MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

July 26, 2019

**Via Electronic Submission:** 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: Comments on Proposed Regulations – Fiduciary Conduct Standard**

Dear Secretary Galvin:

Managed Funds Association[1] ("MFA") appreciates the opportunity to respond to the proposed regulations (the "Proposal") on the fiduciary standard of conduct for investment advisers and broker-dealers released by the Massachusetts Securities Division (the "Division"). MFA and its members strongly support the longstanding fiduciary obligations of investment advisers to their clients. Investment adviser fiduciary obligations are well established based on equitable common law principles and decades of jurisprudence, including the U.S. Supreme Court's decision in *SEC v. Capital Gains*,[2] and are fundamental to investment advisers' relationships with their clients under the Investment Advisers Act of 1940. We are concerned, however, that the Proposal goes beyond the Division's stated concerns for protecting retail investors in light of the U.S. Securities and Exchange Commission's (the "SEC") recently adopted Regulation Best Interest.

We do not believe it is necessary or appropriate to alter the existing fiduciary standard for investment advisers with respect to institutional and sophisticated clients to address the Division's concerns regarding retail investors. If applied to such investment advisers, the Proposal is likely to introduce additional costs and burdens that negatively impact the investment activities of sophisticated investors, which include public and private pension funds, endowments and other institutions. We are also concerned that the Proposal would subject advisers to a new and different standard inconsistent with the existing standard, and introduce a state-by-state approach that would cause uncertainty and confusion for both investors and investment advisers. We therefore

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[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963) ("SEC v. Capital Gains").

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recommend that the Division either limit its application to direct retail clients or customers of investment advisers and/or broker-dealers, with clear definitions of "retail" and non-retail, or not proceed with the Proposal.

**If the Division Proceeds with the Proposal, it Should Apply to Retail Clients and Customers Only**

The Division expressly provides that investment advisers to and broker-dealers for institutional and other sophisticated clients do not need to be subject to the new standards of conduct by excluding certain persons from the definition of "client" or "customer" in the Proposal.[3] The list of sophisticated clients in the Proposal, however, does not include certain institutional investors that are not retail clients or customers. We recommend that the Division, if it moves forward with the Proposal, amend the list of excluded clients and customers in §12.207(d) to add private funds as defined in 950 CMR §12.205(2)(c)1.c., as well as any entity that meets the definition of a qualified purchaser in §2(a)(51)(A)(iv) of the Investment Company Act of 1940.[4] Private funds and qualified purchasers are sophisticated investors, and advisers to and brokers for these types of clients should not be subject to the proposed fiduciary standards designed to address concerns with retail investors and customers. Any amended regulations ("Regulations") should provide the same treatment to clients that are private funds and qualified purchasers as it would provide to registered investment companies and other types of institutional buyers under the Massachusetts CMR, which would be excluded from the scope of the new fiduciary standard. Any Regulations should also clarify that the terms "client" and "customer" refer to direct clients of the applicable adviser (or direct customers of the applicable broker), as opposed to investors or beneficial owners of interests in commingled private funds to which such adviser provides services.

**The Proposed Fiduciary Standard is Unworkable and Inconsistent with the Existing Fiduciary Standard for Investment Advisers**

The Division's press release accompanying the Proposal states that the conduct standard set out in the Proposal is based on common law fiduciary duties. We respectfully disagree, as we believe that the standard set out in the Proposal is distinct from the existing fiduciary standard that investment advisers owe to their clients. We are concerned that the proposed language in §12.207(c)(2) goes far beyond the existing fiduciary standard and creates new obligations that would in many cases be unworkable for an investment adviser. In particular, we note three provisions in §12.207(c)(2) that we believe are inconsistent with investment advisers' existing fiduciary standard of care.

First, the Proposal says an investment adviser's duty of loyalty requires it to "avoid conflicts of interest." We believe that the applicable standard of care owed by an investment adviser with respect to conflicts of interest is set out in *SEC v. Capital Gains*, which states that an investment adviser's duty is to "eliminate, **or at least to expose**, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested"

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[3] *See* 950 Code of Massachusetts Regulations ("CMR") §12.207(d), as amended by the Proposal.

[4] §2(a)(51)(iv) includes "any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than $25,000,000 in investments."

[emphasis added].[5] The SEC has recently reaffirmed this standard of care in its interpretation of the standard of conduct for investment advisers, which it recently finalized.[6] The language in the Proposal requiring an investment adviser to avoid conflicts of interest is not consistent with this standard, and could create a standard with which an adviser could not practically comply. For example, investment advisers frequently have clients with different fee arrangements, and clients (such as private funds) in which they have financial ownership. To the extent the Proposal requires an investment adviser to avoid the conflicts presented by these types of arrangements, instead of disclosing the arrangements and obtaining client consent, we believe the Proposal is inconsistent with the existing fiduciary standard and would be unworkable.

Second, the concern regarding the language about avoiding conflicts of interest is magnified by the language in proposed §12.207(c)(2)(ii), which provides, "[t]here shall not be a presumption that disclosing a conflict of interest alone shall satisfy the duty of loyalty." We would point out that obtaining informed client consent in connection with disclosure by an investment adviser is a key element in enabling an investment adviser to meet its fiduciary obligations with respect to conflicts of interest; accordingly, by suggesting that disclosure is not an appropriate method of satisfying the duty of loyalty, the language in the Proposal is fundamentally inconsistent with this well-established fiduciary standard.

Finally, we believe that the proposed language in §12.207(c)(2)(i) creating a presumed breach for offering or receiving compensation for a recommendation "that is not the best of the reasonably available options for the customer or client" goes beyond the existing fiduciary standard. We are not aware of any existing formulation of an investment adviser's fiduciary obligation that requires the investment adviser to meet a "best of" standard with respect to recommendations. As noted in the SEC's recent interpretation of the standard of conduct for investment advisers, there are a number of factors that investment advisers should consider when making a recommendation to a client.[7] An investment adviser's fiduciary obligation when making a recommendation is to provide advice that is in the best interest of the client, taking into account relevant factors. The proposed "best of" standard suggests that there is only one appropriate recommendation that would satisfy an investment adviser's duty of loyalty or that there is an objective, best recommendation that an investment adviser should make. We do not believe that it is possible to determine a best option, if one even exists; the Proposal therefore creates a standard that is not possible for investment advisers to meet and would lead to substantial uncertainty as to the merits of an adviser's recommendations with the benefit of hindsight.

**States Should Avoid Creating a Patchwork of Fiduciary Standards for Investment Advisers that Would Create Confusion and Uncertainty for Investors**

As discussed above, investment advisers are subject to a well-established existing standard of conduct, as articulated in *SEC v. Capital Gains*. This fiduciary standard applies to investment advisers regardless of the state in which they operate and regardless of whether or not they are

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[5] *SEC v. Capital Gains*, 375 U.S. 180, 194 (1963).

[6] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 ("SEC Standard of Conduct Interpretation").

[7] *See* SEC Standard of Conduct Interpretation.

subject to registration requirements. We are concerned that state regulators' adoption of different fiduciary standards will create unnecessary confusion and uncertainty for investors, particularly those investors who have client relationships with advisers in multiple states. Differing standards of conduct between the SEC and a state regulator and among different state regulators also could create conflicts for investment advisers seeking to meet their fiduciary obligations to clients. We believe that state regulators should avoid creating their own fiduciary standards for investment advisers and instead make clear that investment advisers, including state-registered investment advisers and investment advisers exempt from registration, must comply with their fiduciary obligations as recently articulated by the SEC. We believe this approach better serves the Division's stated investor protection objective by confirming that all investment advisers are subject to the robust, well-established fiduciary duty and providing investors with the clarity and certainty that comes from a common understanding across jurisdictions of an investment adviser's obligations.

We are concerned that, instead of promoting investor protection, the Proposal instead would disrupt long-standing industry norms and create legal and compliance uncertainty that is likely to limit investment choices and increase costs for clients who rely on the professional assistance of an investment adviser to invest in U.S. capital markets. This uncertainty could have deleterious effects on existing relationships between investment advisers and their clients, particularly those involving institutional clients and sophisticated natural persons that have carefully negotiated the terms of those relationships. Accordingly, the Proposal would not be beneficial to investors, particularly sophisticated investors, and MFA encourages that Division to either not proceed with the Proposal or, at a minimum, limit the scope of the Regulations to those investment advisers and broker-dealers providing services directly to retail clients and customers, which should not include private funds, qualified purchasers, and/or other sophisticated clients.

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MFA appreciates the opportunity to provide these comments to the Division on the Proposal. Further, we welcome the opportunity to work with the Division and provide any additional information that may be useful. Please do not hesitate to contact either of the undersigned at (202) 730-2600 should you have any questions.

Respectfully submitted,

/s/ Benjamin Allensworth

Benjamin Allensworth
Associate General Counsel

/s/ Matthew Newell

Matthew Newell
Associate General Counsel