March 1, 2019

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

Re: Draft Fiduciary Regulations pursuant to SB 383

Dear Ms. Foley:

The undersigned organizations write in response to the Securities Division's proposal to apply a state-based fiduciary standard to broker-dealers' and investment advisers' advisory activities. Given the unfortunate demise of the Department of Labor (DOL) Fiduciary Rule and the clear deficiencies in the Securities and Exchange Commission's (SEC's) proposed Regulation Best Interest,[1] we greatly appreciate states such as Nevada that are willing to step in to fill the regulatory void by providing the protections investors need and expect. Contrary to arguments from industry groups, Nevada is well within its authority in proposing this rule.

Several aspects of the Division's proposal are vastly more protective of investors than corresponding provisions in proposed Regulation Best Interest. These include the provisions in the Division's proposal that apply a fiduciary standard across an appropriately broad range of advisory activities. We urge the Division to retain those protections in a final rule. At the same time, other aspects of the proposal need to be clarified and strengthened in order to better achieve the intended improvement in protections for investors. Specifically, we urge the Division to clarify what's required under the fiduciary standard and to reinforce that standard with strong anti-conflict requirements. This will help to ensure that advice is not tainted by conflicts of interest, to investors' detriment.

It is unfortunate that insurance providers are statutorily exempted from the definition of who is considered a fiduciary by virtue of being a financial planner. This leaves investors vulnerable to harmful conflicted advice from purveyors of some of the highest-cost, most complex and opaque investment products on the market. However, we recognize that the Division has limited authority in this space, and we hope that either the legislature or the Insurance Division apply a fiduciary duty to insurance providers' advice in the near future.

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[1] *See, e.g.,* Letter from Michael Pieciak, NASAA President and Vermont Department of Financial Regulation Commissioner, to the Securities and Exchange Commission, February 19, 2019, https://bit.ly/2IytBAa.

I. Broker-dealers hold themselves out and function as investment advice providers who are in positions of trust and confidence with their customers. Applying a fiduciary duty to these relationships is entirely appropriate.

There are myriad ways in which broker-dealers seek to persuade the investing public that they are providing objective, trustworthy investment advice rather than mere sales pitches.[2] For example, brokerage firms and their registered representatives routinely market themselves as "financial advisors," "financial consultants," or "wealth managers," giving the impression of specialized advisory expertise. They commonly describe their services as "investment advice" or "retirement planning" and market those services as designed to serve customers' best interests. In holding themselves out as impartial experts, they seek to occupy positions of trust and confidence with their customers. The clear intent of this marketing is to convince investors that they should trust that their advisor will be looking out for their best interests and to encourage them to rely on their expertise and recommendations.

The harm to investors is immense when they reasonably, but mistakenly believe they are getting advice that's in their best interest based on a trusted relationship with their financial professional. In addition to paying higher costs, investors who rely on biased sales recommendations as if they constituted unbiased advice can end up facing unnecessary risks or receiving substandard returns. Cumulatively, these industry practices drain tens of billions of dollars every year out of investors' pockets and into the pockets of firms and their financial professionals. According to one study, Nevada IRA investors alone lose approximately $104 million a year as a result of conflicted advice.[3] The losses are even larger when considering all types of accounts and the full range of products sold within accounts.

Given how broker-dealers advertise and function as advisers in position of trust and confidence with their customers, it is entirely appropriate to apply a fiduciary duty to their advisory activities.

II. We strongly support the provisions in the proposal that would impose a uniform fiduciary standard on broker-dealers and investment advisers and apply that standard across a broad range of advisory activities.

Consistent with the advisory role that they play, the proposal requires both broker-dealers and investment advisers to comply with a fiduciary duty and applies that standard across a broad range of advisory activities. This stands in stark contrast to the SEC's proposed Regulation Best Interest, which maintains different standards for investment advisers' and broker-dealers' advice -- one standard that is fiduciary and one that is decidedly not. By applying a fiduciary standard to both types of advisory relationship, the Nevada proposal will ensure that, regardless of what type of professional an investor works with or the type of account they use, they will be protected by the same fiduciary protections. This is vitally important, since repeated studies have shown that

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[2] *See* Micah Hauptman and Barbara Roper, *Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways*, CONSUMER FEDERATION OF AMERICA, January 18, 2017, http://bit.ly/2jKUbFD.
[3] Heidi Shierholz and Ben Zipperer, *Here is what's at stake with the conflict of interest ('fiduciary') rule*, ECONOMIC POLICY INSTITUTE, May 30, 2017, https://bit.ly/2EQJ9gE.

investors do not distinguish between broker-dealers and investment advisers and expect both types of financial professionals to act in their best interests when providing investment advice.

A. Definition of Investment Advice

Unlike the SEC's proposed Regulation Best Interest, which provides a narrow application of its non-fiduciary "best interest" standard, this proposal applies a fiduciary standard across a range of advisory activities. The fiduciary duty is triggered when the broker provides investment advice to clients, manages assets, performs discretionary trading, uses a title designed to portray their services as primarily advisory in nature, or otherwise creates a fiduciary relationship with the client. Moreover, investment advice is itself broadly defined. Importantly, that definition includes several types of recommendations not captured by Regulation Best Interest:

- recommendations on the type of account that an investor should use;
- recommendations on the fee options an investor should choose; and
- recommendations of insurance products by comparison to securities or that include recommendations to buy, sell, or hold a security.

We strongly support this broad definition.

While it is implied by the current language, we urge the Division to clarify that the fiduciary duty also applies to recommendations to roll over or transfer accounts. These decisions often involve large sums of money, when the need for high-quality advice and the risk of being harmed by conflicts of interest are especially pronounced. In the vast majority of instances, such recommendations by broker-dealers or investment advisers include the purchase or sale of securities and therefore fit within the definition. But given how important rollover and account transfer decisions can be, we urge the Division to provide further clarity here.

B. Fiduciary Titles and Holding Out

Unlike the proposed Regulation Best Interest/Form CRS approach to titles, which is too narrow to be effective and too easy to evade, this proposal includes an appropriately broad holding out provision that triggers an ongoing fiduciary duty that follows the contours of the advisory relationship. Specifically, when a broker-dealer uses titles, names or biographical descriptions, or otherwise holds out as an advisor/adviser, financial planner/financial consultant, retirement consultant/retirement planner, wealth manager, or counselor, they cannot disclaim or limit their fiduciary duty to their client. In addition to its broad coverage, the proposal includes a backstop so as to discourage the creation of new titles designed to recreate the impression of being a trusted advice provider, stating that the Division reserves the right to restrict additional titles from use by persons who are not acting as a fiduciary. This is entirely appropriate in our view. We support this broad approach, which provides a strong signal to the industry that attempts to evade the rule will not be tolerated.

C. Ongoing Fiduciary Duty That Follows the Contours of the Relationship

Unlike proposed Regulation Best Interest, which treats even long-term relationships as if they consisted of a series of one-time recommendations that can be assessed in isolation, this proposal requires brokers to comply with an ongoing fiduciary duty that follows the contours of the relationship. The proposal includes an appropriately narrow episodic fiduciary duty

exemption for truly one-off transactions. It is only available where the facts and circumstances are clear, and neither party reasonably expects a continuing relationship or advice to be provided. Under these appropriately limited circumstances, a broker would not have an ongoing duty to monitor the investor's portfolio or keep informed regarding the client's financial circumstances. However, in all other cases where the investor's reasonable expectations are that the broker will provide ongoing services, a broker would have a duty to periodically monitor the investor's account and keep informed regarding the client's financial situation to ensure that the investor's portfolio remains on track.

Many investors are confused about the extent to which brokers in long-term relationships will monitor past recommendations to determine whether they need to be updated. And many investors reasonably believe, based on their interactions with their brokers, that their broker will provide ongoing services. Unlike proposed Regulation Best Interest, which would defeat investors' reasonable expectations about the nature of their relationship with their financial professional, this proposed approach would match the reasonable expectations of investors who have a long-term relationship with their broker. Accordingly, we strongly support it.

Importantly, the episodic fiduciary duty exemption does not allow for hat-switching by brokers and advisers. As a result, a dual registrant who is a fiduciary to a client with regard to an advisory account cannot limit its ongoing fiduciary duty with respect to recommendations that it makes for a brokerage account. This will ensure that investors with different types of accounts receive the same protections across the board. It provides the uniformity that industry has long touted as a benefit of SEC rulemaking but that the SEC chose not to provide.

III. Aspects of the proposal must be clarified and strengthened in order to better achieve the intended improvement in protections for investors.

While we strongly support the provisions, discussed above, that apply a fiduciary duty across a broad range of advisory activities, some aspects of the proposal suffer from weaknesses that are similar to weaknesses in the SEC's proposed Regulation Best Interest. To ensure that the proposed rule achieves its intended goal of improving protections for investors, it's critical that the Division give the fiduciary standard real meaning and reinforce that standard with strong anti-conflict requirements. This is necessary in part because of ambiguity that the SEC has helped to create regarding the obligations that fiduciaries owe to their clients. Clarifying that standard, and backing it by strong anti-conflict provisions, will help to ensure that advice is not tainted by conflicts of interest.

A. Definition of Best Interest

Similar to proposed Regulation Best Interest, the proposal doesn't define best interest. As a result, it's not clear how or whether the proposed standard improves on the existing FINRA suitability standard, which has also been described as requiring brokers to act in their customers' best interest. We urge the Division to define best interest in a way that clearly and meaningfully improves protections for investors beyond those provided under FINRA rules. Specifically, the Division should state that brokers and advisers must be required to recommend, from among those investments they have reasonably available to recommend, the investment or investments that they reasonably believe are the best option or options for the investor.

As part of this analysis, brokers and advisers would be required to consider the relative costs and risks to the customer whenever they are considering various investment alternatives or investment strategies to achieve the customer's goals. This does not mean that a broker would always be required to recommend the lowest cost or lowest risk option. But it does mean that a broker must take costs into account when determining what to recommend. Where the broker has two or more similar products or strategies reasonably available that accomplish the same goals, and otherwise present comparable risks and benefits, but where one product or strategy has lower costs, the broker must recommend the product or strategy with the lower cost.

B. Duty of Loyalty and Conflict Mitigation

The proposal's most serious shortcoming, in our view, is its failure to include substantive requirements to prevent brokers' conflicts of interest from tainting their recommendations. While some might view that as implicit in a fiduciary standard, the SEC has cast doubt on this interpretation, allowing disclosure of harmful conduct to satisfy its Advisers Act fiduciary standard. The SEC's proposed Regulation Best Interest wouldn't even prevent firms from artificially creating incentives – like sales quotas and bonuses for recommending certain products – that encourage recommendations that would reasonably be expected to result in recommendations that put the firm's interests ahead of the customers' interests. That is a weakness that the Nevada proposal, as currently drafted, appears to share.

To achieve a meaningful fiduciary standard that clearly improves protections for investors, it is critical that the Division make clear that brokers and advisers must act "without regard to their own financial or other interests." In addition, the best interest standard must be backed by requirements for firms to rein in the use of harmful incentives that encourage and reward bad advice. This includes cracking down on the use of sales contests, trips, bonuses, and quotas for meeting certain production requirements, for example, that are designed to encourage the sale of products and services that are most profitable for them, rather than those that are best for the customer. Conflicts that cannot be eliminated should be appropriately managed to ensure that they do not undermine compliance with the best interest standard.

It is also critical that the standard not allow firms and financial professionals to rely on disclosure alone to satisfy their fiduciary duty. There is simply no evidence that disclosure is effective in protecting investors from the harmful impact of conflicts. While we believe that it is not the Division's intent to allow disclosure alone to satisfy the fiduciary duty, it is not completely clear from the proposal whether the fiduciary duty can be satisfied through disclosure alone with regard to the sale of proprietary products. Therefore, we believe that the Division should clarify that the recommendation of proprietary products is not a *per se* breach of the fiduciary duty *so long as it otherwise complies with the fiduciary duty,* including the requirements that the recommendation nonetheless be in the client's best interest and the fees and compensation be reasonable. Similarly, the Division should clarify that the receipt of transaction-based compensation does not constitute a *per se* breach of the fiduciary duty *so long as it otherwise complies with the fiduciary duty*.

IV. Arguments that this proposal would be preempted if it were enacted have no merit.

We expect that members of the broker-dealer and investment adviser community will argue that the proposal would be preempted by federal law. However, the National Securities Markets Improvement Act (NSMIA) preempts states only in specifically enumerated areas, none of which are implicated here.[4]

The Securities Industry and Financial Markets Association (SIFMA), the Financial Services Institute (FSI), and other industry groups incorrectly argue that the reference to recordkeeping in NSMIA precludes states from promulgating a fiduciary duty for brokers' advice. They erroneously claim that any heightened state-based standard of conduct that might cause a firm to *voluntarily* keep a record that isn't also required under federal law would be preempted. This is clearly wrong. Merely because a firm may *voluntarily* choose to adopt more rigorous recordkeeping practices for their own business purposes does not mean that the firm is legally required to do so. Nothing in the proposal imposes an affirmative obligation on broker-dealers to keep new or additional records. And the simple fact is that existing recordkeeping requirements under federal law should provide more than an adequate basis to determine whether a firm complied with or violated this fiduciary proposal. Moreover, states can and often do impose fiduciary duties on brokers in specific circumstances, despite the fact that there is no federal fiduciary duty for brokers.[5] This further demonstrates that their interpretation of NSMIA's preemptive effect is misguided.

V. Conclusion

The Department's proposal provides a model for how to extend a fiduciary standard to the broad array of services that investors reasonably rely on as fiduciary investment advice. As such, it helps to ensure that Nevada investors will receive uniform protections regardless of whether they rely on a broker-dealer or investment adviser for investment advice. (The one gaping loophole in this approach – its failure to include insurance agents – is unfortunately outside the Department's purview.) Having cast an appropriately broad net, the Department should clarify the meaning of the proposal's best interest standard and should strengthen restrictions on harmful conflicts of interest. If the Department does these things, it will provide a model that both the SEC and other states could emulate to protect vulnerable investors.

Thank you for your consideration of our views.

Alliance for Retired Americans
Americans for Financial Reform Education Fund
Better Markets
Center for Economic Justice
Consumer Action

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[4] *See, e.g.*, Letter from A. Valerie Mirko, Esq., General Counsel, North American Securities Administrators Association, Inc., to Honorable Herbert Lemelman, Presiding Officer Office of the Secretary of the Commonwealth of Massachusetts, March 30, 2017, https://bit.ly/2GC1Wg5.

[5] The SEC acknowledges this in its proposed Regulation Best Interest, stating, "[A] broker-dealer may have a fiduciary duty under certain circumstances. This duty may arise under state common law, which varies by state." Regulation Best Interest proposal footnote 15 at 14.

Consumer Federation of America
Committee for the Fiduciary Standard
Culinary Union
EPI Policy Center
Legal Aid Center of Southern Nevada
Make the Road Nevada
National Employment Law Project
Nevada Women's Lobby
Progressive Leadership Alliance of Nevada Action Fund
U.S. PIRG
Woodstock Institute