



Getting the full picture

The emerging best interest and fiduciary duty patchwork

June 3, 2019

Preemption of state securities laws

With the recent announcement by the Securities and Exchange Commission (SEC) that it will hold an open meeting on June 5, 2019, to consider adopting Regulation Best Interest, one of the major issues that the SEC may clarify is its view of whether Regulation Best Interest preempts state securities regulations that impose a fiduciary duty on broker-dealers.¹

The North American Securities Administrators Association, Inc. (NASAA), recently submitted a supplemental comment letter to the SEC regarding the preemption of state securities regulations by Regulation Best Interest.² In its letter, NASAA argues that Regulation Best Interest does not preempt state securities regulations imposing a separate standard of conduct on broker-dealers, because such preemption was not contemplated by the National Securities Market Improvement Act of 1996 (NSMIA). The broker-dealer community has pushed back, urging the SEC to weigh in and indicate that Regulation Best Interest is intended to preempt these state securities initiatives.

Given these recent developments, we want to help set the stage and provide the framework regarding preemption of state securities laws.³

NSMIA Background

State securities regulators have historically retained parallel authority to regulate securities offerings as well as broker-dealer firms and their registered representatives operating in their state. However, in 1996, NSMIA amended various aspects of the federal securities laws and altered state jurisdiction over the regulation of securities issuances and distributions.

The amendments related to broker-dealers are codified in Section 15(i) of the Securities Exchange Act of 1934, as amended (the 1934 Act). More specifically, these amendments preempt state laws related to “capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements” applicable to broker-dealers that differ from, or are in addition to, the SEC’s requirements. In addition, these amendments require the SEC to periodically consult with state securities regulators regarding the adequacy of what the 1934 Act requires of broker-dealers.

NSMIA did not alter state authority to register, examine, investigate, or sanction broker-dealers and their registered representatives.

¹ See SEC’s Open Meeting Agenda for June 5, 2019, available at <https://www.sec.gov/news/openmeetings/2019/agenda060519.htm>.

² See NASAA Supplemental Comment Letter on SEC’s Regulation Best Interest (Apr. 25, 2019), available at <https://www.sec.gov/comments/s7-07-18/s70718-5416320-184548.pdf>.

³ We briefly note that this alert focuses on broker-dealers only. With respect to registered investment advisers, we note that Sections 203A(b) and 222 of the Investment Advisers Act of 1940 (the Advisers Act) already have the effect of preempting certain state laws impacting SEC-registered advisers. The SEC has historically interpreted Section 203A(b) of the Advisers Act to preempt not only a state’s specific registration, licensing, or qualification requirements, but also all regulatory requirements imposed by state law on SEC-registered advisers relating to their advisory activities or services, except for those provisions that are specifically preserved by NSMIA (generally relating to fraud). See SEC Advisers Act Release No. IA-1633 (May 15, 1997), available at <https://www.sec.gov/rules/final/ia-1633.txt>.

State Fiduciary Laws

The SEC's Regulation Best Interest initiative is separate from the laws and regulations that are being proposed, and, in some cases, adopted by various states and their securities regulators. Notably, Nevada and New Jersey have recently proposed (New Jersey) or already adopted (Nevada) laws that would impose certain "fiduciary" standards on financial services professionals. Nevada, which adopted a fiduciary standard by amending its financial planning statute in July 2017, recently has even proposed implementing regulations interpreting this new standard and applying it to broker-dealers and investment advisers.⁴ These newly proposed or adopted state standards of conduct would differ—in some cases, substantially—from the SEC's proposed "best interest" standard of conduct.

NSMIA Preemption

Given the potential dual layers of state and federal regulation in this area, there remains an unanswered question of whether the SEC's proposal would preempt these state laws.

The preemption categories covered by NSMIA do not explicitly include preemption of laws governing a broker-dealer's standard of conduct. However, if compliance with the new state fiduciary laws would require broker-dealers to maintain separate records not covered by the 1934 Act's requirements, arguably the state laws may be preempted by NSMIA.

SEC Clarity and Moving Forward

So now all eyes are on the SEC to see whether it will address this issue. Comment may be provided formally in the release, informally as part of the discussion in the open meeting, or not at all. We will know a lot more in just a few days.

⁴ See Nevada Securities Division, Notice of Draft Regulations and Request for Comment (Jan. 18, 2019), available at <https://us.eversheds-sutherland.com/portals/resource/NevadaProposal.pdf>.

Contacts

For more commentary regarding the emerging landscape related to the standards of conduct for investment professionals, visit Eversheds Sutherland's www.fiduciaryregulatory.com.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Eversheds Sutherland attorney with whom you regularly work.

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