Institute for Portfolio Alternatives

Via electronic submission to NASAAComments@nasaa.org
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December 4, 2023

Re: Proposed Revisions to NASAA's Model Rule on Dishonest or Unethical Business Practices of Broker-Dealers and Agents dated September 5, 2023 (the "Proposal")

Members of the Broker-Dealer and Regulatory Policy and Review Project Group and the Broker-Dealer Section:

The Institute for Portfolio Alternatives (the "Institute") welcomes the opportunity to comment on the Proposal. The Institute represents the sponsors and distributors of alternative products, including non-listed REITs and business development companies, interval funds, and tender-offer funds.[1]

The Institute urges NASAA to withdraw the Proposal for the following reasons:

- *The Proposal Would Conflict with Reg BI.* The Proposal would not "update" or codify Regulation Best Interest. In fact, the Proposal would conflict with Reg BI in many significant ways.

  Unlike Reg BI, the Proposal's requirement that broker-dealers consider "reasonably available alternatives" ("RAA") would demand a single-minded focus on those alternatives that the state administrator believes have a "lower cost and lower risk." By driving broker-dealers toward the cheapest and least "risky" securities and strategies (without defining "risk"), the proposed RAA test would encourage recommendation of securities and strategies without regard to whether they would provide overall portfolio diversification or other benefits that would help a retail customer achieve her investment objectives.

[1] For more than 35 years, the Institute has advocated for increased investor access to portfolio diversifying investment strategies, accompanied by straightforward disclosure about their risks and benefits and strong investor protection from inappropriate sales practices. Our members include the asset management companies that sponsor diversifying investments, wirehouse broker-dealers, independent broker-dealers, regional broker-dealers, registered investment advisers, law firms, accounting firms, transfer agents, valuation firms, due diligence firms, and technology firms.

The Proposal also effectively would prohibit traditional, federally-regulated forms of brokerage compensation that are permissible under Reg BI and other federal regulations. There is no policy justification for this sweeping state prohibition.

The Proposal would reformulate Reg BI's definitions of "recommendation" and "retail customer." These new, inconsistent, untested definitions would sow confusion in the industry, undermine compliance programs, and harm retail customers.

The Proposal also would require broker-dealers to "neutralize" conflicts of interest, a term that the Proposal does not define and that is without precedent in Reg BI or federal and state securities law. The Proposal would prohibit disclosure as a stand-alone solution in any circumstance, contrary to the explicit provisions of Reg BI.

- *The Proposal Would Interfere with Ongoing Federal Initiatives.* Federal regulatory agencies are engaged in various initiatives that concern precisely the questions that the Proposal is intended to address. For example, the Department of Labor recently proposed a new fiduciary standard under ERISA and the SEC has proposed a rule concerning predictive data analytics. Adoption of the Proposal would unnecessarily interfere with these federal regulatory initiatives.

- *Federal Law Would Preempt the Proposal.* Various provisions of federal law, such as NSMIA, the Investment Advisers Act and ERISA, would preempt any state's adoption of the Proposal.

For these reasons, we respectfully recommend that NASAA withdraw the Proposal.

1. The Proposal Would Conflict with Reg BI.

According to the request for public comment, the Proposal is intended to "update the model rule in light of the U. S. Securities and Exchange Commission's 2019 adoption of Regulation Best Interest" and "fully account for revisions to federal conduct standard for broker-dealers and agents arising out of the adoption [by the SEC] of Reg BI."[2] Subparts 1d(1) through (8) are intended "to define, clarify, or simply emphasize an obligation or component of Reg BI."[3]

Contrary to its stated purpose,[4] the Proposal would conflict with Reg BI and impose heightened obligations on broker-dealers. An essential purpose of Reg BI was to preserve

[2] Proposal at 1-2.

[3] Proposal at 2.

[4] As a preliminary matter, NASAA does not need to amend the Model Rule to incorporate Reg BI. At least 34 state administrators participated in NASAA's examinations on Reg BI implementation. *See* NASAA Regulation Best Interest Implementation Committee, *Regulation Best Interest: National Examination Initiative Phase One* 2 (September 2020). Moreover, many state administrators believe that their rules already incorporate Reg BI

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investor choice, to ensure that investors can obtain financial services from a broker-dealer who must act in the customer's best interest:

> [T]here is broad acknowledgment of the benefits of, and support for, the continuing existence of the broker-dealer business model, including a commission or other transaction-based compensation structure, as an option for retail customers seeking investment recommendations.[5]

By contrast, the Proposal would undermine the broker-dealer model and drive retail customers into investment advisory, insurance or other financial services, and could deprive smaller retail customers of any financial advice at all.

The Proposal would create a new patchwork of state broker-dealer regulation, unnecessarily increasing compliance costs for broker-dealers that they will pass along to their customers. It would create unnecessary confusion in compliance programs, perhaps exposing customers to the very sales practice issues that it is designed to address. Customers are best served with a uniform broker-dealer standard of care across the nation, which Reg BI already provides. Reg BI ensures that broker-dealers act in the best interest of their retail customers, while preserving investor choice and access to investment services. As a uniform national standard, Reg BI facilitates compliance and ensures that retail customers have access to the investment planning services they need to meet their retirement and other investment goals.

The Proposal would conflict with Reg BI in many significant respects. Each of these provisions on their own represents a major departure from existing regulations, but in combination they would fundamentally alter the business model of broker-dealers across the country. In this letter we discuss the conflicts arising from the proposed RAA test, prohibition of most forms of compensation, reformulation of the definitions of "recommendation" and "retail customer," and requirement to "neutralize" conflicts of interest.

A. The Proposed RAA Test Would Conflict with Reg BI and Would Harm Retail Investors.

Of particular concern to the Institute's members is the Proposal's reformulation of the SEC's requirement that broker-dealers consider reasonably available alternatives to a

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principles or the regulation itself. *See, e.g.,* Ohio Admin. Code 1301:6-3-19(A)(6) ("No dealer or salesperson shall . . .. fail to comply with the obligations set forth in 'Regulation Best Interest.'"). Some states that have not incorporated Reg BI into their rules are in the midst of doing so. *See* NASAA, *Report and Findings of NASAA's Broker-Dealer Section Committee, National Examination Initiative Phase II(B)* 17 (September 2023) ("NASAA Phase II Report") ("as states begin adopting their own regulations that incorporate Reg BI principles, more will be issuing deficiency letters").

[5] *Regulation Best Interest: The Broker-Dealer Standard of Conduct,* 84 Fed. Reg. 33318, 33319 (July 12, 2019) ("Adopting Release").

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recommendation to a retail customer. Under Reg BI, as part of the Care Obligation a broker-dealer "generally should consider reasonably available alternatives offered by the broker-dealer."[6]

> The SEC requires a nuanced RAA analysis:
>
> The Care Obligation will require a broker-dealer to have a reasonable basis to believe, based on its understanding of the potential risks, rewards and costs of the recommended security or investment strategy involving securities, and in light of the retail customer's investment profile, that the recommendation is in the best interest of a *particular* retail customer and does not place the broker-dealer's interest ahead of the retail customer's interest . . . A broker-dealer could recommend a more expensive security or investment strategy if there are other factors about the product that reasonably allow the broker-dealer to believe it is in the best interest of the retail customer, based on that retail customer's investment profile.[7]

The SEC recognizes that the analysis cannot be "simplified" into a choice between two products:

> We also recognize that different products are rarely perfectly equal, and that differences will be both quantitative and qualitative in nature. A broker-dealer will not be required to recommend the single "best" of all possible alternatives that might exist, in part because many different options may in fact be in the retail customer's best interest.[8]

The SEC staff has issued guidance on Reg BI emphasizing that the RAA analysis must incorporate such factors as the investor's need for liquidity (or, presumably, lack thereof). The broker-dealer must take into account not only the cost but the potential benefits, risks and compatibility of the recommended security with the investor's profile.[9] An agent need not evaluate every possible alternative available through the firm.[10] If a reasonably available alternative has a lower cost or lower perceived risk, the SEC staff encourages the broker-dealer to consider the less costly or lower risk alternative *only* if it "is consistent with the investor's investment profile."[11]

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[6] Adopting Release at 33381.

[7] Adopting Release at 33380-81 (emphasis retained).

[8] Adopting Release at 33381 (footnote omitted).

[9] *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Care Obligations* at 6 https://www.sec.gov/tm/standards-conduct-broker-dealers-and-investment-advisers#, April 20, 2023 ("Staff Bulletin").

[10] Staff Bulletin at 6.

[11] Staff Bulletin at 8.

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NASAA asserts that the RAA requirement in Subpart 1d(3) merely "codifies a simplified form of the SEC's lengthy guidance."[12] This statement is simply untrue. The Proposal would conflict with the fundamental principles and the spirit of Reg BI.

I. The Proposed RAA Test Would Inappropriately Exclude Consideration of Factors Other Than Cost and Risk.

Subpart 1d(3)(b) would require consideration of reasonably available alternatives that is inconsistent with the RAA test in Reg BI:

> To satisfy this care obligation, a broker-dealer or agent shall make reasonable inquiry regarding lower-cost and lower-risk securities and investment strategies that are reasonably available to the broker-dealer or agent, as well as products or services available if the agent is also [licensed or registered] in other capacities such as an investment adviser representative or insurance agent.

This RAA test in the Proposal does not contemplate any comparison of the features of reasonably available alternatives, other than their "cost" and "risk."[13] Unlike Reg BI, the Proposal's RAA test would effectively prevent a broker-dealer from recommending a more expensive security or investment strategy even when other factors about the product reasonably allow the broker-dealer to believe it is in the best interest of the retail customer, based on that retail customer's investment profile. Any broker-dealer that considers the potential diversification, income-producing or other benefits of a more expensive or risky alternative would run the risk of a state enforcement action under the Proposal.

Indeed, Reg BI *forbids* a broker-dealer from limiting its RAA evaluation to the cost and risk of alternative securities and investment strategies. In the words of the SEC:

> [A] broker-dealer would not satisfy the Care Obligation by simply recommending the least expensive or least remunerative security without any further analysis of these other factors [*i.e.,* the potential risks and rewards of the recommended security or investment strategy] and the retail customer's investment profile.[14]

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[12] Proposal at 5.

[13] A general provision, Subpart 1d(3)(a), similarly would require a broker-dealer, in making a recommendation, to consider securities and investment strategies "that can achieve the retail customer's investment objectives with less risk or less costs." Subpart 1d(3)(a) also would require a broker-dealer to consider conflicts of interest, customer information, and "[a]ny other relevant information." Subpart 1d(3)(a) is not part of the RAA test in Subpart 1d(3)(b), which requires consideration only of the cost and risk of competing products.

[14] Adopting Release at 33380-81.

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By focusing on cost and risk to the exclusion of all other considerations, the proposed RAA test would directly conflict with Reg BI and federal supervisory requirements, without any justification for doing so.

II. The Proposed RAA Test Would Limit Investor Choice.

The Proposal's RAA test would limit investor choice. It would harm, not help, retail customers by failing to incorporate consideration of the comparable benefits of the recommended security and its reasonably available alternatives and a consideration of how those benefits might help a particular customer achieve her objectives based upon her investment profile. The RAA test does not countenance consideration of how an alternative investment could help a retail customer diversify her investment portfolio and reduce its volatility.

By driving broker-dealers toward the cheapest and least risky securities, retail customers would face more limited investment opportunities under the proposed RAA test and be deprived of the opportunity to invest in any product that is deemed "complex, costly and risky." The Proposal is biased against federally-regulated alternative investments like non-traded REITs. In its National Exam Initiative Phase II (B) Report, upon which the Proposal is based, NASAA labels four securities as "complex, costly and risky," including non-traded REITs.[15]

By contrast, Reg BI is a product agnostic regulation. Moreover, the phrase "complex, costly and risky" appears nowhere else in the securities laws, including Reg BI, and NASAA has never defined it. Different standards and requirements, aside from causing confusion, will inevitably contribute to fewer options in terms of advice, products and services. In fact, it is likely that many products and services that have helped investors achieve their long-term objectives would no longer be available under the Proposal.

As NASAA is aware, non-traded REITs, today known as "NAV REITs,"[16] are registered with the SEC. FINRA regulates their distribution by broker-dealers and the SEC and states regulate their distribution by investment advisers. They are distributed by large wirehouses, independent dealer firms and investment advisers. NAV REITs are sponsored by some of the most prominent global asset management companies.

NAV REITs provide portfolio diversification that can reduce the volatility of investment portfolios. Many institutions, including state employee pension funds, invest in NAV REITs or other real estate programs for this purpose. There is no reason to deprive retail customers of

[15] NASAA Phase II Report at 2. NASAA had focused on these same four types of securities in its Part II(A) report, too.

[16] Virtually all non-listed REITs today are "net asset value" REITs, as compared to an older generation of "lifecycle" REITs. In 2023, capital raising for non-listed REITs has been approximately $9.4 billion, about 99.7% of which was raised for NAV REITs. Source: Robert A. Stanger & Co., Inc.

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the same opportunity for portfolio diversification. Yet the Proposal would encourage a broker-dealer to recommend other types of securities rather than NAV REITs that could provide better portfolio diversification, could be better aligned with a retail customer's long-term investment objectives, and would be consistent with the broker-dealer's Reg BI Care Obligation.

III. The Proposed RAA Test Would Undermine Investor Protection.

The Proposal's RAA test would undermine investor protection by requiring consideration of products and services that the broker-dealer does not offer and cannot supervise. Reg BI permits a broker-dealer and its agents to disregard alternative brokerage products or services that are not on its platform.[17] Of course, Reg BI permits a broker-dealer and its agent to disregard *nonbrokerage* products and services, too. Under Reg BI, investment advisory or insurance products and services cannot be considered "reasonably available" alternatives to a broker-dealer's recommendation of a security or investment strategy – whether or not the broker-dealer or its agent is dually registered in an advisory or insurance capacity.

By requiring a dually-licensed agent to consider investment adviser, insurance, or other services that the broker-dealer does not offer in its capacity as broker-dealer, the Proposal would create an entirely new RAA analysis that is inconsistent with Reg BI and would harm retail customers. Broker-dealers have no compliance system to review an agent's recommendation of a fixed annuity, life insurance, or advisory account. Broker-dealers – including the brokerage personnel of multiservice firms – typically have little expertise concerning these products and services. Yet the Proposal would require a dually-licensed agent to consider financial services that the broker-dealer does not offer, that it cannot supervise, and for which it cannot afford its retail customers any protection. The Proposal would expose retail brokerage customers to harm and abuse from unsupervised agents selling nonbrokerage products.

IV. The Proposed RAA Test Would Raise Interpretive Questions.

The Proposal's RAA test would raise a host of interpretive questions. Subpart 1d(4) would define "costs" to include "costs arising from tax considerations." Agents typically are not CPAs and lack tax planning expertise. How should they fulfill the requirement to consider costs arising from tax considerations?

State administrators will be expected to answer other interpretive questions. How must a broker-dealer balance considerations of "lower cost" and "lower risk"? What if a security or strategy that is "lower cost" is not "lower risk," or vice versa? Must a broker-dealer consider the risk of the recommended security standing alone or may the broker-dealer also consider its possible effects on the overall risk of the customer's portfolio? How does NASAA define "risk?" Is it standard deviation, variance, Sharpe Ratio, value at risk, beta, or another definition?

[17] Adopting Release at 33381.

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The Proposal would allow wide variability in state adoption and interpretation of its provisions:

> It is important to note that [Subparts 1d(1) through (8)] are presented as a menu of provisions that NASAA members can use to define, clarify or emphasize the obligations and components of Reg BI that matter most to each jurisdiction. Members may desire definition and clarity that is best achieved by adopting one, some, or all of the subparts.

How should broker-dealers address the different and inconsistent interpretations of these terms and other parts of the Proposal among state administrators?

Because the RAA requirement does not align with Reg BI, we strongly recommend that NASAA eliminate the RAA requirement even if NASAA proceeds with the Proposal.

B. The Proposal Would Conflict with Reg BI by Effectively Banning Most Forms of Compensation.

Reg BI permits not only commissions and other forms of transaction-based compensation. It preserves virtually all forms of compensation that broker-dealers traditionally have earned.[18] By contrast, Subpart 1d(2)(b) would presume that receipt of any type of compensation permitted by Reg BI (other than the sales commissions) violates the broker-dealer and agent's obligation to act in the customer's best interest. This prohibition could be read to apply even when the compensation has little to do with a recommendation to a customer as defined in Reg BI and when Reg BI adequately addresses any related conflict of interest.[19]

Although framed as a "presumption," as a practical matter this provision would prohibit virtually all forms of brokerage compensation other than commissions. Agents would not be able to receive payment for their attendance at conferences, perquisites such as parking garage

[18] Reg BI does prohibit sales contests, sales quotas, bonuses, and non-cash compensation based on the sale of specific securities or security types within a limited period of time. *See* Rule 15l-1(a)(2)(iii)(D). All other forms of compensation were preserved but subjected to the various protections that Reg BI affords to broker-dealer customers.

[19] Subpart 1d(2)(b) would create the presumption for compensation awards "beyond the sales commission as a result of that recommendation." This phrase is ambiguous in several respects. It is unclear to which "recommendation" it refers, and it is unclear whether the awards or the commission must be "as a result of" the recommendation.

Presumably NASAA intends that the presumption apply to *awards* that are a result of the recommendation. An essential business of retail broker-dealers is to provide recommendations to their customers. Virtually any form of compensation could be considered to be a "result" of those recommendations. Therefore, if NASAA intended to narrow the awards to those that are a result of the recommendation, the narrowing could have little practical effect.

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spaces, employee compensation like bonuses and incentives tied to appraisals or performance reviews. Broker-dealers could not receive compensation that does not result from sales activity like compensation for sub-accounting or administrative services provided to a mutual fund. The Proposal could be interpreted to prohibit the receipt of any form of compensation other than sales charges and – perhaps – Rule 12b-1 fees. The Proposal thus could be interpreted to prohibit revenue sharing, payment for order flow, interest for the extension of margin to customers, and revenue from cash sweep programs.[20] All of these forms of compensation have been earned by broker-dealers for decades. They are federally regulated to ensure that they present little risk of customer harm.

This prohibition of virtually all forms of compensation would conflict with Reg BI. It would upend the broker-dealer business model without affording any additional investor protection. The prohibition would be even more onerous than the rules governing investment advisers. The Proposal is intended to reflect "the blurring of brokerage and advisory service models."[21] Yet investment advisers – including those regulated by NASAA members – are not prohibited from charging the forms of compensation that the Proposal would deny broker-dealers.

The consequences of the Proposal could be profound. Some firms may limit or eliminate broker-dealer services. Customers would then likely have to choose between moving to more expensive fee-based advisory accounts or moving to internet or call center-based, execution only platforms. In all of these cases retail customers would be harmed, not helped by the proposed prohibition of traditional brokerage compensation.

C. The Proposed Definitions of "Recommendation" and "Retail Customer" Would Conflict with Reg BI.

The Proposal also would conflict with Reg BI by substituting untested, novel concepts for well-understood terms in federal securities regulation, without any stated policy justification. The Proposal claims to "clarify" the term "recommendation," but this term needs no clarification under federal law. As NASAA admits, "'recommendation' is a well-established concept with sufficient elasticity to accommodate technological advancements within the industry."[22] FINRA and the SEC have issued guidance concerning the meaning of "recommendation," and for decades this term has served as the foundation of FINRA's suitability rule and Reg BI.

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[20] The Proposal says that "both upfront and trailing sales commission" would be permitted. Proposal at 4. The proposed rule text does not explicitly permit Rule 12b-1 fees, however. It merely permits "*the* sales commission." The text is ambiguous as to whether it would permit a broker-dealer to charge not only an upfront sales commission but other transaction-based fees.

[21] Proposal at 2.

[22] Proposal at 6.

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NASAA asserts that its new "recommendation" definition would "provide greater regulatory certainty regarding a key term."[23] In fact, the Proposal would radically rewrite the meaning of "recommendation" in a way that would cause needless uncertainty and confusion in the compliance programs of broker-dealers. The new definition in Subpart 1d(5) would cover "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." Under the Proposal, a newspaper advertisement for account services, an educational webinar about investment strategies, a Morningstar reprint about mutual funds offered through the broker-dealer could be deemed "recommendations" – as would an infinite variety of communications that have never before been considered recommendations subject to FINRA's suitability rule and that are not subject to Reg BI today. This unprecedented expansion of the term has no precedence or basis in public policy and offers no demonstrable benefit to retail investors.

The Proposal also would redefine the term "retail customer" in Reg BI. According to Reg BI, a "retail customer" is a natural person who receives a "recommendation" as defined by Reg BI and uses it "primarily for personal, family, or household purposes."[24] In contrast, Subpart 1d(6) of the Proposal would define "retail customer" as virtually all "current and prospective customers and clients." The Proposal would only exclude certain institutional investors and "institutional buyers" as defined differently by various state administrators. Any natural person who reads a broker-dealer's advertisement, attends its educational webinar about investment strategies, or otherwise receives anything that "features or promotes" an account type, specific security, or investment strategy, whether directly or through a third party, would be a retail customer under the Proposal. The broker-dealer would have to somehow act "in the best interest" of that person "based on [her] investment profile," and avoid or eliminate conflicts of interest and use the requisite care, skill and diligence with respect to that person. This redefinition of "retail customer" is impossibly broad and unworkable.

D. The Proposal Would Conflict with Reg BI by Introducing the Novel Concept of "Neutralize."

The Proposal would conflict with Reg BI by introducing a new requirement that conflicts of interest be "neutralized," an undefined term that appears in neither Reg BI nor any other provision of the federal securities laws. It would prohibit disclosure as a stand-alone solution for any conflict of interest, in direct contravention to Reg BI.[25] The Proposal presents no justification for these severe policies nor does it explain why Reg BI is insufficient to ensure that broker-dealers act in their retail customers' best interest.

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[23] Proposal at 7.

[24] See Rule 15l-1(b)(1).

[25] See SEC Rule 15l-1(a)(2)(iii)(A)(broker-dealers must "[i]dentify and at a minimum disclose" conflicts of interest).

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2. The Proposed Rule Would Interfere with Ongoing Federal Initiatives.

Federal regulatory agencies are engaged in various initiatives with which the Proposal would conflict. For example, the Department of Labor recently proposed a new fiduciary standard under ERISA that would govern most interactions between a broker-dealer and an employee plan or an IRA account. In general, the proposal would require compliance with a revised prohibited transaction exemption. The Institute is reviewing the proposal, but even based on an initial review it is evident that the Department of Labor's proposal would conflict with NASAA's proposed model rule amendments. NASAA should not create a new, untested standard of care for broker-dealers while transformational federal regulations like the Department of Labor's new fiduciary proposal are being finalized and perhaps subjected to judicial review.

The Proposal also would conflict with the SEC's initiatives. Earlier this year the SEC proposed a new rule concerning predictive data analytics. NASAA asserts that the Proposal is necessary because Reg BI does not account for "the emergence of fintech and other digital investing platforms."[26] While we disagree with this assertion, the SEC's predictive data analytics proposal would address precisely this question. Moreover, Reg BI *does* address any conflict of interest that could arise from a broker-dealer's use of these platforms in its recommendations to retail customers. NASAA should not attempt to address questions that are currently under review by the SEC during an open rulemaking process.

Under Chairman Gensler, the SEC has asserted that it will follow Reg BI "to the letter" in examinations and enforcement. Investigations of potential Reg BI violations have entered a more serious phase, with substantial actions from the SEC and FINRA against alleged client abuses. The SEC has recently announced its examination priorities, some of which are related to the implementation of Reg BI.[27] NASAA's Proposal is intended to "clarify" the application of Reg BI to a broker-dealer's recommendation of NAV REITs, among other purposes. The SEC's examination and enforcement initiatives are meant to address any violation or unintended application of Reg BI. NASAA should wait for the outcome of the SEC's initiatives before it issues any new standard of care applicable to broker-dealers.

3. Federal Law Would Preempt the Proposal.

Finally, and importantly, various provisions of federal law would preempt and render unenforceable any state's adoption of the Proposal.

A. NSMIA Would Preempt the Proposal.

[26] Proposal at 2.

[27] United States Securities and Exchange Commission, Division of Examinations, *Examination Priorities Report* (2023)

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Section 15(i) of the Securities Exchange Act of 1934 (enacted in NSMIA) prohibits any state from adopting rules governing such matters as broker-dealer custody, margin and the making of books and records that differ from or in addition to those under the Act. The proposed compensation provision in Subpart 1d(2)(b) would restrict a broker-dealer's ability to earn payment for custodial services and interest on margin accounts. Section 15(i) would preempt such a restriction.

Additionally, no broker-dealer could comply with the Proposal without adopting an entirely new system of state-specific books and records, covering such matters as compliance with the RAA requirements, the making of "recommendations" as defined by the Proposal, the identification of "retail customers" under the Proposal, and efforts to "neutralize" conflicts of interest. These new state-specific books and records requirements would be in addition to the books and records obligations of a broker-dealer under Reg BI. Section 15(i) would preempt the Proposal's books and records requirements.

NASAA inserted a savings clause in Subpart 1d(8). This savings clause attempts to interpret the Proposal as not involving custody, margin, books and records or other matters that causes its preemption under NSMIA. The savings clause would be ineffective. The Proposal manifestly *does* regulate custody, margin, and books and records. That fact cannot be mitigated and the effects and purposes of NSMIA preemption cannot be avoided, with a state rule that merely denies in one savings clause what it does in other provisions: regulate custody, margin and books and records.

B. The Investment Advisers Act Would Preempt the Proposal.

The Proposal would require that an agent consider reasonably available alternatives to his recommended security or investment strategy. An agent who is also a licensed investment adviser representative would have to consider an alternative investment adviser account or product. If the agent is associated with a dually-registered broker-dealer and investment adviser, then the firm's supervision of the agent would be subject to the Investment Advisers Act of 1940. To ensure that the agent complies with the Proposal the firm would have to adopt necessary supervisory policies and procedures to reflect the cost and risk analysis that the RAA test would require. Section 203A(b) of the Investment Advisers Act preempts state regulation of federally-registered investment advisers.[28] Under Section 203A(b) a state administrator would be preempted from requiring a federally-registered investment adviser to adopt compliance procedures reasonably designed to ensure that the agent complies with the RAA requirements. While state regulators have the authority to bring enforcement actions for fraud and deceit, they may not impose substantive conduct and supervisory requirements on federally-registered investment advisers.

[28] *See, e.g.,* Investment Advisers Act Release 1733 (August 31, 1998).

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C. ERISA Would Preempt the Proposal.

The Proposal also would violate the preemption provisions of ERISA. It would impose a new state-specific standard of conduct on broker-dealers who make "recommendations" as broadly defined in the Proposal to any retail customer, which under a particular state's law could include an employee-benefit plan. The Proposal attempts to carve out employee-benefit plans but it fails to do so. The savings clause in Subpart 1d(7) excludes from the Proposal "a person acting in the capacity of a fiduciary to an employee benefit plan, its participants, or its beneficiaries, as those terms are defined in the Employee Retirement Income Security Act . . ." ERISA's preemption clause, Section 514, broadly preempts state laws insofar as they "relate to" ERISA-covered employee benefit plans. This preemption is *not* limited to state laws governing ERISA fiduciaries. It also applies to persons providing nonfiduciary services to plans, including persons that the Proposal seeks to regulate. Section 514 of ERISA thus would preempt the Proposal.

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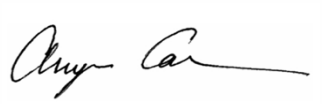
For the reasons state in this letter, the Institute strongly urges NASAA to withdraw the Proposal.

The Institute appreciates the opportunity to comment on the Proposal. Should you have any questions about our comments, please feel free to contact me or Gina Gombar at (617) 710-7272.

Sincerely,



Anya Coverman
President and CEO

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