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SB 383 (Ch. 322, Laws of 2017)
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Thank you for the opportunity to speak here today. I am here on behalf of the Securities Industry and Financial Markets Association. SIFMA represents the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets. Our industry raises over $2.5 trillion annually for businesses and municipalities in the U.S., serves retail clients with over $16 trillion in assets, and manages more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans.

We appreciate the Division's interest in soliciting input as regulations on SB 383 are being developed. SIFMA has previously commented on the legislation - both prior to enactment and then in two on the record group submissions to the Division. I would like to highlight some of our key thoughts and concerns here. My comments are organized to correspond with the proposed agenda items put forth on September 8, 2017.

I. Agenda Item 3A: Application of Fiduciary Duty to broker dealers, sales representatives of broker dealers, sales representative of the issuer, investment advisers, representatives of investment advisers.

SIFMA and its members share Nevada's interest in maintaining high conduct standards for our profession and ensuring that all financial advisors act in the best interest of their customers. For many years, SIFMA has proactively and publicly supported SEC action to enhance standards of conduct for BDs and RIAs. Since 2009, SIFMA's formal written advocacy on this issue has included: Congressional testimony on five separate occasions, seven separate comment letters to the SEC, one comment letter to FINRA, and countless media interviews, op-ds, and public speaking engagements on the topic. As recently as last month, SIFMA filed a comment letter with the SEC recommending that it establish a best interest standard for broker-dealers ("BDs") that encompasses a duty of loyalty, a duty of care, and enhanced up-front disclosures to investors.

While SIFMA and the State of Nevada have similar objectives, we may disagree on the best way to achieve those objectives. We believe a uniform national standard is in everyone's best interest. We are concerned that a state by state approach would subject financial professionals and firms to a confusing and potentially contradictory array of requirements and further muddy the waters for consumers trying to determine their relationship with their broker. We understand possible skepticism that a federal uniform standard is achievable. That said, SEC Chairman Clayton has shown substantial interest in this issue. In June, he requested public comment on standards of

conduct for investment advisers and broker-dealers. At a Senate hearing last week, he also declared that harmonizing a fiduciary rule with the Department of Labor was one of his top priorities.

So, if uniformity is what everyone is seeking, why shouldn't Nevada just use the new DOL Fiduciary Rule as a basis for its proposed regulations? We would encourage you against taking this approach for at least four reasons. First, the DOL Rule is currently under review, and DOL has recently proposed an 18-month implementation delay, which is expected to be finalized within the next few weeks. Second, the mutual commitment of SEC Chair Clayton and DOL Secretary Acosta to engage in a coordinated endeavor to develop a best interest standard that could uniformly apply across multiple regulatory frameworks suggests that the current DOL language may undergo some revision. Third, the Fifth Circuit is expected to issue a decision in the coming weeks on the Rule's legality. That decision could have implications for any Nevada rule built upon the DOL fiduciary structure. Finally, and most importantly, we believe the Rule has significant flaws which are being reviewed by DOL before full implementation.

I would like to now focus on some of the flaws of the DOL Rule. The effects of this Rule already show new limitations that have been put on investor choice and access to investment advice. In fact, a SIFMA commissioned study by Deloitte (summary) found that access to brokerage advice services has been eliminated or limited by many financial institutions as part of their approach for complying with the Rule. Specifically:

- 53% of the study participants have eliminated or limited access to brokerage advice services, which is estimated to impact 10.2 million accounts and $900 billion assets under management;

- 95% of financial institutions represented by the study have reduced access to or choices within the products offered to retirement investors with, for example, 29% eliminating No Load funds from their brokerage platform, impacting 22.8 million accounts;

- 67% of firms have reduced the number of mutual funds offered to retirement investors.

Essentially, the DOL Fiduciary Rule is driving increased movement by firms and financial professionals to a fee-based business model, resulting in many lower and middle-market investors being without access to financial products and professional advice and services because of the nature and structure of the fee-based model. Generally, these accounts have higher fees and certain minimum asset requirements that keep some investors out of these options. This will result in any saver with less than the required minimums from accessing certain financial products and potential access to professional advice and services.

So, what if anything should Nevada do while waiting for clarity at the national level? For consistency purposes, we would encourage you to tie any specific requirements to FINRA Rule 2111 (FINRA's "best interests" requirement), FINRA Rule 2330 regarding variable annuities, FINRA Regulatory Notice 12-25 and various interpretive guidance. In our view, FINRA Rule 2111, sometimes described as a suitability standard, provides much more consumer protection than is commonly believed. Over the last eighty-plus years, the SEC, FINRA and state securities regulators who oversee BDs have developed a comprehensive regulatory regime based on brokers' duty of fair

dealing.[1] This regime includes the obligation to make suitable recommendations, ensure best execution, and observe high standards of commercial honor and just and equitable principles of trade – a concept which itself embodies fiduciary principles.[2] As stated by SEC staff and FINRA guidance, the suitability obligation generally requires a BD to make recommendations that are "consistent with the best interests of his customer."[3] Numerous securities cases have explicitly held the same.[4]

II. Agenda Item 3B: Identification of duties encompassed within the Fiduciary Duty

As described in our July 21, 2017 submission to the SEC in response to its June 1 request for public comment, SIFMA believes that the SEC should consider a best interest standard for BDs that encompasses, among other things, a duty of loyalty and a duty of care. We suggest that the Suitability Rule could be amended to provide that when making a recommendation to a retail customer, a BD shall act in the best interest of such customer at the time the recommendation is made (duty of loyalty) and shall not have a continuing duty to that customer after making the recommendation. We further believe that the recommendation shall reflect the reasonable diligence and the reasonable care, skill and prudence that a prudent registered representative would exercise based on the customer's investment profile (i.e. duty of care). As stated earlier, we believe this enhanced duty is best achieved at the federal level.

We remain concerned that any new fiduciary duties under the Nevada law would impose additional recordkeeping requirements that would violate the National Securities Markets Improvement Act of 1996 ("NSMIA). As you well know, NSMIA precludes states from enacting regulations relating to the making and keeping of records "that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act]." We are hard pressed to envision a scenario in which new duties do not require the creation of a new record.

For example, under the new law, broker-dealers and their agents are subject to NRS 628A.020. This provision states:

> "A financial planner has the duty of a fiduciary toward a client. A financial planner shall disclose to a client, at the time advice is given, any gain the financial planner may receive, such as profit or commission, if the advice is followed. A financial planner shall make diligent inquiry of each client to ascertain initially, and keep currently informed concerning,

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[1] *See* MORGAN, LEWIS & BOCKIUS LLP, DEPARTMENT OF LABOR RETIREMENT INITIATIVE FAILS TO CONSIDER CURRENT REGULATORY REGIME, WHICH COMPREHENSIVELY PROTECTS INVESTORS INCLUDING IRA INVESTORS, AND PRESERVES INVESTOR CHOICE (2015) (explaining how the current framework governing financial professionals protects investors as broker dealers and their registered representatives are subject to extensive regulatory oversight in addition to investors' private rights of action) available at https://www.morganlewis.com/~/media/files/publication/morgan%20lewis%20title/white%20paper/im_whitepaper_dolretirementinitiative_march2015.ashx.

[2] *See In re E.F. Hutton & Co. Inc.*, Release No. 25887, 41 S.E.C. Docket 413, 418 (July 6, 1988) ("The concept of just and equitable principles of trade embodies basic fiduciary responsibilities….").

[3] SEC Staff Study on Investment Advisers and Broker-Dealers (January 2011), at 59, available at https://www.sec.gov/news/studies/2011/913studyfinal.pdf; FINRA Regulatory Notice 11-02 (January 2011), at 7 n. 11, available at http://www.finra.org/sites/default/files/NoticeDocument/p122778.pdf.

[4] FINRA Rule 2111 (Suitability) FAQs, at A7.1, n. 69 (citing numerous cases), available at https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq.

the client's financial circumstances and obligations and the client's present and anticipated obligations to and goals for his or her family."

Both the disclosure and information collection requirements would need to be done in writing, or verbally followed by the creation of a written record to document compliance with and ensure adequate supervision of these obligations. In our view, even if the Division does not require that a new form be filled out, the broker-dealer would still have to create a new record to demonstrate compliance, which violates NSMIA. We encourage you to continue to explore options that do not create additional books and records issues.

III. Agenda Item 3C: Definition of Terms

While there are several definitional issues which we have previously identified, I would like to highlight four of those issues here.

First, we believe that the new law does not make all BDs, IAs and their sales representatives financial planners. The law does eliminate the automatic exemption for these entities but they, by their activities, must still satisfy the financial planner definition. A financial planner is defined as "a person who for compensation advises others upon the investment of money or upon provision for income to be needed in the future or who holds himself or herself out as qualified to perform either of these functions . . ." There are certainly instances in which an entity by its activities falls outside the definition of financial planner and the intent of the new law, including, for example, clearing BDs. There are also various registered and licensed representatives that support the sale to the end consumer that should not be included in the definition of a financial planner (*e.g.,* internal wholesalers, sales reps on trading desks, and other non-advisers). We encourage you to recognize this in your proposed regulations.

We are aware of the language under Sec. 1.7 (1) which states that BDs, IAs and sales reps "shall not violate the fiduciary duty toward a client imposed by NRS 628.020." Respectfully, we do not believe that this language makes all BDs, IAs and sales representatives fiduciaries. Rather, the duties are not imposed unless the entity is a financial planner, and an entity is not a financial planner unless it for compensation advises other upon the investment of money.

Second, there is much to be clarified in the language requiring that a financial planner disclose, at the time advice is given, any gain s/he may receive, such as profit or commission, if the advice is followed. At a minimum, we believe that advice should be defined and there should be some language describing what is meant by the term "profit." We believe it should also be made clear that an exact dollar amount is not required, that disclosure can come in a more narrative way, and that for IAs, disclosure of information contained in Form ADV is deemed sufficient.

Third, the law requires that a financial planner make diligent inquiry of each client to ascertain initially, and keep currently informed concerning, the client's financial circumstances and obligations and the client's present and anticipated obligations to and goals for his or her family. We believe that "family" needs to be defined, that compliance with FINRA Rule 2090 (Know your Customer) should be deemed sufficient, and that this obligation does not apply to a one-time recommendation. We further believe that there should be language making clear that at some point the obligation ends.

Finally, while we are not sure whether this is the appropriate subcategory to raise this issue or not, we respectfully ask you to clarify that the new law has no effect on arbitration agreements. NRS 628A.030, as amended, permits parties with standing to file new civil actions against BDs and IAs who are financial planners. We are concerned that the language, as it stands, could lead to confusion and increased filings in civil court that would be moved to arbitration. We respectfully request that, for the sake of clarity and efficiency – the proposed rules explicitly state that the new law does not affect the rights of any party in relation to the arbitration of any dispute under the Federal Arbitration Act or any agreed-to pre-dispute arbitration agreement.

IV. Agenda Item 3F: Conduct or registrants potentially exempt from the fiduciary duty

SIFMA believes that certain registrants and conduct should be exempt from the fiduciary duty requirement. I would like highlight five categories of exemptions today.

First, there are basic foundational activities of a relationship between clients and BDs, IAs and sales representatives where no specific personalized advice is given. Under Section 1.7 of the new law, you have the authority to "define or exclude an act, practice or course of business as a violation of the fiduciary duty." To ensure that investors continue to have access to education, guidance and services, we respectfully suggest you exclude the following (non-exhaustive) list of activities:

- Providing general research and strategy literature;
- Discussing general investment and allocation strategies;
- Seminar content that is not specific to a customer;
- General marketing and education materials that are not specific to a customer;
- Financial planning tools and calculators that use customer information but do not recommend specific securities;
- BD investing web sites where retail customers use tools to analyze securities to make self-directed investment decisions;
- Holding securities, including concentrated positions or other complex or risky investment strategies, at the customers' request in a nondiscretionary account;
- Taking and executing unsolicited customer orders;
- Account and customer relationship maintenance (*e.g.*, periodic contact to remind customers to rebalance assets to match allocations previously established, absent efforts to recommend changes to the allocation percentages):
- Needs analyses (*e.g.*, meetings to determine customers' current and any new investment objectives and financial needs);
- Pre-existing systematic investment programs (e.g., dividend re-investment programs and ongoing purchases of mutual funds and other investment products);

- Any conversation or action involving assets of a qualified retirement plan where the service provider is hired by the plan fiduciary to give information and assistance to plan participants;

- Providing ancillary account features and services (*e.g.*, debit card, cash sweep, and margin lending);

- Market making, absent efforts to recommend the traded securities;

- Underwriting, absent efforts to recommend the underwritten security;

- Referring customers to affiliated or third-party providers of financial or financially related services; and

- Use of social media to convey investment strategies to a broad audience.

Second, institutional investors and sophisticated governmental entities should be excluded from the fiduciary duty requirement. Currently, NRS 628A makes no distinction between natural persons, institutional investors, and sophisticated governmental entities – despite the fact that institutional investors and certain governmental entities are significantly more sophisticated and experienced in financial markets than the average retail investor. We believe the clear intent of these amendments is to protect retail investors and therefore respectfully request that dealings with institutional investors and certain sophisticated governmental entities be excluded.

Third, it is important for NRS 628A to be limited to customers with Nevada domiciles who have a financial planner registered in the state. Because NRS 628A is now a one-of-a-kind statute, any other proposal (*i.e.,* including all clients with Nevada-registered financial planners in the scope of the law) would lead directly to forum-shopping and could force Nevada courts to hear cases with only a glancing connection to the state. This is especially true for BDs and IAs, which often register in multiple states – if not all 50.

Fourth, as I previously mentioned, we believe that the new law does not make all BDs, IAs and their sales representatives financial planners but rather only those entities that satisfy the financial planner definition. We encourage you to recognize this by, for example, exempting clearing BDs and those that support the sale to the end consumer (such as internal wholesalers, sales reps on trading desks, and other non-advisers).

Finally, we echo our insurance colleagues' comments that both fixed and variable annuities should be excluded from NRS 628A.

We appreciate your time and consideration. I am happy to answer any questions.