

## MEMORANDUM

TO: File Nos. S7-07-18 and S7-08-18

FROM: Bradford Bartels, Division of Trading and Markets

RE: Meeting with SIFMA Representatives and Members

DATE: March 5, 2019

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On March 4, 2019, representatives of the U.S. Securities and Exchange Commission (“SEC”) participated in a meeting with representatives and members of SIFMA. The SEC representatives were Brett Redfearn, Lourdes Gonzalez, Emily Westerberg Russell, Alicia Goldin, Roni Bergoffen, Daniel Fisher, Stephen Benham, and Bradford Bartels from the Division of Trading and Markets; Sarah ten Siethoff, Sirimal Mukerjee, Parisa Haghshenas, Jennifer Songer, Elizabeth Miller, Benjamin Kalish, James McGinnis, Alexis Palascak, Matthew Cook, and Olawale Oriola from the Division of Investment Management, and Jennifer Juergens, Iulian Obreja, James McLoughlin, and Mattias Nilsson from the Division of Economic and Risk Analysis. The SIFMA representatives were Ira Hammerman and Kevin Carroll. The member representatives were Stephanie Nicolas (Wilmer Hale), Christina Jaramillo (Wilmer Hale), Evan Charkes (Bank of America Merrill Lynch), Christopher Gilkerson (Charles Schwab), Jesse Hill (Edward Jones), David Forman (Fidelity), Margo Topman (Goldman Sachs), Julie Glynn (JP Morgan), Jose Guerra (JP Morgan), Dean Pinto (Morgan Stanley), and Dave Sparks (Raymond James).

The participants discussed among other things, the SEC’s proposed rule, Regulation Best Interest, and proposed new form, Form CRS. At the meeting, SIFMA representatives also distributed the attached comment letter.



March 1, 2019

Via email to: [fiduciaryduty@sos.nv.gov](mailto:fiduciaryduty@sos.nv.gov)

Ms. Diana Foley  
Nevada Secretary of State's Office, Securities Division  
2250 Las Vegas Boulevard North, Suite 400  
North Las Vegas, Nevada 89030

Re: Proposed regulations re: Nevada Revised Statutes ("NRS") 90.575, 628A.010 and 628A.020 (January 18, 2019),<sup>1</sup> as modified by Nevada Senate Bill No. 383 ("SB 383")<sup>2</sup>

Dear Ms. Foley:

The Securities Industry and Financial Markets Association ("SIFMA")<sup>3</sup> appreciates the opportunity to comment on the above-captioned proposed regulations (the "Proposal"). SIFMA represents the interests of more than 340 broker-dealers ("BDs"), investment advisers ("IAs"), and asset managers operating in the U.S. and global capital markets. Many of our members do business and serve retail investors in the state of Nevada.<sup>4</sup>

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<sup>1</sup> Available at <https://www.nvsos.gov/sos/home/showdocument?id=6156>.

<sup>2</sup> Nevada Senate Bill No. 383, approved by the Governor, Chapter 322 (effective July 1, 2017), available at <https://www.leg.state.nv.us/Session/79th2017/Reports/history.cfm?ID=847>.

<sup>3</sup> SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>4</sup> Most SIFMA members who serve retail investors are dually registered as both BDs and IAs, or provide services through separate but affiliated registered BDs and IAs and dually-licensed representatives, thereby giving investors choice about the level of service and how to pay for it. Notwithstanding an IA's fiduciary duty versus a BD's current suitability standard, BDs are generally subject to more extensive regulation and more frequent examination and enforcement by the SEC and FINRA. See Morgan, Lewis & Bockius LLP, *Current Regulatory Regime Comprehensively Protects Investors and Preserves Investor Choice*, at p. 17 (March 2015), available at [https://www.morganlewis.com/-/media/files/publication/morgan-lewis-title/white-paper/im\\_whitepaper\\_dolretirementinitiative\\_march2015.ashx](https://www.morganlewis.com/-/media/files/publication/morgan-lewis-title/white-paper/im_whitepaper_dolretirementinitiative_march2015.ashx).

SIFMA supports strong, substantive conduct standards for BDs and IAs to enhance investor protection, while at the same time preserving investor access to transaction-based advice and a variety of investment products. For that reason, we have supported the efforts of the U.S. Securities and Exchange Commission (“SEC”) to develop and finalize comprehensive federal regulations that will meaningfully raise the bar for BDs when providing personalized investment advice about securities to retail customers. We expect that the SEC will finalize and publish its Regulation Best Interest rules this year.

The most reasonable approach to protect investors and avoid investor confusion is to allow the SEC – the primary federal securities regulatory agency – to promulgate a uniform, nationwide, heightened, best interest standard of conduct for BDs. A state-by-state approach would result in an uneven patchwork of laws that would be duplicative of, different than, and/or in conflict with federal standards.<sup>5</sup> It would also introduce a new level of investor confusion, which would undercut not only the new, uniform federal standard, but also the interest of investor protection generally.

A state-by-state approach also runs a significant risk of imposing regulations that are sufficiently costly, burdensome and/or difficult if not impossible to operationalize such that firms would be strongly incentivized to: (i) migrate brokerage accounts to fee-based accounts (Though such moves may be appropriate, they may ultimately be more costly for certain investors.); (ii) scale back brokerage services to execution only (i.e., do not provide brokerage advice); (iii) raise prices to cover their higher costs; and/or (iv) discontinue service to BD accounts altogether.

The Proposal, as currently drafted, would create these same incentives. As a result, many Nevada investors would likely suffer the loss of access to brokerage accounts and equally important, the loss of access to advice from BDs. The ability to receive advice incidental to brokerage services as permitted by SEC rules is often more appropriate for, among others, smaller investors, for whom a brokerage account is usually more economical, as well as investors who generally buy and hold and do not need or want to trade frequently, or who do not want to pay for ongoing advice and monitoring through an advisory account. In addition, many of these same investors, particularly smaller investors, would not qualify for fee-based accounts, and so would lose access to advice altogether.<sup>6</sup> Nevada should affirmatively avoid creating these incentives and the unintended negative consequences that will likely follow.

For all the foregoing reasons, we appreciate the opportunity to participate in your regulatory process. We respectfully offer the following comments and recommendations on the Proposal, which we hope you find informative and helpful.

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<sup>5</sup> State regulation also raises numerous federal preemption issues, discussed *infra* Sections 2 – 4.

<sup>6</sup> Similar consequences were associated with the U.S. Department of Labor’s Fiduciary Rule where our industry experienced a significant migration of brokerage retirement accounts to fee-based account and a contraction of service offerings. *See* additional discussion *infra* Section 13. *See also* **Appendix – Empirical Studies** (providing quantitative data and findings documenting these consequences).

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**1. The Securities Division should await the conclusion of the SEC’s rulemaking to establish a uniform, heightened, best interest standard for BDs.**

In April 2018, the SEC issued proposed Regulation Best Interest and Form Customer Relationship Summary (“CRS”) (collectively, “Reg BI”) for public comment.<sup>7</sup> Reg BI would create a new, nationwide, heightened standard of conduct for BDs. Under the current Reg BI proposal, a BD making a personalized recommendation about a securities transaction or an investment strategy must: (1) act in the client’s best interest, without placing its financial or other interest ahead of the client’s interest; (2) act with diligence, care, skill and prudence; and (3) disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with the recommendation.

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<sup>7</sup> SEC Regulation Best Interest, Release No. 34-83062; File No. S7-07-18, available at <https://www.sec.gov/rules/proposed/2018/34-83062.pdf>; Form Customer Relationship Summary (“CRS”), Release No. 34-83063; File No. S7-08-18, available at <https://www.sec.gov/rules/proposed/2018/34-83063.pdf>.

SIFMA generally supports proposed Reg BI because it: (i) raises the bar from the existing Financial Industry Regulatory Authority (“FINRA”) suitability standard and incorporates fiduciary principles (e.g., “diligence, care, skill and prudence”); (ii) adds meaningful new investor protections; (iii) preserves investor choice and allows investors to continue to receive advice through the brokerage model; (iv) applies broadly to all retail customer accounts, including retirement accounts; and (v) allows the primary federal securities regulatory agency – the SEC – to enforce a uniform standard not only across the industry but also across the country.

Moreover, while the best interest obligation under Reg BI applies at the time of the recommendation, the obligation is generally consistent with the fiduciary obligation imposed on an investment adviser when providing personalized investment advice about securities to a client.<sup>8</sup>

Based on our conversations with the SEC Commissioners and staff, we understand that Reg BI remains a top priority for SEC Chairman Clayton, and the SEC is working diligently to publish a final rule as soon as possible. We anticipate that the final rule may be published sometime prior to the fourth quarter of 2019.<sup>9</sup>

Based on the foregoing, we urge the Securities Division to await the conclusion of the SEC’s Reg BI rulemaking process before moving forward with any final regulations. Doing so would give the Securities Division an opportunity to determine if there are material gaps between Reg BI and its proposed regulation under SB 383. This is particularly important since SB 383 was enacted to address a perceived gap at the federal level that is now being filled by the SEC through Reg BI.<sup>10</sup>

If the Securities Division nevertheless proceeds with the Proposal, then the Proposal should be revised to clarify that firms that comply with Reg BI shall be deemed in compliance with the Nevada standard. We are concerned that Section 10.1. of the Proposal, as currently drafted, could be interpreted as giving the Administrator the authority to layer Reg BI, when adopted, on top of any final Nevada regulation. We strongly believe that Reg BI should be a substitute for, rather than an addition to, any state fiduciary standard, particularly given that the Proposal, as currently drafted, has several fatal flaws, discussed in greater detail below.

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<sup>8</sup> See SIFMA comment letter to SEC re: Reg BI (August 7, 2018) at p. 8, available at <https://www.sifma.org/resources/submissions/regulation-best-interest-reg-bi/>.

<sup>9</sup> See SEC Rule List, available at [https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION\\_GET\\_AGENCY\\_RULE\\_LIST&currentPub=true&agencyCd=3235&Image58.x=58&Image58.y=9](https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCd=3235&Image58.x=58&Image58.y=9). The DOL has also added a Fall 2019 placeholder on its regulatory calendar for potential action on the vacated DOL Fiduciary Rule. See DOL Rule List, available at [https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION\\_GET\\_AGENCY\\_RULE\\_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=1200](https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=1200).

<sup>10</sup> *Minutes of the Senate Committee on Commerce, Labor and Energy, Seventy-ninth Session* at 2-7 (April 12, 2017), available at <https://www.leg.state.nv.us/Session/79th2017/Minutes/Senate/CLE/Final/787.pdf>.

**2. Because SB 383 and the Proposal, as applied to SEC-registered IAs (“RIAs”), are preempted in their entirety by NSMIA, all references to state regulation of RIAs in the Proposal should be stricken.**

Congress enacted the National Securities Markets Improvements Act (“NSMIA”) in 1996 to promote efficiency in the financial markets by eliminating the dual system of state and federal registration of securities and securities professionals.<sup>11</sup> With respect to IAs specifically, NSMIA added section 203A(b)(1) to the Investment Advisers Act of 1940 (“Advisers Act”) which states:

No law of any state or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser or supervised person of an investment adviser shall apply to any person (A) that is registered under section [203] as an investment adviser, or that is a supervised person of such person, except that a State may license, register or otherwise qualify an investment adviser representative that has a place of business located within that State; or (B) that is not registered under [Section 203] because that person is excepted from the definition of an investment adviser under section [202(a)(11)].<sup>12</sup>

In the Rules Implementing Amendments to the Advisers Act, the SEC explained that Section 203A(b)(1), as amended by NSMIA, preempts not only a state’s specific registration, licensing, and qualification requirements, but also all regulatory requirements imposed by state law on RIAs relating to their advisory activities or services, except those provisions relating to enforcement of anti-fraud prohibitions.<sup>13</sup>

Based on the foregoing, as applied to RIAs, SB 383 and the Proposal are preempted in their entirety by NSMIA. Accordingly, we recommend that all references to state regulation of RIAs in the Proposal be stricken, or that the references be amended to clarify that they are referring only to IAs who are licensed with the state of Nevada and who are not RIAs.

**3. SB 383 and the Proposal suffer from additional preemption and other legal infirmities that make the regulations invalid and ultimately unenforceable.**

SB 383 and the Proposal suffer from additional preemption and other legal infirmities including but not limited to the following:

- NSMIA/Exchange Act. See discussion *infra* Section 4.

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<sup>11</sup> Pub. L. No. 104-290, 110 Stat. 3416 (1996).

<sup>12</sup> 15 U.S.C. §80b-3a(b)(1).

<sup>13</sup> Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA-1633, File No. S7-31-96, (May 22, 1997), available at <https://www.govinfo.gov/content/pkg/FR-1997-05-22/pdf/97-13284.pdf> (“On its face, section 203A(b)(2) preserves only a state’s authority to investigate and bring enforcement actions under its antifraud laws with respect to Commission-registered advisers. The Coordination Act does not limit state enforcement of laws prohibiting fraud. Rather, states are denied the ability to reinstitute the system of overlapping and duplicative regulation of investment advisers that Congress sought to end.” (text at nn.155-56)).

- Express and Conflict Preemption – Advisers Act / Exchange Act. SB 383 and the Proposal directly conflict with the Exchange Act and Advisers Act, and/or interfere with the achievement of federal objectives in those Acts.
- Employee Retirement Income Security Act of 1974 (“ERISA”). Any portions of SB 383 or the Proposal that apply or relate to any employee benefit plan are explicitly preempted by ERISA.<sup>14</sup>
- Federal Arbitration Act (“FAA”). To the extent NRS 628A.030 (*Liability of a financial planner*) – which permits a customer to bring a “civil action” against a financial planner – is applicable to a BD or IA, it is expressly preempted by the FAA because it restricts the enforcement of arbitration agreements commonly found in BDs’ and (and sometimes in IAs’) customer agreements.
- Advisers Act. Under the Advisers Act, there is no private right of action against RIAs. Thus, to the extent the Proposal deems an RIA to be a financial planner and subject to the liability of a financial planner under NRS, the Proposal is contrary to and preempted by the Advisers Act, which prohibits Nevada’s imposition of a private right of action against RIAs.
- Commerce Clause of the Constitution. The imposition of a fiduciary duty under SB 383 and the Proposal is unconstitutional because it imposes a burden on interstate commerce that is clearly excessive in relation to the putative local benefits.
- First Amendment to the Constitution. The titling restriction in Section 5.4 of the Proposal (NRS 90.575) violates the First Amendment because it places an impermissible burden on commercial speech.
- Nevada Administrative Procedure Act (“Nevada APA”), NRS 233B. The Proposal violates the Nevada APA on the following grounds, among others:
  - It fails to include a “statement of the need for and purpose of the proposed regulation” (NRS 233B.060(a)(1));
  - It fails to include a “statement of the estimated economic effect of the regulation on the business which it is to regulate and on the public” (NRS 233B.060(a)(4));
  - It fails to state “the impact on a small business” (NRS 233B.060(a)(5));
  - Because the regulation overlaps or duplicates a federal regulation, it fails to “include the name of the regulating federal agency” (NRS 233B.060(a)(7));

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<sup>14</sup> Pursuant to ERISA § 514(a), ERISA supersedes all state laws insofar as they relate to any employee benefit plan subject to ERISA. ERISA § 514(b)(2)(A) provides a limited exception to ERISA’s broad preemption of state law for certain state laws that regulate insurance, banking or securities. NRS Chapter 628A, however, which applies only to financial planners, does not fall within this limited exception. NRS Chapter 628A is also subject to conflict preemption because it upends ERISA’s carefully crafted fiduciary responsibility and remedies provisions. *Aetna Health Inc. v. Davila*, 124 S. Ct. 2488 (2004).



- Because the regulation includes provisions that are more stringent than a federal regulation that regulates the same activity, it fails to include “a summary of such provisions” (NRS 233B.060(a)(9)); and
- It exceeds the statutory mandate under SB 383 by including regulations that are not necessary to the proper execution of the statute.

The foregoing preemption and other legal infirmities render the proposed regulations as drafted invalid and ultimately unenforceable.

#### **4. The Proposal imposes a host of new and different book and recordkeeping requirements for BDs that are preempted by NSMIA and should be eliminated.**

NSMIA added Section 15(i)(1) to the Securities Exchange Act of 1934 (“Exchange Act”) which states:

No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish capital, custody, margin, financial responsibility, *making and keeping records*, bonding, or financial or operational reporting requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers *that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act]*” (emphasis added).<sup>15</sup>

In turn, under Exchange Act Rule 17(a)-4, BDs are required to keep a record of “all communications ... by the member ... relating to its business as such....”<sup>16</sup>

The Proposal imposes on BDs (and in many cases, IAs) the following new books and records requirements, among others, that differ from, or are in addition to, those imposed by federal law and/or FINRA rules:

- Overbroad scope of investment advice. Under the Proposal, the scope of the fiduciary duty is not limited to recommendations about securities to retail customers as it is under current FINRA rules and prospective Reg BI. Instead, the Proposal overbroadly defines investment advice – and thus the applicability of the fiduciary duty – to include, for example, “providing analyses or reports regarding a security to a client” (Section 4.1.(c)),<sup>17</sup> “providing advice ... regarding the type of account a client should open” (Section 4.1.(e)), “providing advice ... regarding fee options” (Section 4.1.(f)),

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<sup>15</sup> 15 U.S.C. §78o(i)(1).

<sup>16</sup> 17 CFR §§ 240.17a-4(b)(4).

<sup>17</sup> As discussed *infra* Section 6 (*Scope*), under current FINRA rules and prospective Reg BI, general research, for example, is not considered investment advice. At firms with research departments, many research analysts carry only a research license, Series 86/87. The Proposal thus raises questions about its potential impact on licensing. If, for example, Nevada deems a firm and its associated persons to be far more extensively engaged in providing investment advice, then would additional brokerage licenses (e.g., Series 65/66) be required, or would Nevada registered representatives need to be licensed and registered as IAs?

“recommending a broker dealer, ... investment adviser, ... or financial planner” (Section 4.1.(k)), and “providing advice or a recommendation regarding an insurance product” (Section 4.1.(l)).<sup>18</sup> By doing so, the Proposal would require BDs to (a) develop new supervisory systems and procedures to address these new, expansive, fiduciary activities, and (b) make and keep new records to document compliance with these requirements.

- Ongoing fiduciary duty. Under the Proposal, a BD owes an ongoing fiduciary duty “through the term of engagement of services” (Section 1.2.(g)), when providing *unsolicited* investment advice (Section 2.2.(g)), and if the BD uses certain titles (Section 5.4.), unless a limited exemption to the ongoing duty applies (Section 2.). Under current FINRA rules and prospective Reg BI, BD conduct standards apply only at the point of recommendation and not beyond. By subjecting BDs to an ongoing fiduciary duty – and thus a new duty to monitor the performance of an account – the Proposal would require BDs to develop new supervisory systems and procedures, and make and keep new records to document compliance with the new requirement.
- Disclosure of gains. The Proposal requires a BD to disclose to a client an extensive list of “gains” received by the BD as a result of the client following their advice (Section 7.1.(a) – (j)). Under current federal securities laws, BDs disclose information about their compensation for a transaction in a customer confirmation report delivered at or before the completion of the transaction.<sup>19</sup> The “gains” included in the Proposal include compensation, particularly compensation paid by third parties, that appears to significantly exceed the compensation required to be reported in a BD’s customer confirmation report. Thus, the BD would need to make and keep new records to report such “gains.”
- Disclosure of referral fees. The Proposal requires that a BD disclose to a client any referral fee or other benefit for recommending a BD or IA, for example. A BD owes no such disclosure obligation under current law. Thus, the BD would need to make and keep new records to document compliance with this new disclosure obligation.
- Other disclosures. The Proposal also requires that a BD disclose to a client, among other things,
  - “all risks associated with [a proprietary] product” (Section 6.1.(c));
  - “current offering documents on the product *prior to* execution of the transaction” (Section 8.1.(e)) (emphasis added);
  - “all ... features of the product” (Section 8.1.(f)); and
  - “all information regarding a potential conflict of interest” Section 8.1.(g)).

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<sup>18</sup> A number of these activities not only do not represent investment advice as commonly understood under current law but would also chill the provision of such services to clients – often for free – because BDs would not want to incur the liabilities of being deemed a fiduciary by providing such services.

<sup>19</sup> See Exchange Act Rule 10b-10.

BDs currently deliver offering documents for a limited number of transactions (generally limited to new issues) at the time of the customer confirmation, not for all transactions, and not prior to trade execution. SEC rules require disclosure of material risks and conflicts. Contrary to the Proposal, BDs are not currently required to disclose *all* risks associated with proprietary products, or *all* product features, or *all* information about potential conflicts. Thus, BDs would need to make and keep new records to document compliance with these new requirements.<sup>20</sup>

NSMIA not only limits state regulations that directly impose new or different recordkeeping requirements, but also state regulations that by their nature require BDs to make and keep new or different records than those required by federal law and FINRA rules.<sup>21</sup> Thus, any state regulation that imposed a new or different communication or disclosure requirement on broker-dealers, including any new timing requirement for such disclosures, would in turn trigger a new or different record-keeping obligation, which would in turn be subject to express federal preemption under NSMIA.

Although the Proposal states that it should be “interpreted and applied in harmony with [NSMIA]” (Section 10.2.), this provision is insufficient to relieve the Securities Division of its obligation to avoid imposing, directly or indirectly, NSMIA-preempted books and records requirements. As currently drafted, the Proposal cannot be reconciled with NSMIA and therefore would be unlikely to survive a legal challenge on NSMIA grounds.

**5. The Securities Division should redraft the Proposal to clarify and explicitly state that BDs and IAs are *not* “financial planners” per se as defined in NRS 628A.010, and that a BD or IA must actually provide personal financial planning services to a client for (*separate*) compensation in order to owe the fiduciary duty of a financial planner to that client.**

SB 383 made the following two primary changes, among others: First, it removed the exemption for BDs and IAs from the definition of “financial planner” under NRS 628A.010 (*Definitions*). Second, it amended Chapter 90 of NRS (i.e., the Uniform Securities Act) to provide that BDs and IAs “shall not violate the fiduciary duty toward a client imposed by NRS 628A.020 (*Duties of financial planner*).

By taking this approach, however, SB 383 is unnecessarily vague and creates substantial uncertainty about how it is intended to apply. There are three separate and distinct possible interpretations:

- (i) The first is that SB 383 intends that BDs and IAs should be deemed “financial planners” per se as defined in NRS 628A.010 (*Definitions*), thereby subjecting them to the fiduciary duty imposed by NRS 628A.020 (*Duties of financial planner*).

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<sup>20</sup> See *infra* Section 11 (recommending that the Proposal conform to federal securities laws and FINRA rules, which appropriately limit disclosure to *material* risks and conflicts).

<sup>21</sup> See Exchange Act Rule 17(a)-4, requiring broker-dealers to keep a record of “*all communications ... by the member ... relating to its business as such...*” (emphasis added). 17 CFR §§ 240.17a-4(b)(4).

- (ii) The second is that SB 383 intends that regardless of whether or not BDs and IAs are “financial planners” who provide financial planning services, they nevertheless owe their clients the fiduciary duty of a financial planner.
- (iii) The third is that SB 383 intends to subject BDs and IAs to the fiduciary duty imposed by NRS 628A.020 (*Duties of financial planner*), but *only if* they are actually engaged in providing personal financial planning services for compensation.

The answer to which interpretation is correct is not simply academic; it matters. If the first interpretation is correct – that BDs and IAs are financial planners per se, then NRS 628A.030 (*Liability of financial planner*) would necessarily also apply to BDs and IAs in instances in which loss resulted from their advice (under the circumstances listed therein). SB 383 likely did not intend that result.

Although SB 383 removed the BD and IA exemptions from the definition of “financial planner” (NRS 628A.010), it did *not* thereby – explicitly, implicitly or otherwise – necessarily *include* them in that definition. SB 383 is completely silent on whether BDs and IAs are subject to the liability of a financial planner (NRS 628A.030). Notably, in this regard, SB 383 explicitly *exempts* BDs and IAs from the surety bond requirement of a financial planner (NRS 628A.040) – thereby evidencing an intent *not* to impose the full panoply of financial planner regulations on BDs and IAs in all circumstances.

Moreover, if SB 383 intended BDs and IAs to be deemed financial planners per se, then the statute should have explicitly *included* BDs and IAs in the definition of “financial planner” (NRS 628A.010), and also explicitly imposed on BDs and IAs the liability of a financial planner (NRS 628A.030). SB 383 does neither.

Finally, it would be neither reasonable nor logical to interpret SB 383 as: (i) imposing “financial planner” status on BDs and IAs (merely by removing their exemption from the definition); and (ii) imposing the liabilities of a financial planner on BDs and IAs (by remaining silent on that point). Accordingly, we request that you confirm our understanding and explicitly clarify that neither SB 383 nor the Proposal should be interpreted such that BDs and IAs are deemed to be “financial planners” per se as defined in NRS 628A.010 (*Definitions*).

The second interpretation of SB 383 – that BDs and IAs owe their clients the fiduciary duty of a financial planner – regardless of whether they are engaged in financial planning services – also seems unlikely and unintended. If the Nevada legislature intended to impose a general fiduciary duty on BDs and IAs under state law, then it would have more clearly and easily done so directly under the Nevada securities laws governing BDs and IAs,<sup>22</sup> rather than importing the fiduciary duty from the separately regulated financial planning profession.<sup>23</sup>

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<sup>22</sup> See NRS Title 7 (Business Associations; Securities; Commodities), Chapter 90 (Securities (Uniform Act)).

<sup>23</sup> See NRS Title 54 (Professions, Occupations and Businesses), Chapter 628A (Financial Planners).

Moreover, the fiduciary duty of a financial planner is owed to a “client” (NRS 628A.020), which is defined as “a person who receives advice from a financial planner” (NRS 628A.010). In turn, a “financial planner” is defined as “a person who *for compensation* advises others upon the investment of money or upon provision for income to be needed in the future, or who holds himself or herself out as qualified to perform either of these functions...” (emphasis added) (NRS 628A.010).

Thus, for BDs and IAs to determine to whom they owe the statutory fiduciary duty, they need to determine to whom they rendered financial planning advice *for compensation*. Thus, the fiduciary duty owed under NRS 628A.020 depends intrinsically on the advice giver’s status as a “financial planner” who has provided personal financial planning advice to a client *for compensation*.

Based on the foregoing, the ***third*** interpretation of SB 383 – that BDs and IAs are subject to the fiduciary duty of a financial planner, but *only if* they are actually engaged in providing personal financial planning services *for compensation* – is the most reasonable, common sense interpretation.

Financial planning is a profession separate and distinct from brokerage or advisory services, and it is regulated as such under Nevada law. BDs and IAs, as previously discussed, are regulated separately and distinctly from financial planners under Nevada’s state securities laws.<sup>24</sup>

Financial planning services are inherently different than basic BD or IA services. Not all BDs and IAs are financial planners, and not all financial planners are BDs or IAs. Generally speaking, if a BD or IA recommends to a client an individual product such as a security, but not as part of an overall financial plan, such BD or IA is not considered to be engaged in personal financial planning.<sup>25</sup>

In contrast, financial planning involves a much more comprehensive review of a client’s finances. A financial plan is generally understood to be:

a comprehensive evaluation of an investor's current and future financial state by using currently known variables to predict future cash flows, asset values and withdrawal plans. Most individuals work in conjunction with a financial planner and use current net worth, tax liabilities, asset allocation, and future retirement and estate plans in developing financial plans. These metrics are used along with estimates of asset growth to determine if a person’s financial goals can be met in the future, or what steps need to be taken to ensure that they are.<sup>26</sup>

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<sup>24</sup> Compare NRS Chapter 628A (Financial Planners) (regulating financial planners) with Chapter 90 (Securities (Uniform Act)) (regulating BDs and IAs).

<sup>25</sup> Similarly, when a BD or IA provides basic ‘planning,’ including without limitation providing customers with a ‘retirement readiness score’ or an ‘overall portfolio health,’ for example, such BD or IA would not be deemed to be engaged in personal financial planning.

<sup>26</sup> See [https://www.investopedia.com/terms/f/financial\\_plan.asp](https://www.investopedia.com/terms/f/financial_plan.asp). The SEC has historically defined “financial planning services” to mean services that “typically involve preparing a financial program for a client based on the client’s financial circumstances and objectives. A financial planner generally seeks to address a wide spectrum of

For that reason, BDs and IAs who elect to provide their clients with detailed financial planning services generally enter into a separate, written engagement to provide a client with personal financial planning services, and are *separately compensated* for such services – separate and apart from any commissions or fees, respectively, that may be earned in accounts that may help effectuate a financial plan.

When a BD receives only commissions for transactions (as opposed to separate compensation for financial planning services), such BD is *not* “a person who for compensation advises....”. This is so because commissions paid to BDs are *not* compensation for advice, but for facilitating transactions and selling financial products. Giving advice is neither necessary nor sufficient for a BD to earn a commission. If a transaction is consummated in the absence of advice, then a commission is still paid. If no transaction is consummated, then no commission is paid, even if extensive advice was rendered.

IAs, on the other hand, generally receive advisory fees that are compensation for advice. But that does *not* mean that all advisory services constitute financial planning. As discussed above, financial planning services are much more comprehensive: (i) they are separately contracted and paid for; and (ii) they are separately and distinctively regulated by states, including Nevada.

Accordingly, we request that you redraft the Proposal to explicitly clarify that BDs and IAs are subject to the fiduciary duty of a financial planner, *but only* with respect to a client to whom they provide personal financial planning services *for separate compensation*.

**6. Scope – The scope of the fiduciary duty for a BD should be limited to when the BD is making a recommendation of a securities transaction or investment strategy involving securities to a retail customer.**

As discussed above, under current FINRA rules and prospective Reg BI, a BD’s best interest obligation applies only when making recommendations about a securities transaction or investment strategy involving securities to a retail customer. The term “securities transaction” includes a sale, purchase, and exchange, and may, for example, include recommendations to roll over or transfer assets from an ERISA account to an IRA.<sup>27</sup> The term “recommendation” has the meaning long-interpreted and applied under FINRA rules and broker-dealer regulation generally.<sup>28</sup> Factors that are considered when determining whether a broker-dealer has made a recommendation include whether the communication “reasonably could be viewed as a ‘call to

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the client’s long-term financial needs, including insurance, savings, and investments, taking into consideration anticipated retirement or other employee benefits.” SEC Release Nos. 34-50979; IA-2339; File No. S7-25-99, *Certain Broker-Dealers Deemed Not Be Investment Advisers*, (January 6, 2005), available at <https://www.sec.gov/rules/final/34-50979.htm>.

<sup>27</sup> See FINRA Regulatory Notice 13-45, *Rollovers to Individual Retirement Accounts: FINRA Reminds Firms of Their Responsibilities Concerning IRA Rollovers* (Dec. 2013), available at <http://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf>.

<sup>28</sup> See FINRA Rule 2111 (Suitability) FAQ, available at <http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq>.

action” and whether it “reasonably would influence an investor to trade a particular security or group of securities.”<sup>29</sup>

Thus, a BD’s best interest obligation does not extend to financial planning tools and calculators that do not recommend specific securities, general research and strategy literature, seminar content, product marketing materials that are broadly circulated and not tailored to any specific investor or group of investors, and general marketing and education materials that do not offer or recommend specific securities, or investing web sites where retail customers use tools to make self-directed investment decisions. Likewise, a BD’s best interest obligation does not apply to, for example, recommendations of account types (Section 4.1.(e)),<sup>30</sup> recommendations referring another financial professional (Section 4.1.(k)),<sup>31</sup> recommendations of an insurance product (Section 4.1.(l)),<sup>32</sup> or where no recommendation is made at all (e.g., an unsolicited transaction).

The Proposal would effectively impose the new statutory fiduciary duty on every aspect of a BDs business. In doing so, the Proposal overbroadly interprets SB 383 in a manner inconsistent with the NRS generally, the statutory intent of SB 383, common law, and the commonly understood use and meaning of the term “investment advice.”

The overbreadth of the Proposal is particularly apparent when applied to self-directed BD platforms. In the self-directed brokerage environment, individual investors conduct their own trading in securities without ever expecting investment recommendations from investment professionals. Firms in this space, however, usually employ registered representatives to handle phone calls from, and provide concierge services to, self-directed investors. Since the Proposal fails to link the application of the fiduciary duty to the rendering of investment recommendations, self-directed BDs may become subject to the Proposal’s fiduciary duty merely because one of their representatives uses the CFP designation (or one of the other titles listed in Section 5.4 of the Proposal) in a client email or some other client-facing communication (Section 5.4).

Similarly, self-directed BDs may also become subject to the fiduciary duty in situations where investors choose to maintain both self-directed brokerage relationships with BDs and separate advisory relationships with affiliated advisors of those BDs offering self-directed platforms (Section 3.2). Furthermore, many BDs with online self-directed platforms offering a variety of tools and guidance would be deemed to be subject to the fiduciary duty and may need to limit what they provide online and/or implement controls and disclosures to limit use by Nevada

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<sup>29</sup> See FINRA Notice to Members 01-23, *Suitability Rule and Online Communications* (April 2001), available at <http://www.finra.org/industry/notices/01-23>.

<sup>30</sup> See *infra* Section 10 (The Proposal should eliminate any fiduciary obligation to conduct an account type review for both prospective and existing customers).

<sup>31</sup> Notably, Section 4.1.(k) is unclear whether its application is limited to recommending “another” financial professional. It could also be interpreted to mean recommending one’s *own* services. This interpretation would be unworkable for the same reasons that it would be inappropriate to apply a fiduciary duty prior to the establishment of a formal customer relationship. See *infra* Section 10. The Proposal should clarify that the foregoing interpretation does not apply.

<sup>32</sup> See SIFMA *et al.* joint trades comment letter to Nevada Securities Division (March 1, 2019) at p.3 (discussing Section 4.1.(l) of the Proposal and concluding that insurance products are properly excluded from its scope).



clients. The costs that BDs offering self-directed platforms would face as a result of complying with Nevada’s overbroad fiduciary duty would likely cause some to consider limiting services to Nevada clients.

Thousands of middle-income investors in Nevada make occasional buy and hold mutual fund purchases with the assistance of a BD. Many of these investors do not need, nor are they willing or able to pay for, a more extensive fiduciary relationship. The unfortunate result of the Proposal, however, would be to require many of these investors of modest means to purchase additional services. In this regard, the Proposal undermines investor choice of and access to the level of services that they want.

For the foregoing reasons, we recommend that the Proposal conform the overbroad definition of “Investment Advice” (Section 4.1.) to be consistent and in harmony with current FINRA rules and prospective Reg BI and common English language understandings, such that the proposed fiduciary duty applies only when making a recommendation of a securities transaction or investment strategy involving securities to a retail customer.

**7. Duration – The duration of the fiduciary duty for a BD should be limited to the point in time when a recommendation is made; an ongoing fiduciary duty for BDs is inconsistent with both the NRS and common law fiduciary principles.**

As discussed above, under the FINRA suitability rule and prospective Reg BI, the duration of a BD’s suitability or best interest obligation is limited to the point in time when a recommendation is made. The Proposal, however, would impose an ongoing fiduciary duty under various circumstances, which would as a practical matter impose on the BD a new duty to monitor the performance of its customers’ accounts.<sup>33</sup> Yet, BD accounts, and supervisory systems, were never designed or intended to provide continuous monitoring. Rather, the primary purpose of a BD account is to execute episodic transactions as directed by the customer and, as discussed above, that is the primary function for which a BD is compensated. Moreover, an ongoing fiduciary duty for BDs is inconsistent with both the NRS and common law fiduciary principles.

BDs 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. If they were forced to provide such monitoring, they would be unable to do so in a BD account without completely re-engineering existing supervisory systems and procedures. They likely would be required to either migrate their BD brokerage clients to fee-based advisory accounts, if appropriate, or cease servicing those brokerage accounts.<sup>34</sup> That outcome would be a major disservice to the hundreds of thousands of Nevada investors who hold BD accounts today and who want to continue to receive episodic brokerage advice.

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<sup>33</sup> For example, the Proposal requires that clients be advised of “all risk associated with” a cash position (Section 6.2.(a)). As the amount of cash in an account changed over time, would the BD then be required to monitor those changes and advise the client of the risks associated with the new cash amounts?

<sup>34</sup> See *supra* note 6 (Similarly, the Department of Labor’s Fiduciary Rule directly caused the migration of brokerage retirement accounts to fee-based accounts, and a marked contraction of service offerings).



Accordingly, we recommend that the Proposal conform the duration of the duty to be consistent and in harmony with current FINRA rules and prospective Reg BI, such that the duration of a BD's best interest obligation is limited to the point in time when a recommendation is made.

**8. To Whom Owed – The fiduciary duty should apply for the benefit and protection of “retail investors” as defined by FINRA rules, and should explicitly exclude “institutional investors.”**

As discussed above, the fiduciary duty under the Proposal is owed to a “client” (NRS 628A.020), which in turn is defined as “a person who receives advice from a financial planner” (NRS 628A.010). The universe of “clients” to whom the duty is owed should be further refined and limited to capture only those persons who actually need the protections of such a duty.

We recommend that the fiduciary duty should apply *only* for the benefit and protection of “retail investors” as defined by FINRA rules.<sup>35</sup> The FINRA definition is optimal because it is the one that BDs already use to develop policies and procedures, controls, and compliance structures to identify retail investors for purposes of suitability, communications, and disclosure obligations. More importantly, the FINRA definition appropriately captures only those persons who need the protections of a heightened standard, and explicitly excludes institutional investors.<sup>36</sup>

It was clearly not the legislature's intent to use the financial planning statute to impose fiduciary duties on BDs interacting with sophisticated investors (e.g., financial institutions and other institutional investors).<sup>37</sup> If, for example, Nevada were to apply a fiduciary standard to interactions with institutional clients, then BDs would be unable to provide liquidity to institutional counterparties in Nevada, thereby reducing overall market liquidity for all investors. Accordingly, the Proposal should explicitly clarify and state that it does not apply to “institutional investors.”

**9. The “gains” disclosure requirement is unworkable for BDs; the Proposal should allow the customer confirmation to satisfy this requirement.**

As discussed above, the Proposal requires that a BD disclose to a client an extensive list of “gains” received by the BD as a result of the client following the BD's advice (Section 7.1.). The term “gains” would seem to include all compensation received (as opposed to net profits). As such, this provision could be read to require the BD to differentiate and account for the

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<sup>35</sup> FINRA Rule 2210(a)(6) defines a “retail investor” as “any person other than an institutional investor.” An “institutional investor,” in turn is defined in Rule 2210(a)(4) to include, among others, any “institutional account.” The term “institutional account” is defined in Rule 4512(c) as “the account of: (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.”

<sup>36</sup> See SIFMA comment letter to SEC re: Reg BI (August 7, 2018) at pp. 10 – 16 for a more detailed discussion.

<sup>37</sup> *Minutes of the Senate Committee on Commerce, Labor and Energy, Seventy-ninth Session* at 2-7 (April 12, 2017), available at <https://www.leg.state.nv.us/Session/79th2017/Minutes/Senate/CLE/Final/787.pdf>.

compensation it received and the compensation the registered representative received (which may include both a base salary and an annual discretionary bonus), as well as the compensation paid by the retail customer and any compensation paid by a third party (e.g., 12b-1 fees, revenue sharing, etc.).

BDs currently do not disclose “gains” in such granularity and detail either “at the time the advice is given” (as Section 7.1. requires except in limited circumstances) or with the customer transaction confirmation. In fact, the overbroad gains disclosure in the Proposal would require firms to generate many new disclosures that they currently either do not track, or are unable to calculate or provide in any meaningful or comprehensive manner.

In order to systematically calculate such gains, numerous operational steps would be necessary to gather the data, which often resides on different systems. No one system holds all the details that could be compiled or easily presented to a retail customer. For example, securities systems, holding certain details about the securities traded, would need to communicate with compensation systems, holding details about the compensation received by the firm and its financial professionals, which in turn would need to incorporate information from external vendors that is not internally available.

Creating and implementing such a system would require a significant outlay of time, money and resources by most firms that would far outweigh any incremental benefit of the additional disclosure to the retail customer. Additionally, certain enumerated gains (such as “payment for order flow”) often are in amounts of fractions of a penny per individual transaction, and are of virtually no value to a customer.

The gains disclosure would also be problematic for BDs that compensate their financial professionals by paying a salary and an annual discretionary bonus, rather than by paying commissions. It is unclear if the firm would be required to allocate the amount of salary and bonus attributable to a particular client, or a particular transaction. Moreover, since discretionary bonus amounts are typically determined at year-end, it is unclear how the firm could satisfy the obligation to make the gains disclosure “within a reasonable time period.” For firms that follow this business model, it would be very costly and difficult if not impossible to operationalize such a gains disclosure requirement.

In addition, Section 7.3 requires disclosure of “correct actual calculations” to the client. Such requirement should be stricken as unreasonable, unduly burdensome, and of minimal disclosure value to customers.

Notwithstanding the foregoing, customers already receive full and fair disclosure of compensation paid by third parties (e.g., 12b-1 fees, revenue sharing, reimbursement for sub-transfer agency services, etc.) under current disclosure mediums, including without limitation Form ADV, client relationship guides, and customer confirmations. Moreover, the SEC’s proposed Reg BI includes Form CRS which provides a consistent format for both BDs and IAs to disclose their compensation, among other things.

Finally, for the reasons discussed above, Section 7 of the Proposal is in direct conflict with NSMIA and must be stricken. Alternatively, Section 7 of the Proposal should be revised to state that a BD may satisfy its obligation to disclose “gains” by delivering a customer confirmation as required under the federal securities laws. In addition, as discussed generally above, Section 7 should be revised to state that a BD or IA who complies with any relevant, gain-related, Reg BI disclosures shall be deemed in compliance with the Nevada standard. The Proposal should also provide BDs and IAs with discretion to disclose any Section 7 gains (including without limitation any “finder’s fee, referral fee, or other benefit” under Section 7.5) in the form of a range or percentage of total fees or compensation. Finally, the disclosure of “applicable contracts” under Section 7.5 would be burdensome, unnecessary, and of negligible informational or other value to investors and thus should be stricken.

**10. The Proposal should eliminate any fiduciary obligation to conduct an account type review for both prospective and existing customers.**

As discussed above, the Proposal would impose the fiduciary duty when making a recommendation about “the type of account a client should open” (Section 4.1.(e)). This provision would put firms in the untenable position of owing a duty to *prospective* clients, individuals with whom the firm has no existing relationship. That outcome would be unworkable and inconsistent with the common law. Fiduciary relationships are ones of trust and confidence and are defined by a formal contract between the parties. Where there is no contractual relationship, there is no fiduciary duty. Moreover, as a practical matter, recommendations about account types inherently involve forecasting the type and quantity of transactions that the investor will ultimately make, so it would be unfair to hold BDs and IAs to a fiduciary duty at that particular juncture.

Firms are already required to exercise reasonable care in recommending account types and both the SEC and FINRA now regularly examine for this issue. Imposing a fiduciary duty in this context is not only unnecessary, but also would impose significant burdens and costs on firms, with no specified or appreciable benefit to prospective investors. For example, presumably this ‘advice’ is subject to the requirements to disclose any “gains as a result of a client following their advice”, making an initial account opening discussion a trigger for an ongoing fiduciary duty, even if no other advice is provided after that initial meeting. This could also potentially allow a prospective client, who never opens an account with a firm, to sue that firm alleging a breach of a fiduciary duty if they open a recommended account type elsewhere.

The Proposal also appears to impose on BDs an obligation to conduct a ‘20-20 hindsight’ review of his or her existing BD accounts to assure they remain in the client’s best interest. Specifically, the Proposal provides that “A [BD] does not breach the fiduciary duty by receiving [commissions], *so long as it is in the client’s best interest to be charged by transaction as opposed to other types of fees ...*” (emphasis added) (Section 6.3.). This provision ignores the fact that many customers may self-select a commission account or may only be eligible for a commission-based account due to their account size. This provision also seems to impose a duty to analyze each transaction to compare the fees of that transaction versus what a client could have been paying in an alternate fee arrangement.

As articulated above, BDs are already required to facilitate clients' reasonable account type choices, and both the SEC and FINRA have made this issue an examination priority. It would be neither necessary nor appropriate for the Securities Division to subject this issue to a fiduciary duty. Moreover, if a BD determined that it may be appropriate to switch a client from a BD account to an advisory account, then it could face a breach of fiduciary duty claim for recommending the BD account in the first case. This outcome would probably discourage advice to switch account types when in fact such a switch may be appropriate.

For these reasons, we recommend that the Proposal eliminate any fiduciary obligation to conduct an account type review for either prospective or existing customers.

**11. The Proposal is impermissibly vague and overbroad, and fails to provide a sufficiently defined standard that puts BDs and IAs on fair notice of what is and is not permissible or required to comply with the Proposal.**

Because the Proposal is vague and overbroad, it fails to provide fair notice to BDs and IAs of how to comply with the new regulations in the following respects, among others:

- The Proposal fails to provide any standards on how to assess “best interest” (Sections 6.3 and 8.1.(b)). We recommend that the Proposal remedy this deficiency by adopting the same approach taken by Reg BI, which states that a BD satisfies the best interest obligation by meeting certain enumerated obligations (i.e., disclosure, care, and conflicts of interest).
- The Proposal fails to define when a commission is deemed “reasonable” (Section 6.3.) or when a fee is deemed “unreasonable” (Section 8.1.(k)). FINRA rules already require that BD commissions and fees be fair and reasonable.<sup>38</sup> Accordingly, we recommend that the Proposal adopt the definition and interpretation of “reasonableness” as set forth under FINRA rules and associated guidance.
- The Proposal fails to define the term “recommendation” (Section 4.1.). As discussed in Section 6 supra, we recommend that the Proposal adopt the meaning of “recommendation” as interpreted and applied under FINRA rules and guidance.
- The Proposal fails to define the term “value” (Section 4.1.(b)). The term “value” should be defined to explicitly exclude providing to a client the current trading price of, quote for, or other generally available market information about, a security.
- The Proposal fails to incorporate a concept of “materiality,” requiring disclosure of, for example:
  - “all risks associated with [a proprietary] product” (Section 6.1.(c));
  - “all risks or features of the product or investment strategy” (Section 8.1.(c));
  - “all ... features of the product” (Section 8.1.(f)); and

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<sup>38</sup> See FINRA Rules 2100 et seq.

- “all information regarding a potential conflict of interest” Section 8.1.(g)).

The requirement to disclose *all* risks, features, and information is grossly overbroad. It would result in disclosures that were so over-inclusive as to overwhelm meaningful disclosure of “material” conflicts of interest to retail customers. Thus, we recommend that the Proposal adopt the same approach taken under the federal securities laws and FINRA rules and require disclosure of only material facts and conflicts.<sup>39</sup>

- Under the Proposal, it is a breach of fiduciary duty for a BD or IA to give advice “without understanding” *all* the risks or features of the product or strategy (Section 8.1.(c)). Firms have no administrable ways or means to supervise, police or demonstrate their employees’ “understanding” of all the risks or features. It is an inappropriate regulatory standard and thus we recommend it be stricken from the Proposal.
- Moreover, the Proposal is impermissibly overbroad in the sense that nearly any infraction however minor or insignificant – including without limitation non-compliance with firm policies and procedures – is deemed to be a breach of the fiduciary duty. *See, e.g.*, Sections 5(2), 6(2)(c), and 8(k)(1). For example, correspondence from FINRA stating that a piece of the firm’s marketing material needs to be revised to add a risk disclosure, or even a FINRA exam letter noting non-compliance with an internal policy, may be alleged to breach the fiduciary duty. Simply stated, the Proposal goes too far, certainly beyond what is reasonable and necessary to limit the scope of what constitutes a breach of the fiduciary duty.
- Finally, the Proposal includes an open-ended, overbroad, “catch-all” provision that “other conduct” – other than the specifically enumerated breaches listed in Section 8.1.(a) through (m)) – “may be considered a breach of the fiduciary duty.” This is an inappropriate regulatory approach that would invite regulation by enforcement, and it is patently unfair to BDs and IAs who should be given fair notice at the outset of what constitutes a breach under the new standard. For these reasons, the Proposal should strike the “catch all” provision. If the Securities Division later identifies conduct that it determines should be a breach of the fiduciary duty, then it would be free to amend its regulations to incorporate that change.

## **12. The exemptions to the fiduciary duty standard set forth in Sections 5 and 2 of the Proposal are also impermissibly vague and need to be amended.**

### **a. The Section 5 exemptions are vague and unavailable as a practical matter.**

The Proposal sets forth four exemptions to the fiduciary duty standard in Section 5. Many of these exemptions, as drafted, are vague and unworkable and therefore need to be amended.

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<sup>39</sup> *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) (setting the materiality standard); *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) (reaffirming the materiality standard). *See also* FINRA Rule 2210 (requiring disclosure of material facts) and Rules 2241 and 2242 (requiring disclosure of material conflicts of interest in research).

Section 5.1 purports to provide an exemption for unsolicited transactions. The exemption does not apply, however, if “the client receives investment advice (implicitly or explicitly)” or “ongoing contractual services.” Section 4 in turn overbroadly defines “investment advice” to include, for example, providing advice “regarding the value of a security to a client” (4.1(b)) and providing “information about a security that is not provided in the offering documents or is an opinion regarding the security” (4.1(j)).

Thus, for example, if a BD tells the client the price at which a security is trading at the time the client places the unsolicited order, then the BD has presumably – by definition – given investment advice.” The exemption for unsolicited transactions would be thereby lost and the BD would be subject to the fiduciary duty standard.

Similarly, providing any information not in the offering statement, or the BD’s “opinion” (not defined in the Proposal), would convert an unsolicited transaction into one subject to the fiduciary duty standard. Moreover, providing “implicit” investment advice – a vague, confusing and undefined term – voids the exemption.

Finally, with respect to “ongoing contractual services,” it should be noted that every BD enters into a contractual relationship with a client who opens a brokerage account. Thus, the phrase “ongoing contractual services” alone entirely swallows the exemption for unsolicited transactions since all such transactions will be subject to an “ongoing” brokerage client agreement.

Based on the foregoing, the unsolicited transactions exemption, as drafted, is essentially unavailable and useless as a practical matter. The Proposal should be amended to provide that all unsolicited transactions are exempt from the definition of “investment advice.” In addition, the Proposal should strike the “explicit vs. implicit” investment advice distinction, as well as the reference to “ongoing contractual services.”

Section 5.2 purports to provide an exemption for taking instructions from another IA or representative of an IA. This exemption also hinges on not providing “investment advice.” Given the inherent flaws in the definition of “investment advice described above, this exemption is likewise unworkable.

Section 5.3 purports to provide an exemption for clearing firms. This exemption is entirely appropriate given that clearing firms generally have no direct in-person exchanges with retail customers. The exemption is lost, however, if the clearing firm did not act “in good faith” (yet another undefined term). The good faith trigger is unnecessary because clearing firms are already subject to potential liability for any alleged bad faith conduct.

The Section 5.3 exemption is also lost (as are the exemption under Section 5.1 and 5.2) if the BD had not “otherwise complied with *all* applicable laws, self-regulatory rules, and firm policies and procedures.” (Emphasis added.) Thus, any minor technical error or procedural misstep would put the exemption at risk. For that reason, the “otherwise complied ....” clause should be stricken from each of Sections 5.1, 2, and 3. Accordingly, the Proposal should be amended to provide clearing firms with an unqualified exemption from the fiduciary duty standard.

Section 5.4 states that if a BD uses the words “advisor” or “adviser”, among others,<sup>40</sup> in their title or holds themselves out as such, then such BD cannot limit the fiduciary duty owed to a client. Today, many BDs do use the words “advisor” or “adviser” in their representatives’ titles. The use of titles alone should *not* disqualify a BD from availing itself of either the Section 5 exemptions, or the episodic fiduciary duty exemption in Section 2.1. BDs have used these titles for decades and would suffer significant costs and burdens to unwind the use of these terms. BDs would have to repaper all of their agreements and all public communications (including business cards) solely for Nevada residents, or, potentially for all clients who are serviced by Nevada registered representatives.

**b. The Section 2 episodic fiduciary duty exemption (the “Episodic Exemption”) is vague and unavailable as a practical matter.**

The Episodic Exemption in Section 2, as drafted, is essentially unavailable and useless for the following reasons:

- The definition of “investment advice” in Section 4 is critical to meeting the Episodic Exemption. As stated above, this definition overbroadly captures not only basic brokerage activities such as providing a client with the price of a security when asked, but also extends to recommendations about the type of account to open, whether investment advisory or brokerage. As a result, a BD could never qualify for the Episodic Exemption, or would always be wary that it has tripped the line into “investment advice” because of the overbroad definition.
- Section 2.2(b) of the Episodic Exemption does not apply to “ongoing investment advice.” Does this mean that a BD cannot make a subsequent “hold” or “sell” recommendation about a security after the BD had initially recommended its purchase? Would that constitute “*ongoing* investment advice”? It certainly meets the definition of “investment advice” itself (see Section 4.1(a)(“providing advice or a recommendation regarding the buy, hold, or sale of a security to a client”). The phrase “ongoing investment advice” is not defined in the Proposal, which leads to ambiguity and confusion.
- Section 2.2(d) of the Episodic Exemption states that it does not apply if the BD “has not otherwise developed a fiduciary relationship with the client from previous or concurrent services undertaken on behalf of the client.” As a result, if a BD client also has, *or has had*, an investment advisory account (which would be the case for many dual registrants), then the Episodic Exemption would be unavailable. This cannot be the result that Nevada intended with the Proposal.
- Section 2.2(e) of the Episodic Exemption states that if the BD uses any of the titles in Section 5.4 then the exemption is unavailable. For the reasons stated above, this provision should be stricken.

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<sup>40</sup> Section 5.4 lists numerous other titles that result in fiduciary status and loss of the Episodic Fiduciary Duty Exemption, and includes the catch-all “other titles that the Administrator may by order deem appropriate.”



- Section 2.2(f) of the Episodic Exemption states that the exemption may apply if “the facts and circumstances surrounding the transaction do not indicate that additional or ongoing investment advice is reasonably expected by the client relative to that transaction, type or product or advice.” Thus, the Episodic Exemption hinges on the client’s “reasonable” expectation as to whether or not “ongoing” investment advice will be forthcoming from the BD. This is an impossible standard around which to design supervisory systems or procedures because it is based on a client’s subjective understanding of the advice. As a practical matter, it makes little sense because most BD clients reasonably expect their representatives to make a subsequent hold or sell recommendation about a security, as appropriate, following an initial purchase recommendation. Therefore, under this standard of a “reasonable expectation,” all BD clients are likely to expect such advice, which has the effect of completely swallowing the Episodic Exemption.

**13. The Proposal would impose a duty whose application firms could not adequately confine to Nevada investors, thereby accelerating the move from brokerage to fee-based accounts and significantly reducing the availability of securities brokerage services in Nevada.**

As a practical matter, it is unclear how firms could limit the application of the proposed regulations to Nevada retail customers for compliance purposes. A firm should be able to limit its application to retail customers who are legal residents of Nevada or who reside in Nevada. A BD or IA who has a place of business in Nevada should not owe the additional statutory fiduciary duties imposed by the Proposal to all of their clients, regardless of whether those clients have any nexus to Nevada.

At the same time, the Proposal makes it nearly impossible for a BD to avoid being considered a fiduciary under the proposed regulations, even if the BD has not entered into a fiduciary relationship or engaged in any conduct that is subject to the fiduciary duty. For example, the Proposal imposes a presumption that a BD owes the fiduciary duty and has the burden to prove otherwise (Section 9).

Moreover, for a dually-registered firm or individual, or a firm that has an affiliated investment advisor, the Proposal imposes a presumption that such firm and individual are acting in their capacity as an IA, and is subject to a continuous fiduciary duty for which there is no exemption (Section 3.2.). There is no basis in the securities laws for imposing a presumption that dually registered BDs or dually licensed representatives shall be deemed to be acting in an advisory capacity in servicing their brokerage accounts – or that a firm that carries a customer’s advisory accounts should be deemed to be acting as an IA for that customer’s brokerage accounts.

The foregoing conditions would create strong incentives for firms to (i) migrate brokerage accounts to fee-based accounts (where such moves are appropriate), (ii) scale back brokerage services to execution only (i.e., do not provide brokerage advice or other brokerage services in Nevada), (iii) raise prices to cover the higher costs, and/or (iv) discontinue service to BD accounts in Nevada (i.e., terminate their relationship with the client). These are all outcomes that Reg BI is explicitly intended to *avoid*. BD accounts represent an important choice for retail investors – often the less expensive choice – and provide access to affordable advice, particularly



for smaller, buy-and-hold investors. For that reason, the SEC recognizes that these type accounts should be maintained and encouraged, not stamped out by problematic regulations.<sup>41</sup>

Accordingly, we recommend that the Proposal be revised to (i) provide adequate guidance about which BDs and IAs are subject to the statutory fiduciary, and which are not, (ii) limit which retail investors are owed the statutory fiduciary duty to those who are legal residents of Nevada or who reside in Nevada, and (iii) strike the unnecessary and onerous presumptions for BDs (Section 9) and dually-registered firms (Section 3.2).

**14. The Proposal should specify an appropriate future effective date, and provide for a sufficient implementation period prior to such date.**

The Proposal should specify an appropriate future effective date, and to provide firms with a sufficiently lengthy implementation period prior to such date. The Securities Division should also explicitly state that there shall be no retroactive application of the implementing regulations to the date of SB 383 (July 1, 2017).

As discussed above, the Proposal requires significant revision as it is currently unworkable, unreasonable, and subject to legal challenge on several different grounds. The Proposal also raises many new issues for BDs and IAs. In order to comply with the Proposal's new requirements, firms would need to develop significant new infrastructure and policies and procedures, which would be a complex and resource intensive undertaking, particularly considering the range of business models that would be subject to the proposed regulations. Firms would also need sufficient time to implement training programs and to build systems to comply with the prospective new regulations, including those necessary to create new books and records.

Alternatively, firms would also need sufficient time to identify whether and how to scale back all or parts of their business activity in Nevada as part of their strategy to address the new regulations. Since there is no grandfathering provision in the Proposal, BDs and their representatives cannot limit their fiduciary duty by ceasing to make recommendations to existing Nevada brokerage account clients. Firms will therefore need time to determine whether and how to either scale-back or terminate these relationships.

Based on the foregoing, we recommend that the Securities Division specify a sufficiently lengthy implementation period to allow firms to either come into compliance and/or scale back their business activity in Nevada. Specifically, we recommend that the Proposal provide an implementation period of at least 18 months, followed by an initial effective date thereafter.

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<sup>41</sup> SEC Regulation Best Interest, Release No. 34-83062; File No. S7-07-18 at pp. 21, 37 – 41, available at <https://www.sec.gov/rules/proposed/2018/34-83062.pdf>.

We appreciate the opportunity to comment and your consideration of our views. If you have any questions or require any additional information, please feel free to contact us: Kevin Carroll, [kcarroll@sifma.org](mailto:kcarroll@sifma.org), and Kim Chamberlain, [kchamberlain@sifma.org](mailto:kchamberlain@sifma.org).

Sincerely,

A handwritten signature in black ink that reads "Kevin M. Carroll". The signature is written in a cursive style with a long horizontal flourish at the end.

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Kevin M. Carroll  
Managing Director & Associate General  
Counsel  
SIFMA

## **APPENDIX – Empirical Studies**

SIFMA directs the Securities Division’s attention to the following empirical studies which include quantitative data and findings, and press coverage, relevant to the Proposal.

### **NERA Economic Consulting, *Comment on the Department of Labor Proposal and Regulatory Impact Analysis (July 17, 2015)*<sup>42</sup>**

- Investors select the fee model (commission versus fee) that best suits their own needs and trading behavior, according to account-level data. Investors who expect to trade often rationally choose fee-based accounts, and those who do not trade often are likely to choose commission-based accounts.<sup>43</sup>
- The evidence shows that commission-based accounts and fee-based accounts exhibit similar performance and returns.<sup>44</sup>
- If the costs associated with maintaining commission-based accounts become too high for firms, then many investors would lose access to advice, because many commission-based account balances are too small for advisory accounts.<sup>45</sup>
  - Using a conservative minimum account balance of \$25,000, over 40% of commission-based accounts would be unable to open fee-based account.<sup>46</sup>
  - Using a \$50,000 threshold, over 57% of accounts would not meet minimum balance requirements for fee-based accounts.
  - If the threshold is \$75,000, then two-thirds of account holders would be left without any professional advice.
- Losing access to advice would detrimentally impact individual investors because individual investors make systematic errors when investing on their own.<sup>47</sup>
- The benefits of financial advisors include: (i) their ability to help investors stop making investment mistakes, (ii) portfolio allocations that are more diversified and closer to

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<sup>42</sup> Available at <https://www.sifma.org/wp-content/uploads/2017/05/nera-analysis-comment-on-the-department-of-labor-proposal-and-regulatory-impact-analysis.pdf>.

<sup>43</sup> *Id.* at 6-7.

<sup>44</sup> *Id.* at 10-11.

<sup>45</sup> *Id.* at 9.

<sup>46</sup> *Id.* at 12 (citing 76 Fed. Reg. 66136, 66151, Investment Advice – Participants and Beneficiaries (October 25, 2011), available at <https://www.gpo.gov/fdsys/pkg/FR-2011-10-25/pdf/2011-26261.pdf>).

<sup>47</sup> *Id.* at 13-16 (citing 76 Fed. Reg. 66136, 66153 – 54, Investment Advice – Participants and Beneficiaries (October 25, 2011), available at <https://www.gpo.gov/fdsys/pkg/FR-2011-10-25/pdf/2011-26261.pdf>).

model portfolios, (iii) tax minimization, (iv) increased savings, and (v) economies of scale with respect to the cost of information.<sup>48</sup>

**Deloitte, *The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors* (August 9, 2017)<sup>49</sup>**

- 53% of study participants eliminated or limited access to brokerage advice services as part of their approach for complying with the DOL Fiduciary Rule.<sup>50</sup>
- The shift of retirement assets to fee-based or advisory programs has accelerated as a result of the elimination or limitation of brokerage advice services.<sup>51</sup>
- DOL Fiduciary Rule implementation and ongoing compliance efforts have caused significant operational disruption and increased costs for financial institutions.<sup>52</sup>

**Oliver Wyman, SIFMA, *Standard of Care Harmonization, Impact Assessment for SEC* (October 2010) (“OW Study”)<sup>53</sup>**

- 95% of households hold commission-based accounts, whereas only 5% of households hold fee-based accounts.<sup>54</sup>
- Fee-based services are 23 – 27 basis points more expensive than brokerage.<sup>55</sup>
- For an investor with \$200,000 in assets, the cost of shifting to fee-based pricing would reduce returns by more than \$20,000 over a 20-year horizon.<sup>56</sup>
- Access to investment products offered on a principal basis (*i.e.*, corporate and municipal securities) is more affordable through commission-based accounts, particularly for small investors.<sup>57</sup>

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<sup>48</sup> *Id.* at 17-21.

<sup>49</sup> Available at <https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf>.

<sup>50</sup> *Id.* at 5, 11.

<sup>51</sup> *Id.* at 5, 12.

<sup>52</sup> *Id.* at 6, 17-24.

<sup>53</sup> Available at <https://www.sifma.org/wp-content/uploads/2017/05/study-standard-of-care-harmonization-impact-assessment-for-sec.pdf>.

<sup>54</sup> *Id.* at 4.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> See Oliver Wyman, SIFMA supplement to SEC (Nov. 17, 2010), available at <https://www.sifma.org/resources/submissions/sifma-submits-comments-to-the-sec-on-study-regarding-obligations-of-brokers-dealers-and-investment-advisers/>.