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March 13, 2019

The Honorable Delores G. Kelley
Chair, Senate Finance Committee
3 East
Miller Senate Office Building
Annapolis, MD 21401

RE: Senate Bill 786 - Financial Consumer Protection Act of 2019 – Opposed

Dear Chair Kelley and Members of the Senate Finance Committee:

On behalf of our members, the Insured Retirement Institute ("IRI")[1] appreciates the opportunity to submit this written testimony regarding Senate Bill 786, the Financial Consumer Protection Act of 2019. For the reasons outline below, IRI's position on this bill is "opposed." In particular, we respectfully urge the Committee to amend the bill to remove the provision that would significantly expand the universe of financial professionals deemed to be fiduciaries by adding new section 11-803 to the Maryland Securities Act (Md. Code Ann., Corps. & Ass'ns § 11-101 et. seq.).

IRI is a member of the Maryland Consumer Best Interest Coalition, and we fully support and endorse the Coalition's comments on this bill.

[1] IRI is the leading association for the entire supply chain of insured retirement strategies, including life insurers, asset managers, and distributors such as broker-dealers, banks and marketing organizations. IRI members account for more than 95 percent of annuity assets in the U.S., include the top 10 distributors of annuities ranked by assets under management, and are represented by financial professionals serving millions of Americans. IRI champions retirement security for all through leadership in advocacy, awareness, research, and the advancement of digital solutions within a collaborative industry community.

In 2016, our members had total variable annuity sales of $1.8 billion in Maryland, making it the 19th largest variable annuity market in the U.S. We count among our members several large financial institutions headquartered in and around Baltimore, as well as nearly 500 financial advisors across the state who are affiliated with more than 50 different broker-dealer firms.

Importance of Regulatory Coordination

We commend Senator Rosapepe and his co-sponsors for recognizing the need for appropriate standards of conduct and rules for financial professionals who work with Maryland investors. IRI and our members have long-supported the creation of a workable best interest standard for financial professionals.

However, as we noted in the written testimony we submitted on the 2018 version of this legislation, this is part of a much larger debate involving Congress and numerous regulatory agencies with differing jurisdictions, including the U.S. Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA"), and the U.S. Department of Labor ("DOL") at the federal level, as well as the North American Securities Administrators Association ("NASAA"), the National Association of Insurance Commissioners ("NAIC"), and the individual state securities and insurance departments. Since that time, significant progress has been made on numerous fronts.

The SEC now has a pending proposal to enhance the standard of conduct applicable to broker-dealers ("BDs") under the federal securities laws (the "SEC Proposal"). We believe the SEC is the appropriate federal regulator to lead the development of a standard of conduct consistent with the principle that financial professionals should be required to act in their clients' best interest when providing personalized investment advice, while also preserving consumer choice and access to the products and services they need to achieve their financial goals. IRI and our members believe the SEC Proposal provides a solid foundation for appropriate enhancements to the standard of conduct for BDs.

Unlike the now-vacated DOL Rule[2], the SEC Proposal recognizes and seeks to preserve the important and valuable distinctions between different types of financial professionals. BDs simply have different relationships with their clients than investment advisers ("IAs"), and, as such, investors have different expectations depending on whether they are working with a BD or an IA. The principles-based framework embodied in the SEC Proposal will help investors understand the differences between BDs and IAs, thereby enabling them to make informed decisions about the type of financial professional that would best meet their needs.

We also support the decision to rely on existing SEC and FINRA enforcement mechanisms in the SEC Proposal; the private right of action that would have been created under the DOL Rule was among the most problematic aspects of that rulemaking and, in our view, has been

[2] As used in this letter, the term "DOL Rule" means, collectively, the final regulation defining the term "fiduciary" (the "Fiduciary Definition Regulation") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), the Best Interest Contract Exemption (the "BIC Exemption"), and the amendments to prohibited transaction exemption 84-24 (the "Amended PTE 84-24") issued by the DOL on April 8, 2016 and vacated *in toto* by the United States Circuit Court of Appeals for the Fifth Circuit on March 15, 2018.

appropriately avoided by the SEC. Moreover, the formulation of the best interest standard under the SEC Proposal would provide a clear and straight-forward compliance roadmap for firms and financial professionals.

NASAA has also expressed support for the SEC Proposal.[3] In a comment letter dated August 23, 2018, NASAA stated as follows:

> In sum, we believe *the Proposals represent a good initial step* but that significant improvements are needed in order to promulgate final rules that will serve the best interest of investors as the Commission intends. NASAA encourages the Commission to make modifications to the text of the proposed rules and to substantially reform its guidance on the Proposals prior to their adoption. *NASAA agrees that the Commission should act to address investor confusion regarding the different roles of investment advisers and broker-dealers* and that the Commission should raise the current standard of care applicable to broker-dealer recommendations from suitability to a standard akin to the fiduciary duties owed by investment advisers. We believe the Commission's approach of raising the standard for broker-dealers, while not weakening the current standard applicable to investment advisers, is the correct one. *NASAA supports the Proposals' effort to address conflicts of interest, improve fee transparency, restrict the use of potentially misleading professional titles, and clarify investment adviser conflict of interest obligations*. [Emphasis added.]

In an October 2018 interview with Wealth Management magazine, NASAA President Michael Pieciak, the Commissioner of Financial Regulation in Vermont, explained that NASAA has significant concern about "having a hodgepodge of rules," and believes that the SEC Proposal is "the clear path forward" and that "a uniform standard…is a better strategy." NASAA's most recent comment letter to the SEC re-iterates its commitment to working collaboratively with federal regulators to formulate a new standard for BDs.[4]

For its part, the NAIC has been working to develop enhancements to its Suitability in Annuity Transactions Model Regulation (the "NAIC Model") for more than a year. In recognition of the importance of a harmonized standard of conduct for annuities across regulatory platforms, the NAIC has indicated that its effort is aimed at development of a credible draft of modifications to the Model to use for meaningful engagement between the NAIC and SEC. NAIC leadership has

[3] National American Securities Administrators Association, Comment Letter on Proposed Regulation Best Interest, Form CRS, and the Proposed Commission Interpretation Regarding Standard of Conduct of Investment Advisors (Aug. 23, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4259557-173080.pdf.

[4] National American Securities Administrators Association, Inc., Supplemental Letter on Proposed Regulation Best Interest, Form CRS, and the Proposed Commission Interpretation Regarding Standard of Conduct of Investment Advisors (Feb. 19, 2019), https://www.sec.gov/comments/s7-07-18/s70718-4947456-178566.pdf .

further intimated that the NAIC is unlikely to adopt final modifications to the NAIC Model prior to final adoption of the SEC Proposal.

In addition, a small number of individual states have taken steps to create their own best interest or fiduciary rules. We have specific concerns about each of those proposals. More significantly, though, in the broader context of the ongoing federal and state activities, these individual state proposals would create a patchwork of inconsistent, conflicting or duplicative rules that would significantly impair consumers' access to valuable financial products and professional assistance about whether, when, and how to use those products.

IRI and our members have been and will continue to be actively engaged in all of these efforts. Our engagement on this issue has been consistently guided by two core principles. First, we have long-supported the creation of a workable best interest standard for financial professionals that will effectively protect investors against bad actors without unduly restricting investors' ability to access the products and services they need to achieve their financial goals. And second, we have urged each and every policymaker to participate in a constructive dialogue with other interested regulatory bodies in order to establish consistent and clear standards for recommendations made with respect to all securities and insurance products.

As you consider how to move forward, we respectfully urge you to consider how this bill would fit within the broader tapestry of regulations governing the conduct of financial professionals. We hope you will recognize the benefits of participating in these efforts and allowing time for them to play out so as to avoid the creation of duplicative, conflicting, or incompatible rules which could deprive Americans of access to valuable financial products and services.

<u>Applicability to Insurance Producers</u>

The fiduciary duty that would be imposed under the bill would apply not only to BDs, IAs, and their agents and representatives, but also to insurance producers. The bill would also authorize the Maryland Securities Commissioner to adopt regulations implementing the fiduciary duty. In our view, the inclusion of insurance producers in this bill is inconsistent with the allocation of jurisdiction over financial professionals under Maryland law.

The Maryland Insurance Administration has jurisdiction over insurance producers pursuant to the Insurance Article of the Maryland Statutes, and has rules in place specifying the standards of conduct applicable to insurance producers: Suitability in Annuity Transactions (COMAR 31.09.12). This regulation is based on the NAIC model regulation referenced above. If and when the NAIC finalizes any modifications to this model regulation to incorporate an enhanced standard of conduct, the Insurance Administration will have an opportunity to assess whether to amend its regulation to reflect the changes made by the NAIC. Until such time, we believe it would be premature for Maryland or any other state to consider any legislative or regulatory

proposal that would subject Maryland producers to different standards than those that apply to the vast majority of producers across the country.

Based on the foregoing, if the fiduciary provision is not removed from the bill in its entirety, per our recommendation above, we would urge you to at least remove the reference to insurance producers in that provision. While this change would not fully address our concerns with the bill, it would avoid the imposition of inconsistent standards of conduct on Maryland insurance producers.

Risk of Federal Preemption

As you may know, the National Securities Markets Improvement Act of 1996 ("NSMIA") expressly prohibits states from imposing certain regulations on BDs, including recordkeeping regulations that require broker-dealers to make and keep records that differ from, or are in addition to, the recordkeeping requirements imposed under federal securities law.[5] In our view, any law or rule under which BDs would be subject to a fiduciary duty would run afoul of this prohibition. Based on our understanding of state fiduciary duties and the current federal recordkeeping requirements, we believe any fiduciary duty imposed on BDs would necessarily require them to create and maintain significant and extensive new records that are beyond the current federal recordkeeping requirements. These records would be necessary to demonstrate compliance with the fiduciary obligations that would be imposed under the bill.

We recognize that the bill includes language intended to avoid preemption under NSMIA by affirmatively asserting that it does not impose any recordkeeping requirements that are not imposed under federal law. However, we see no way for our member companies to defend themselves against regulatory enforcement actions or private litigation without creating extensive documentation to prove that they satisfied their fiduciary obligations. The absence of explicit recordkeeping provisions in the bill does not address the practical problems associated with requiring BDs to conform to a fiduciary obligation, and we do not believe this disclaimer is sufficient to accomplish its intended goal of avoiding preemption.

Moreover, it is clear from the SEC's own statements that the current federal recordkeeping requirements would prove insufficient to determine whether a broker-dealer met any fiduciary obligations.[6] When the SEC last amended the recordkeeping rule in 2001, it explicitly stated that the amendment was designed "to provide regulators, particularly State Securities Regulators, with access to books and records which enable them to review for compliance with

[5] 15 U.S.C. 78o.

[6] Books and Records Requirementsfor Brokers and Dealers Under the Securities Exchange Act of 1934, 66 FR 55818 (Nov. 2, 2001).

suitability rules."[7] Nothing in the rule suggests that BDs would be required to maintain records necessary to determine whether they have satisfied an ongoing fiduciary duty.

Based on feedback from our members and our understanding of the purpose behind the latest amendment to the federal recordkeeping requirements, it is clear that the current recordkeeping structure would fall short of enabling the Maryland Division of Securities to determine whether a particular financial professional has fulfilled his or her fiduciary duty, nor would it allow BDs to present adequate defenses against alleged fiduciary violations in litigation. Therefore, regardless of the disclaimer, the bill would necessitate the creation of additional recordkeeping documents for examination purposes and to enable broker-dealers to raise adequate defenses, contrary to the explicit language in NSMIA.

In addition to violating the express preemption provided for in NSMIA, we also believe the bill would undermine the delicate balance Congress sought to achieve in enacting NSMIA. NSMIA aimed to efficiently divide responsibility for the regulation of financial markets between the Federal and State governments. While the law preserves state antifraud authority and the ability to bring enforcement against fraudulent activity, it also created a broad-based preemption against state interference in legitimate broker-dealer activity.[8] Beyond simply preempting states' ability to promulgate recordkeeping rules, NSMIA also prohibits states from enacting requirements on capital, custody, margin, financial responsibility, bonding, or reporting.[9]

Undoubtedly, the preemption provision is broad and reflects Congress' desire to have a centralized, predictable regulatory system.[10] While the states retain a significant role in combating fraud within their borders, crafting a one-of-a-kind fiduciary regulation certainly goes beyond the antifraud preservation included in NSMIA.

We also note that the fiduciary duty imposed under the bill would seemingly apply to recommendations made in the context of retirement plans covered by the Employee Retirement Income Security Act of 1974 ("ERISA"). However, ERISA includes a broad and well-established preemption provision which effectively prohibits states from imposing any regulations on ERISA plans. State regulations that could otherwise apply to ERISA plans typically

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[7] *Id*.

[8] National Securities Markets Improvement Act of 1996, PL 104–290, October 11, 1996, 110 Stat 3416.

[9] *Id*.

[10] President on National Securities Markets Act Signing (Oct. 11, 1996), 1996 WL 584922, at *1 ("This legislation will save hundreds of millions of dollars for American businesses…. Broker-dealers will benefit from no longer being subject to dozens of differing State net capital and books and records requirements….These changes will all enhance our national capital markets, helping to create and nurture new businesses and new jobs, and enhancing the returns of both businesses and investors.")

include exclusions for such plans, and we would respectfully urge the Division to incorporate such exclusions into the Draft Regulations to avoid running afoul of ERISA preemption.

Conclusion

Thank you again for the opportunity to share our views on this important regulatory effort. As stated above, IRI and our members are supportive of appropriate enhancements to the standards of conduct applicable to financial professsionals. Unfortunately, the bill approaches this objective in a manner that will deprive Maryland residents of access to a wide range of insurance and investment products, and to trained financial professionals who can help them choose which products are right for them. We think there are better ways to achieve our shared goal of requiring financial professionals to act in the clients' best interest, and we stand ready to help you find the right path forward.

If you have questions about anything in this letter, or if we can be of any further assistance in connection with this rulemaking, please feel free to contact me.

Sincerely,

Jason Berkowitz
Chief Legal & Regulatory Affairs Officer
Insured Retirement Institute