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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.