Insured Retirement Institute



August 25, 2017

Ms. Diana Foley
Securities Administrator
Office of the Secretary of State
Securities Division
555 East Washington Avenue, Suite 5200
Las Vegas, Nevada 89101

RE: Ch. 322, Laws of 2017 (Amendments to NRS 628A) Rulemaking

Dear Administrator Foley:

We the undersigned trade associations appreciate your continued engagement with the industry on SB 383 (now known as Ch. 322, Laws of 2017). As you are aware, this new law removes the exemption for broker-dealers (B-Ds), investment advisers (IAs) and sales representatives from the definition of "financial planner" in NRS 628A and adds a new section to NRS Chapter 90 stating that B-Ds, IAs and sales reps "shall not violate the fiduciary duty toward a client imposed by NRS 628A.020."

We understand that you are currently drafting proposed regulations. Per your request, we have provided a brief outline of some of our primary concerns (in no particular order) that we hope you will take into account during the drafting process.

- Not All B-Ds, IAs, and Sales Representatives Will Meet the Definition of Financial Planner. While the new law eliminates the exemption for B-Ds, IAs and sales representatives, we respectfully suggest that it does not automatically make all of these entities "financial planners." They, by their activities, must still satisfy the financial planner definition. There are certainly instances in which an entity falls outside the definition of financial planner and the intent of the new law, including, for example, clearing B-Ds. 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.

As noted above, the new law states that B-Ds, IAs and sales reps "shall not violate the fiduciary duty toward a client imposed by NRS 628.020." Respectfully, this also does not mean that all B-Ds, IAs and sales representatives are fiduciaries. Rather, the entity must first satisfy by its activities the definition of financial planner for the duties to be applicable.

- Certain Foundational Activities, or Activities Not Providing Specific Advice, Should Be Excluded by Rule. There are basic foundational activities of a relationship between clients and B-Ds, 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;
  - B-D 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 financial related services; and
- Use of social media to convey investment strategies to a broad audience.

- Developing A New Fiduciary Standard is Problematic. As you know, the industry has several federal and state regulators. We remain concerned that laws such as the one in Nevada will result in inconsistent definitions and interpretations as to what constitutes a fiduciary and subject financial professionals and firms to a confusing and potentially contradictory array of requirements. We encourage you to tie any specific requirements to FINRA Rule 2111,[1] FINRA Rule 2330 regarding variable annuities,[2] FINRA Regulatory Notice 12-25 and various interpretive guidance.

  We further understand that you are considering using the DOL Fiduciary Rule as a basis for your state law. While we appreciate your interest in trying to achieve consistency, the DOL Rule, as currently drafted, has significant flaws, including limiting investor choice in how to pay for retirement services, reducing access to investment advice, and limiting investor choice in retirement products. Further, we are concerned that there are fundamental differences in the DOL Rule as compared to current securities regulation that may lead to investor confusion and create ambiguity for financial services firms. Several of us have sent letters in response to DOL's recent rulemaking request which lay out some of these concerns.[3]

  SIFMA also commissioned a study by Deloitte (summary) which found that, because of the DOL Fiduciary Rule:

  - 53% of study participants have eliminated or limited access to brokerage advice services;
  - the shift of retirement assets to fee-based or advisory programs has accelerated; and
  - virtually all study participants have made changes to products available to retirement investors, with, for example, 29% eliminating No Load funds from their brokerage platform.

  Mirroring the DOL Fiduciary Rule – particularly if you intend to apply it beyond retirement accounts – would exacerbate the harm.

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[1] For a more in-depth discussion of FINRA Rule 2111 and its existing best interest standard, *see* "Joint Trades Letter to Diana Foley, RE: NV SB 383," dated June 23, 2017, p. 2.

[2] As a matter of parallel, consistent regulation, the NAIC Suitability in Annuity Transactions Regulation imposes suitability and supervision standards for fixed annuity sales that are modeled on FINRA Rule 2330. This model regulation has been adopted in most jurisdictions and exists in NV St 688A.450.

[3] Submissions from: SIFMA (1 - 2), ACLI (1 - 2) ADISA, BDA (1 - 2), FSI (1 - 2), IRI (1 - 2), U.S. Chamber of Commerce (1 - 2), NAIFA (1 - 2), joint filing.

The increasing movement by firms and financial professionals to a fee-based business model could result 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, these accounts generally have higher fees and minimum asset requirements for investors of $250,000 or more. This will result in many lower and middle-market investors who typically have $50,000 to $100,000 to invest losing access to both financial products and professional advice and services.

Moreover, it is difficult to mirror the DOL Rule since it is currently under review and the DOL has recently stated that it is seeking a second, 18-month implementation delay.[4] A decision by the Fifth Circuit in the coming weeks on the Rule's legality may also have implications for any Nevada rule built upon the DOL fiduciary structure. It is also premature to base the Nevada regulation on the DOL Fiduciary Rule in light of the SEC Chairman's June 1, 2017 *Request for Information on Standards of Conduct for Investment Advisers and Broker-Dealers*[5] and the mutual commitment of SEC Chair Clayton and DOL Secretary Acosta to a coordinated endeavor to develop a best interest standard that could uniformly apply across multiple regulatory frameworks. If you use the DOL Fiduciary Rule as a basis, we would encourage you to wait for the Fifth Circuit decision, the coordinated actions between the SEC and DOL to develop a best interest standard, and the Rule's final implementation before moving forward.

- Institutional Investors and Sophisticated Governmental Entities Should Be Excluded from NRS 628A. Currently, NRS 628A makes no distinction between natural persons, institutional investors, and certain sophisticated governmental entities despite the foundational differences between these groups of investors– including but not limited to their varying needs and level of sophistication. Institutional investors and certain governmental entities are significantly more sophisticated and experienced in financial markets than the average retail investor, thus interactions between B-Ds, IAs and institutional and sophisticated governmental entity clients are very different from those with retail investors. It would be problematic to force all of these lines of business into an awkward "one-size-fits-all" state-level regulatory framework (especially when NRS 628A.020 includes requirements referencing the needs of family members). 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.

- Variable Annuities Should Similarly Be Excluded from NRS 628A. We understand that fixed annuities are not included in the scope of NRS 628A as they are purely insurance products and are expressly excluded from the definition of security under state securities law.[6] While variable annuities are neither expressly included nor excluded, we believe that they should also be outside the scope of the forthcoming Nevada rulemaking. The U.S. Supreme Court determined that variable annuities have both insurance characteristics that are subject to state insurance regulation and securities characteristics that are subject to Federal securities regulation.[7] We

[4] *Thrivent Financial for Lutherans v. R. Alexander Acosta, U.S. DOL*, Document 87, Civil Action No. 16-cv-03289-SRN-DTS (D. Minn.)

[5] https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31

[6] *See* NRS 90.295, which expressly defines "security" to exclude "an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed sum of money either in lump sum or periodically for life or some other specified period."

[7] See, SEC v. Variable Annuity Life Insurance Company, 359 U.S. 65 (1959).

encourage you to review NRS 688A.390(4) which states that, "Notwithstanding any other provision of law, the [Insurance] Commissioner has sole authority to regulate the issuance and sale of variable contracts, and to issue such reasonable rules and regulations as may be appropriate […]" Life insurance companies and their associated persons currently comply with a comprehensive array of regulation administered by state insurance departments, the SEC, the Department of Labor, FINRA and various state securities divisions and departments. Quite simply, the insurance industry distribution and sales process is one of the most heavily regulated of the financial services available in the marketplace today. It is important for Nevada regulators to carefully consider the extensive regulatory framework governing fixed and variable annuities to avoid redundant and potentially conflicting standards. [8] Collectively, this body of laws provides significant consumer protection. Additional layering of regulation thwarts effective, efficient regulation.

- The Proposed Rules Should Limit the Scope of NRS 628A 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 B-Ds and IAs, which often register in multiple states – if not all 50.

- Pre-emption Remains a Significant Concern. In our June 23 letter,[9] we detailed our pre-emption concerns. We reiterate them by reference here. In addition, this limitation goes beyond preventing states from requiring a specific new form; it also prohibits any law or rule that would, by its nature, require B-Ds to keep records different than those required by federal law. Thus, for example, under the forthcoming regulations, even if Nevada does not create a new mandatory form, firms may need to document that they, for example, disclosed potential gains and remained cognizant of clients' present and anticipated obligations. We believe that that alone raises significant NSMIA implications.

- The Proposed Rules Should Clarify that the New Civil Cause of Action Would Not Affect Arbitration Agreements. NRS 628A.030, as amended, permits parties with standing to file new civil actions against B-Ds 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 removed 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.

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[8] A detailed discussion on the comprehensive scope of regulations governing fixed and variable annuities appears in the appendix to ACLI's submission on the 2015 DOL Conflicts of Interest Rule, beginning at page 58. *See* https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00621.pdf. *See also* Wilkerson, *Regulatory Retrospective: A Refresher on Selected Federal Securities Law Standards Governing Broker-Dealers and Investment Advisers Distributing Insurance Products While the Courts and the Trump Administration Sort Out the Status of the Department of Labor's Fiduciary Rule*, Association of Life Insurance Counsel Annual Meeting, (April 28, 2017), http://c.ymcdn.com/sites/www.alic.cc/resource/collection/AEED83CB-8E2F-43C8-9E7A-8A5138B2BD73/5.1.17%20DOL%20Update%20-%20Wilkerson.pdf

[9] "Joint Trades Letter to Diana Foley, RE: NV SB 383," dated June 23, 2017, p. 3.

- Under Certain Circumstances, The Exemption For Insurance Producers Applies When the Individual Holds Both Insurance and Securities Licenses. The exemption for insurance producers from the definition of "financial planner" found in NRS 628A.010(3) states that the exemption applies to "A producer of insurance licensed pursuant to chapter 683A of NRS or an insurance consultant licensed pursuant to chapter 683C of NRS, whose advice upon investment or provision of future income is incidental to the practice of his or her profession or business." NRS section 363A.050(3)(d) provides guidance as to when an insurance producer's activity in providing "advice upon investment or provision of future income" is incidental to the practice of his or her profession or business, stating that "A business primarily consists of the sale, solicitation or negotiation of insurance" if more than 50 percent of the annual income of the business from commissions is derived from the sale, solicitation or negotiation of insurance." In light of these provisions of Nevada law, it appears that the investment related activities of an insurance producer would continue to fall under the above-referenced exemption from the definition of financial planner and not be subject to the law's fiduciary duty so long as greater than 50% of the insurance producer's annual income from commissions came from his or her insurance activities.

- The New Law is Ambiguous and Raises Many Questions. Much of the language in the new law requires clarification. We have numerous questions that make compliance challenging. The two provisions provided below are illustrative but not exhaustive:

    - Under existing law, a financial planner must disclose, at the time advice is given, any gain s/he may receive, such as profit or commission, if the advice is followed. Just a few of the questions that have been raised include:

        (1) How is advice defined?
        (2) How do you calculate profit?
        (3) Presumably, an exact dollar amount is not required?
        (4) Can disclosure come in a more narrative way?
        (5) Who has the duty of disclosure – the B-D, the sales rep or both?
        (6) For IAs, is disclosure of information contained in Form ADV sufficient? and
        (7) Can disclosure be given prior to the time advice is given or will it go stale?

    - Similarly, 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. This also raises some questions, including:

        (1) How is family defined?
        (2) Is compliance with FINRA Rule 2090 (Know Your Customer) sufficient?
        (3) Does this apply to one-time recommendations? and
        (4) At what point does the obligation end?

The above represents what we believe to be some key considerations in the drafting of the forthcoming proposed rules. We thank you for both your time and consideration and look forward

to continuing to work with you to develop rules that preserve the spirit of Ch. 322, Laws of 2017 while fitting within the existing regulatory framework.

Sincerely,

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