

From: Sonne, James <[REDACTED]>
Sent: Tuesday, February 19, 2019 2:57 PM
To: Diamond, Eric <[REDACTED]>
Subject: RE: Thank You

Eric,

MassMutual appreciates the opportunity to engage with the SEC on the proposed rulemaking governing the standard of conduct for broker-dealers ("Regulation BI"), as well as the proposed relationship summary disclosure ("Form CRS").

Our firm, a leading mutual life insurance and Fortune 100 company, founded in 1851, places a priority on putting the consumer first when it comes to choosing investment products. Therefore, we support both Regulation BI and Form CRS.

We appreciate our most recent meeting with you and your staff and are grateful for the opportunity to respond to questions on the following:

- A suggested clear and more predictable definition of materiality that would allow broker-dealers to offer consumers more products and services
- Ways to clarify that the Proposing Release's list of mitigation practices is not viewed as a one-size-fits-all approach

We have worked with subject matter experts throughout our firm to address all of the above in the attached. We have also included our previously submitted comment letter for your reference.

We of course welcome further questions. Thank you again for all of your time.

Best regards,

James

From: Diamond, Eric <[REDACTED]>
Sent: Tuesday, November 13, 2018 6:13 PM
To: Sonne, James <[REDACTED]>
Subject: [EXTERNAL]RE: Thank You

Thanks, James. Good to see you again.

Best regards,
Eric Diamond

From: Sonne, James [[mailto:\[REDACTED\]](mailto:[REDACTED])]
Sent: Tuesday, November 13, 2018 3:04 PM
To: Diamond, Eric
Subject: Thank You

Eric,

Thanks for taking the time to meet with us today. We will be in touch with more information soon.

Thanks again!
-James

James L. Sonne
Assistant Vice President, Federal Government Relations | Law Department

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1. Material Conflicts of Interest – Proposed Interpretation

In the proposing release, the Commission proposes to interpret a material conflict of interest as “a conflict that a reasonable person would expect might incline a broker-dealer – consciously or unconsciously - to make a recommendation that is not disinterested”. We understand that this proposed interpretation was driven by a desire to harmonize Regulation BI with the standards applicable to investment advisers. Under the Advisers Act, advisers must, among other things, “make full disclosure of any material conflict or potential conflict.” Amendments to Part 2 of Form ADV Adopting Release, Investment Advisers Act Release No. IA-3060 at 3 (2010) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963)). We fully support requiring broker-dealers to make full disclosure of any material conflict or potential conflict of interest. Our concern, as we discussed, is that the proposed interpretation of material conflict of interest in Regulation BI actually does not include any meaningful concept of materiality in it, and would therefore subject broker-dealers to endless second guessing about what is intended. The only operative standard in the proposed interpretation is whether a “reasonable person” would view a purported conflict as one that “might incline” a broker-dealer to make a disinterested recommendation.

Moreover, the proposed definition is not consistent with the interpretations of materiality under the Advisers Act. *See* Amendments to Form ADV, Rel. No. IA-3060, note 35 (“The standard of materiality under the Advisers Act is whether there is a substantial likelihood that a reasonable investor (here, client) would have considered the information important.” (citing *SEC v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992). *Cf. Basic Inc. v. Levinson*, 485 U.S. 224, 231-232 (1988); *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 445, 449 (1976)). The “might incline” concept appears to have its source in dicta from the Capital Gains opinion. We would point out, however, that this formulation was not essential to the basic holding in the case –that advisers owe their clients a fiduciary duty under the Advisers Act – and has not been used or relied upon the SEC or the courts since then in evaluating when an adviser has a material conflict of interest. As such we would respectfully recommend that the SEC revert back to the traditional concept of materiality in its interpretation of the duties of broker-dealers under Regulation BI. This is not only the right approach from a legal perspective, but also from the standpoint of having a standard that can be operationalized by broker-dealers.

For example, assume that (1) a broker-dealer representative (“rep.”) is in a golf league and his foursome (which the league established) includes a wholesaler for an investment adviser whose mutual funds are on the broker-dealer’s shelf, (2) the rep does not otherwise have a social or business relationship with the wholesaler, and (3) the commissions the rep. receives for selling mutual funds does not vary based on the fund family recommended. Under the SEC’s proposed interpretation, the disclosure would be required if a reasonable person would expect that the relationship might incline a broker-dealer even unconsciously to make a recommendation that is not disinterested. Given the impossibility of trying to prove that the rep. was not unconsciously biased, there would be a strong incentive for the broker-dealer to make the disclosure to avoid being second-guessed. The conundrum, of course, is that it will be impossible for a broker-dealer to try and identify the myriad type of relationships that each of its rep. may have that the someone could argue after the fact was a conflict that might have unconsciously inclined the rep. to make a recommendation that was disinterested. And a general disclosure written to cover all of the possible relationships would not prove helpful to an investor. On the other hand, under the traditional concept of materiality, we do not believe that any disclosure of this societal relationship would be required because of a complete absence of a substantial likelihood that a reasonable investor (here, client) would consider the information important.

2. Mitigation of Material Conflicts of Interest Arising From Financial Incentives – Neutral factors

As we discussed during our recent meetings with you, MassMutual fully supports the Commission stated intent to eschew mandating specific mitigation measures or a “one-size fits all” approach but instead “leave broker-dealers believes with flexibility to develop and tailor reasonably designed policies and procedures that include conflict mitigation measures, based on each firm's circumstances.” (p. 179) However, we expressed our concern that despite the proposing release’s endorsement of a principles-based approach for addressing the Conflicts of Interest Obligation, it then proceeds to suggest a more rigid, prescriptive description of methods for mitigating financial conflicts that in practice has the potential to fly in the face of this stated goal.

Specifically, the Release states that broker-dealers should consider incorporating a list of potential practices into their policies and procedures to promote compliance, including establishing differential compensation criteria based on neutral factors” (i.e., the “time and complexity” of the work involved). As you likely know, this was one of the most problematic provisions of the DOL’s Best Interest Contract Exemption for the reasons set forth in our comment letter¹. While it is true that the proposing release does not mandate the use of such a regime, courts will look to the proposing release (and adopting release) for guidance regarding the SEC’s views on appropriate mitigation approaches, and will very likely question why a broker-dealer did not use the neutral factors test. For the reasons set forth in our comment letter as explained during our meetings, we believe it is impossible to comply with the neutral factors test with any reasonable degree of confidence and accordingly, requested that the reference to neutral factors be eliminated in the adopting release.

Although we continue to believe that the final rule should not reference the neutral factors test, we believe there is a way to address our concern, including how the neutral factors test has the potential to limit investor choice, without removing neutral factors as one of several examples of mitigation practices. Specifically, we would suggest rewording the language currently contained in the proposing release (pages 181-182) as follows:

“While many broker-dealers may have programs currently in place to manage conflicts of interest, each broker-dealer will need to carefully consider whether its existing framework complies with the proposed obligations under Regulation Best Interest.

For example, while the commission is not mandating any specific measures, broker-dealers generally may consider incorporating one or more of the following non-exhaustive list of potential practices as relevant into their policies and procedures to promote compliance with (a)(2)(iv) of proposed Regulation Best Interest:

- Avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales;
- minimizing compensation incentives for employees to favor one type of product over another, proprietary or preferred provider products, or comparable products sold on a principal basis—for example, establishing differential compensation criteria based on neutral factors (e.g., the time and complexity of the work involved);

¹ MassMutual Comment Letter, Regulation Best Interest, Form CRS Summary Relationship (August 7, 2018). A copy of this letter is included in this submission.

- eliminating compensation incentives within comparable product lines (e.g., one mutual fund over a comparable fund) by, for example, capping the credit that a registered representative may receive across comparable mutual funds or other comparable products across providers;
- implementing supervisory procedures to monitor recommendations that are: Near compensation thresholds; near thresholds for firm recognition; involve higher compensating products, proprietary products or transactions in a principal capacity; or, involve the rollover or transfer of assets from one type of account to another (such as recommendations to rollover or transfer assets in an ERISA account to an IRA, when the recommendation involves a securities transaction) [318] or from one product class to another [319];
- adjusting compensation for registered representatives who fail to adequately manage conflicts of interest; and
- limiting the types of retail customers to whom a product, transaction or strategy may be recommended (e.g., certain products with conflicts of interest associated with complex compensation structures).”

While such practices may be elements of an effective conflicts program, other approaches may also be appropriate depending on the business model of any particular firm. For example, firms that offer both proprietary and nonproprietary products often utilize product review committees or similar new product vetting structures to ensure that both classes of products are subject to equal due diligence and that controls are in place to ensure suitability and related supervisory procedures are applied in a consistent manner. In its 2013 conflicts report, FINRA described at length multiple governance approaches that the industry has developed to identify and manage the conflicts inherent in designing a product shelf.² These approaches vary markedly and reflect the diversity of business models. We are encouraged that the Release eschews a “one size fits all” view of conflicts mitigation practices and, consistent with that view, we encourage the SEC to recognize that strong product governance structures, tailored to each firm’s particular situation, play an important roles in ensuring that material conflicts are mitigated.

² FINRA Report on Conflicts of Interest (October 2013)