FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

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Via electronic submission to NASAAComments@nasaa.org

cc: kopletona@dca.njoag.gov and stephen.bouchard@dc.gov

North American Securities Administrators Association, Inc.
750 First Street, N.E., Suite 990
Washington, D.C. 20002

Attn: Amy Kopleton, Stephen Bouchard

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

Dear Ms. Kopleton and Mr. Bouchard:

The Financial Services Institute ("FSI")[1] appreciates the opportunity to comment on the Proposed Revisions to the North American Securities Administrators Association ("NASAA's") Model Rule on Dishonest or Unethical Business Practices of Broker-Dealers and Agents ("Proposed Rule").[2] Developed by NASAA's Broker-Dealer Market and Regulatory Policy and Review Project Group and the Broker-Dealer Section Committee.

According to the Request for Public Comment, the Proposed Rule is "intended to update the model rule in light of the Securities and Exchange Commission's… Regulation Best Interest… and other developments in the securities industry." Regulation Best Interest (Reg BI")[3] became effective on June 30, 2020, after having been adopted by the Securities and Exchange Commission ("SEC") the previous year.

The Request for Public Comment goes on to outline the three main purposes of the proposed amendments to the Model:

(1) acknowledge and incorporate by reference the new federal conduct standard applicable to broker-dealer and agents pursuant to Reg BI;

[1] The **Financial Services Institute (FSI)** is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 100 independent financial services firm members and their 160,000+ affiliated financial advisors – which comprise over 60 percent of all producing registered representatives. We effect change through involvement in FINRA governance as well as constructive engagement in the regulatory and legislative processes, working to create a healthier regulatory environment for our members so they can provide affordable, objective advice to hard-working Main Street Americans. For more information, please click here.

[2] https://www.nasaa.org/wp-content/uploads/2023/09/Request-for-Public-Comment-on-BD-Best-Interest-Model-Rule.pdf

[3] 17 C.F.R. § 240.15l-1

(2) define and clarify various obligations or components of this new conduct standard for purposes of state interpretation and enforcement; and

(3) prohibit misleading uses of the title "advisor" or "adviser."

While FSI appreciates NASAA's intent in updating its model rules to reflect Reg BI and protecting investors, we are deeply concerned because the Proposed Rule diverges from, and conflicts with, recently established national standards, such as Reg BI and the National Association of Insurance Commissioners ("NAIC's") Suitability in Annuity Transactions Model Regulation,[4] in multiple, material respects.

As discussed below, we believe it is unnecessary, and likely harmful, for NASAA to amend its model rules in ways that expand on, diverge from, or conflict with Reg BI. From its founding, FSI's stated mission has been "to ensure that all individuals have access to competent and affordable financial advice, products and services delivered by a growing network of independent financial advisors and independent financial services firms." We are deeply concerned that the Proposed Rule could result in people losing access to advice and other services – particularly those with lower income and less savings.

In addition to our concerns regarding access, below we discuss the deviations from Reg BI and the need for uniformity; conflicts with and preemption by federal law; the codification of interpretive statements; and the unsettled regulatory landscape.

In light of these issues, FSI respectfully requests that the Proposed Rule, as drafted, not be adopted at this time. Instead, after all written comments have been considered, we encourage NASAA to engage FSI and other stakeholders in constructive dialogue to understand any areas of continued disagreement and to seek solutions.

Background on FSI Members

FSI is an industry group comprised of members from the independent financial services industry. The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 53 percent of all producing registered representatives.[5] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers ("IBD"). FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. The majority of FSI's IBD member firms have affiliated Registered Investment Advisors ("RIAs") and are thus dually

[4] Suitability in Annuity Transactions Model Regulation https://content.naic.org/sites/default/files/inline-files/MDL-275.pdf. The NAIC model was amended to establish a best interest standard for the sale of annuities, consistent with Reg BI.

[5] Cerulli Associates, Advisor Headcount 2016.

registered. FSI also has some Independent RIA members as well. FSI members make substantial contributions to our nation's economy.

According to Oxford Economics, FSI members nationwide generate $35.7 billion in economic activity. This activity, in turn, supports 408,743 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly $7.2 billion annually to federal, state, and local government taxes.[6]

Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI members and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

Discussion

I. Access to Financial Advice, Services and Products

FSI is concerned that the Proposed Rule could significantly impinge on investors' access to financial advice, services and products. Our members are rightfully proud to serve Main Street America and its small businesses and individual investors saving for their children's education and their retirement. But the Proposed Rule would unnecessarily impose compliance and operational burdens and costs on our firms and financial professionals, limiting our members' ability to serve current and prospective clients.

The additional burdens and costs arise mainly from the Proposed Rule's broad expansion on, and deviation from, national standards (See Section II). Differing regulatory requirements and standards raise costs and risks for firms and financial professionals that must be effectively managed. Because smaller accounts generally generate lower revenues, increased costs and risks disproportionately impact the ability of firms to serve those clients, as well as potential new clients. For these reasons, we believe there must be a high bar to clear when proposing regulations that exceed or differ from national standards.

The Request for Comment and Proposed Rule did not indicate that NASAA undertook an effort to assess the costs and burdens the Proposed Rule would have on firms and financial professionals, nor the consequential impact on investors. This stands in contrast to the SEC as it developed and then proposed Reg BI. While we recognize that NASAA does not have the resources of the SEC, we strongly encourage NASAA to pause its rule adoption process and, at a minimum, engage the industry to gain a better understanding of the potential impact of the Proposed Rule on both the industry and investors.

II. Deviation From National Standards

[6] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2020).

FSI is very concerned that the Proposed Rule will undermine regulatory uniformity that the financial services industry and regulators alike have worked diligently for decades to achieve. We are troubled that the Proposed Rule not only opens the door to a multiplicity of state regulations, but almost encourages it insofar as "Revision Set #2" of the Proposed Rule proffers a list of eight optional provisions that states may choose to adopt in whole, in part, or not at all.

Notwithstanding the possibility of myriad state variations of the Proposed Rule being adopted, even a lock-step adoption by all states would leave the financial services industry facing dual federal-state rules governing the same business activity.

a. The Definition of "Retail Customer" in the Proposed Rule and Related Definitional Concerns

The Proposed Rule redefines "retail customer" and "recommendation" to greatly expand the scope beyond that of Reg BI. FSI has significant concerns regarding both. We outline these concerns for "retail customer" below. With regard to the definition of "recommendation" we are including Appendix A drafted by A. Valerie Mirko, formerly General Counsel at NASAA and now in private practice at Armstrong Teasdale.

We disagree with the Proposed Rule's characterization that the definition of "retail customer" is "consistent with SEC guidance regarding the scope of the term for purposes of Reg BI." We explain below why we do not agree with this position. Rather, the Proposed Rule's definition of "retail customer" follows an expanded approach specifically rejected by the SEC during Reg BI rulemaking in 2018. Therefore, we have concerns about the NASAA Proposal attempting to move away from the Reg BI definition of "retail customer" and closer to what NASAA believes the definition should be.

i. The Proposed Rule includes all "prospective" customers and clients

Reg BI takes a nuanced approach to the inclusion of prospective retail customers. As described in the Reg BI Release,[7] the SEC leverages the use requirement in the definition of retail customer for multiple purposes, including that any prospective customers must "use" the recommendation to be considered retail customers and that the use of the recommendation be for personal, family, or household purposes. Unlike Reg BI, the Proposed Rule does not address the purpose of the recommendation and does not contemplate that the recommendation has to be used.

When proposing and adopting Reg BI, the SEC intended to align the standard of conduct for broker-dealers to align with but not mirror the fiduciary duties applicable to investment advisers. While Reg BI does not capture all of the fiduciary concepts, it is intended as a corresponding, albeit different set of obligations. Under the fiduciary duty structure applicable to

[7] Reg BI Release, p. 33345: "Whether the recommendation complies with Regulation Best Interest will be evaluated based on the circumstances that existed *at the time the recommendation was made* to the retail customer. Accordingly, broker- dealers should carefully consider the extent to which associated persons can make recommendations to prospective retail customers (*i.e.*, that have received, but not yet "used" the recommendation as noted above) in compliance with Regulation Best Interest, including having gathered sufficient information that would enable them to comply with Regulation Best Interest at the time the recommendation is made, should the prospective retail customer use the recommendation."

investment advisers, there is a distinction between the anti-fraud standards that apply more generally and the fiduciary standards that apply when the fiduciary relationship commences.[8] While Reg BI has not been subject to completed litigation, we note that the Reg BI enforcement mechanism is akin to Advisers Act enforcement matters. The concepts of use and purpose clarify what type of activity is Reg BI activity subject to enforcement as there are specific trigger points.

In contrast, besides abandoning the use and purpose inquiries of Reg BI's definition for retail customer, NASAA does not provide any guidance or assurances on how to identify "prospective customers or clients." For example, the NASAA Proposal does not explicitly require that the broker-dealer actually intends the prospective customer to become a customer or that the broker-dealer has a contractual or other relationship with the prospective customer. We are concerned that the broad language would result in any party outside of the enumerated carve-outs being treated as a prospective customer.

ii. The Proposed Rule conflates "clients" as "customers."

The Proposed Rule further expands the definition of "retail customer" to include "clients." We believe this is an internal drafting inconsistency, as under NASAA's existing Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule, the clientele of broker-dealers and agents is referred to exclusively as "customers." The proposed revisions would abandon that approach solely for purposes of the new standards of conduct, which is what leads us to believe this is a drafting inconsistency.

In contrast, Reg BI addresses when investment adviser fiduciary duties or broker-dealer's best interest standard is intended to apply. By including "clients" within the Proposed Rule's standards, NASAA appears to be incorporating advice – though likely does not intend to incorporate such advice – given by an investment adviser representative within the scope of the Proposed Rule's standards of conduct. While we believe this is a drafting inconsistency, we are concerned about adoption as is, as it would further deviate the NASAA Proposal from Reg BI rule text.

iii. Concerns from NASAA Reg BI Comment Letters from 2018/2019 Part of the NASAA Proposal

As part of the Reg BI comment process, NASAA requested in a comment letter that Reg BI "should be extended to include *all* customers not just 'retail customers,' as we can think of no reason why all investors should not receive the benefit of this new standard regardless of

[8] *See also* Fiduciary Interpretation at footnotes 42–44 and accompanying text. See FN 42: "In addition, with respect to prospective clients, investment advisers have antifraud liability under section 206 of the Advisers Act, which, among other things, applies to transactions, practices, or courses of business which operate as a fraud or deceit upon prospective clients, including those regarding investment strategy, engaging a sub-adviser, and account type. We believe that, in order to avoid liability under this antifraud provision, an investment adviser should have sufficient information about the prospective client and its objectives to form a reasonable basis for advice before providing any advice about these matters. At the point in time at which the prospective client becomes a client of the investment adviser (*e.g.,* at account opening), the fiduciary duty applies. Accordingly, while advice to prospective clients about these matters must comply with the antifraud provisions under section 206 of the Advisers Act, the adviser must also satisfy its fiduciary duty with respect to any such advice (*e.g.,* regarding account type) when a prospective client becomes a client."

wealth."[9] The SEC specifically read, considered and rejected this point, going so far as to cite the letter in the Reg BI Release.[10]

Further, in the same letter, NASAA explicitly requested that the requirement that retail customers "use[] the recommendation primarily for personal, family, or household purposes" be struck.[11] Again, the SEC considered and rejected omitting this requirement.

Despite the SEC rejecting both the expansion of retail customers beyond individuals and their legal representatives and the deletion of the use requirement from the definition, the Proposed Rule expands the scope of retail customers beyond individuals and their legal representatives and omits the use requirement. While we appreciate that model rule proposals can sometimes require additional drafting, we are concerned that NASAA is attempting to accomplish a significant and substantive regulatory change by state model rule after failing to convince the SEC it should be implemented at the national level. Under the Proposed Rule, NASAA would retain the "retail" qualifier on "retail customer" in name only.[12]

b. Other Deviations from Reg BI

The Proposed Rule deviates from Reg BI in multiple additional ways. In the interest of brevity and consistency, FSI wishes to refer you to the chart provided by the Securities Industry and Financial Markets Association (SIFMA) in a letter dated and submitted on December 1, 2023. FSI has reviewed the chart and believes it is a comprehensive and helpful assessment comparing the Proposed Rule to Reg BI.[13]

c. NAIC Model Suitability

Recently, the NAIC undertook to amend its Suitability in Annuity Transactions Model Regulation, adopting the amendments as an organization in 2020. The amendments effectively do away with the suitability standard and adopt a best interest standard in line with Reg BI, including care, disclosure, and conflicts of interest obligations.

FSI was pleased to support the NAIC Model which raised standards and provided substantive new protections for consumers consistent with Reg BI. We are very concerned how the Proposed Rule would interplay with the NAIC rule for our members who offer annuities to some clients as an important retirement security tool. The NAIC Model mainly applies the Reg BI principles, including the obligations, to annuity sales. It includes its own supervision, training, recordkeeping and other requirements for insurers and producers. Recognizing the possible regulatory overlap for the sale of annuities that are securities, the NAIC updated the safe harbor provisions of its annuity sales rule. In short, broker-dealers and registered representatives

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[9] Page 8 of in the August 2018 NASAA Letter.
[10] FN 236, p 33342 of the Reg BI Release. See also Appendix A for a further comparison.
[11] Page 23 of in the August 2018 NASAA Letter.
[12] Further, NASAA's approach is likely to cause confusion to broker-dealers and their customers as the "retail customers" for purposes of the Form CRS is a vastly different group than what is being proposed by NASAA.
[13] https://www.sifma.org/wp-content/uploads/2023/12/SIFMA-comment-on-NASAA-model-rule-FINAL-12.1.2023.pdf (See Appendix 2)

complying with "applicable SEC and FINRA rules pertaining to best interest obligations and supervision of annuity recommendations and sales" are operating under a "comparable standard" and need not separately comply with the NAIC standards. In other words, broker-dealers and registered representatives can currently rely on compliance with a single standard and related rules. However, to the extent the Proposed Rule deviates from Reg BI, these firms and representatives would have to comply with those different standards and rules.

III. State Adoption of the Proposed Rule May Be Subject to Preemption under Federal Law

FSI believes that the Proposal presents significant legal and policy weaknesses, including preemption issues for both broker-dealers and their registered representatives and for investment adviser Representatives (IARs) of SEC-registered investment advisers, known as federal covered advisers under state law. In addition to the specific preemption concerns outlined below – conflict preemption and express preemption – we also note several additional preemption concerns, particularly with regard to preemption pursuant to the Employee Retirement Income Security Act of 1974 (ERISA).[14]

We also have preemption concerns in the context of IARs as NASAA expanded the definition of "retail customer" to include "clients." As noted above, we believe this may be an internal drafting inconsistency, but nevertheless address preemption for IARs as IAR capacity is also referred to in Proposed Rule 1.d.(3)b.

a. Conflict Preemption: Lack of Alignment Between Proposed Rule and Reg BI Triggers Conflict Preemption

Conflict preemption covers several types of implied preemption doctrines, including preemption as a result of impossibility – where it is impossible to comply with both state and federal law[15] – or obstacle/interference preemption, where preemption applies because state law interferes with or creates an obstacle to achieve the objective of federal law.[16] We urge NASAA and its members to revisit the circumstances when states attempted to promulgate rules around order flow disclosures and acknowledgments in the mid-1990s and the resulting litigation and caselaw.[17] This caselaw stands alone – separate from National Securities Markets

[14] These concerns could be specific to state, in addition to ERISA, concerns, such as: preemption language in the Advisers Act, the Exchange Act and the Securities Act, express preemption issues, conflict preemption, and the Constitution's Commerce Clause.

[15] *Dahl v. Charles Schwab & Co.*, 545 N.W.2d 918, 924 (Minn. 1996) ("State law is preempted if Congress has entirely displaced the possibility of state regulation or if state regulation conflicts with federal law.") (citing *Pacific Gas & Electric v. State Energy Resources Comm'n.*, 461 U.S. 190 (1983)).

[16] *Guice v. Charles Schwab & Co.*, 674 N.E.2d 282, 291 (N.Y. Ct. App. 1996) ("Even if the goals of Federal and State law are the same, '[a] state law also is pre-empted if it interferes with the methods by which the federal statute was designed to reach this goal.'" (quoting *Int'l Paper Co. v. Ouellette*, 479 U.S. 481, 494 (1987)).

[17] *Guice v. Charles Schwab & Co.*, 674 N.E.2d 282 (highest court in New York state held that SEC Rule 10b-10 preempted a New York regulation that sought to regulate order flow because a patchwork of state regulations involving order flow would interfere with the federal rule regarding order flow and create major challenges for

Improvement Act (NSMIA) developments in the same decade - and demonstrates that state courts have been willing to apply conflict preemption when state law extended beyond or interfered with federal law.

There are specific components of the Proposed Rule that are misaligned with Reg BI, which could be raised in litigation if the Proposed Rule is ever adopted by a state. Most importantly, the Proposed Rule requires a more prescriptive approach to costs and includes a new definition of what is "in the best interest of the retail customer" in Subpart 1.d.(3). This prescriptive approach could result in broker-dealers facing two different sets of requirements – Reg BI's requirements and the Proposed Rule's requirements – and therefore potentially causing broker-dealers to have a compliance regime for the Proposal that might run contrary to fulfilling Reg BI obligations.[18] Such differences are analogous to the differences cited between state and federal law in the *Guice* and *Dahl* matters. For example, Dahl cites the misalignment between federal order flow requirements (disclosure *after* payment) and state order flow requirements (disclosure and consent *before* receiving payment) were impossible to comply with. The Proposal's approach to conflicts has a misalignment with Reg BI, requiring elimination as a baseline as opposed to Reg BI's disclosure and mitigation baseline.

b. Conflict Preemption: Expansiveness of Proposed Rule Raises Concerns for Dual Registrants

We are also concerned about NASAA taking the position that IARs and their clients (as opposed to broker-dealer customers) are subject to the Proposed Rule. While we appreciate that the inclusion of the term client could be a drafting error, we note the Proposed Rule 1.d.(3)b. specifically includes IAR capacity. While Proposed Rule 1.d.(3)b. addresses the concept of product alternatives, it requires a registered representative to assess alternatives available in his/her IAR capacity. In practice, this could extend the Proposed Rule – should it be adopted by a state – to an IAR's conduct in that state. We believe Proposed Rule 1.d.(3). would be particularly challenging to implement for dual registrant firms and may likely result in these firms having to re-examine dual registration.

Furthermore, in addition to the challenges of implementation of Proposed Rule 1.d.(3)b. for dual registrants, we also note that Congress expressly authorized the SEC to create, if necessary, a new standard of care for broker dealers through Dodd Frank Section 913. Under this directive, the SEC promulgated Reg BI, which applies only to broker-dealers and – despite

broker-dealers who operate nationally); *Dahl v. Charles Schwab & Co.*, 545 N.W.2d 918 (highest court in Minnesota Supreme Court held, similar to the *Guice* Court, that SEC Rule 10b-10 preempted Minnesota's attempt to regulate order flow at the state level, determining that because the SEC's rule required disclosure after the agency received the payment and the state rule required the agent to receive consent before accepting payment, it was impossible to comply with both the federal and state requirements); *Orman v. Charles Schwab & Co., Inc.*, 688 N.E.2d 620 (Ill. 1997) (highest court in Illinois held that Congress and the SEC "achieved the appropriate balance between necessary regulation and free market forces in advancing the National Market System," and accordingly, the comprehensive nature of federal regulation regarding order flow preempted Illinois's state law attempting to regulate order flow); *Shulick v. PaineWebber, Inc.*, 722 A.2d 148 (Pa. 1998) (Highest court in Pennsylvania held that "federal regulation of the narrow subject of disclosure of order flow payments is so thorough that we have no difficulty finding" a reasonable inference that Congress left no room for a state to impose additional requirements regarding order flow).

[18] We understand that the Massachusetts Fiduciary Rule (950 CMR 12.207) did not have the same outsized impact on broker-dealer firms in terms of conflicting Massachusetts and federal rules. Rather, firms were able to leverage their Reg BI compliance programs and add Massachusetts Fiduciary Rule compliance to their Reg BI compliance programs. In contrast, largely because of Proposed Rule's new Care and Conflicts components, we expect firms will not be able to leverage their Reg BI compliance programs to implement the Proposed Rule, should it be adopted by a state.

discretion provided to the SEC in Section 913 – did not extend the Advisers Act standard of care to broker-dealers. We note that Congress also did not intend nor authorize a change to Advisers Act standards for SEC-registered investment advisers or their associated person, some of whom are IARs.[19] Accordingly, NASAA's proposed extension of certain aspects of the Proposed Rule – which is for broker-dealers and their [agents/representatives] – to IARs could be understood to frustrate the objective of Congress to create a new standard of care for broker-dealers.

c. Express Preemption: Preemption Under NSMIA Applies with Regard to Broker-Dealer Books and Records

Under NSMIA, states are prohibited from requiring broker-dealers to, among other things, make and keep records that differ from, or are in addition to, the records required under the federal rules.[20] As a practical matter, the Proposal would have the effect of imposing new recordkeeping requirements on broker-dealers, as broker-dealers seek to develop, implement and document compliance with the Proposal's many requirements. There are numerous components of the Proposal which require additional books and records, such as the changes to the disclosure requirements for under Proposed Rule 1.d.(2), which do not have a materiality threshold, and the new method of calculating costs, which is set forth in Proposed Rule 1.d.(4). These components, and other parts of the Proposal, would require extensive documentation to demonstrate compliance. Therefore, the Proposal, should it be adopted by a state, would result in a state requiring documentation in express opposition to the NSMIA prohibition on states. For the foregoing reasons, we believe that the Proposal could be subject to express preemption challenges in addition to conflict preemption challenges.[21]

IV. Codifying Interpretive Guidance

The Proposed Rule's Revision Set #2, is a list of eight items described by NASAA as "attempts to define, clarify, or simply emphasize an obligation or component of Reg BI that is functionally incorporated via the first revision. These subparts include definitions and interpretations drawn directly from SEC guidance in its Adopting Release for Reg BI (but not expressly included within the text of the SEC's rule) as well as definitions and interpretations intended to fill certain gaps in SEC guidance."

We are very concerned about the prospect of states taking SEC guidance and interpretation and codifying it into state law. Guidance and interpretation have a different force and effect than regulations adopted after a public comment period. The SEC was deliberate in not incorporating the concepts of the adopting release or staff bulletins directly into Reg BI as proposed and adopted. We would also distinguish between language in the adopting release

[19] We note that while there may have been some convergence in SEC staff guidance regarding Reg BI and Advisers Act fiduciary duty, ultimately the two regimes are considered separately in this guidance.
[20] Securities Exchange Act of 1934, 15 U.S.C. § 78o(i).
[21] We note that litigation regarding a state adopting the Proposed Rule would likely differ from the currently ongoing litigation in connection with the Massachusetts Fiduciary Rule (*See e.g. Robinhood Financial LLC v. Secretary of the Commonwealth,* Mass. Sup. Judicial Court, SJC-13381 (Ma. 2023)) because the Massachusetts Fiduciary Rule does not differ from Reg BI as much as the Proposal differs from Reg BI. However, we also note that the *Robinhood* matter currently remains ongoing and that certain of the open items yet to be litigated include items (such as the definition of a recommendation) that could in turn have an impact on the Proposed Rule.

and formal interpretation adopted by the Commission. Reg BI adoption was accompanied by two Commission-approved Interpretive Releases[22] related to the Investment Advisers Act of 1940[23] which stands in contrast to explanatory language included in an adopting release. State adoption of these comments as state regulation - with the force of law that entails – is clearly in conflict with Reg BI and the SEC's intent. We therefore believe Revision Set #2 in its entirety should be excluded from the Proposed Rule.

V. Unsettled Regulatory Landscape

Over the past several years, firms and financial professionals have made substantial investments and undergone significant compliance, operational and other changes in response not just to market conditions, but to regulatory changes related to standard of care obligations. Those regulatory changes remain in flux, and it is into this uncertainty that NASAA is interjecting additional changes.

In 2016, the Department of Labor adopted a fiduciary rule[24] (Fiduciary Rule) that upended overhauled and expanded regulations that had been in place for over 40 years. Firms and financial professionals made massive investments and substantial changes in response, even as the uncertainty that is typical of any new significant regulatory initiative remained. The Fiduciary Rule was later overturned by the U.S. Court of Appeals for the 5th Circuit in 2018,[25] but by this time, the SEC was well along the way in its consideration of a of a new standard of care for brokers-dealers. In this environment, firms largely left in place changes initiated in response to the Fiduciary Rule, pending the expected SEC rule. In 2019, the SEC adopted Reg BI which became effective June 30, 2020. Again, firms made large investments and made significant changes in order to comply with their new obligations, even as some uncertainty remained. Further adjustments were made as the DOL adopted a new Prohibited Transaction Exemption, PTE 2020-02.[26] Additionally, as discussed above, the NAIC model was approved in 2020 and has been adopted on a rolling basis over the past three years in 40 states.

In the wake of these recent regulatory changes, firms and financial professionals face ongoing adjustments. Interpretations of some Reg BI elements have been the subject of three staff bulletins from the SEC,[27] including as recently as April of 2023. SEC, FINRA and state examinations have continued to shed light on regulators expectations under Reg BI as firms fine tune their operations and compliance. NASAA's own Coordinated National Regulation Best Interest Examination Initiative concluded with a third report released on September 5, 2023, just three months ago. Collectively, these development help guide firms as they adjust compliance to ensure they meet regulators' interpretations and expectations.

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[22] Commission Interpretation Regarding Standard of Conduct for Investment Advisers (sec.gov) and Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser (sec.gov)
[23] 15 U.S.C. 80b
[24] 29 C.F.R. § 2510.3-21(a)(1) (2017)
[25] Chamber of Commerce v. U.S. Dep't of Labor, 885 F.3d 360 (2018)
[26] 29 CFR Part 2550
[27] SEC.gov | Regulation Best Interest, Form CRS and Related Interpretations

Yet even as aside from these new regulations, firms are now facing the prospect of another overhaul proposed by the DOL[28] as well as the SEC's proposed "predictive data analytics" rules.[29] Like NASAA's Proposed Rule, these two proposals overlap significantly with Reg BI. As a result, there is a substantial likelihood of conflicts, confusion and disruption as these initiatives proceed in tandem, while Reg BI clarity is now coming into clearer focus.

This unsettled regulatory environment does not inure to the benefit of investors who are likely to face confusion and possibly the loss of access to advice, services and products they would otherwise benefit from. Firms, financial professionals and regulators alike will struggle with a multiplicity of overlapping and conflicting standards and requirements.

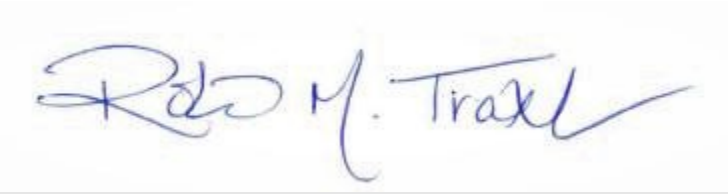
The timing of the Proposed Rule is unfortunate in light of the evolving regulatory landscape. Therefore, to the extent the Proposed Rule diverges from Reg BI in any respect, we urge NASAA to set aside those issues and reassess at a later time.

Conclusion

In sum, FSI appreciates NASAA's goal of updating state model regulations to reflect and align with Reg BI. However, expanding the Proposed Rule beyond the four corners of Reg BI has significant and concerning implications for investors, firms and financial professionals, and regulators alike. We urge that NASAA pause any efforts that go beyond stringent alignment with Reg BI. We are committed to engaging in a good faith dialogue to address ongoing concerns of NASAA.

Thank you in advance for considering our comments. If you have questions about anything in this letter, or if we can be of any further assistance in connection with this rulemaking, please feel free to contact my colleague Dan Barry at dan.barry@financialservices.org or (202) 517-6464.

Respectfully submitted,



Robin Traxler
Senior Vice President, Policy & Deputy General Counsel

Cc: James Nix, Chairman, NASAA Broker-Dealer Section Committee

[28] Defining Investment Advice Fiduciary | U.S. Department of Labor (dol.gov)
[29] Proposed Rule: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (sec.gov)

Appendix A

Concerns Regarding the NASAA Proposed Rule's Expanded Definition of Recommendation

By
A.Valerie Mirko, Partner and Leader, Securities Regulation and Litigation Practice[30]
Armstrong Teasdale LLP

Summary regarding "Recommendation" and "Unsolicited Transaction": The NASAA Proposed Rule greatly expands the definition of "recommendation" by deeming that a recommendation is made "[i]f the broker-dealer or agent utilized any means, method or mechanism to feature or promote an account type, specific security or investment strategy to a retail customer, whether directly or through a third-party[.]"[31] In contrast, Reg BI applies solely "when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer."[32] We address below the potential impact of this proposed expansion in the NASAA Proposed Rule.

I. NASAA Departs from the SEC's Intent to Preserve the Definition of Recommendation When the SEC Raised the Broker-Dealer Standard of Care from Suitability to Best Interest through the Adoption of Reg BI.

As described in the Reg BI Release, the SEC's intent was to align recommendations pursuant to Reg BI to recommendations under the now former FINRA suitability regime. The Proposed Rule seeks to modify this approach through the following expansive language: "recommending . . . the purchase, sale or exchange of any security." The SEC and FINRA had historically rooted the concept of a recommendation in a facts and circumstances analysis, including factors such as "whether the communication ''reasonably could be viewed as a 'call to action''' and 'reasonably would influence an investor to trade a particular security or group of securities.'"[33] The Proposal declines to follow this approach though leaves the suitability requirement in Subpart 1.c. of the business practices rule largely untouched.[34] Further, in

[30] Valerie was a member of NASAA's legal department from 2012 to 2019, serving as General Counsel from 2015 to 2019. She gratefully acknowledges the contributions of Margaret Mudd, Partner, Armstrong Teasdale, in writing this appendix.

[31] We would like to note that the NASAA Proposal's discussion of recommendations expresses concerns for "individual retail investors, especially vulnerable unsophisticated investors" but fails limit the broad application of the expansion of recommendations to this group.

[32] § 240.15l–1(a)(1).

[33] Reg BI Release, 84 FR 33335.

[34] Reg BI Adopting Release (***"Adopting Release"***) at pp. 79-80 and fn 164, and p. 104, https://www.sec.gov/files/rules/final/2019/34-86031.pdf.

addition to the expansion of recommendation, the NASAA Proposed Rule only retained a narrow definition of unsolicited transactions to which the Proposed Rule would apply.

Without the benefit of a facts and circumstances approach, anything deemed to be a recommendation by the Proposed Rule could be subject to the full scope of the Proposed Rule. This results in a large deviation from Reg BI for actions that are accepted under current industry practices. We have addressed a few types of activities that would be covered by this expanded below. At a high level, however, we note that a firm would be presented with a challenge in building a compliance and supervisory program designed to address the "any" security, as currently included without qualifier in the NASAA Proposed Rule.

II. The Proposed Rule's Breadth Could Have a Chilling Effect on Advertising and Remove the Ability for Customers to Learn More about Broker-Dealer Efforts.

Based on the Proposed Rule, we would anticipate and are concerned that even advertising featuring an account type, specific security or investment type, would be deemed a recommendation under the Proposed Rule. The Proposed Rule offers no reason for including advertising materials as de facto recommendations. Instead, the Proposed Rule's explanation/guidance focuses on "the advent of fintech," without providing additional context. We anticipate that, if enacted in any jurisdiction, the Proposed Rule could ultimately prohibit the majority – if not all – broker-dealer advertising, making it difficult for customers to even be aware of what services broker-dealers offer.

a. "Any means, method or mechanism to feature or promote an account type, specific security or investment strategy" could include educational materials.

The NASAA Proposal could include educational materials, certain modeling and other communications that have previously been provided by broker-dealers to clients as helpful tools to understand brokerage products rather than to provide recommendations. This inclusion would have a chilling effect on investor education. As a result, if the Proposed Rule is finalized and then adopted in one or more multiple jurisdictions, we would anticipate less customer education to come from broker-dealers or agents. Further, we would anticipate that broker-dealers and agents would be discouraged from correcting misinformation that is in the public domain to avoid making what could be an inadvertent recommendation.

b. "Any means, method or mechanism" could include digital engagement practices.

The NASAA Proposal attempts to address digital engagement practices and other technologies under the auspices of "Reg BI" while the SEC is actively considering these technologies in Release No. 34-97990 ("Predictive Analytics Release").[35] In NASAA's comment letter[36] to the Predictive Analytics Release, NASAA takes the position that ***new*** federal regulation is needed to address self-directed brokerage conflicts. Therefore, we understand

[35] U.S. SEC Release No. 34-97990, Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (available at: https://www.sec.gov/files/rules/proposed/2023/34-97990.pdf).
[36] Comment Letter dated October 10, 2023.

NASAA to be aware that these items are not covered by the existing Reg BI framework. Further, NASAA also acknowledges that whether digital engagement practices ("DEPs") constitute recommendations is a "particularly nettlesome issue," and "NASAA believes *some* DEPs constitute recommendations" (emphasis added).[37]

Despite NASAA's awareness of the complexities and nuances of DEP-related issues, the new definition of recommendation under the NASAA Proposal would capture many, if not all, DEPs and other technologies as "any means, method or mechanism." While we are not commenting on the SEC's ongoing work in this area, we discourage NASAA from addressing these issues at a time that remains premature and requires additional consideration.

III. Under the Proposed Rule, the Unauthorized Actions of a Third Party Could be Deemed to be a Recommendation by a Broker-Dealer.

Under the NASAA Proposal, a broker-dealer or agent can make a recommendation "directly or through a third-party". It is unclear whether there are any limitations on the amount of control, intent or oversight that must be exerted over the third-party by the broker-dealer or agent. While the broker-dealer or agent must "utilize" any means, method or mechanism for a recommendation to occur, the Proposed Rule lacks clarity on the downstream effects caused by third parties. For example, if a broker-dealer provides a recommendation to a retail customer, and that retail customer shares the recommendation with a friend, the Proposed Rule could be unclear whether a recommendation was made by the broker-dealer to the retail customer's friend.

IV. The NASAA Proposal's Limitations on the Carveout for Unsolicited Transactions is Misaligned with the Expansion to "Recommendations."

The NASAA Proposal contains a limited exception for unsolicited transactions, which includes the requirement that the broker-dealer or agent "execute" unsolicited transactions for their "customers." NASAA retained an execution requirement for the unsolicited transactions. Since the recommendations are no longer directly tied to securities transactions, things like variable annuity purchases could fall within the scope of "recommendation" but could never be deemed "executed" for purposes of the exclusion. This misalignment between the terminology used for recommendation and unsolicited transaction could create a de facto prohibited set of products that broker-dealers and agents are unable to make available to customers on an unsolicited basis.

[37] *Id.*, page 2.