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April 25, 2019

By electronic mail to rule-comments@sec.gov

Vanessa Countryman
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549-1090

Re: Supplemental Comment Letter Re: Regulation Best Interest (File No. S7-07-18), Form CRS Relationship Summary, Amendments to Form ADV, Required Disclosures, and Restrictions on the Use of Certain Names or Titles (File No. S7-08-18), and Standards of Conduct for Investment Advisers (File No. S7-09-18)

Dear Ms. Countryman,

On behalf of the North American Securities Administrators Association, Inc. ("NASAA"),[1] I am submitting the following supplemental comments regarding the above-referenced proposals (collectively, "Reg. BI") by the U.S. Securities and Exchange Commission (the "SEC" or "Commission").[2] These comments are in specific response to the March 29, 2019, letter regarding Reg. BI from the Securities Industry and Financial Markets Association ("SIFMA").[3]

SIFMA's March 29 letter asks the SEC to weigh-in on the scope of federal preemption of state regulatory authority in any final Commission Reg. BI rulemakings. The Commission should decline to take up SIFMA's suggestions for the following reasons: (1) it is improper under the Administrative Procedure Act ("APA") for a federal agency to express an intent to preempt state law, whether expressly in the text of a new rule or through agency guidance, absent a full notice-and-comment period with respect to the potential preemption;[4] and (2) even if the Commission

[1] NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as a forum for these regulators to work with each other to protect investors at the grassroots level and promote fair and open capital markets.

[2] NASAA previously submitted Reg. BI comment letters to the SEC on August 7, 2018, August 23, 2018, and February 19, 2019.

[3] *See* SIFMA, Comment Letter on Reg. BI (Mar. 29, 2019), available at: https://www.sec.gov/comments/s7-07-18/s70718-5263945-183727.pdf.

[4] *See, e.g.*, *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987) (upholding an Indiana anti-takeover statute that was not inconsistent with the federal securities laws and where there was no explicit indication of congressional intent to preempt such laws); *Rowinski v. Salomon Smith Barney Inc.*, 398 F.3d 294, 301 (3d. Cir. 2005) ("Federal securities law is circumscribed, and strikes a balance between uniform regulation of a national market and

were to reopen the notice-and-comment period for Reg. BI to specifically address preemption issues, the analysis and legal conclusions proffered in SIFMA's March 29 letter are fundamentally flawed. The Reg. BI rulemaking process is the wrong forum for addressing the complex preemption issues under the National Securities Markets Improvements Act of 1996 ("NSMIA"). These issues are more properly reserved for the courts.[5]

First, to the extent federal agencies seek to preempt state laws through regulation, the APA requires a thorough vetting of this issue. In *Wyeth v. Levine*, the U.S. Supreme Court disregarded a federal agency's preemption guidance where the agency issued the guidance "without offering States or other interested parties notice or opportunity for comment."[6] This principle applies in the area of securities law as well, where there is a presumption against preemption.[7] For the Commission to follow SIFMA's request would require a new notice-and-comment period under *Wyeth.*

Further, NASAA strongly disagrees with SIFMA's preemption analysis and conclusions. While it is not our purpose here to fully debate the merits of SIFMA's preemption analysis, a cursory review demonstrates the analysis is erroneous. SIFMA asks the Commission to agree with the conclusion that "*any state law or regulation requiring broker-dealers to make specific communications or disclosures would require the creation of a new record, in violation of NSMIA*."[8] The plain language of this statement would suggest that the myriad state laws applicable to broker-dealers today are unenforceable.

For instance, under SIFMA's analysis, state tax laws would be void *ab initio* as to broker-dealers, as it is necessary to make disclosures and create records to pay taxes in the states in which they conduct business. This would certainly be an erroneous reading of the law. In addition, states routinely conduct examinations and investigations that require written responses from broker-dealers. The authority to conduct those examinations and investigations was expressly preserved in NSMIA; Congress included savings clauses to make clear that, notwithstanding the significant changes Congress was making in the federal securities laws, states retained their enforcement authority to police offering frauds and broker-dealer sales practices.[9] Again, SIMFA's suggestion would certainly be an inappropriate reading of the law.

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preservation of those areas 'traditionally left to state regulation,' such as corporate, contract and fiduciary law," *quoting Santa Fe Indus. Inc. v. Green*, 430 U.S. 462, 478-80 (1977).).

[5] To the extent the SEC weighs-in on preemption in any final Reg. BI rulemakings, a simple disclosure that the Commission is not intending to change existing law in this area is all that need be said. We offer the following suggestion: "These rules are not intended to – and they do not – preempt any state law, rule, regulation or order not otherwise preempted by federal law." (The language we offer is more to clarify Reg. BI's intent with respect to preemption, in contrast to SIFMA's language, which attempts to insert legal conclusions about preemption into the rulemaking.)

[6] *Wyeth v. Levine*, 555 U.S. 555, 577 (2009).

[7] *See McDaniel v. Wells Fargo Invs.*, 717 F.3d 668, 675 (9th Cir. 2013).

[8] *See* SIFMA Comment Letter, *supra* note 3, at 4.

[9] *See* NSMIA § 102 (codified as 15 U.S.C. § 77r(c)(1)) and § 307 (codified as 15 U.S.C. § 80b-3a(b)(2)). *See also* H.R. Rep. No. 104-622, 1996 WL 354335, at *30 (1996) (stating the House Committee did not intend for NSMIA to

Finally, SIFMA's analysis is predicated upon mistaken references to NSMIA's legislative history.[10]

The intersections of federal and state securities laws and the scope of federal preemption of state securities regulatory authority are complex and, in some areas, unsettled. To the extent concerned parties have disputes about the scope of preemption, these disputes are more appropriately addressed through the courts. The Commission need not – and should not – expose any final Reg. BI rulemakings to this thorny issue. In recent years, NASAA has weighed in twice on preemption issues, and we are attaching these two letters for your reference.[11]

Over two decades of work and debate have culminated in the Commission's Reg. BI proposals. It is unnecessary and would be counterproductive for the SEC to attempt to insert preemption issues into any final Reg. BI rulemakings. Thank you for considering these additional comments. Please contact NASAA Executive Director Joseph Brady [redacted]) if you have any questions about this letter.

Sincerely,

Michael Pieciak
NASAA President
Commissioner, Vermont Department of Financial Regulation

Enclosures

cc: The Honorable Jay Clayton
The Honorable Robert J. Jackson Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
Dalia Blass, Director, Division of Investment Management
Brett Redfearn, Director, Division of Trading and Markets

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limit states' authority "to investigate, bring actions, or enforce orders, injunctions, judgments or remedies based on alleged violations of State laws that prohibit fraud and deceit or that govern broker-dealer sales practices").

[10] For instance, SIFMA's citation to House Report 104-864 is mistaken. SIFMA's letter quotes the House Report for the proposition that NSMIA was intended "to eliminate duplicative and unnecessary regulatory burdens [on broker-dealers and investment advisers]." That is incorrect. NSMIA was first and foremost a bill to remove duplicative and unnecessary regulatory burdens on *securities offerings*, particularly sales of mutual funds. NSMIA was only secondarily about the regulation of broker-dealers and investment advisers. SIFMA's insertion of "[on broker-dealers and investment advisers]" into the House Report misconstrues the central purposes behind the legislation.

[11] See enclosed March 7, 2019, letter from NASAA President Michael Pieciak to Diana J. Foley (available at: http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Nevada-Comment-Letter-3-7-2019.pdf), and March 30, 2017, letter from NASAA General Counsel A. Valerie Mirko to Hon. Herbert Lemelman (available at: http://www.nasaa.org/wp-content/uploads/2017/04/NASAA-Amicus-Letter-Massachusetts-3-30-17.pdf).

Enclosure 1

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March 7, 2019

By Email to: nvsec@sos.nv.gov

Diana J. Foley
Securities Consultant
Nevada Securities Division
2250 Las Vegas Boulevard North, Suite 400
North Las Vegas, Nevada 89030

RE: Notice of Draft Regulations and Request for Comment

Ms. Foley:

On behalf of the North American Securities Administrators Association, Inc. ("NASAA"),[1] I am writing in response to the January 18, 2019, Notice of Draft Regulations and Request for Comment (the "Draft Regulations") published by the Nevada Securities Division (the "Division").[2] NASAA has long advocated for raising the standard of care for broker-dealers when they make investment recommendations to customers while maintaining a strong fiduciary duty standard for investment advisers.[3] NASAA applauds the Division's efforts in this regard and supports Nevada's right to protect its investors.

The Division is proposing the Draft Regulations in response to Nevada Senate Bill No. 383, which was enacted in 2017. Senate Bill No. 383 imposed a fiduciary duty on broker-dealers, broker-dealer sales representatives, investment advisers, and investment adviser representatives under the Nevada Financial Planner statute (NRS § 628A.010 *et seq.*) and made violation of this duty punishable under the Nevada Securities Act (*see* NRS § 90.575).[4] Senate Bill No. 383

[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] The Draft Regulations are available on the Nevada Secretary of State website at: https://www.nvsos.gov/sos/Home/Components/News/News/2623/309?backlist=%2Fsos.

[3] *See, e.g.*, Letter from NASAA President Joseph P. Borg to Brent J. Fields (August 23, 2018), http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Reg-BI-Comment-Letter-8-23-2018.pdf; Letter from NASAA President William Beatty to Brent J. Fields (July 21, 2015), http://www.nasaa.org/wp-content/uploads/2011/07/2015-07-21-NASAA-Comment-to-SEC-re-coordination-with-DOL.pdf; Letter from NASAA President A. Heath Abshure to Elizabeth M. Murphy (July 5, 2013), http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Fiduciary-Duty-Letter-final-07052013.pdf.

[4] Senate Bill No. 383 is available at: https://www.leg.state.nv.us/Session/79th2017/Bills/SB/SB383_EN.pdf.

authorized the Division to define the scope of this fiduciary duty and prescribe regulations to enforce it. The Draft Regulations are being issued pursuant to this explicit statutory authority.

Overview of the Draft Regulations

The Draft Regulations state that broker-dealers, sales representatives, investment advisers, and investment adviser representatives have a fiduciary duty within the meaning of the Nevada Financial Planner statute when they (1) provide investment advice, (2) perform discretionary trading, (3) maintain assets under management, (4) act in a fiduciary capacity towards a client, (5) disclose fees or gains, as well as (6) through the term of any client contract or (7) through the term of engagement of services for a client.[5] The Draft Regulations define "investment advice"[6] and provide for an episodic transactional fiduciary duty for broker-dealers.[7]

The Draft Regulations furthermore provide a non-exclusive list of conduct that would breach this fiduciary duty. Conduct resulting in violations would include failing to perform adequate and reasonable due diligence on a product or investment strategy prior to recommending it, recommending a security or investment strategy that is not in a client's best interest, providing investment advice on a product or investment strategy without understanding or conveying all risks or features of the product or investment strategy, or engaging in conduct prohibited by FINRA conduct rules or Nevada's unethical business practices rule.[8] Three specific types of conduct also could be violative, but would not constitute *per se* violations.[9] The Draft Regulations also restrict the use of potentially misleading professional titles by anyone not acting as a fiduciary.[10]

The Draft Regulations Comply With the Limited Preemptive Impact of NSMIA on the Differing Broker-Dealer and Investment Adviser Regulatory Structures

We expect that members of the financial services industry and their associations will submit comment letters urging the Division to make further revisions to the Draft Regulations, pointing to various federal laws and/or SEC pronouncements including the National Securities Markets Improvement Act of 1996 ("NSMIA").[11] However, a reading by the industry of broad preemption in the federal securities laws of state authority is simply an overreach.

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[5] *See* Draft Regulations Sec. 1 and Sec. 3.

[6] *See id.* Sec. 4.

[7] *See id.* Sec. 2.

[8] *See id.* Sec. 8.

[9] *See id.* Sec. 6.

[10] *See id.* Sec. 5.

[11] *See* National Securities Markets Improvement Act of 1996, Pub. Law 104-290, 110 Stat. 3416.

In the field of securities law, state laws are preempted only to the extent they conflict with the federal securities laws.[12] This is made explicit through, for example, Section 28(a) of the Securities Exchange Act of 1934, which states: "Except as otherwise specifically provided in this chapter, nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations under this chapter."[13] Under basic conflict preemption principles, a state law is invalid if "compliance with both federal and state requirements is impossible" or if the state law "poses an obstacle to the accomplishment of Congress's objectives" in enacting the federal law.[14] The Draft Regulations are a valid exercise of state regulatory authority because it will not be *impossible* to comply both with the Draft Regulations and the federal securities laws nor do the Draft Regulations *pose an obstacle to Congress's objectives* in the federal securities laws.

The Securities Act of 1933 and the Securities Exchange Act of 1934 contain broad anti-preemption provisions to uphold state regulatory authority.[15] Congress has preempted some state securities regulatory authority, most notably through NSMIA. But Congress intended NSMIA to have limited preemptive impact. In particular, after NSMIA, states retain freedom to regulate broker-dealers except in the areas of "capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements."[16] The Draft Regulations do not tread upon these forbidden areas, remaining entirely neutral with respect to NSMIA and broker-dealer recordkeeping.

Furthermore, while Senate Bill No. 383 includes broker-dealers and investment advisers, raising the standard of care for broker-dealer clients is where it and the Draft Regulations will have the most positive impact.[17] It will be possible for broker-dealers and their sales representatives to comply with the Draft Regulations and federal law. The Draft Regulations are entirely consistent with congressional intent in enacting NSMIA because states retain broad authority to regulate conduct standards. Furthermore, broker-dealers already owe fiduciary duties in certain circumstances; for instance, broker-dealers generally owe fiduciary duties to customers under federal and state law when they exercise discretion over customer accounts or otherwise

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[12] *Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1106 (4th Cir. 1989) (*en banc*), ("It is well-settled that federal law does not enjoy complete preemptive force in the field of securities.").

[13] 15 U.S.C. § 78bb(a)(1) (2018).

[14] *Whistler Invs. v. Depository Trust & Clearing Corp.*, 539 F.3d 1159, 1166 (9th Cir. 2008).

[15] These provisions are in Section 18 of the Securities Act (*see* 15 U.S.C. § 77r(c)(1)) and Section 28 of the Securities Exchange Act (*see* 15 U.S.C. § 78bb(a)(1)).

[16] *See* NSMIA § 103.

[17] In contrast, with regard to investment advisers, it is already well established that, under federal case law, advisers already owe clients a duty of "utmost good faith, and full and fair disclosure of all material facts" and must "eliminate, or at least expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested." *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 194 (1963).

assume positions of trust and confidence.[18] Furthermore, in some states, pursuant to existing caselaw, broker-dealers already are fiduciaries with respect to *all* customer accounts, even non-discretionary ones.[19] The Draft Regulations are thus entirely consistent with the existing federal and state regulatory structure for broker-dealers.

The Draft Regulations Will Be Good for Nevada Investors

In closing, we applaud the Division's work to strengthen protections for Nevada investors, as NASAA has long advocated raising standards of care.[20] Investor protection should always be the *sine qua non* of securities regulation. The Draft Regulations should curb abusive sales practices in Nevada. The Division will likely receive objections to the Draft Regulations from the securities industry; however, we must remember the securities industry has proven itself adaptive and can accommodate these new regulations.

Sincerely,

Michael Pieciak
NASAA President
Commissioner, Vermont Department of Financial Regulation

[18] *See, e.g.*, *United States v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006); *Dimsey v. Bank of N.Y.*, 831 N.Y.S.2d 359, 342 (N.Y. Sup. Ct. 2006).

[19] *See, e.g.*, *Holmes v. Grubman*, 691 S.E.2d 196, 201 (Ga. 2010) ("[a] stock broker's duty to account to its customer is fiduciary in nature") citing *Minor v. E.F. Hutton & Co.*, 409 S.E.2d 262 (Ga. Ct. App. 1991); *Apollo Cap. Fund v. Roth Cap. Partners*, 158 Cal. App. 4th 226, 246 (Cal. Ct. App. 2007) ("the rule is long settled [in California] that a stockbroker owes a fiduciary duty to his or her customer") citing *Duffy v. Cavalier*, 215 Cal. App. 3d 1517, 1534-35 (Cal. Ct. App. 1989).

[20] *E.g.*, Letter from NASAA President Michael Pieciak to Brent J. Fields (Feb. 19, 2019), http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Reg-BI-Supplemental-Comment-Letter-021919.pdf; Letter from NASAA President Joseph P. Borg to Brent J. Fields (Aug. 23, 2018), http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Reg-BI-Comment-Letter-8-23-2018.pdf; Letter from NASAA President William Beatty to Phyllis C. Borzi (Jul. 21, 2015), http://www.nasaa.org/wp-content/uploads/2011/07/2015-07-21-NASAA-Comment-to-DOL.pdf; Letter from NASAA General Counsel Rex A. Staples to Employee Benefit Securities Administration (Mar. 15, 2011), http://www.nasaa.org/wp-content/uploads/2011/07/7-DOLCommentLetter_0352011.pdf.

Enclosure 2

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DELIVERED AS AN EXHIBIT TO THE RICE SECTION'S SUPPLEMENTAL MEMORANDUM OF LAW OPPOSING FIDELITY'S SECOND MOTION FOR SUMMARY DECISION

March 30, 2017

Honorable Herbert Lemelman
Presiding Officer
Office of the Secretary of the Commonwealth
Division of Securities
One Ashburton Place
Boston, Massachusetts 02108

RE: In the Matter of Fidelity Brokerage Services, LLC (Docket No. E-2015-0078) – Submission of the North American Securities Administrators Association In Support of the Massachusetts Securities Division

Dear Hon. Lemelman,

The North American Securities Administrators Association, Inc. ("NASAA") is submitting this letter in connection with the pending proceeding over which you are presiding, *In the Matter of Fidelity Brokerage Services* (Docket No. E-2015-0078), brought by the Registration, Inspections, Compliance and Examinations Section (the "RICE Section") of the Massachusetts Securities Division (the "Division"), to provide NASAA's views on the important preemption issues raised by the Respondent.[1]

NASAA's U.S. member organizations are responsible for administering state securities laws, commonly known as "Blue Sky Laws." The Secretary of the Commonwealth of Massachusetts, who oversees the Division and its RICE Section, is the NASAA member

[1] Formed in 1919, NASAA is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada and Mexico. NASAA has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. NASAA supports the work of its members and the investing public by promulgating model rules, providing training opportunities, coordinating multi-state enforcement actions, and commenting on legislative and rulemaking proposals. NASAA also offers its legal analysis and policy perspective to state and federal courts as *amicus curiae* in cases involving the interpretation of state and federal securities laws.

representative from Massachusetts. NASAA and its U.S. members have an interest in this adjudicatory proceeding because Respondent has raised foundational questions about the scope of federal preemption of state laws and state securities enforcement authority after the National Securities Markets Improvement Act of 1996 ("NSMIA").[2] The outcome of this matter could affect not only the Division's ability to bring enforcement actions in the future but also, potentially, the ability of other NASAA member organizations to do so. Accordingly, in light of the importance of the preemption issues raised by Respondent and at the request of the Division, NASAA respectfully offers its views for your consideration.

I. BACKGROUND AND ISSUES PRESENTED.

The RICE Section filed an Administrative Complaint against Respondent in 2015. The Administrative Complaint charged Respondent with acting in a dishonest and unethical manner in breach of Respondent's obligations to observe high standards of commercial honor and just and equitable principles of trade under Mass. Gen. Laws ch. 110A, § 204, and 950 Mass. Code Regs. 12.204.[3]

Respondent raised a NSMIA preemption argument in 2016.[4] This argument was rejected by a ruling in December 2016, whereupon Respondent renewed this argument in a brief filed February 7, 2017.[5] Respondent's February 7 brief asserted the RICE Section's unethical business practices claim was preempted because the RICE Section sought to impose (i) books and records or operational reporting requirements beyond those required by federal law, and (ii) a duty to analyze customer trading authorizations that was not recognized under federal law. Respondent wrote: "As NSMIA plainly says, this proceeding is[]preempted because the RICE Section seeks to impose requirements that 'differ from' and are 'in addition to' the federal law regulating broker-dealers."[6] Respondent restated its arguments in a further brief filed February 28, 2017, writing in part, "NSMIA preempts this case because the RICE Section accuses Fidelity of violating a requirement that does not exist under federal law."[7]

The RICE Section's action is predicated on allegations that Respondent facilitated unregistered investment advisory activity via Respondent's trading platform. Investment adviser registration is a core requirement of state and federal securities laws. Knowingly allowing violations of law does not raise broker-dealer books and records or operational reporting issues. Thus, Respondent's preemption argument based on NSMIA books, records, and operational reporting issues has no merit and will not be the focus of this letter. This letter focuses instead on Respondent's argument that NSMIA precludes the RICE Section

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[2] Pub. Law 104-290, 110 Stat. 3416 (1996).

[3] *See* Administrative Complaint, Oct. 26, 2015.

[4] *See* Memorandum of Law in Support of Fidelity's Motion for Summary Decision, Oct. 14, 2016, at 25-26; Fidelity's Reply Brief in Further Support of its Motion for Summary Decision, Nov. 30, 2016, at 14.

[5] *See* Supplemental Briefing Further Explaining Why Summary Decision Must Enter on Grounds of Federal Preemption, Feb. 7, 2017.

[6] *Id.* at 9.

[7] Fidelity's Reply Brief on Federal Preemption, Feb. 28, 2017, at 1.

from seeking to hold Respondent liable for a duty that Respondent asserts is not recognized by federal law.[8] As will be shown, NSMIA poses no such limitation. Congress intended the scope of NSMIA's preemption of state regulation of broker-dealers to be extremely narrow. Furthermore, states can – and do – impose duties on broker-dealers, including broker-dealers that are registered with the U.S. Securities and Exchange Commission ("SEC") and are members of the Financial Industry Regulatory Authority ("FINRA"), which are different from, or even unrecognized by, federal law.

II. CONTRARY TO RESPONDENT'S ASSERTIONS, NSMIA DOES NOT PRECLUDE THE RICE SECTION FROM SEEKING TO HOLD RESPONDENT LIABLE FOR BREACH OF A DUTY NOT RECOGNIZED BY FEDERAL LAW.

A. Overview of Federal Preemption.

There are three potential ways in which federal law may preempt state law. First, Congress may explicitly write into federal legislation that it intends to preempt state laws in a particular field. Second, in the absence of such explicit preemptive intent, Congress may impliedly preempt the states by completely occupying an entire area of law, leaving no room for state regulation. Third, where Congress has not entirely preempted state regulation either expressly or by implication, preemption may nonetheless still exist if state laws conflict with federal law.[9] In the field of securities law, state laws are preempted only to the extent of conflicts with federal law.[10]

As the Massachusetts Supreme Judicial Court has acknowledged, a conflict between federal law and Massachusetts law will result in preemption "when compliance with both state and federal law is impossible, . . . or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" in enacting the federal law.[11] But findings of preemption are "not favored," and Massachusetts courts must uphold state laws "unless a conflict with Federal law is clear."[12] The burden of establishing preemption rests with the party seeking to invalidate a state action and must be shown through "hard evidence of conflict based on the record."[13] The task for a court or other trier of fact is to discern whether Congress intended for federal law to preempt state law in the

[8] For purposes of this letter, NASAA assumes *arguendo* Respondent's contention that the RICE Section is seeking to enforce a duty not recognized under federal law.

[9] *See Sawash v. Suburban Welders Supply Co*., 553 N.E.2d 894, 896 (Mass. 1990).

[10] *Chanoff v. U.S. Surgical Corp.*, 857 F. Supp. 1011, 1015 (D. Conn. 1994) ("It is settled, however, that Congress did not act to occupy the field of securities; rather the federal law preserved the states' broad powers to regulate areas within the field. Thus, to find preemption in this instance, the court must find actual conflict between the state and federal laws . . .") (citations omitted), *aff'd* 31 F.3d 66 (2d Cir. 1994).

[11] *Sawash*, 553 N.E.2d at 896 (internal quotations and citations omitted).

[12] *Id.*

[13] *Id.*

particular circumstances of the case.[14] In so doing, a trier of fact should consult the structure and purpose of the relevant federal statute(s) and legislative history.[15]

B. Congress Intended for NSMIA to Have Limited Preemptive Impact on States' Securities Enforcement Authority Against Broker-Dealers.

The Securities Act of 1933, 15 U.S.C. § 77a *et seq*. (the "Securities Act"), and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq*. (the "Exchange Act"), are the two principal federal statutes regulating securities. To broadly simplify, the Securities Act regulates securities offerings while the Exchange Act regulates broker-dealers and the securities markets.

Section 28(a) of the Exchange Act makes clear that Congress intended to preempt state regulation of broker-dealers only to the extent of conflicts with federal law. "Except as otherwise specifically provided in this chapter, nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations under this chapter."[16] This provision in the Exchange Act has existed virtually unchanged since Congress first adopted the Exchange Act in 1934.[17] Section 18 of the Securities Act as originally adopted in 1933 expressed a similarly limited preemptive intent.[18] This letter will now address the relevant NSMIA amendments to the Securities Act and the Exchange Act.

1. NSMIA's Amendments to Securities Act Section 18.

In 1996, Congress revisited federal and state securities regulation through NSMIA. Congress's primary purpose behind NSMIA was to preempt state laws requiring registration of national securities offerings and eliminate the inefficiencies and burdens on issuers of complying with a multitude of federal and state requirements.[19] In so doing, Congress amended Section 18 of the Securities Act (which had existed since 1933) to the basic form it appears today. Congress wrote these changes into Section 102 of NSMIA.[20]

Congress included an explicit savings clause in Section 102 to acknowledge that, notwithstanding the significant changes Congress was making to Section 18 of the Securities Act, states retained their enforcement authority to police offering fraud and broker-dealer

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[14] *See Commonwealth v. College Pro Painters*, 640 N.E.2d 777, 779 (Mass. 1994).

[15] *See Roberts v. Sw. Bell Mobile Sys*., 709 N.E.2d 798, 804-05 (Mass. 1999).

[16] 15 U.S.C. § 78bb(a)(1) (2016).

[17] *See* 73 Cong. Ch. 404, 48 Stat. 881, 903 (June 6, 1934).

[18] *See* 73 Cong. Ch. 38, 48 Stat. 74, 85 (May 27, 1933) ("Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person.").

[19] *Lander v. Hartford Life & Annuity Ins*., 251 F.3d 101, 108 (2d Cir. 2001).

[20] *See* Pub. Law 104-290, § 102.

sales practices. Section 102 stated in relevant part: "Consistent with this section, the securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions."[21]

Congress included this savings clause because legislators were concerned that NSMIA might be misinterpreted as preempting states' enforcement authority, particularly vis-à-vis broker-dealers. A House committee report made this point: "The Committee does not intend . . . [to] limit [states'] ability to investigate, bring actions, or enforce orders, injunctions, judgments or remedies based on alleged violations of State laws that prohibit fraud and deceit or that govern broker-dealer sales practices . . .."[22] The issue of NSMIA's preemptive impact was also discussed during floor debate.

Congressman Moran:	"Mr. Speaker, . . . our State Corporation Commission in Virginia . . . [is afraid] they will not have sufficient enforcement authority [after NSMIA] . . .."
Congressman Bliley:	"Mr. Speaker, reclaiming my time, they have all of that enforcement authority and they retain their fees."
Congressman Moran:	"They retain their fees and enforcement authority."
Congressman Bliley:	"That is correct."[23]

Thus, whereas NSMIA Section 102 substantially limited states' ability to regulate certain national securities offerings, it did not materially curtail states' enforcement authority against broker-dealers or others.

2. NSMIA's Amendments to the Exchange Act.

NSMIA similarly did not materially expand the limited scope of preemption under the Exchange Act. In contrast to the significant amendments Congress made to the Securities Act, Congress did not touch Exchange Act Section 28(a)'s broad state law savings clause. NSMIA did, though, cabin states' regulatory authority vis-à-vis some specific broker-dealer activities. Section 103 of NSMIA amended the Exchange Act to preempt states from establishing any standards for broker-dealer "capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements" that exceeded federal standards.[24]

The very limited preemptive nature of Section 103 is apparent. Section 103 expressly preempted states in the enumerated areas of broker-dealer capital, margin, books and records,

[21] *Id.* (codified as 15 U.S.C. § 77r(c)(1)).

[22] H.R. Rep. No. 104-622, 1996 WL 354335, at *30 (1996).

[23] 142 Cong. Rec. H6436-05, 1996 WL 332161, at H6448 (1996).

[24] *See* Pub. Law 104-290, § 103.

etc. But this is all that Section 103 did. The plain language of Section 103 shows Congress did not intend to preclude states from potentially adopting different, or even heightened, broker-dealer standards in areas *outside of* capital, margin, books and records, etc. Section 103 thus does not preempt states generally from adopting heightened duties of care or conduct standards for broker-dealers that differ from standards established under federal law.

3. States Retained their Enforcement Authority after NSMIA.

The present adjudicatory proceeding is a clear example of a state exercising its retained broker-dealer regulatory authority after NSMIA. The RICE Section charged Respondent with liability for engaging in a dishonest or unethical business practice within the meaning of 950 Mass. Code Regs. 12.204. Section 12.204 is a long-standing regulation, dating back at least to 1977.[25] It is substantially like a 1983 NASAA model rule.[26] Many other states also have venerable broker-dealer unethical business practices regulations.[27] Had Congress wanted to preempt these well-established state standards when it enacted NSMIA in 1996, Congress would have clearly said so. What is more, the absence of any legal authority in the past twenty years to find that NSMIA preempts these state standards is noteworthy.

Like NASAA's 1983 model rule, Section 12.204 defines certain conduct as dishonest or unethical.[28] But the enumerated conduct is not all-encompassing; Section 12.204 makes clear that dishonest or unethical conduct "includ[es], but [is] not limited to," what is expressly enumerated therein.[29] And Section 12.204 should be interpreted broadly, in accordance with the fundamentally remedial purposes of federal and state securities laws.[30] Triers of fact in Massachusetts accordingly can find that other conduct not expressly named within Section 12.204 is also dishonest or unethical. The RICE Section's Administrative Complaint against

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[25] *See In re First Fin. Equity Corp.*, Mass. Secs. Div., 1977 WL 39216 (Nov. 23, 1977) (cease and desist order against unregistered broker-dealer for violation of Section 12.204).

[26] *Compare* 950 Mass. Code Regs. 12.204 *with* Dishonest or Unethical Business Practices of Broker-Dealers and Agents, NASAA Model Rule (adopted May 23, 1983), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/29-Dishonest_Practices_of_BD_or_Agent.83.pdf.

[27] *E.g.*, Dishonest and Unethical Business Practices by Broker-Dealers and Agents, Mo. Code Regs. tit. 15, § 30-51.170 (original rule filed June 25, 1968); Dishonest or Unethical Practices in the Securities Business, Iowa Admin. Code § 191-50.16(502) (original rule filed Aug. 1, 1963).

[28] *See* 950 Mass. Code Regs. 12.204(1)(a) (2016).

[29] *Id.* ("Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Acts and practices, *including, but not limited to* the following, are considered contrary to such standards and constitute dishonest or unethical practices . . .") (emphasis added).

[30] *E.g.*, *Aaron v. SEC*, 446 U.S. 680, 695 (1980) ("Congress intended securities legislation . . . to be construed not technically and restrictively, but flexibly to effectuate its remedial purposes") (internal citation omitted); *Crown v. Kobrick Offshore Fund*, 8 N.E.3d 281, 295 (Mass. App. Ct. 2014) ("securities laws are a remedial measure intended to encourage the prosecution of securities fraud actions") (internal citation omitted). *See also Johnson-Bowles Co. v. Division of Securities*, 829 P.2d 101, 114 (Utah Ct. App. 1992) (recognizing "a legislative intent to delegate the interpretation of what constitutes dishonest and unethical practices in the securities industry to the Division").

Respondent certainly asserts a potentially dishonest or unethical practice where Respondent allegedly facilitated unregistered investment advisers' unlawful use of its trading platform.[31]

In sum, NSMIA's text and legislative history, along with the development of the law in this area, demonstrate that Congress did not intend to preempt states from exercising their inherent police powers over broker-dealers except as to the specific issues listed in NSMIA Section 103. In accordance with the guidance of the Massachusetts Supreme Judicial Court, therefore, the RICE Section's claim against Respondent is not preempted because Respondent cannot show by hard evidence that either (a) it would have been impossible to comply with Respondent's duties under federal law and the obligations the RICE Section is seeking to enforce, or (b) the obligations the RICE Section is seeking to enforce pose an obstacle to the full execution of Congress's regulatory intent in the Securities Act and the Exchange Act.

III. EXISTING DIFFERENCES IN FEDERAL / STATE BROKER-DEALER REGULATION DISPROVE RESPONDENT'S PREEMPTION ARGUMENT AND RESPONDENT'S ARGUMENT, IF ADOPTED, WOULD DEPRIVE THE MASSACHUSETTS SECURITIES DIVISION OF ITS POLICING POWER.

Respondent's argument that NSMIA preempts this action because the RICE Section is seeking to enforce a duty not recognized by federal law is fallacious. Respondent has cited no federal authority for the proposition that a broker-dealer may permit unregistered investment advisers to offer investment advice for compensation via the broker-dealer's platform. To the contrary, federal law requires investment advisers to register either with the SEC or with a state and broker-dealers have a duty to prevent, rather than facilitate, violations of this requirement. Moreover, as demonstrated above, states may adopt broker-dealer conduct standards that differ from, and are even higher than, federal standards. And states have indeed done so.

For example, there is no universally applicable standard across federal and state securities laws as to the scope of a broker-dealer's duties to a traditional non-discretionary brokerage account. The general standard under federal law is that broker-dealers are not fiduciaries of non-discretionary accounts and owe these customers only transactional duties of care and loyalty.[32] This is also the standard in New York state.[33] But this is not the standard everywhere. Georgia and California hold brokers of non-discretionary trading accounts to the heightened duties of a fiduciary.[34] In Massachusetts, the nature of a broker's duties appears to

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[31] *See* Administrative Complaint, Oct. 26, 2015.

[32] *E.g.*, *United States v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006) ("there is no general fiduciary duty inherent in an ordinary broker/customer relationship") quoting *Indep. Order of Foresters v. Donald, Lufkin & Jennrette*, 157 F.3d 933, 940 (2d Cir. 1998); *Zazzali v. Alexander Partners, LLC*, Case No. 12-cv-828, 2013 WL 5416871, at *8 (D. Del. Sept. 25, 2013).

[33] *E.g.*, *Celle v. Barclays Bank*, 48 A.D.3d 301, 302 (N.Y. App. Div. 2008) ("brokers for nondiscretionary accounts do not owe clients a fiduciary duty") citing *Fesseha v. TD Waterhouse Inv. Servs.*, 305 A.D.2d 268 (2003).

[34] *E.g.*, *Holmes v. Grubman*, 691 S.E.2d 196, 201 (Ga. 2010) ("[a] stock broker's duty to account to its customer is fiduciary in nature") citing *Minor v. E.F. Hutton & Co.*, 409 S.E.2d 262 (Ga. Ct. App. 1991); *Apollo Cap.*

depend upon the unique facts and circumstances of the customer relationship.[35] These extant regulatory differences belie Respondent's argument that states cannot establish broker-dealer regulatory standards that are higher than, or even materially different from, federal ones.

As another example, Alabama and Indiana recently enacted legislation establishing a new duty for certain qualifying individuals of broker-dealers or investment advisers to report to state authorities when they suspect certain customers may be the victims of financial exploitation.[36] A third state, Vermont, adopted these standards by regulation.[37] In so doing, Alabama, Indiana and Vermont created new legal duties for the broker-dealer industries in their states. These three state statutes and regulations were based on model legislation from NASAA, the *NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation* (the "Model Act").[38] No such duties to report currently exist under federal law, whether through a statute, SEC regulation, FINRA rule, case law or otherwise.[39] The drafters of the NASAA Model Act were well aware of potential federal preemption issues and carefully crafted the Model Act to avoid potential entanglements with federal law. Under Respondent's flawed preemption reasoning, though, the Model Act and related state laws and regulations would be *void ab initio* until and unless a concomitant reporting duty is created under federal law. NASAA, of course, vigorously disagrees.

Respondent's argument essentially rewrites Massachusetts securities law, erasing the clause in Section 12.204 that says dishonest or unethical practices include, *but are not limited to*, the conduct expressly listed therein. This would be contrary to all authority and would divest the Division of authority to pursue claims against broker-dealers. What is more, if Respondent's argument was an accurate reflection of the law, the Division would never be able to bring new types of enforcement actions or raise untested legal theories against broker-

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Fund v. Roth Cap. Partners, 158 Cal. App. 4th 226, 246 (Cal. Ct. App. 2007) ("the rule is long settled [in California] that a stockbroker owes a fiduciary duty to his or her customer") citing *Duffy v. Cavalier*, 215 Cal. App. 3d 1517, 1534-35 (Cal. Ct. App. 1989).

[35] *See Patsos v. First Albany Corp.*, 741 N.E.2d 841, 848 (Mass. 2001) ("in Massachusetts a relationship between a stockbroker and a customer may be either a fiduciary or an ordinary business relationship, depending on whether the customer provides sufficient evidence to prove a 'full relation of principal and broker'") (citations omitted).

[36] *See* SB 220, Alabama Regular Session 2016, *available at* http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2016rs/PrintFiles/SB220-enr.pdf*;*

SEA 221, Indiana Second Regular Session 2016, *available at* http://iga.in.gov/legislative/2016/bills/senate/221#document-72ee118f .

[37] *See* Vt. Sec. Reg. § 8-5, Protection of Vulnerable Adults from Financial Exploitation, *available at* http://dfr.vermont.gov/reg-bul-ord/vermont-securities-regulations.

[38] *See* NASAA Press Release, NASAA Members Adopt Model Act to Protect Seniors and Vulnerable Adults (Feb. 1, 2016); *available at* http://www.nasaa.org/38777/nasaa-members-adopt-model-act-to-protect-seniors-and-vulnerable-adults/.

[39] The SEC recently approved FINRA rule amendments designed to help redress senior financial exploitation. Unlike the Model Act, though, FINRA's rule amendments do not include a mandatory reporting obligation. *See* Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of the Proposed Rule Change, SEC Release No. 34-79964, File No. SR-FINRA-2016-039 (Feb. 3, 2017), *available at* https://www.sec.gov/rules/sro/finra/2017/34-79964.pdf.

dealers, whose business models and processes are everchanging. Rather, in any broker-dealer enforcement action, the Division would have to be able to point to some pre-existing federal precedent permitting it. The Division would have no ability to, for instance, lead the way on investigations into market timing or auction rate securities, as the Division and other state securities regulators have in the past. Congress did not intend for NSMIA to so thoroughly geld the states.

IV. CONCLUSION.

For the reasons outlined above, Respondent is wrong to the extent Respondent asserts that the RICE Section's claim against it is preempted for lack of a potentially cognizable legal duty. Congress never intended NSMIA to curtail state enforcement authority in the way Respondent claims. Were you to conclude otherwise, you would strip the Division of its legitimate regulatory authority over broker-dealers operating in the Commonwealth of Massachusetts and potentially do damage to the ability of other states to exercise their legitimate police powers as preserved by Congress.

Sincerely,

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Administrators Association, Inc.
Email: [redacted]