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Massachusetts Proposes Final Fiduciary Rule –Takeaways for Financial Professionals

By Anthony R. Leone | December 19, 2019

Recently, the Massachusetts Securities Division made public its proposed final fiduciary duty rule (the “Proposed Rule”). The MSD has requested public comment concerning the Proposed Rule by January 7, 2020. The Massachusetts Securities Division had previously issued a preliminary fiduciary duty rule on June 14, 2019 (the “Preliminary Rule”). From the perspective of a former enforcement attorney with the MSD, the Proposed Rule contains a mix of positive and negative changes for financial professionals. Undoubtedly, the Proposed Rule, if adopted as drafted, will impact a wide range of financial professionals.

Here are nine key changes between the Proposed and Preliminary Rule.

1. The addition of commodity or insurance product oversight and regulation

The Proposed Rule contains language expanding a potential breach of fiduciary duties to commodity and insurance products. While the Preliminary Rule contained no such language, the Proposed Rule deems the failure to act with a fiduciary duty in connection with the “the opening . . . transferring . . . or the purchase, sale, or exchange” of any commodity or insurance product to be “unethical or dishonest conduct.” This reach is not entirely novel, given that there are similar commodity and insurance enforcement provisions existing within the regulations. Nevertheless, there is a tension between the scope of the regulations as they pertain to securities and the inclusion of insurance and commodity oversight.

2. The addition of “titling” triggers

The Proposed Rule includes what appears to be a supercharged SEC Regulation Best Interest titling provision which provides that titles such as “‘advisor,’ ‘manager,’ ‘consultant,’ or ‘planner,’ in conjunction with any of the terms ‘financial,’ ‘investment,’ ‘wealth,’ ‘portfolio,’ or ‘retirement,’ or any terms of similar meaning or import” may trigger fiduciary duty requirements. In particular, the Proposed Rule provides that a broker-dealer, agent, investment advisor or investment advisor representative (“Financial Professional”) has a fiduciary duty where a client has a reasonable expectation that said person will “monitor the customer’s or client’s account(s) or portfolio on a regular or periodic basis.” The Proposed Rule appears to provide that the use of any of the above referenced titles will create a presumption that a client has a reasonable expectation that said person will “monitor the customer’s or client’s account(s) or portfolio on a regular or periodic basis” and thus a fiduciary duty is triggered.

3. The addition of conflict of interest requirements

The Proposed Rule further expands upon duty of loyalty requirements as originally provided in the Preliminary Rule. The Proposed Rule provides in part, that a Financial Advisor must “[m]ake all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts that cannot be avoided, and mitigate conflicts that cannot be avoided or eliminated” Importantly, simply disclosing or mitigating conflicts (while still required) does not meet the fiduciary standard.

4. The addition of “utmost” duties

The Proposed Rule provides that Financial Professional must “adhere to duties of utmost care and loyalty to the customer or client.” In the context of fiduciary duties among partners the term “utmost” is often used when the parties wish to apply a duty to act in good faith, fair dealing, and loyalty to one another in their affairs. Here, no further guidance is given regarding the MSD’s motivation for including the term “utmost.”

5. The addition of risk tolerance

Similar to the Preliminary Rule, the Proposed Rule provides that a Financial Advisor's duty of care includes a requirement to conduct reasonable inquiry into a customer or client's investment objectives, financial situation, and needs. The Proposed Rule, however, also includes a provision that Financial Professionals must also evaluate a customer or client's risk tolerance. While perhaps already wrapped within the duty to evaluate a client's objectives, situation, and needs, the further inclusion of risk tolerance appears to create an additional requirement above and beyond the requirements of the Preliminary Rule.

6. The addition of prospective clients

Notably all of the fiduciary duties imposed by the Proposed Rule, apply equally to both current and prospective customers and clients. What defines a prospective customer is unclear, thus creating uncertainty regarding the reach of the Proposed Rule to "prospective" clients. The Proposed Rule, as drafted, would therefore appear to raise potential risks in connection with mass marketing efforts and even in more informal networking situations when read broadly.

7. The addition of sales contests.

The Proposed Rule provides that a presumptive breach of the duty of loyalty exists where "[a] recommendation is made in connection with any sales contest, implied or express quota requirement, or other special incentive program." Upon initial review, the provision appears to target certain widely publicized practices. However, enforcement of the Proposed Rule, in particular the clause "special incentive program," if broad, could cover widely implemented annual meetings for Financial Professionals who meet certain threshold revenue figures.

8. The removal of an "advisor" definition

The Preliminary Rule included a broad definition of an advisor subject to the new Rule. Notably, the Preliminary Rule included persons registered and those excluded from registration. This removal is significant for a number of reasons, and prudent on the part of the MSD, as it removes doubt as to whether the Proposed Rule would apply, for instance to federally registered investment advisors. The Proposed Rule has eliminated excluded persons and also the rebuttable presumption that investment advisors and investment advisor representatives "as well as other persons who charge fees based on assets under management or portfolio performance" are subject to the fiduciary rule.

9. The removal of "best of reasonable available options"

According to the Preliminary Rule, recommending any investment strategy, opening or transferring of an account or "the purchase, sale, or exchange of any security that is not the best of the reasonably available options for the customer or client" constituted a breach of the fiduciary duty. The MSD removed the "best of reasonable available options" from the Proposed Rule. As such the rule appears to remove doubt as to whether a financial professional must provide the best available option within the advisors own platform and erases doubt over the potentially problematic situation where a better option may be available on an alternative platform beyond the reach of a Financial Professional.

If you have any questions, please feel free to contact us. If you are a Massachusetts investment advisor please follow the Massachusetts Association of Investment Advisors at <https://www.linkedin.com/company/massinvestmentadvisor> for further discussion.

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