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Via e-mail: securitiesregs-comments@sec.state.ma.us

July 26, 2019

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

Dear Secretary Galvin:

We appreciate the opportunity to comment on the Massachusetts Securities Division’s proposed regulation “to apply a fiduciary conduct standard on broker-dealers, agents, investment advisers (“IAs”), and investment adviser representatives when dealing with their customers and clients,” known hereafter as the “Proposal.”

The Alternative and Direct Investment Securities Association (“ADISA”),¹ has particular interest in Massachusetts since our member firms, located in Massachusetts or doing business in the state, represent hundreds of retail investors and are, themselves, comprised primarily of small and medium-sized securities firms. These retail clients come to ADISA members specifically to invest in non-traded, alternative investment securities (“Alternatives”).

ADISA agrees with the need to set appropriate standards around advice provided by all financial professionals, whether episodic or continuous in nature. We understand that this is a preliminary solicitation and, as the Division reviews all comments, we urge you to consider the following:

1. **Alternatives are Distinct from Their Publicly-Traded Counterparts In Many Respects, Including Cost and Liquidity**

¹ ADISA is the nation’s largest trade association for the non-traded alternative investment space. ADISA represents over 4,500 financial industry members, reaching over 220,000 finance professionals, with sponsor members having raised in excess of \$200 billion in equity in serving more than 1 million investors.

Alternative investments are important to and represent valuable components of a diversified portfolio for all manner of savers, including retirement savers who invest through an individual retirement account (“IRA”). Many small, retail investors actively choose to include Alternatives in their portfolios for diversity and to safeguard against volatility in the markets, though the misconception is that these investments are reserved for select, high balance accounts of well-to-do retirement savers. With retail Alternatives, an investment strategy of the wealthy becomes open to all.

Indeed, unique characteristics of alternative securities specifically include:

- A diversity of non-traded and non-marketable products;
- The non-regular basis of most product recommendations;
- The relationship between retail investors and their financial professionals with respect to these securities, which is generally more infrequent than on-going in nature.

2. Alternative Investments Play a Crucial Role in Small-Balance, Retail Portfolios.

Alternatives are designed to mitigate the volatility of traded securities markets while providing the potential benefit of asset ownership and diversification with securities which have low correlations to financial asset markets. This is particularly important since the 2008 meltdown and publicly-traded securities have experienced significantly increased levels of volatility – and hence risk – the loss of asset value which would especially impact small-balance retail investors.

In fact, 78% of “millennials” and 70% of “Gen X” savers endorse having access to alternatives for their investment accounts.² Furthermore, these products can have (and historically have had), a significant, positive impact on investor rates of return when incorporated into more traditional liquid portfolios.³ The Division should account for these crucial distinctions.

3. Alternatives Include Many Important Non-public Products

Alternative investments include investment products which may be available only through advisers and Broker-Dealers, important to portfolio diversity; examples include, but are not limited, to non-listed real estate investment trusts (“REITS”), real estate partnerships, real estate income and development funds, oil and gas interests, non-listed business development

² Natixis Global Asset Management Survey, <http://durableportfolios.com> 2014.

³ From 1999-2009 the generic “balanced” (i.e., 60% equity/40% bond) portfolio after fees returned zero percent (0%), while the Yale, Harvard, and Stanford portfolios with alternatives generated returns ranging from 135% to 198% in total (Wildemuth, D. *Wise money: How the Smart Money Invests*. McGraw Hill, 2012, pp. 64-65).

companies (“BDCs”), private equity, non-listed closed end funds, and other securitized investments not correlated to the stock and bond market.

4. A Broad, “One-Size Fits All” Fiduciary Duty is Incompatible with Alternatives

The duty of care owed by financial professionals to their customers must be capable of being maintained in a manner that is consistent with the unique nature of alternative investments. The Nevada State Securities Division has recognized the unique and important nature of episodic transactions and added an “Episodic Fiduciary Duty Exemption” to its proposed regulations.⁴ Certain products are designed to have durations over several years, and therefore are less liquid investments (in the short term); in other words, some investment ideas are by their nature entered into only episodically and with a long term investment horizon.

Allowing a broker-dealer’s duties to effectively reflect these facts (and by creating a regulation that allows such firms to receive one-time or periodic commissions), aligns the interest and, importantly, the expectations and understanding, of the broker-dealer and its representative with that of the client. Such alignment is the essence of a financial professional’s duty toward its clients.

An “episodic” fiduciary would not be freed from all aspects of fiduciary status – rather the approach would recognize the more limited nature of the duties owed to (and expected from), retail investors in the more episodic context that relates to the recommendation and sale of Alternatives.

A broker-dealer’s duty must effectively reflect these facts and must align the interest – and importantly – the expectations and understanding of the broker-dealer and its representative with that of the retail client, who should expect such alignment. This approach recognizes the more limited nature of the duties owed to (and expected from) clients in the more episodic context that relates to the recommendation and sale of Alternatives.

Just as importantly, retail clients should retain flexibility to pay their broker-dealer transaction-based compensation so long as it is in the client’s best interest to be charged in this manner (as opposed to other types of remuneration), and so long as the commission or other compensation charged does not result from the broker-dealer putting its interest ahead of the client’s interest.

5. Regulation Best Interest Adds Investor Protections

On June 5, 2019, the SEC adopted Regulation Best Interest (“Reg BI”) which creates a new nationwide, heightened standard of conduct for broker-dealers (“BDs”) and their

⁴ See Nevada Revised Statutes 90.575, 628.010 and 628.020. [JHG- Shouldn’t we cite to NV rulemaking efforts to date, as well?]

representatives when dealing with retail customers. The Reg BI rulemaking package is substantial and substantially and materially exceeds the existing FINRA suitability standard.

We respectfully request that you allow a time after the implementation of Reg BI to learn of its consequences (intended and not) before considering state-specific fiduciary requirements which would limit investor choice.

6. A “Best of” Standard is Only Theoretical

The Proposal requires that a recommended security or account type must be “the best of the reasonably available options.” This is a subjective and only theoretical. No such “best of” standard exists under current federal securities laws, and federal agencies and securities regulators have generally accepted the fact that it is not possible to definitively identify a single “best” option without the benefit of hindsight, essentially rendering the standard unattainable and impossible to satisfy.⁵

7. An Ongoing Monitoring Requirement Limits Consumer Choice

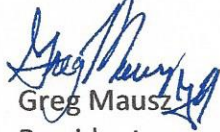
The Proposal imposes a broad and ongoing fiduciary duty obligation on broker-dealers and their agents. Conversely, Reg BI generally limits the duration of a BD’s best interest obligation to the point in time when a recommendation is made; there is no ongoing obligation to monitor brokerage accounts⁶. Even though Reg BI requires new time-consuming tasks and additional responsibility of the finance professional, we believe it in principle to be a step forward. Brokerage accounts represent an important, cost-conscious choice for consumers and provide access to affordable advice, particularly for small, buy-and-hold investors. BDs generally do not have supervisory systems or procedures – or a compensation structure – in place to provide continuous and ongoing monitoring of securities purchased, sold, or held due to recommendations made in their BD accounts.

⁵ Both the SEC and FINRA have long recognized that there is no single “best” security recommendation, which is a core tenet of modern portfolio theory. *See, e.g., SEC Beginner’s Guide to Asset Allocation, Diversification and Rebalancing*, available at <https://www.sec.gov/reportspubs/investor-publications/investorpubsassetallocationhtm.html>. *See also FINRA’s Diversifying Your Portfolio*, available at <http://www.finra.org/investors/diversifying-your-portfolio>. Even the DOL acknowledged as much in connection with its now vacated fiduciary rule. *See* Preamble to the BIC Exemption, 81 Fed. Reg. at 21,029 (“... the [DOL] also confirms that the Best Interest standard does not impose an unattainable obligation on Advisers and Financial Institutions to somehow identify the single ‘best’ investment for the Retirement Investor out of all the investments in the national or international marketplace, assuming such advice were even possible.”), available at <https://www.federalregister.gov/documents/2016/04/08/2016-07925/best-interest-contract-exemption>.

⁶ Reg BI does make clear that if a BD voluntarily monitors an account, then Reg BI would apply to explicit recommendations to hold. If a BD engages in agreed-upon account monitoring, then Reg BI applies to both explicit and implicit recommendations to hold. SEC Release No. 34-86031; File No. S7-07-18, RIN 3235-AM35 (“Adopting Release”), pp. 101 – 106. Available here: <https://www.sec.gov/rules/final/2019/34-86031.pdf>.

Thank you for the opportunity to weigh in on these important issues. We stand ready to meet with you and your colleagues in the Division to discuss these issues in more depth if you would find that helpful.

Sincerely,

A handwritten signature in blue ink, appearing to read "Greg Mausz".

Greg Mausz

President

cc: Drafting Committee: Catherine Bowman, John H. Grady, John Harrison, Thomas Rosenfield