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Amy Kopleton

Acting Chief, New Jersey Bureau of Securities

Chair, Broker-Dealer Market / Regulatory Policy and Review Project Group

North American Securities Administrators Association

Stephen Bouchard

Associate Commissioner for Securities, District of Columbia Department of Insurance,

Securities, and Banking

Former Chair, Broker-Dealer Section

North American Securities Administrators Association

Jim Nix

Administrator, Illinois Securities Department

Chair, Broker-Dealer Section

North American Securities Administrators Association

Re: Proposed Revisions to NASAA's Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule

Sent via electronic email to NASAAComments@nasaa.org

Dear Ms. Kopleton, Mr. Bouchard, and Mr. Nix:

The American Securities Association (ASA)¹ submits these comments in response to the proposal issued by the North American Securities Administrators Association (NASAA) to revise its broker-dealer conducts rules (Proposal). The ASA urges NASAA to swiftly withdraw the Proposal because it is ill-advised, unlawful, and will prove to be detrimental to millions of American investors that rely on the expertise and professionalism of broker-dealers to guide them through some of the most important financial decisions of their lives.

I. General Discussion.

Over the past decade, NASAA has morphed from a conference of state regulators into an activist lobbying organization that aligns itself with special interests at the expense of the actual needs of

¹ The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.





investors. Instead of prioritizing the well-being of investors, NASAA used its finite resources on futile attempts to push regulations that have been rejected by bipartisan coalitions in Congress and the U.S. Securities and Exchange Commission (SEC).

NASAA has launched a calculated and pervasive assault on the SEC's nationally recognized Regulation Best Interest (Reg BI) standard since it was established in 2019. This is harmful to investors because it undermines the existing regulatory regime, and carelessly dismisses Reg BI which is *the* prudential standard of conduct for financial professionals.

In 2019, the SEC adopted Regulation Best Interest (Reg BI) after a years-long examination by the SEC and Congress into standards of conduct that apply to both broker-dealers and investment advisers. Reg BI increased investor protections by clarifying and expanding the duties that broker-dealers have to their clients when making investment recommendations.

Reg BI also established a strong, national standard which ensures that any investor – regardless of the state in which they reside or the income level– understands the rules that apply to the financial professionals they elect to work with. In fact, many states adopted Reg BI to strengthen preexisting suitability standards, showing that it is possible to harmonize standards of care.

Reg BI was adopted after almost a decade of uncertainty for the financial services industry as the U.S. Department of Labor (DOL) attempted to implement a fiduciary standard for retirement accounts that limited access to financial advice and products for lower and moderate-income investors. The DOL's "fiduciary" rule was strongly opposed by a broad, bipartisan spectrum of Members of Congress and was ultimately vacated by the courts.²

The SEC had a clear role and congressional obligation to re-assert its national authority over the broker-dealer industry, and it went through a careful and deliberate process to promulgate Reg BI. NASAA's persistence in encouraging states to adopt rules reminiscent of the failed DOL "fiduciary" rule not only defies federal law, but it also disregards the express will of Congress, longstanding statutes, and the courts. In other words, NASAA is pushing a radical, unconstitutional agenda at the behest of embedded partisans and professional activists instead of the voters who its members are supposed to serve.

NASAA's continued march to undermine Reg BI and encourage individual states to adopt DOL-like rules to regulate the broker-dealer industry has no basis in law. To be crystal clear, NASAA members have absolutely no authority to re-write Reg BI on their own, or to make arbitrary decisions about what aspects of Reg BI "matter most" to them and could therefore justify expansive new rules. The fact that an unelected body of officials assume they have such

² Chamber of Commerce of the United States of America vs. U.S. Department of Labor (March 15, 2018)
<http://www.ca5.uscourts.gov/opinions/pub/17/17-10238-cv0.pdf>





authority completely undermines any credibility that NASAA has in the eyes of the regulated public.

NASAA should stop pretending it is a regulator with any authority and recognize it is a lobbying organization with zero accountability. The ASA's specific concerns are outlined in more detail below and we recommend NASAA stop trying to usurp the authority of voters with its harmful ideas.

II. State Regulators Do Not Have the Authority to Rewrite Reg BI.

NASAA explains in the Proposal that it is seeking to provide individual states with a “menu” of options that states can choose from in order to “define,” “clarify,” or “emphasize” certain aspects of Reg BI which may “matter most” to an individual state. It is impossible to read the words “define,” “clarify,” or “emphasize,” as anything other than a license for a state to *re-write* Reg BI any way it sees fit.

Not only is this ill-advised, it is also unlawful. The National Securities Markets Improvement Act of 1996 (NSMIA) ***explicitly preempts*** state regulators from adopting the types of mandates that are contemplated in the Proposal. Specifically, NSMIA contains express prohibitions against states adopting recordkeeping mandates that go beyond federal law and regulation. There is little question that if a state were to adopt the proposed NASAA revisions, brokers in that state would face new recordkeeping obligations that are not already contained in Reg BI or other SEC regulations.

The conference committee report accompanying NSMIA stated that “The system of dual Federal and state securities regulation has resulted in a degree of duplicative and unnecessary regulation...that, in many instances, is redundant, costly, and ineffective.”³ Redundant, costly, and ineffective are all terms that come to mind when considering the impact that NASAA's Proposal would have on regulation of the broker-dealer industry. Given the high likelihood that the courts will find any further state effort to subvert Reg BI will violate federal law, NASAA and individual states should be prepared to defend the rulemaking in legal action.

Further, a patchwork of state regulations will only lead to investor confusion and limiting of services in states that adopt the proposal. We are concerned that states will adopt different “options” from the menu presented by NASAA without harmonizing standards.

Financial professionals are licensed in an average of 20 different states, which means that they could have to navigate 20 different state-by-state standards of conduct. It's very likely that

³ National Securities Markets Improvement Act of 1996, HR 3005 Conference Report House Conf. Rep. No. 104-864 (Sept. 28, 1996)





advisors will decide to limit the services they offer depending on state-specific rules in a way that reduces access to personalized advice and services.

NASAA is also seeking to undermine existing rules and legal precedent by introducing novel interpretations of requirements that currently apply to broker-dealer recommendations. For example, the Proposal would impose new tests to determine whether a broker has adequately reviewed “reasonably available alternatives” when making a recommendation and would discriminate against certain types of products that can enhance diversification and the returns of an investor portfolio. This differs starkly from Reg BI’s product-agnostic approach towards determining potential alternatives to a recommendation.

Additionally, the Proposal would mandate that brokers “neutralize” (i.e. eliminate) conflicts of interest under certain circumstances. The word “neutralize” appears nowhere in securities law or regulation and can only be read as a means towards compelling broker-dealers to cease engaging in certain practices, even if those practices do not involve problematic conflicts of interest or any type of harm inflicted upon investors. In other words, NASAA is trying to make new federal law at the state level that has no legal basis or precedent in current securities regulation.

III. If Adopted, the Proposal Would Have the Same Negative Effect on Investors as the 2016 DOL Fiduciary Rule.

It is no secret that NASAA and its activist allies want to use any means possible to reinstate the 2016 DOL fiduciary rule. But memories are short, and supporters of a DOL fiduciary rule have quickly forgotten the extent of the investor harm that rule caused, particularly for small savers, even during the short period of time it was in effect.

Surveys conducted soon after the 2016 DOL rule was finalized found, among other problems, that⁴:

- Over 2/3 of financial advisors planned to stop providing advice to at least some of their customers due to the increased regulatory risk and cost of the rule;
- 35% of advisors planned to stop serving accounts under \$25,000, and 25% planned to raise their minimum account thresholds; and
- 70% of insurance providers planned to exit the market for small balance individual retirement accounts (IRAs) altogether.

Additionally, a 2021 report from the Hispanic Leadership Fund found that if the 2016 DOL rule were reinstated, the retirement savings of 2.7 million individuals with incomes below \$100,000

⁴ https://www.uschamber.com/assets/archived/images/ccmc_fiduciaryrule_harms_smallbusiness.pdf





would be reduced by \$140 billion over ten years. The rule would also contribute to a roughly 20% increase in the wealth gap for Black and Hispanic Americans.⁵

When the DOL proposed its first iteration of the fiduciary rule in 2011, NASAA wrote: “We fully support the DOL’s instant rule proposal and the ways that it will help to shape the future of the brokerage industry for the better of all concerned.”⁶

Since NASAA first offered that unconditional support, it has appeared to ignore all the evidence, data, and legal cases showing the problems for investors associated with DOL’s approach. Unfortunately, NASAA’s proposed revisions would have much of the same effect as the DOL rule if it were adopted by state regulator members.

IV. The Proposal is Unduly Restrictive on Broker-Dealers.

The Proposal states that a “broker-dealer or agent will be presumed to have placed its financial interest ahead of the interest of the retail customer where the broker-dealer or agent...rewards the broker-dealer or agent with additional cash or non-cash compensation beyond the sales commission as the result of that recommendation.” In other words, NASAA is proposing to ban all types of compensation for brokers aside from trading commissions.

This is deeply concerning because it is based upon NASAA’s complete failure to understand how the broker-dealer business model works. Brokers can be offered incentive compensation or bonus payments without those payments presenting the problematic conflicts of interest that Reg BI properly addressed in 2019.

For example, when adopting Reg BI, the SEC was careful not to ban all types of incentive compensation or sales bonuses for brokers. Reg BI prohibits bonuses based upon sales contests that are tied to the sale of specific securities within a certain period of time. This is an entirely appropriate prohibition and one that ASA fully supports.

However, Reg BI allows for bonuses or incentive payments to be made to brokers based upon other activities or goals – for example, asset gathering (i.e. gaining new clients or managing additional investments from existing clients).

By contrast, NASAA's attempts to ban all forms of compensation except for transaction commissions is nothing more than a draconian restriction, unsupported by Reg BI and one that would severely hinder brokers and jeopardize their ability to operate effectively, echoing the aftermath of the 2016 DOL rule.

⁵ https://hispanicleadershipfund.org/wp-content/uploads/2021/11/FINAL_HLF-Quantria_FiduciaryRule_08Nov21.pdf

⁶ https://www.nasaa.org/wp-content/uploads/2011/07/7-DOLCommentLetter_0352011.pdf





The Proposal, by contrast, makes no such distinction and would effectively ban all types of payments to brokers aside from transaction commissions. Brokers would find it extremely difficult – if not financially impossible – to operate in any state that imposed such an onerous, unprecedented, and unlawful restriction. Again, the ultimate effect on investors would be similar in nature to what happened after DOL adopted the 2016 fiduciary rule.

V. NASAA Has Not Conducted Any Economic or Investor Impact Analysis to Support the Proposal.

It is telling, but perhaps not surprising, that the Proposal is not accompanied by any kind of economic analysis to support the new restrictions. Unlike federal regulators – which are subject to the requirements of the Administrative Procedure Act – NASAA appears to think there is no need to commission a cost-benefit analysis to support its revised “standards.”

This oversight is intentional because NASAA is aware that any objective and comprehensive analysis of the Proposal would show it would do more harm than good. Incorporating economic analyses into policy proposals is necessary to understand (1) the outcome of these proposals on the economy and individuals, and (2) to avoid legal challenges.

VI. Conclusion.

NASAA’s Proposal lacks merit, economic justification, compassion for low-and -middle-income Americans, and any legal authority. We remind the American people that NASAA is not a regulator with any legal authority to bind them, rather it is a partisan lobbying organization pushing an agenda on behalf of well-funded special interest groups.

NASAA should drop this ill-conceived Proposal with all deliberate speed and use its resources to support the *national* standard that is Reg BI. We also recommend NASAA’s leaders reflect on why they have proposed a policy that would harm small investors and minorities by increasing the wealth gap in America.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
President & Chief Executive Officer
American Securities Association

