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2017 Changes to Nevada's Financial Planner Law Impose Fiduciary Duty on Investment Advisers and Broker-Dealers

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August 14, 2017 TO: ICI Members
Investment Company Directors
Bank, Trust and Retirement Advisory Committee
Broker/Dealer Advisory Committee
Investment Advisers Committee
Operations Committee
Pension Committee
Pension Operations Advisory Committee
SEC Rules Committee
Transfer Agent Advisory Committee SUBJECTS: Investment Advisers
Operations
Pension RE: 2017 Changes to Nevada's Financial Planner Law Impose Fiduciary Duty on Investment Advisers and Broker-Dealers

In 1993, Nevada enacted a law governing the activities of financial planners.[1] Aside from the definitional section, this law: (1) imposes a fiduciary, disclosure, and due diligence duty on financial planners (Section 628A.020, NRS);[2] (2) authorizes clients to sue a financial planner if the financial planner violates its fiduciary duty or any law of the state when recommending an investment or service, or was grossly negligent in advising the client (Section 628A.030, NRS); and (3) requires financial planners to maintain either insurance for liability or a surety bond (Section 628A.040 NRS).[3] The law imposes no registration, licensure, or qualification requirements on financial planners.[4] Until 2017, Nevada's law expressly excluded broker-dealers and investment advisers that were licensed under the State's securities act from the law's definition of "financial planner." Effective July 1, 2017, the law was revised to remove these exclusions.[5]

In addition to eliminating the exclusions for broker-dealers and investment advisers, the bill that effected these changes (Senate Bill 383) revised Nevada's Uniform Securities Act to prohibit a broker-dealer or investment adviser from violating the financial planner law and to authorize Nevada's securities administrator to (1) define or exclude acts, practices, or courses of business that would constitute a violation of the registrant's fiduciary duty under the financial planner law; and (2) prescribe means reasonably designed to prevent broker-

dealers and investment advisers from engaging in any act practice, or course of conduct that would violate their fiduciary duty. Such rules would be adopted under the State's securities act – not under the financial planner law.[6]

While there seems to be much consternation regarding these changes to Nevada law, when considering them, members should remember the limitations imposed on the states' authority under the National Markets Improvement Act of 1996 (NSMIA). Aside from preempting the states' authority over mutual funds, NSMIA also limited the states' authority over investment advisers and broker-dealers as discussed below.

NSMIA's Provisions Relating to Investment Advisers

Generally speaking, NSMIA divided the world of investment advisers into two groups: state-registered advisers and SEC-registered advisers.[7] For those advisers that post-NSMIA are only registered with the SEC, it is important to remember that NSMIA added new Section 203A(b)(a) to the Investment Advisers Act of 1940 to prohibit any state from requiring the registration, licensing, or qualification of any Federally-registered investment adviser. As explained by in the SEC Release implementing NSMIA's changes to the Investment Advisers Act, "section 203A(b) preempts not only a state's specific registration, licensing, or qualification requirements, ***but all regulatory requirements imposed by state law on Commission-registered advisers relating to their advisory activities or services, except those provisions that are specifically preserved by [NSMIA]***."[8] In other words, NSMIA's preemption would extend to any duties a state securities administrator attempts to impose on any Federally-registered investment adviser.

With respect to state-registered advisers, NSMIA also limits state authority. In particular, NSMIA added Section 222 to the Investment Advisers Act. Subsection (b) of this section prohibits any state from imposing on any out-of-state adviser any requirement "to maintain any books or records in addition to those required under the laws of the State in which [the adviser] maintains its principal place of business" if the adviser is registered in its home state and in compliance with such state's recordkeeping requirements. This preemption would extend to any obligation a state securities administrator adopts that has the effect of imposing a recordkeeping requirement on an out-of-state adviser.

NSMIA's Provision Relating to Broker-Dealers

NSMIA's preemptive provision relating to broker-dealers is in Section 15(i) of the Securities Exchange Act of 1940. This provision prohibits any state from establishing, by rule, regulation, order, or other administrative action, any "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 by the SEC or FINRA. [Emphasis added.] In other words, to the extent any state securities administrator attempts to impose any regulatory requirement that would require a Federally-registered broker-dealer to make or keep any record, such requirement is preempted by NSMIA. NSMIA would not preclude any state from adopting such requirements so long as they are limited in application to broker-dealers that are not Federally registered or a member of FINRA.

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endnotes

[1] Section 628A.010 of the Nevada Revised Statutes (NRS) defines "financial planner" to mean "a person who, for compensation, advises others upon the investment of money or upon provision for income to be needed, in the future, or who holds himself or herself out as qualified to perform either of these functions."

[2] In addition to affirmatively stating that a financial planner "has the duty of a fiduciary towards a client," Section 628A.020 of the law requires financial planners to: (1) disclose to a client, at the time advice is given, any gain (*e.g.,* a profit or commission) the financial planner may receive if the advice is followed; and (2) make diligent inquiry of each client to ascertain initially and on and ongoing basis the client's financial circumstances and obligations and the client's present and anticipated obligations to and goals for his or her family. Note that, unlike the Department of Labor's fiduciary standard, Nevada's financial planners law applies to all advice rendered without regard to whether the advice involves a retirement product.

[3] Financial planners must have at least $1 million in coverage through insurance or a bond.

[4] *Cf.* Nevada's Uniform Securities Act, Chapter 90 NRS, which imposes such requirements on investment advisers and broker-dealers.

[5] Nevada is not the only state that imposes a fiduciary duty on broker-dealers. According to a 2017 Connecticut legislative research report,

> [B]roker-dealers have been held to a fiduciary standard under some states' common-law. . . . Courts in at least four states (California, Missouri, South Carolina, and South Dakota) have explicitly imposed a fiduciary standard on broker-dealers. On the other hand, courts in 14 states have expressly held that a fiduciary duty does not exist between a client and a broker-dealer (Arizona, Arkansas, Colorado, Hawaii, Massachusetts, Minnesota, Mississippi, Montana, New York, North Carolina, North Dakota, Oregon, Washington, and Wisconsin). Minnesota and Wisconsin laws provide that a broker does not owe a fiduciary duty to clients unless there is a special agreement between the parties.

See Broker-Dealers' Standard of Care, Connecticut Office of Legislative Research (Report No. 2017-R-0033) (January 26, 2017).

[6] The Nevada securities administrator is currently soliciting input regarding the contents of any rules that may be proposed under this new grant of authority.

[7] Prior to NSMIA, investment advisers were required to be registered with the SEC and with any state in which the adviser conducted business.

[8] *See Rules Implementing Amendments to the Investment Advisers Act of 1940,* SEC Release No. IA-1633 (May 15, 1997). [Emphasis added.] NSMIA preserved to the states the authority to investigate and bring enforcement actions with respect to fraud and deceit.