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Submitted Electronically to fiduciaryduty@sos.nv.gov

Ms. Diana Foley
Securities Consultant
Nevada Secretary of State
Securities Division
2250 Las Vegas Boulevard North, Suite 400
North Las Vegas, Nevada 89030

Re: Draft Regulations under Amendments to NRS 90 and 628A Enacted by SB 383

Dear Ms. Foley:

The Insured Retirement Institute ("IRI")[1] appreciates the opportunity to provide these comments to the Nevada Securities Division (the "Division") on the draft regulations (the "Draft Regulations") issued by the Division on January 18, 2019, pertaining to Nevada Revised Statutes Chapters 90 and 628A, as modified by SB 383 (now known as Ch. 322, Laws of 2017) (the "Amended Statutes"). While we appreciate the extensive efforts undertaken by the Division to formulate a regulation to implement the Amended Statutes, we have significant and extensive concerns about the Draft Regulations.

The Amended Statutes impose a statutory fiduciary duty on broker-dealers and their registered representatives (collectively, "BDs") and registered investment advisers and investment adviser representatives (collectively, "IAs"). While the the legislature's desire to enhance the standard

[1] The Insured Retirement Institute (IRI) is the leading association for the entire supply chain of insured retirement strategies, including life insurers, asset managers, and distributors such as broker-dealers, banks and marketing organizations. IRI members account for more than 95 percent of annuity assets in the U.S., include the top 10 distributors of annuities ranked by assets under management, and are represented by financial professionals serving millions of Americans. IRI champions retirement security for all through leadership in advocacy, awareness, research, and the advancement of digital solutions within a collaborative industry community.

In 2018, our members had total annuity sales of $1.2 billion in Nevada. We count among our members more than 200 financial advisors located here in Nevada, affiliated with more than 15 different broker-dealer firms.

of conduct for financial professionals[2] who work with Nevada investors is commendable, we believe the Amended Statutes cast too wide a net in terms of the circumstances under which fiduciary status should apply. Fortunately, the Amended Statutes provided a mechanism to more appropriately tailor the application of the fiduciary duty by authorizing the Division to adopt regulations to further define this duty. To assist the Division in this important and challenging rulemaking effort, IRI provided oral and written testimony in connection with a workshop held by the Division in late 2017 (the "2017 Workshop"). Regrettably, rather than easing the overreach of the Amended Statutes, the Draft Regulations would actually exacerbate the problems created by the Amended Statutes.

Executive Summary

The following is an overview of our comments on the Draft Regulations:

General Comments

1. The Division should collaborate and coordinate with federal and state policymakers to develop appropriate, cohesive, and workable standard of conduct rules, and should not finalize the Draft Regulations until this effort is complete.
2. The Division should view this rulemaking as an opportunity to build and grow trust between investors and financial professionals.

Specific Comments

1. Recommendations of annuities and other insurance products are not "Investment Advice" under the Draft Regulations.
2. The Draft Regulations would impose an overly broad and ill-defined fiduciary duty to an overly expansive universe of financial professionals.
3. The Draft Regulations should take a more streamlined approach to compensation disclosure.
4. The Draft Regulations would require financial professionals to make and keep significant new records in order to comply with the fiduciary duty, and therefore are preempted by NSMIA.

[2] The term "financial professional" is used throughout this letter to refer to any individual who provides advice or recommendations about annuities or other insurance or investment products, including state-regulated insurance producers as well as securities-licensed representatives of broker-dealer or investment adviser firms.

5. A reasonable implementation period will be needed to ensure the industry has adequate time to develop the necessary compliance processes.

These comments are discussed in greater detail below.

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General Comments

1. *The Division Should Collaborate and Coordinate with Federal and State Policymakers to Develop Appropriate, Cohesive, and Workable Standard of Conduct Rules, and Should Not Finalize the Draft Regulations Until This Effort is Complete.*

During the 2017 Workshop, and in the written comments we submitted following the 2017 Workshop, we called the Division's attention to the ongoing national debate on this issue. Numerous policymakers with differing jurisdictions have been part of this debate, including the U.S. Department of Labor ("DOL"), the U.S. Securities and Exchange Commission ("SEC"), and the Financial Industry Regulatory Authority ("FINRA") at the federal level, as well as the North American Securities Administrators Association ("NASAA"), the National Association of Insurance Commissioners ("NAIC"), and the individual securities and insurance departments at the state level. Since that time, significant progress has been made on numerous fronts.

The SEC has a pending proposal to enhance the standard of conduct applicable to BDs under the federal securities laws (the "SEC Proposal"). We believe the SEC is the appropriate federal regulator to lead the development of a standard of conduct consistent with the principle that financial professionals should be required to act in their clients' best interest when providing personalized investment advice, while also preserving consumer choice and access to the products and services they need to achieve their financial goals. IRI and our members believe the SEC Proposal provides a solid foundation for appropriate enhancements to the standard of conduct for BDs.

Unlike the now-vacated DOL Rule[3], the SEC Proposal recognizes and seeks to preserve the important and valuable distinctions between different types of financial professionals. BDs and IAs simply have different relationships with their clients, and, as such, investors have different expectations depending on whether they are working with a BD or an IA. The principles-based

[3] As used in this letter, the term "DOL Rule" means, collectively, the final regulation defining the term "fiduciary" (the "Fiduciary Definition Regulation") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), the Best Interest Contract Exemption (the "BIC Exemption"), and the amendments to prohibited transaction exemption 84-24 (the "Amended PTE 84-24") issued by the DOL on April 8, 2016 and vacated *in toto* by the United States Circuit Court of Appeals for the Fifth Circuit on March 15, 2018.

framework embodied in the SEC Proposal will help investors understand the differences between BDs and IAs, thereby enabling them to make informed decisions about the type of financial professional that would best meet their needs.

We also support the decision to rely on existing SEC and FINRA enforcement mechanisms in the SEC Proposal; the private right of action that would have been created under the DOL Rule was among the most problematic aspects of that rulemaking and, in our view, has been appropriately avoided by the SEC. Moreover, the formulation of the best interest standard under the SEC Proposal would provide a clear and straight-forward compliance roadmap for firms and financial professionals.

NASAA has also expressed support for the SEC Proposal.[4] In a comment letter dated August 23, 2018, NASAA stated as follows:

> In sum, we believe *the Proposals represent a good initial step* but that significant improvements are needed in order to promulgate final rules that will serve the best interest of investors as the Commission intends. NASAA encourages the Commission to make modifications to the text of the proposed rules and to substantially reform its guidance on the Proposals prior to their adoption. *NASAA agrees that the Commission should act to address investor confusion regarding the different roles of investment advisers and broker-dealers* and that the Commission should raise the current standard of care applicable to broker-dealer recommendations from suitability to a standard akin to the fiduciary duties owed by investment advisers. We believe the Commission's approach of raising the standard for broker-dealers, while not weakening the current standard applicable to investment advisers, is the correct one. *NASAA supports the Proposals' effort to address conflicts of interest, improve fee transparency, restrict the use of potentially misleading professional titles, and clarify investment adviser conflict of interest obligations*. [Emphasis added.]

In an October 2018 interview with Wealth Management magazine, NASAA President Michael Pieciak, the Commissioner of Financial Regulation in Vermont, explained that NASAA has significant concern about "having a hodgepodge of rules," and believes that the SEC Proposal is "the clear path forward" and that "a uniform standard…is a better strategy." NASAA's most

[4] National American Securities Administrators Association, Comment Letter on Proposed Regulation Best Interest, Form CRS, and the Proposed Commission Interpretation Regarding Standard of Conduct of Investment Advisors (Aug. 23, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4259557-173080.pdf.

recent comment letter to the SEC re-iterates its commitment to working collaboratively with federal regulators to formulate a new standard for BDs.[5]

For its part, the NAIC has been working to develop enhancements to its Suitability in Annuity Transactions Model Regulation (the "NAIC Model") for more than a year. In recognition of the importance of a harmonized standard of conduct for annuities across regulatory platforms, the NAIC has indicated that its effort is aimed at development of a credible draft of modifications to the Model to use for meaningful engagement between the NAIC and SEC. NAIC leadership has further intimated that the NAIC is unlikely to adopt final modifications to the NAIC Model prior to final adoption of the SEC Proposal.

In addition, a small number of individual states have taken steps to create their own best interest or fiduciary rules. As with the Draft Regulations, we have specific concerns about each of those proposals.More significantly, though, in the broader context of the ongoing federal and state activities, these individual state proposals would create a patchwork of inconsistent, conflicting or duplicative rules that would significantly impair consumers' access to valuable financial products and professional assistance about whether, when, and how to use those products.

IRI and our members have been and will continue to be actively engaged in all of these efforts. Our engagement on this issue has been consistently guided by two core principles. First, we have long-supported the creation of a workable best interest standard for financial professionals that will effectively protect investors against bad actors without unduly restricting investors' ability to access the products and services they need to achieve their financial goals. And second, we have urged each and every policymaker to participate in a constructive dialogue with other interested regulatory bodies in order to establish consistent and clear standards for recommendations made with respect to all securities and insurance products.

As you consider how to move forward, we respectfully urge you to consider how the Draft Regulations will fit within the broader tapestry of regulations governing the conduct of financial professionals. We hope you will recognize the benefits of participating in these efforts and allowing time for them to play out so as to avoid the creation of duplicative, conflicting, or incompatible rules which could deprive Americans of access to valuable financial products and services.

[5] National American Securities Administrators Association, Inc., Supplemental Letter on Proposed Regulation Best Interest, Form CRS, and the Proposed Commission Interpretation Regarding Standard of Conduct of Investment Advisors (Feb. 19, 2019), https://www.sec.gov/comments/s7-07-18/s70718-4947456-178566.pdf .

2. *The Division Should View this Rulemaking as an Opportunity to Build and Grow Trust Between Investors and Financial Professionals.*

As noted above, IRI and our members believe financial professionals should be required to act in their clients' best interest when providing personalized recommendations. Although the vast majority of financial professionals already act in their clients' best interest, some investors remain hesitant to seek out professional financial advice. According to a new report from RAND Corporation and the SEC Office of Investor Advocate, trust is a major determinant in whether an investor will accept investment advice.[6] As part of the report, 45 percent of investors who do not currently receive financial advice indicated that it is difficult to find a trustworthy financial professional.[7] In addition, nearly a quarter of investors who do not currently receive financial advice do not believe that financial professionals are honest in their dealings with clients.[8]

Despite the reality that 97 percent of investors using a financial professional believe that their financial professional has their best interest in mind already[9], investors without a financial professional remain skeptical. Requiring financial professionals to act in their clients' best interest may encourage more investors to seek out the financial advice they need to better prepare for retirement. As Americans continue to live longer than ever before and access to defined benefit plans continue to diminish, it is critical that they receive the financial advice necessary to protect against longevity risk. Studies show that consumers who receive assistance from financial professionals save more throughout their working years, make better use of available retirement planning products and strategies, and experience better returns on their investments. Financial professionals have been shown to help consumers earn 1.59 percent in additional annual returns, which over time leads to 22.8 percent more income in retirement.[10]

The enactment of the Amended Statutes provides an opportunity for the Division to encourage more Nevadans to work with financial professionals by formulating rules designed to give investors confidence that financial professionals will act in their clients' best interest. Critical to

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[6] Rick Fleming, Investor Advocate, Office of the Investor Advocate, Investor Testing Regarding Standards of Conduct for Investment Professionals (Oct. 12, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4513005-176009.pdf.

[7] *Id*.

[8] *Id*.

[9] U.S. Chamber of Commerce, Supplemental Comment Letter on Proposed Regulation Best Interest, Form CRS, and the Proposed Commission Interpretation Regarding Standard of Conduct of Investment Advisors (Sept. 5, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4305949-173212.pdf.

[10] Insured Retirement Institute, Comment Letter on Proposed Regulation Best Interest, Form CRS, and the Proposed Commission Interpretation Regarding Standard of Conduct of Investment Advisors (Aug. 7, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4185630-172656.pdf.

this goal, however, is the avoidance of unnecessary compliance burdens that would adversely impact investors' access to professional financial advice. Many of our specific concerns regarding the Draft Regulations, as discussed in detail below, are focused on provisions that would unintentionally make it more difficult for many Nevadans to obtain the financial advice they need to achieve their goals.

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In addition to these general comments, we also have a number of specific comments and recommendations intended to improve the Draft Regulations. To be clear, however, the comments and recommendations discussed below would not – even if fully implemented – sufficiently address all of our concerns or produce a workable regulatory framework. We offer these specific comments in the spirit of providing constructive feedback, but we also firmly believe, for the reasons described above, that the Division should wait for the SEC and the NAIC to finalize their regulatory efforts before deciding whether and how to proceed.

Specific Comments

1. *Recommendations of Annuities and Other Insurance Products Are Not "Investment Advice" under the Draft Regulations.*

As we explained during the 2017 Workshop, annuities are the only products available in the private market that can provide retirees and pre-retirees with a source of income guaranteed to combat against longevity risk. Compared to non-annuity owners, Baby Boomers who own annuities are more likely – by more than a two-to-one ratio – to be among those who are most confident in living comfortably throughout all their retirement years. Baby Boomer annuity owners also are more likely to engage in positive retirement planning behaviors than Baby Boomer non-annuity owners, with 62 percent having calculated a retirement goal and 64 percent having consulted with a financial adviser (versus 31 percent and 19 percent of Boomers, respectively, who do not own annuities). And annuity owners are overwhelmingly middle-income, with eight in 10 having annual household incomes of less than $100,000.

As more fully explained in the letter submitted by IRI and eleven other trade groups on August 25, 2017, variable annuities are already subject to extensive regulation by the Nevada Insurance Division, the SEC and FINRA. An additional layer of regulation under the Draft Regulations is unnecessary and could create redundant and potentially conflicting standards. Nevada law recognizes this fact. Fixed annuities are expressly excluded from the definition of "security" under NRS 90.925,[11] and jurisdiction over variable annuities is expressly allocated to the Insurance Division under NRS 688A.390(4).[12]

Notwithstanding these provisions of Nevada law, the Draft Regulations define "Investment Advice" to include "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." We believe the intent of this provision is to acknowledge the limited circumstances under which the Division could already have jurisdiction over recommendations regarding insurance products or investments that are not securities (such as real estate or collectibles). We recognize that the Division may have jurisdiction when an insurance product is recommended in comparison to a security (e.g., where the financial professional specifically advises a client not to purchase a mutual fund and instead to purchase an annuity) or in connection with a recommendation to buy, sell, or hold a security. In fact, it could be reasonably argued that the inclusion of this provision is unnecessary, given that it simply restates the Division's existing limited jurisdiction over insurance products. We are concerned, however, that Section 4(1)(l), as currently drafted, could be interpreted as exerting jurisdiction over insurance products in the absence of these narrow situations.

***IRI's Recommendation*: If the Division decides to move forward with this rulemaking, Section 4(1)(l) should be revised as follows to avoid any confusion regarding the applicability of the Draft Regulations to insurance products:**

"providing advice or a recommendation regarding an insurance product or an investment that is not a security, but only if such advice or recommendation is made (i) by comparison to a security or (ii) in connection with advice or a recommendation to buy, sell~~, or that includes the buy, sale~~, or hold of a security."

2. *The Draft Regulations Would Impose an Overly Broad and Ill-Defined Fiduciary Duty to an Overly Expansive Universe of Financial Professionals.*

As drafted, IRI is concerned about the broad scope and ambiguity of the fiduciary duty imposed under the Amended Statutes. The Draft Regulations sweep far too many financial professionals within the ambit of the fiduciary requirements without providing workable exemptions. While

[11] "'Security'…does not include…[a]n insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or some other specified period…"

[12] "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 rules and regulations as may be appropriate…"

the Draft Regulations do include explicit exemptions if certain specified conditions are met, it is unclear to us how financial professionals could actually satisfy those conditions. Given that the Nevada Legislature provided the Division the power to exclude acts, practices, and courses of business from fiduciary regulation, we recommend that the Division provide more clarity regarding the scope of the fiduciary obligations and establish more appropriate conditions for the availability of the exemptions.

In particular, IRI is concerned about the triggering events as they are described in Section 1 of the Draft Regulations. Section 1 stipulates that broker-dealers or sales representatitves who provide “investment advice” must conform to the fiduciary obligations prescribed in the regulation. However, in Section 4 of the Draft Regulations, “investment advice” is given an unduly broad definition that seemingly includes third-party analysis or reports, providing platform lists to plan sponsors, and, as discussed above, recommendations regarding insurance products. By defining “investment advice” in such broad and sweeping terms, the Division is indicating that a host of financial services – disconnected from the Division’s mandate to define the statutory fiduciary standard – would be subject to fiduciary obligations. Using such broad terms is likely to have a chilling effect on the market for brokerage services and limit consumer access to these vital services necessary for Americans to reach their retirement security goals.

Additionally, Section 1 fails to provide broker-dealers guidance on when the fiduciary duty will be in effect. The Draft Regulations stipulate that BDs are acting as ficuiaries during time periods in which they provide investment advice along with when they furnish several other services. Several of these prescribed services in which the broker-dealer is required to act as a fiduciary are ill-defined. For instance, subsection (f) of Section 1 imposes a fiduciary duty on BDs through the completion of any contract; however, the rule is silent as to whether “contracts” includes only contracts between broker-dealers and their clients, or if it also includes investment contracts (in which case the fiduciary duty would last as long as the recommended investment is held by the client). Therefore, we suggest the Division consider clarifying the enumerated events in Section 1 to provide more detail on the scope and duration of the fiduciary status.

Section 8, which designates certain conduct as a breach of the fiduciary duty, is overly broad. The catch-all provision at the end of the section, which stipulates that the enumerated conduct is not all-inclusive, would hinder efforts by the industry to build compliance programs to meet their obligations under the Draft Regulations. The Division should enumerate all potential violations, so financial professionals can understand the intricacies of their responsibilities. Furthermore, IRI suggests that Section 8 be amended to include a *materiality* qualifier to protect financial professionals from dubious litigation based on non-material claims.

To properly tailor the fiduciary duty, the Division should also resolve confusion over the exemptions included in the Draft Regulations. The conditions for the Episodic Fiduciary Duty Exemption in Section 2 and the exemptions in Section 5 are so broad that it is difficult to conceive of circumstances under which a financial professional could actually qualify for them.

The Episodic Fiduciary Duty Exemption appears to recognize the distinction between transactional and ongoing advice, and we would support an exemption that actually facilitates the availability of transactional advice for Nevada investors.[13] As currently crafted, however, the exemption would discourage financial professionals from providing periodic investment plans for their clients or moving clients from advisory accounts into brokerage accounts, even when such moves are in the clients' best interest.

The exemption in Section 5 also presents fundamental issues. Because the exemption only applies to BDs who execute unsolicited transactions and avoid giving their clients "investment advice," the exemption is toothless. As noted above, the term "investment advice" is defined so broadly that it would be extremely difficult for a financial professional to interact with a client in any way without providing some form of investment advice.

The presumption that all BDs have a fiduciary duty regardless of their specific conduct, is similarly problematic, especially as it relates to financial professionals registered as both a BD and an IA. For any given client, a BD could provide non-fiduciary customer service and education, transaction-focused recommendations, and/or ongoing advice. As described throughout this section, the scope of the fiduciary obligations are broad and leave large gaps open to interpretation, potentially sweeping large volumes of activity that should be non-fiduciary under a fiduciary label. This presumption signals that any ambiguity left under the Draft Regulations will be construed against BDs who never intended to become fiduciaries. Including such a presumption will undermine compliance efforts and make financial professionals vulnerable to unwarranted legal attacks.

<u>IRI's Recommendation</u>: If the Division decides to move forward with this rulemaking, the Draft Regulations should be revised to (a) more narrowly define the types of conduct that would trigger the statutory fiduciary duty, (b) provide more workable exemptions to avoid improperly treating non-fiduciary conduct as subject to the fiduciary duty, and (c) provide a more clear and precise path for fiduciaries to satisfy their obligations.

[13] If the Division moves forward with this rulemaking, we would suggest that the Division re-name this exemption as the "Transactional Advice Exemption." We believe this name would more clearly distinguish among: (a) interactions other than advice; (b) transactional advice; and (c) ongoing advice.

3. *The Draft Regulations Should Take a More Streamlined Approach to Compensation Disclosure.*

IRI and our members are concerned that many investors will be overwhelmed and/or confused by the extensive, detailed compensation disclosures contemplated by Section 7 of the Draft Regulations. While financial regulation is largely premised on the belief that "sunlight is the best disinfectant" and that mandatory disclosures are necessary to inform decisionmakers, research has demonstrated that investors are too often blinded by the light. Psychological research has shown that when consumers are faced with the difficult task of sorting through detailed information, their cognitive performance tends to decline, making them unable to utilize the disclosed information properly. In short, more information is not always better, particularly when that information is peripheral to the decision at hand.

The SEC has recognized the problems associated with information overload and has taken steps to mitigate its consequences by adopting a layered disclosure framework, as embodied in its best interest rule proposal. The layered disclosure framework has been endorsed over the years by SEC Commissioners on both sides of the political aisle, including former Chairman Mary Jo White, who recognized that the "ever-increasing amounts of disclosure make it difficult for an investor…to ferret out the information that is most relevant."[14] Instead of burying consumers in an avalanche of information, layered disclosure recognizes that some information is inherently material to consumer decisions (e.g., the type of compensation a producer will receive), while other information is not inherently material but should be available on demand (e.g., the frequency of trail commission payments).

To be fair, we recognize the difficulty inherent in crafting disclosure requirements that strike the right balance between too much information and not enough information. In this case, however, we believe the Draft Regulations err too far on the side of too much information. For the vast majority of consumers, it would be sufficient to explain how their financial professional will be compensated and how the amount of compensation is determined, rather than how much compensation is paid. Put another way, consumers should be provided with information necessary to help them understand:

(a) that compensation will be paid;

(b) whether and on what basis the amount of compensation on a particular product might rise or fall;

[14] Speech by SEC Chairman Mary Jo White, *The Path Forward on Disclosure* (October 15, 2013), available at https://www.sec.gov/news/speech/spch101513mjw#_ftnref7.

(c) how the amount of compensation may vary among different products;

(d) what benefits, services, and value the producer will provide; and

(e) how to get more information, if so desired.

The Draft Regulations, however, seem to be premised on the notion that all consumers would want more information, and therefore requires that all investors be informed of the exact amount of compensation actually received by their financial professional. In our view, this level of specificity is not generally relevant to an investor's decision about whether to work with a particular financial professional or whether to purchase an annuity product from that financial professional. Moreover, this requirement would necessitate the development of a unique disclosure tailored to each investor's investment amount. Putting to one side the potential confusion and lack of comparability that might result in the absence of a standard and common set of assumptions for fees and charges, it would be extremely expensive for the industry to develop new systems to comply with these disclosure requirements.

In addition, as a practical matter, the exact amount of compensation paid to the financial professional commonly includes amounts calculated based on the amount invested and the performance of the investment, which may fluctuate over time. While paragraph 2 of Section 7 does acknowledge that the exact amount of compensation may not actually be known at the time advice is given, it would still require the exact amount to be disclosed within a reasonable time period. In many cases, the financial professional's compensation includes a trail commission paid on an annual basis based on the account value of a specified date each year. As currently formulated, the Draft Regulations would require financial professionals to send a disclosure of the amount of the actual amount of the trail commission they receive each year. It is unclear to us how this information would have any value to an investor.

Based on the foregoing, we do not believe detailed information about compensation should automatically be provided to every investor. We acknowledge, however, that some investors may want additional information about their financial professional's compensation, and therefore, we would not oppose a requirement to provide certain information upon request. In this regard, however, we would respectfully recommend that the Division expressly permit such additional information about compensation to be provided as amounts, percentages, or ranges of amounts or percentages, using hypothetical compensation examples based on standardized and common assumptions. We would be happy to work with the Division to formulate appropriate assumptions for use in calculating estimated compensation.

We have two additional comments regarding the treatment of compensation under the Draft Regulations. First, we are concerned that the term "gain," as used in the Draft Regulations, could be interpreted as including common employee benefits such as health insurance and access to a retirement savings plan. We do not believe this was the Division's intent, and we therefore ask that these types of employee benefits be expressly excluded from the definition.

Second, we do not believe the Division intended to favor any particular compensation arrangement over another. The current regulatory environment allows for a flourishing competitive marketplace in which product manufacturers and distributors employ different compensation models to meet customer demands. In seeking to provide greater protections for investors, the Division should take care not to disrupt the diverse business models that provide Nevadans access to critical retirement savings products. To achieve this goal, the Draft Regulations should expressly state that it does not favor one compensation model over another.

<u>IRI's Recommendation</u>: If the Division decides to move forward with this rulemaking, Section 7 should be revised to implement a layered disclosure approach under which investors would (a) automatically receive the most important basic information about compensation and (b) have the right to obtain more detailed compensation information upon request.

4. *The Draft Regulations Would Require Financial Professionals to Make and Keep Significant New Records in Order to Comply with the Fiduciary Duty, and Therefore are Preempted by NSMIA.*

As you know, the National Securities Markets Improvement Act of 1996 ("<u>NSMIA</u>"), expressly prohibits states from imposing certain regulations on BDs, including recordkeeping regulations that require broker-dealers to make and keep records that differ from, or are in addition to, the recordkeeping requirements imposed under federal securities law.[15] In our view, any regulation under which BDs would be subject to a fiduciary duty would run afoul of this prohibition. Based on our understanding of state fiduciary duties and the current federal recordkeeping requirements, we believe any fiduciary duty imposed on BDs would necessarily require them to create and maintain significant and extensive new records that are beyond the current federal recordkeeping requirements. These records would be necessary to demonstrate compliance with the new ongoing fiduciary obligations to client and, in some cases, to rebut the Draft

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[15] 15 U.S.C. 78o(h)

Regulations' presumption that BDs are acting as fiduciaries and fall within the enumerated exemptions.

While the Division has attempted to avoid preemption under NSMIA by affirmatively asserting that the Draft Regulations are not intended to create a recordkeeping obligation, we see no way for our member companies to defend themselves against regulatory enforcement actions or private litigation without creating extensive documentation to prove that they satisfied their fiduciary obligations. The omission of explicit recordkeeping provisions in the rule does not address the practical problems associated with requiring BDs to conform to a fiduciary obligation, and we do not believe this disclaimer is sufficient to accomplish its intended goal of avoiding preemption.

Moreover, it is clear from the SEC's own statements that the current federal recordkeeping requirements would prove insufficient to determine whether a broker-dealer met any fiduciary obligations.[16] When the SEC last amended the recordkeeping rule in 2001, it explicitly stated that the amendment was designed "to provide regulators, particularly State Securities Regulators, with access to books and records which enable them to review for compliance with suitability rules."[17] Nothing in the rule suggests that BDs would be required to maintain records necessary to determine whether they have satisfied an ongoing fiduciary duty.

Based on feedback from our members and our understanding of the purpose behind the latest amendment to the federal recordkeeping requirements, it is clear that the current recordkeeping structure would fall short of enabling the Division to determine whether a particular financial professional has fulfilled his or her fiduciary duty, nor would it allow BDs to present adequate defenses against alleged fiduciary violations in litigation. Therefore, regardless of the Divisions' disclaimer, the Draft Regulations would necessitate the creation of additional recordkeeping documents for examination purposes and to enable broker-dealers to raise adequate defenses, contrary to the explicit language in NSMIA.

In addition to violating the express preemption provided for in NSMIA, we also believe the Draft Regulations would undermine the delicate balance Congress sought to achieve in enacting NSMIA. NSMIA aimed to efficiently divide responsibility for the regulation of financial markets between the Federal and State governments. While the law preserves state antifraud authority and the ability to bring enforcement against fraudulent activity, it also created a broad-based

[16] Books and Records Requirementsfor Brokers and Dealers Under the Securities Exchange Act of 1934, 66 FR 55818 (Nov. 2, 2001).

[17] *Id*.

preemption against state interference in legitimate broker-dealer activity.[18] Beyond simply preempting states' ability to promulgate recordkeeping rules, NSMIA also prohibits states from enacting requirements on capital, custody, margin, financial responsibility, bonding, or reporting.[19]

Undoubtedly, the preemption provision is broad and reflects Congress' desire to have a centralized, predictable regulatory system.[20] While the states retain a significant role in combating fraud within their borders, crafting a one-of-a-kind fiduciary regulation certainly goes beyond the antifraud preservation included in NSMIA.

On a related note, the Draft Regulations also appear to apply to recommendations made in the context of retirement plans covered by the Employee Retirement Income Security Act of 1974 ("ERISA"). However, ERISA includes a broad and well-established preemption provision which effectively prohibits states from imposing any regulations on ERISA plans. State regulations that could otherwise apply to ERISA plans typically include exclusions for such plans, and we would respectfully urge the Division to incorporate such exclusions into the Draft Regulations to avoid running afoul of ERISA preemption.

***IRI's Recommendation**: If the Division decides to move forward with this rulemaking, it must reformulate the Draft Regulations to avoid imposing duties that would, in practice, require BDs to make and keep records not already required under federal securities law.*

5. A Reasonable Implementation Period Will be Needed to Ensure the Industry Has Adequate Time to Develop the Necessary Compliance Processes.

The regulatory changes contemplated by the Draft Regulations will, of course, require our members to develop and implement systems and operational changes to implement the new rules. For example, firms will need time to assess how exactly these regulations apply to their business model and create new procedures to ensure compliance. Given that the Draft Regulations are likely to evolve based on the comments submitted to the Division, we are not prepared to suggest a specific duration for the implementation period; rather, we respectfully

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[18] National Securities Markets Improvement Act of 1996, PL 104–290, October 11, 1996, 110 Stat 3416.

[19] *Id*.

[20] President on National Securities Markets Act Signing (Oct. 11, 1996), 1996 WL 584922, at *1 ("This legislation will save hundreds of millions of dollars for American businesses…. Broker-dealers will benefit from no longer being subject to dozens of differing State net capital and books and records requirements….These changes will all enhance our national capital markets, helping to create and nurture new businesses and new jobs, and enhancing the returns of both businesses and investors.")

encourage the Divison to consider how much time industry will reasonably need to implement the final rules.

> ***<u>IRI's Recommendation</u>: If the Division decides to move forward with this rulemaking, it should provide a reasonable amount of time following adoption for firms and individuals to come into compliance with the final versions of the Draft Regulation.***

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Thank you again for the opportunity to share our views on this important regulatory effort. As stated above, IRI and our members are supportive of appropriate enhancements to the standards of conduct applicable to financial professsionals. Unfortunately, the Draft Regulations approach this objective in a manner that will deprive Nevadans of access to a wide range of insurance and investment products, and to trained financial professionals who can help them choose which products are right for them. We think there are better ways to achieve our shared goal of requiring financial professionals to act in the clients' best interest, and we stand ready to help you find the right path forward.

If you have questions about anything in this letter, or if we can be of any further assistance in connection with this rulemaking, please feel free to contact me.

Sincerely,

Jason Berkowitz
Chief Legal & Regulatory Affairs Officer
Insured Retirement Institute