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

VIA ELECTRONIC MAIL

March 1, 2019

Ms. Diana Foley
Office of the Secretary of State
Securities Division
2250 Las Vegas Blvd. North, Suite 400
North Las Vegas, Nevada 89030

Re: Proposed Fiduciary Duty Regulations

Dear Ms. Foley:

On January 18, 2019, the Nevada Securities Division (the Division) published its request for comment on draft regulations to be added to Chapter 90 of the Nevada Administrative Code (Proposed Fiduciary Duty Regulation or Proposed Regulation).[1] The Proposed Fiduciary Duty Regulation eliminates exemptions for broker-dealers, investment advisers and sales representatives from the definition of "financial planner" and imposes a related fiduciary duty on these firms and individuals.

The Financial Services Institute[2] (FSI) appreciates the opportunity to comment on this important proposal. We remain concerned that the Proposed Fiduciary Duty Regulation will have unintended consequences for financial advisors and their small businesses, and restrict Nevada residents from accessing affordable and comprehensive financial services. We urge the Division to avoid creating confusion and uncertainty for firms, financial advisors, and their clients by waiting to take further action until after the U.S. Securities and Exchange Commission (SEC) has finalized its Regulation Best Interest and mirroring its provisions. Absent that, we request the Division provide extensive clarification and adjustments to the Proposed Regulation.

Background on FSI Members

FSI is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors[3] and independent financial services firms. FSI's independent broker dealer

[1] Notice of Draft Regulations and Request for Comment, Nevada Securities Division, *available at:* https://www.nvsos.gov/sos/home/showdocument?id=6156

[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and 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 been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[3] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a

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. These independent financial advisors are self-employed independent contractors, rather than employees of the independent broker dealers. This means they are small-business owners with strong ties to their communities. They hire and pay their own employees, pay all their own overhead costs, pay self-employment taxes, and embody the entrepreneurial spirit.

According to a 2016 study by Oxford Economics, FSI members in Nevada support $316 million of economic activity in the state. This activity, in turn, supports 3,479 jobs including direct employees, those employed in the FSI supply chain (indirect), and those supported in the broader economy (induced). In addition, FSI members contribute nearly $19.7 million annually to state and local government tax collections. FSI members account for approximately 18% of the total financial services industry contribution to Nevada's economic activity.[4]

Discussion

FSI appreciates the opportunity to comment on the Proposed Fiduciary Duty Regulation. We remain concerned that the Proposed Regulation will result in reduced product choices for Nevadans and a loss of access to much needed retirement planning services. Much of the benefit of financial planning services results from an advisor's ability to encourage product diversification, and behavioral coaching: encouraging savings; establishing and maintaining long term strategies; and eliminating the emotional decision-making that often arises during periods of market volatility. These benefits are especially critical for lower and middle-class investors and it is imperative that they have access to financial education and guidance. Further, the Division should not finalize the Proposed Fiduciary Duty Regulation until the SEC publishes its final Regulation Best Interest in order to avoid confusion for the industry and investors. These concerns are discussed in greater detail below.

A. Background

On October 6, 2017, FSI participated in the Division's workshop to provide input on drafting the Proposed Fiduciary Duty Regulation.[5] Our oral testimony outlined FSI members' concerns about the potential consequences of the rule, specifically that the resulting higher industry costs will be passed on to the consumer in the form of reduced access to a range of investment products, services, and advice. We pointed to our members' experience implementing the now vacated Department of Labor Fiduciary Rule, which demonstrated that firms were limiting product choice for several reasons, including: the large fixed costs to establish the necessary data feeds from product manufacturers and mutual fund families; the increased risk of litigation; and the complexity of compliance. We remain concerned that the increased compliance and operational costs associated with the Proposed Regulation will unintentionally restrict our financial advisor members, their small businesses and Nevada residents from accessing affordable and comprehensive financial services.

We also expressed concern that the fiduciary duty may be interpreted to apply to financial advisors who do not have a meaningful presence in Nevada and to cover essential functions

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dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

[4] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

[5] Oral Testimony of the Financial Services Institute (October 6, 2017) (on file with author).

unrelated to individualized investment advice or services. We asked that subsequently proposed regulations: limit their scope to financial advisors and clients with Nevada domiciles; exclude basic functions involving incidental or unsolicited services such as customer education, guidance, and other tools essential to producing an informed investing public; and clarify that registered broker-dealers and their associated persons who follow the rules and standards of their primary regulator will be deemed to be in compliance with the Nevada fiduciary duty.

B. Impact on Nevada Investors

We are concerned that the Proposal fails to acknowledge the impact it will have on low and middle-income Nevadan investors' access to financial advice. There exists a large body of quantitative research and evidence that demonstrate the essential and constructive role played by independent broker dealer firms in this market. Research from a variety of sources has shown that investors who work with financial advisors save more and are better prepared for their retirement.

We are concerned that the approach taken by the Proposal ignores the importance of a holistic investment approach to saving for retirement and other important needs. This is particularly important for low-income savers. FSI financial advisor members assist clients with their total financial picture. FSI financial advisor members emphasize the importance of commencing and retaining retirement savings, encouraging employers to adopt plans and individuals to participate in those plans and/or IRAs. In fact, independent broker dealers, their affiliated investment adviser firms and their financial advisors have been instrumental in promoting retirement savings to segments of our population underrepresented in the retirement system. FSI financial advisor members help clients weather market volatility, where inexperienced retail investors often make impulsive and ill-informed decisions like buying securities at market highs and selling at market lows. They offer their skill and expertise to help clients navigate major financial pressures imposed by medical concerns, bankruptcy, deaths in the family, and caring for aging family members. They assist clients in providing for other types of financial needs, such as life insurance, to provide security to clients' family members as well as lifetime income and longevity protection in retirement. FSI financial advisor members protect investors from cashing out their retirement accounts for short-term needs and help prevent retirement asset "leakage." Finally, Nevadan investors need professional financial advisors to assist them with decisions related to estate and tax planning and making their assets last through their retirement. Nevadan investors must retain their ability to choose both the relationships with their financial professional and the products and investment vehicles they wish to utilize to meet their financial goals because research shows that investors who work with financial professionals save more, are better prepared for their retirement, and have greater confidence in their retirement planning.[6]

C. Potential Conflicts with Regulation Best Interest

On May 5, 2018, the SEC proposed the Regulation Best Interest rulemaking package (Proposed Regulation Best Interest) consisting of two proposed rules and interpretive guidance designed to enhance the quality and transparency of investors' relationships with registered investment advisers, registered broker-dealers, and their associated persons while preserving

[6] Claude Montmarquette, Nathalie Viennot-Briot, Centre for Interuniversity Research and Analysis on Organizations (CIRANO), The Gamma Factor and the Value of Advice of a Financial Advisor, available at https://www.cirano.qc.ca/files/publications/2016s-35.pdf

access to a variety of types of advice relationships and investment products.[7] The Proposed Regulation Best Interest extends to broker-dealers a duty to act in the customer's best interest in addition to imposing extensive disclosure and conflict mitigation requirements that go beyond existing suitability requirements. FSI has repeatedly expressed its support for a uniform best interest standard of care that is applicable to all financial advisors providing personalized investment advice to retail clients. However, we believe that the SEC is the appropriate jurisdictional agency to enforce such a standard, reflecting input from the Financial Industry Regulatory Authority (FINRA), state regulators, and other stakeholders. FSI is concerned that if the states each formulate their own fiduciary duty, this will create an unworkable patchwork of varying requirements creating confusion and uncertainty not only amongst firms and financial advisors but among their clients as well. FSI urges the Division to reduce this uncertainty by putting its rulemaking on hold until the SEC finalizes its Regulation Best Interest (which is anticipated no later than September 2019). Once Regulation Best Interest is adopted, the Division should ensure that its regulation mirrors the SEC's. We suggest clarifying that registered broker-dealers and their associated persons who comply with Regulation Best Interest will be deemed to be in compliance with the Nevada Fiduciary Duty.

D. <u>The Proposal will add complexity to an already complicated regulatory environment for broker-dealers, investment advisers, financial advisors, and investors.</u>

Independent broker-dealers and independent financial advisors are subject to comprehensive regulation and legal obligations under federal and state securities laws, rules, and regulations. The SEC regulates broker-dealers through its antifraud authority in the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), and certain Exchange Act rules. Under these rules, broker-dealers are required to deal fairly with their customers. Although broker-dealers are generally not subject to a fiduciary duty under the federal securities laws, courts have found broker-dealers to have a fiduciary duty in certain circumstances. As independent broker-dealers and financial advisors, our members are also subject to self-regulatory organization (SRO) rules, oversight, and frequent examinations. A broker-dealer may transact business only after it satisfies the membership requirements of an SRO, which is typically FINRA for registered broker-dealers interacting with the public. SRO rules require broker-dealers to commit to observe just and equitable principles of trade and high standards of commercial honor.

A broker-dealer's obligation to meet minimum business conduct requirements under SRO rules cannot be satisfied through disclosure and cannot be waived by a customer.[8] In addition, broker-dealers are obligated to disclose certain material conflicts of interest to their customers, and federal securities laws and FINRA rules strictly prohibit broker-dealers from participating in certain transactions that may present acute potential conflicts of interest.[9] Both the SEC and FINRA

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[7] U.S. Securities and Exchange Commission, Proposed Regulation Best Interest ("Proposed Regulation Best Interest"), 83 Fed. Reg. 21574 (May 9, 2018) available at: https://www.sec.gov/rules/proposed/2018/34-83062.pdf; Proposed Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, 83 Fed. Reg. 21203 (May 9, 2018) available at: https://www.sec.gov/rules/proposed/2018/ia-4889.pdf; Form CRS Relationship Summary; Amendments to Form ADV ("Proposed Form CRS"); Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles, 83 Fed. Reg. 21416 (May 9, 2018) available at: https://www.sec.gov/rules/proposed/2018/34-83063.pdf.

[8] See Securities Exchange Act of 1934 [Exchange Act] § 29.

[9] See, e.g. FINRA Rule 5121(a), (f)(5).

diligently pursue compliance through timely examination and vigorous enforcements.[10] The Proposal would overlay this regime with a complex regulatory framework that will raise new regulatory barriers to the availability of professional investment services for Nevada investors.

The creation of a new and distinctly different fiduciary duty for advice provided to Nevadans will serve only to exacerbate the existing lack of consistency in our regulatory system. Instead of increasing investor protection, the Proposal will foster investor confusion about professional standards. As recently noted by FINRA's Chairman and Chief Executive Officer, an effective regulatory environment would apply a consistent best interest standard across, at least, all securities investments, and have the examination and enforcement mechanisms to oversee compliance with the standard.

E. Preemption

Federal law preempts several of the Proposed Fiduciary Duty Regulation's provisions, which the Division should consider revising or removing. Section §103 of the National Securities Markets Improvement Act of 1996 (NSMIA) expressly pre-empts states from enacting regulations that impose new or different recordkeeping requirements than those established under the Securities and Exchange Act. The Proposed Regulation would likely require broker-dealers to create and maintain new records to demonstrate compliance with the Proposed Regulation. We believe this would result in pre-emption of the rule under NSMIA.

Further, Section 514(a) of the Employee Retirement Income Security Act of 1974 (ERISA) provides that it supersedes any and all state laws insofar as they relate to any employee benefit plan. While ERISA applies to "qualified accounts," and the Proposed Fiduciary Duty Regulation would apply only to "non-qualified" accounts, we are concerned that creating two different standards for different types of accounts would add unnecessary regulatory complexity and ultimately result in investor confusion, particularly if different rules apply to some of a client's accounts and other rules apply to the other types of client accounts.

F. Necessary Changes

a. Complicated and Confusing Disclosures

The Proposed Fiduciary Duty Regulation would impose complicated disclosure requirements that are likely to be inaccurate despite a financial advisor's best efforts to comply, causing unnecessary investor confusion rather than providing transparency. FSI supports requiring reasonable and streamlined disclosures to ensure industry participants effectively communicate their conflicts of interest to their clients and potential clients. However, any disclosure regime should take into account the value that investors place on their relationship with their financial advisor. As previously discussed, research shows that investors who work with financial professionals save more and are better prepared for their retirement.[11] While the sale of proprietary products and receipt of transaction-based compensation are not *per se* violations of the fiduciary duty, the regulation would require additional disclosures at the time the advice is

[10] In fiscal year 2014, the SEC reported a record 755 enforcement actions (up from 686 in 2013), with orders totaling $4.16 billion in disgorgement and penalties. U.S. Securities and Exchange Commission, SEC's FY 2014 Enforcement Actions Span Securities Industry and Include First-Ever Cases (Oct. 16, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184660.
[11] Montmarquette and Viennot-Briot supra. FN 6.

given. Financial advisors would be required to disclose the exact amount of any gain including fees, commissions, discounts or payments. This is nearly impossible to provide at the time of advice for many common types of compensation such as trailing commissions, commissions based on a percentage of assets managed, or other similar fees. These new disclosures are likely to be inaccurate despite a financial advisor's best efforts to comply and could unnecessarily confuse investors.

The Proposed Fiduciary Duty Regulation allows that if the exact amount of the gain is not known at the time the advice is given, financial advisors must disclose the fact that the gain may be paid, the manner of ascertaining the gain, and provide the amount actually received within a reasonable time period. In order to give financial advisors and firms greater clarity, we suggest that the Division expand Section 7.3 to deem financial advisors who receive gains (fees, commissions, discounts, etc.) based on a percentage and who annually provide statements of the correct actual calculations and charges to be compliant with the disclosure requirements of the proposal. We also suggest that the Division clarify that the definition of a 'reasonable time period' is set by law or the rules of a self-regulatory organization such as FINRA.

b. Definition of Investment Advice

The Proposed Fiduciary Duty Regulation's definition of investment advice is overly broad and likely to capture basic services where no individualized advice is given. We remain concerned that the Proposed Fiduciary Duty Regulation may have the unintended consequence of regulating certain key functions that involve incidental or unsolicited services, as well as customer education, guidance and other tools that are essential to producing an informed investing public. The Proposed Fiduciary Duty Regulation's definition of investment advice includes functions that do not relate to providing personalized advice, such as: analyses or reports regarding a security; discussing available fee options; providing a limited list of securities for consideration; or recommending another financial advisor. We urge the Division to clarify the definition of investment advice to exclude investor education such as: budgeting advice, providing general research literature, general investment and allocation strategies, marketing and education materials that are not customer specific, and planning tools and calculators that use customer information but do not recommend specific securities.

The Proposed Fiduciary Duty Regulation's definition of investment advice also includes providing advice or a recommendation regarding an insurance product or an investment by comparison to a security, or that includes the buy, sale or hold of a security. The sale of insurance and annuity products is already subject to existing suitability requirements by the Nevada Division of Insurance. In order to avoid imposing potentially conflicting regulatory requirements and to provide clarity for financial advisors and firms, we urge the Division to clarify that providing advice or a recommendation regarding an insurance product (even by comparison to a security, or that includes the buy, sale, or hold of a security) is excluded from the proposal's definition of investment advice.

c. Title Restrictions

We support the Division's intended purpose in restricting titles to prevent bad actors from using the term "advisor" to mislead customers. However, the title restrictions in the Proposed Fiduciary Duty Regulation are overly prescriptive and so broad as to be arbitrary and capricious. The consequence of the Proposed Regulation's title restrictions is that dual registrants cannot rely

on any of the rule's exemptions. FSI and other industry members are concerned that this will lead many firms to eliminate their brokerage businesses. A brokerage relationship can be more cost effective and better suited to the advice needs of investors with smaller accounts. The Proposed Regulation would make it more difficult for those with small balance accounts to choose whether to work with a broker-dealer or investment adviser based on their needs and preferences. It is critical that Main Street investors continue to have access to affordable financial advice, products, and services necessary to achieve their investment goals.

In its Proposed Regulation Best Interest, the SEC correctly adopted a principles-based standard for title restrictions: a broker-dealer and its associated persons would only be able to use the terms "adviser" or "advisor" in part of its name or title in communications with retail investors if it is registered as an investment adviser under the Advisers Act or with a state. Dually registered firms would be permitted to use the terms in their title, but only associated persons of the firm who are supervised by a registered investment adviser and provide investment advice on their behalf may use them. That is, an associated person who does not provide investment advice may not use the term "adviser" or "advisor" simply by virtue of the fact that they are associated with a dually registered firm. In order to avoid imposing potentially conflicting requirements, likely resulting in investor confusion, we urge the Division to wait until the SEC has finalized its Proposed Regulation Best Interest and align its title restriction provisions.

Further we are concerned that restricting the use of certain titles may lead bad actors to simply adopt other similarly misleading titles rather than solving the problem. Any financial advisor who uses the words "advisor, adviser, financial planner, financial consultant, retirement consultant, retirement planner, wealth manager, counselor, or other titles that the Administrator may by order deem appropriate" in their title, name, or biographical information, may neither limit their fiduciary duty, nor rely on any of the proposed exemptions. The provision stating the enumerated list of titles is not all inclusive adds to industry uncertainty and may perversely result in investor confusion if established businesses are forced to change their names, undermining their credibility and relationships of trust. Indeed, taken to its absurd conclusion, this restriction on the use of these terms in biographical descriptions would require a financial advisor who complies with the conditions of the corresponding exemption in every way, but who references their college job as a camp counselor in their biographical description to owe clients a fiduciary duty.

d. Additional Provisions Needing Clarification

As part of the rulemaking process, industry needs both notice of its obligations and clear instructions regarding the nature of its obligations. FSI is concerned that several provisions of the Proposed Fiduciary Duty Regulation will not provide the industry with sufficient regulatory clarity to fully comply. In order to ensure that financial advisors and firms understand the regulatory requirements, we suggest the Division clarify provisions related to its exemptions, the term reasonable commission, and breaches of fiduciary duty, which are discussed below.

While the Proposed Fiduciary Duty Regulation provides an exemption to [the] Ongoing Fiduciary Duty for Certain Broker Dealers and Sales Representatives Transactions (Exemption), it still imposes a fiduciary duty related to the specific investment advice provided. However, it is unclear when the fiduciary duty commences and concludes. We ask the Division to provide further

clarity surrounding the scope and duration of the fiduciary duty as it relates to all of the exemptions included in the Proposed Fiduciary Duty Regulation.[12]

Further, broker dealers and sales representatives can only rely on the Exemption if the facts and circumstances surrounding the transaction do not indicate the client reasonably expects ongoing investment advice. Because the Exemption is so narrowly tailored, in order for financial advisors to ensure they can rely on it, the Division should provide clear specific guidance as to what facts and circumstances would indicate that the client does not reasonably expect to receive ongoing investment advice.

The Proposed Fiduciary Regulation provides that it is not a breach of the fiduciary duty to receive transaction-based commissions for sales so long as it is in the client's best interest to be charged by transaction as opposed to other types of fees and the commission is reasonable. However, it does not define or provide any guidance as to what the Division considers to be reasonable. In order to provide firms and investors with greater clarity, we suggest that the Division incorporate by reference FINRA Rule 2121[13] to define 'reasonable commission' and may also consider providing specific guidance as to how firms can comply with this requirement.

The standards inherent in the Proposed Fiduciary Duty Regulation's descriptions of conduct that would breach the fiduciary duty are too vague. We ask the Division to clarify the use of the following terms: "adequate and reasonable due diligence;" "fails to adequately disclose all information regarding a potential conflict of interest;" and "recommends or charges a fee that is unreasonable." In order to ensure that financial advisors and firms adequately understand the regulatory requirements, the Division should clarify or remove these provisions. Further, the catch-all provision stating enumerated list of unacceptable conduct is not all inclusive and "other conduct may be considered a breach of the fiduciary duty" does not provide sufficient specificity to put the industry on notice as to its obligations. We suggest the Division remove or clarify it.

e. Burden of Proof and Effective Date

The Proposed Regulation provides that a broker-dealer and sales representative shall be presumed to owe a fiduciary duty to the client and have the burden of proving an exemption to that duty exists. We ask that the burden of proof be reversed so that a broker-dealer and sales representative shall be presumed *not* to owe a fiduciary duty to the client and the client would have the burden of proving such a duty exists in an arbitration, or a civil or administrative hearing.

The Proposed Regulation does not have an effective date. Industry needs both notice of its regulatory obligations and a period of time to ensure compliance with those obligations. If the Proposed Fiduciary Duty Regulation were to become immediately applicable, broker-dealers and investment advisers would be incapable of complying with it. At a minimum, firms will need to make systems enhancements and provide training in order to comply with the new requirements. We ask the Division to add an effective date of 24 months after publication of the final rule in order afford industry sufficient time to comply.

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[12] See Proposed Fiduciary Duty Regulation Sec. 2. Exemption to Ongoing Fiduciary Duty for Certain Broker Dealers and Sales Representatives Transactions (NRS 90.575, NRS 90.420, NRS 90.690); and Sec. 5. Exemptions to Fiduciary Duty Standard (NRS 90.575)

[13] FINRA Rule 2121, Fair Prices and Commissions *available at*: http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11539

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the Division on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

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