendments to 950 CMR 12.204 and 12.205 and newly proposed rule 950 CMR 12.207. Part One of the proposal would amend the existing suitability standard for broker-dealers to include recommending to a customer an

[1] A list of the Committee's member companies is attached as Appendix A.
[2] The Proposal is posted at https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Regulations-as-amended-clean.pdf.

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investment strategy, the opening of any type of account, or the transferring of assets to any type of account. Part One of the proposal would also amend the existing suitability standard for investment advisers to include recommending an investment strategy, the opening of any type of account, or the transferring of assets to any type of account to a client to whom investment supervisory, management or consulting services are provided.

Part Two of the Proposal would require broker-dealers and investment advisers to act as fiduciaries when providing investment advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the purchase, sale, or exchange of any security. To satisfy the duty of care, broker-dealers and investment advisers would be required to use the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use taking into consideration all of the facts and circumstances. The broker-dealer or investment adviser would be required to make reasonable inquiry, including risks, costs and conflicts of interest related to the recommendation or investment advice, and the customer's investment objectives, financial situation and needs, as well as any other relevant information. To satisfy the duty of loyalty, the broker-dealer or investment adviser would be required to avoid conflicts of interest and make recommendations or provide investment advice without regard to the financial or any other interest of the broker-dealer or investment adviser, any affiliated or related entity, or any other third party.

Under the Proposal, a broker-dealer's or investment adviser's fiduciary obligation would extend through the execution of a "standalone" recommendation. However, if a broker-dealer or investment adviser makes ongoing recommendations or provides investment advice, in any capacity, or receives ongoing compensation in connection with the recommendation or advice, then the fiduciary duty would be an ongoing obligation to the client. In addition, if a broker-dealer or investment adviser exercises discretion over a customer's account or has a contractual fiduciary duty, then the broker-dealer or investment adviser would be a fiduciary when making a recommendation or providing investment advice.

The Proposal creates a presumption of a breach of the duty of loyalty for offering or receiving direct or indirect compensation to or from the broker-dealer or investment adviser for recommending an investment strategy, the opening of any specific type of account, the transfer of assets to any specific type of account, or the purchase, sale, or exchange of any security that is not "the best of the reasonably available options" for the customer. The Proposal permits broker-dealers and investment advisers to receive transaction-based remuneration, so long as: (i) the remuneration is reasonable; (ii) the remuneration is the "best of the reasonably available remuneration options" for the customer; and (iii) the broker-dealer's or investment adviser's duty of care is satisfied. Lastly, the Proposal requires broker-dealers and investment advisers to avoid conflicts of interest, as opposed to requiring broker-dealers and investment advisers to disclose conflicts of interest. In fact, the Proposal notes that there would be no presumption that disclosing a conflict of interest in and of itself would satisfy a broker-dealer's or investment adviser's duty of loyalty.

General Comments

The Committee is generally supportive of the Securities Division's efforts to enhance investor protection. The Committee wants to make clear, however, that variable annuities and other variable insurance products are not within the jurisdictional mandate of the Securities Division. Such products are regulated by the Massachusetts Division of Insurance (the "Insurance Division"). The Committee also offers comment on the substantive implications of the Proposal.

Jurisdictional Issues. 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 Securities Division or its rules governing securities.

In 1972, the Massachusetts legislature passed the Act.[3] The Act was modeled after the 1956 version of the Uniform Securities Act (the "1956 USA").[4] Both acts defined a "security" as:

> "any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."[5]

The 1956 USA also provided model language for states to exclude certain insurance and annuity products from the definition of a security. The 1956 USA noted in the last sentence of its definition that a "security" does not include "any insurance or endowment policy or annuity contract under which an insurance company promises to pay [a fixed sum of] money either in a lump sum or periodically for life or for some other specified period."[6]

The Official Code Comment to the 1956 USA (the "1956 Comments") notes that "[t]he last sentence has been explicitly phrased so as not to exclude from the definition the so-called 'variable annuities' which have recently been developed."[7] The 1956 Comments also note that a state should delete the bracketed language from the definition, if the state intends to exclude variable annuities from the definition due to sufficient regulation by state insurance authorities.[8]

When passing the Act, Massachusetts' legislature deleted the bracketed language from the Act, supporting the conclusion that the legislature desired to exclude variable annuities and other insurance products from the definition of "security" because they believed them to be sufficiently regulated by the state insurance authorities.[9]

When amending the definitions in Section 401 of the Act in 1992, 1993 and 2002, the Massachusetts' legislature did not make any changes to the definition of a "security," supporting the conclusion that the legislature continued to desire to exclude variable annuities and other insurance products from the definition of "security".[10]

In 2005, the National Conference of Commissioners on Uniform State Laws adopted a new Uniform Securities Act (the "2005 USA") to account for changes in technology and issues of federal preemption of state laws. The 2005 USA amended the definition of "security" to "not expressly exclude variable insurance products," but instead exempt variable insurance products from securities registration. The Official Comments to the 2005 USA (the "2005 Comments")

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[3] Brandon F. White & Andrew J. Palid, *The Rise of the Massachusetts Uniform Securities Act*, 94 Mass. L. Rev. 117, 118 (2013).
[4] Brandon F. White & Andrew J. Palid, *The Rise of the Massachusetts Uniform Securities Act*, 94 Mass. L. Rev. 117, 118 (2013).
[5] *See* Uniform Securities Act (1956); Mass. Gen. Laws ch. 110A, § 101 et seq.
[6] *See* Uniform Securities Act (1956).
[7] *See* Uniform Securities Act (1956).
[8] *See* Uniform Securities Act (1956).
[9] *See* Mass. Gen. Laws ch. 110A, § 401(k).
[10] *See* Mass. Gen. Laws ch. 110A, § 401. Section 401 (Definitions) of the Act has been amended to: (1) add definitions of "federal covered adviser" and "federal covered security,"; (2) except persons who effect transactions to qualified purchasers and certain exempt transactions from the definition of "agent,"; (3) add limited liability companies and limited liability partnerships to the definition of "person,"; (4) except federal covered advisers and persons who effect certain exempt transactions from the definition of "investment adviser,"; and (4) make phrasing and punctuation changes without altering the substance of the Act.

note that, "[t]he states are divided on the question of whether variable insurance products should be excluded (and not subject to fraud enforcement) or exempted (and subject to fraud enforcement)." The 2005 Comments provide that, "those states that wish to continue to provide or adopt an exclusion for variable insurance products from the definition of security" should remove the brackets from the phrase "or variable" and "[f]or those states that wish variable insurance products to be included in the definition of security, the bracketed phrase should be removed."[11] The 2005 Comments also note that many states exclude variable insurance products from the definition of a "security" and exempt variable insurance products from registration.[12] If variable annuities are excluded from the definition of security and exempted from registration, state securities administrators do not have jurisdiction to bring enforcement actions concerning variable annuities sales practices.[13] However, if variable annuities are included in the definition of security but exempt from registration, state securities administrators have jurisdiction to bring enforcement actions concerning variable annuities sales practices.[14]

The first issue that must be addressed is whether the Act excludes variable annuities in the definition of "security." The second issue that must be addressed is whether the Act exempts variable annuities from registration. The Massachusetts legislature has neither amended its definition of "security," nor has it amended the exemption from registration for variable annuities.[15] Under the Act, variable annuities are not included in the definition of a security, and they are exempt from registration.[16] Therefore, as a matter of law, the Securities Division does not have jurisdiction to regulate variable annuities or bring enforcement actions concerning variable annuities sales practices.[17] We are aware that some time ago the Securities Division published an investor alert, in which the Securities Division stated that variable annuities are regulated by the Securities Division and must be registered.[18] However, we do not understand how the alert comports with the Massachusetts legislature's decision to exclude variable annuities from the definition of security and exempt variable annuities from registration under Massachusetts law.

The Committee also believes that variable annuity products are appropriately regulated in the State of Massachusetts by the Insurance Division.[19] 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.[20] Many states, including Massachusetts, permit broker-dealers to meet state insurance suitability requirements for the sale of annuities by complying with the Financial Industry Regulatory Authority, Inc. ("FINRA") rules pertaining to

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[11] Prefatory Note, Uniform Securities Act (2002) (last revised or amended in 2005).
[12] Prefatory Note, Uniform Securities Act (2002) (last revised or amended in 2005).
[13] Prefatory Note, Uniform Securities Act (2002) (last revised or amended in 2005) (noting that "states are divided on the question of whether variable insurance products should be excluded (and not subject to fraud enforcement) or exempted (and subject to fraud enforcement).").
[14] Official Comments, Uniform Securities Act (2002) (last revised or amended in 2005).
[15] *See* Mass. Gen. Laws ch. 110A, § 401(k); Mass. Gen. Laws ch. 110A, § 402(a)(5).
[16] *See* Mass. Gen. Laws ch. 110A, § 401(k); Mass. Gen. Laws ch. 110A, § 402(a)(5). The 1956 USA provides bracketed language that, if left in, operates to exclude only fixed insurance products from the definition of a "security." The Act does not include the bracketed language, thereby not limiting the exclusion to fixed insurance products but also excluding variable insurance products from the definition of a "security." The 1956 USA also provides bracketed language that, if kept, subjects variable annuities to registration requirements. The Act excludes the bracketed language, thereby exempting variable products from registration requirements. *See also* Official Comments, Uniform Securities Act (1956).
[17] Official Comments, Uniform Securities Act (2002) (last revised or amended in 2005) ("When variable products are included in the definition of security and exempted from registration state securities administrators can bring enforcement actions concerning variable insurance sales practices.").
[18] Mass. Secs. Div., *Are You an Informed Investor*, https://www.sec.state.ma.us/sct/sctinv/pdf/NASAA_Alert_Annuities_MA.pdf.
[19] *See* Mass. Gen. Laws ch. 175, § 1 et seq.
[20] 211 Mass. Code. Regs. 96.05(1).

suitability and supervision of annuity transactions.[21] The Insurance Division has full authority to investigate and enforce consumer protection and suitability rules with regard to these products.[22]

The Proposal. Although variable annuities are not within the regulatory jurisdiction of the Securities Division, the Committee is nonetheless concerned with how the fiduciary duty, as defined by the Securities Division, could be implemented in practice. For example, the Committee believes that the Proposal would benefit from clarification on what it means to provide "ongoing recommendations" to customers. In practice, a broker-dealer cannot possibly know whether a customer will request one or more recommendations over the lifetime of the customer's account, and accordingly cannot make a judgment when establishing an account record as to whether a customer is owed a fiduciary duty through execution of a recommendation, or whether the fiduciary duty will be deemed ongoing on a post-trade basis, because of future, yet-to-be-requested, recommendations. It is also unclear how a broker-dealer or investment adviser would determine, when recommending an investment strategy, the opening of any specific type of account, the transfer of assets to any specific type of account, or the purchase, sale, or exchange of any security, whether it is "the best of the reasonably available options" for the customer.

The Committee also believes that proposed rule text that imposes a fiduciary obligation on broker-dealers who receive "ongoing compensation" is also problematic. Federal law does not prohibit the receipt of compensation that is scheduled to be paid over a set period of time, and state regulation of the terms and conditions of a particular product offering is inconsistent with the National Securities Markets Improvement Act of 1996 ("NSMIA").[23] Yet, without explanatory text, a broker-dealer who receives ongoing compensation in connection with a recommendation or advice would owe an ongoing fiduciary duty to its client under the Proposal. This provision could effectively require SEC-registered broker-dealers to register as investment advisers in the state, which result, we believe, would be inconsistent with federal law.[24] The Proposal could be deemed to require broker-dealers, who are not otherwise subject to investment adviser registration, to provide advisory services, which effectively expands broker-dealer activities to the point that they no longer fit within the solely incidental exclusion from investment adviser registration under federal law.

The Committee believes that NSMIA's jurisdictional boundaries should and must be observed, so that the regulatory burdens and negative impact on competition that led to the adoption of NSMIA are not repeated. In this regard, attention must be paid to the SEC's Regulation Best Interest so that federal and state law are not inconsistent.[25]

CONCLUSION

The Committee appreciates the opportunity to provide these comments on the Proposal. Please do not hesitate to contact Clifford Kirsch (212.389.5052 or CliffordKirsch@eversheds-sutherland.com) or Holly Smith (202.383.0245 or HollySmith@eversheds-sutherland.com), if you have any questions regarding these comments.

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[21] 211 Mass. Code. Regs. 96.05(9)(a).
[22] 211 Mass. Code. Regs. 96.05(9)(a). Furthermore, we note that insurance salespersons must also be registered with FINRA to solicit and sell variable annuities and other variable insurance products. *See* FINRA Rule 1220(b)(2)(A).
[23] *See* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) (codified in scattered sections of 15 U.S.C.).
[24] *See id.* and Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, Advisers Act Release No. 5249 (June 5, 2019).
[25] *See Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 84 Fed. Reg. 33318 (July 12, 2019).

Respectfully submitted,

EVERSHEDS SUTHERLAND (US) LLP

BY: Clifford Kirsch BJAA
Clifford Kirsch

BY: Holly Smith BJAA
Holly Smith

FOR THE COMMITTEE OF ANNUITY INSURERS

Appendix A

COMMITTEE OF ANNUITY INSURERS

AIG
Allianz Life
Allstate Financial
Ameriprise Financial
Athene USA
AXA Equitable Life Insurance Company
Brighthouse Financial, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Global Atlantic Financial Group
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Lincoln Financial Group
Massachusetts Mutual Life Insurance Company
Metropolitan Life Insurance Company
National Life Group
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
Sammons Financial Group
Symetra Financial Corporation
Talcott Resolution
The Transamerica companies
TIAA
USAA Life Insurance Company