March 1, 2019

Diana Foley
Securities Consultant
Nevada Secretary of State's Office
Securities Division
2250 Las Vegas Boulevard North, Suite 400
North Las Vegas, NV 89030

Submitted Electronically – fiduciaryduty@sos.nv.gov

Re: Draft Regulations Regarding Fiduciary Duties of Financial Planners

Dear Ms. Foley:

The Institute for Portfolio Alternatives ("IPA")[1] submits the following comments in response to the Notice of Draft Regulations and Request for Comment issued on January 18, 2019 ("Proposal") regarding the fiduciary duties of financial planners to be added to Chapter 90 of the Nevada Administrative Code and Nevada Revised Statutes Chapters 90 and Chapter 628A, as modified by SB 383. We appreciate your consideration of the points addressed below.

The IPA has an immediate interest in applicable standards of conduct for financial professionals in Nevada as our members include both regulated broker-dealer firms and their investment professionals in your state and nationwide. IPA member firms support individual investor access to a wide variety of asset classes with low correlation to the equity markets and historically available only to institutional investors. These investment products have been held in the accounts of more than 3 million individual investors. With over $135 billion in capital investments, they remain a critical component of an effectively balanced investment portfolio and serve an essential capital formation function for national, state and local economies.[2]

As a preliminary matter, the IPA is concerned about the unintended consequences of differing state standards of conduct in addition to a soon to be released federal standard by the U.S. Securities and Exchange Commission ("Commission"). As you know the Commission has issued a regulatory notice

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1 On Monday, April 9, 2018, the Investment Program Association became the Institute for Portfolio Alternatives. The change reflects our organization's continued commitment to champion the portfolio diversifying investment industry.

2 For over 30 years the IPA has raised awareness of portfolio diversifying investment (PDI) products among stakeholders and market participants, including investment professionals, policymakers and the investing public. We support increased access to investment strategies with low correlation to the equity markets: lifecycle real estate investment trusts (Lifecycle REITs), net asset value REITs (NAV REITs), business development companies (BDCs), interval funds and direct participation programs (DPPs). Through advocacy and industry-leading education, the IPA is committed to ensuring that all investors have access to real assets and the opportunity to effectively diversify their investment portfolios.

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that its rules will be finalized by September 2019,[3] and has indicated its intent to complete those rules in the near future. Many financial professionals operate in multiple states. In order to comply with various and potentially conflicting state and federal standards, firms will have substantial operational costs (legal, personnel, technology/systems) in order to ensure compliance with multiple standards. These costs will have a direct impact on the availability and cost of financial advice for investors in Nevada.

The IPA is also concerned about the negative impact of imposing an overly broad and prescriptive fiduciary duty on financial advisory firms operating in Nevada that employee a transaction or commission-based business model. Following partial implementation of the U.S. Department of Labor's ("DOL") fiduciary rule, numerous studies[4] and anecdotal evidence showed the practical effect of the rule on investors and financial firms. Due to ambiguity in the rule's substantive provisions and a lack of clarity in its implementation, including the litigation risk associated with the best-interest contract exemption private right of action, the rule resulted in a shift away from commission-based brokerage services to fee-based and self-directed accounts.[5] These unintended consequences negatively impacted retail investors with small dollar accounts.

The impact of the DOL rule resulted in changes even within available brokerage services, such as the elimination of certain products, and asset and share classes.[6] These changes primarily impacted retirement accounts but they also impacted other types of accounts. Moreover, firms were considering additional changes that would impact service offerings, products, compensation structures and operational processes and controls. Ultimately, the DOL fiduciary rule, though well intended, resulted in significant costs both to financial firms and investors who did not have sufficient account minimums to maintain fee-based accounts and who could no longer receive personalized advice on self-directed accounts, among other direct and indirect impacts.[7] The IPA is concerned that the breadth of the

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[3] *See* SEC Regulatory Agenda at https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201810&RIN=3235-AM35.

[4] *See, e.g.*, Deloitte, The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors (Aug. 9, 2017), *available at* https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf; Harper Polling, Department of Labor Fiduciary Rule: National Survey of Financial Professionals (July 7-12, 2017), *available at* http://www.fsroundtable.org/wp-content/uploads/2017/08/17.07-FSR-Presentation-1.pdf; U.S. Chamber of Commerce, Fiduciary Rule: Initial Impact Analysis (Sept. 7, 2017), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2017/07/Fiduciary-RuleInitial-Impact-Analysis.pdf?x48633 (survey performed by FTI Consulting).

[5] "As of June 9th, 53% of study participants reported limiting or eliminating access to advised brokerage for retirement investors, impacting 10.2 million accounts and $900b AUM." Deloitte, *supra* note 4, at 11.

[6] "Products affected included, but were not limited to, mutual funds, annuities, structured products, fixed income, and private offerings. It was also noted that study participants had to limit asset classes for which a prohibited transaction exemption was not available (e.g., risk-based principal sales of non-investment grade debt, certain underwriting and new-issue activities)." Deloitte, *supra* note 6, at 13.

[7] A hearing before the House Financial Services Subcommittee on Capital Markets, Securities, and Investment on July 13, 2017 addressed the impact of the DOL fiduciary rule on clients and small accounts. For example, David Knoch, President of 1st Global in Dallas, Texas, testified that moving to a level fee method "will mean that clients who place trades less frequently will subsidize frequent traders" on a fee-based platform and that due to increased paperwork and operating burdens, "we have seen our affiliated financial advisors increasing the minimum account size to serve clients and even

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Proposal and limitations of the Episodic Fiduciary Duty Exemption ("Exemption") will accelerate a move from brokerage to fee-based accounts and will increase costs and/or eliminate the availability of brokerage services investors in Nevada. Ultimately, this outcome limits options for investors that do not want or do not have sufficient account minimums to maintain fee-based accounts.

The Proposal would impose new and additional requirements on broker-dealers and investment advisers in Nevada. The IPA is concerned that activities that qualify as "investment advice" is overly broad and extends beyond federal law definitions and interpretations. It appears that almost any information provided about a security to a client outside of the information "specifically contained in the security's offering documents" would be deemed investment advice. For example, general information such as price, historical performance or market research could be deemed advice. Moreover, the definition of investment advice does not clarify how the terms "advice" and "recommendations" differ, or how a recommendation can amount to advice. We are also concerned that the definition of investment advice would impose a fiduciary duty on insurance agents, and we question the impact on investors if advice can be given about either an insurance product *or* a security without any comparison of the two. Similarly, we believe that the following provisions do not constitute fiduciary investment advice or recommendations to buy, sell or hold securities and thus should be removed from the definition of investment advice: valuation (Sec. 4.1(b)), providing reports (Sec. 4.1(c)), account monitoring (Sec.4.1(d)), information about a type of account (Sec. 4.1(e)) or fee options (Sec. 4.1(f)) or recommending another financial professional (Sec. 4.1(k)).

The IPA would also recommend that the definition of investment advice be narrowed consistent with Rule 4512(c). Excluding institutional investors (and those with institutional accounts[8]) is consistent with long-standing broker-dealer practices, and FINRA books and records requirements. Further, we are concerned with limitations on the use of the Exemption. For example, Sec. 2.2(e) and Sec. 5.4 would effectively foreclose use of the most common titles by broker-dealers and registered representatives. Otherwise, these financial professionals would owe a continuing fiduciary duty after completion of a transaction. There is also uncertainty about the Exemption's scope and application. For example, the Nevada Securities Division ("Division") can add to the list of terms and titles in Sec. 5.4 at any time, adding an additional layer of uncertainty for financial firms. We suggest that any future terms or titles not have retroactive effect. Section 2.2(f) also raises the question of what general statements a registered representative can make in concluding a transaction with a client. If the representative suggests any

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ending relationships with clients whose accounts are not cost effective to continue to service." *See* https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-dknoch-20170713.pdf. Similarly, Jerry Lombard, President of the Private Client Group at Janney Montgomery Scott stated, "[u]pwards of 10,000 of our customer retirement accounts will be relegated to a 'no advice service' desk as they are too small for the risks imposed by the DOL or too costly to place in an advisory account." *See* https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-jlombard-20170713.pdf.

[8] An "institutional investor" is defined in FINRA Rule 2210(a)(4) to include, among others, any "institutional account." The term "institutional account" is defined in FINRA Rule 4512(c) as "the account of: (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million."

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future communication, the representative may be deemed to have an ongoing fiduciary duty. In addition, it is not clear when the fiduciary duty under the Exemption ends. In other words, at what exact point in time is "advice…received by the client, the transaction is complete." We are further concerned that the Proposal removes the construct of dual registration. For example, Sec. 3.2 presumes that a dual registrant is *always* acting in an investment adviser capacity and therefore may never rely on the Exemption. Finally, given the broad list of activities that constitute "investment advice," we are concerned that Sec. 2(b), which restricts use of the Exemption if a broker-dealer enters into a contract to provide investment advice, will cause the Exemption to be unavailable for most broker-dealers. Moreover, if a broker-dealer initiates a discussion about a transaction, again the Exemption will be unavailable under Sec. 2(g). Thus, the practical effect of these limitations is that most broker-dealers will be unable to rely on the Exemption and will thus have an ongoing fiduciary duty to provide investment advice.

The IPA questions the scope and application of a breach of the fiduciary duty. For example, Sec. 8.1(a) provides for a breach if a firm or representative fails to perform "adequate and reasonable" due diligence on a product or strategy. The IPA requests that the Division provide further guidance on complying with this standard. Moreover, it is not clear whether "adequate" and "reasonable" are intended to be identical or different standards. We appreciate that receipt of transaction-based commissions is not a per se violation of the fiduciary duty, but we request more clarification on meeting the "best interest" and "reasonable" standard set forth in Sec. 6.3. Section 8.1(c) states that a breach would occur if a firm or representative provides advice "without understanding" all of the risks and features of the product or strategy. We question how a firm could ensure that its representatives understand *all* risks and features.

While we appreciate that the sale of proprietary products is not a per se violation of the fiduciary duty, in Sec. 8.1(f) a firm must advise the client of "all risks associated with the [proprietary] product." The Proposal does not define "risk" or provide what level of risk disclosure would be deemed material. We suggest that any such disclosure should be consistent with federal law. Further, we are concerned that Sec. 8.1(g) would require disclosure of all potential and actual conflicts. Broker-dealers have historically developed policies and processes to identify "actual" conflicts but not potential conflicts.[9] We would suggest that this provision include a materiality qualifier. We believe that Sec. 8.1(k), read in combination with NRS 628A.030, may also provide greater and conflicting liability than under federal requirements. In addition, we request greater clarity on what would constitute an "unreasonable" fee, thus constituting a breach, under Sec. 8.1(j). Finally, we are concerned that the Division reserves the right to deem other conduct a breach of the fiduciary duty, leaving an uncertain business environment for firms.

We acknowledge that the Proposal allows the Division to adopt any fiduciary duty related rule approved by the Commission, and we encourage the Division to tailor any final rule consistent with the Commission's final Regulation Best Interest rulemaking. We encourage the Division in reviewing public comments to also consider the totality of the existing broker-dealer regulatory regime.[10] Finally, we are

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[9] *See, e.g.*, FINRA Rules 2241, 2242.

[10] FINRA Rule 2111 requires that "[a] broker's recommendations […] be consistent with his customer's best interests, and he or she […] abstain from making recommendations that are inconsistent with the customer's financial situation."

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concerned that the Proposal runs counter to federal standards for broker-dealers, and requires the making and keeping of records that are different or in addition to those required to be made and kept under the federal securities laws, which would be preempted.[11] In other words, this Proposal would necessarily require a broker-dealer to document its compliance with these new requirements. The Division should also consider preemption concerns with respect to ERISA, which would preempt state laws relating to employee benefit plans.

We respectfully request that the Division consider all of the points discussed above as it reviews public comments on the Proposal. If the IPA may be of any assistance, please do not hesitate to contact me or Anya Coverman, IPA's Senior Vice President, Government Affairs and General Counsel, at (202) 548-7190.

Sincerely,

Anthony Chereso
President & CEO, Institute for Portfolio Alternatives

Broker-dealers must deal fairly with their customers and "observe high standards of commercial honor and just and equitable principles of trade"; broker-dealers must have a reasonable basis for recommendations regarding securities in light of a customer's financial situation and needs; and a broker-dealer's recommendations must be consistent with its customer's "best interest," thus prohibiting a broker-dealer from placing its interests ahead of its customer's interest. FINRA provides examples of violations of this standard. FINRA also imposes additional product-specific suitability obligations, including those for variable annuities (Rule 2330), day trading (Rule 2130), direct participation programs (Rule 2310), index and currency warrants (Rule 2350 Series), options (Rule 2360) and security futures (Rule 2370). Finally, FINRA has rules related to fair prices (Rule 2121), prohibitions against trading ahead of customer orders (Rule 5320), front running (Rule 5270), and gifts (Rule 3220). FINRA has sought comment on proposed rules relating to non-cash compensation (proposed Rule 3221) and entertainment (proposed Rule 3222). We believe that FINRA provides a strong regulatory regime for broker-dealers.

[11] Section 15(i)(1)[11] of the Securities Exchange Act of 1934 ("Exchange Act") precludes a state from enacting regulations establishing "capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act]."[11] Under the Exchange Act, Rule 17(a)-4 requires broker-dealers to keep a record of all communications by a [FINRA] member "relating to its business as such." 17 CFR §§ 240.17a-4(b)(4).

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