



December 4, 2023

Ms. Amy Kopleton  
Broker-Dealer Market / Regulatory Policy and Review Project Group Chair  
North American Securities Administrators Association

Mr. Stephen Bouchard  
Broker-Dealer Section Chair  
North American Securities Administrators Association

*Sent via electronic email to [NASAAComments@nasaa.org](mailto:NASAAComments@nasaa.org)*

**Re: Proposed Revisions to NASAA's Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule**

Dear Ms. Kopleton and Mr. Bouchard:

The U.S. Chamber of Commerce (“Chamber”) Center for Capital Markets Competitiveness submits these comments in response to the North American Securities Administrators Association’s (“NASAA”) proposed revisions to its model rule on Dishonest or Unethical Business Practices of Broker-Dealers and Agents (“Proposal”).

The Chamber has serious concerns with the Proposal and its likely ramifications. The Proposal meaningfully diverges from the Securities and Exchange Commission’s (“SEC”) Regulation Best Interest (“Reg BI”), which was adopted in 2019 as a robust, national standard of conduct for broker-dealers. Reg BI has successfully established robust standards of investor protection and increased transparency for retail investors. NASAA itself concedes that broker-dealers have demonstrated “helpful and steady implementation progress” and “enhance[ed] their policies and procedures to focus more directly on Reg BI obligations.”<sup>1</sup> Nonetheless, NASAA is embracing a choose-your-own-adventure approach for states that could result in a disjointed patchwork of standards across 50 different jurisdictions. Investors would be left to fend for themselves to determine what standards apply in which states and what services or products may be restricted because of rules adopted by a particular state.

Equally concerning, the Proposal is being considered at the same time as the SEC’s “predictive data analytics” proposed rulemaking<sup>2</sup> and the Department of Labor’s (“DOL”) third try to redefine the definition of “fiduciary” under the Employee Retirement Income Security Act (“ERISA”).<sup>3</sup> All of these rulemaking initiatives – none of which are supported by robust economic

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<sup>1</sup> Report and Findings of NASAA’s Broker-Dealer Section Committee National Examination Initiative Phase II (September 2023) at 2-3.

<sup>2</sup> Securities and Exchange Commission, “Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers,” 88 FR 53960 (August 9, 2023).

<sup>3</sup> Department of Labor, “Retirement Security Rule: Definition of an Investment Advice Fiduciary,” 88 FR 75890 (November 3, 2023).

analysis or done in coordination with one another – represent a major regulatory threat to retail investors. Collectively, these rulemakings could cost brokers millions of dollars in recurring compliance costs.

Accordingly, the Chamber calls on NASAA to withdraw this proposal and synchronize its requirements with the SEC’s actual Reg BI rule. The Chamber wishes to express the following specific concerns with respect to the Proposal:

- 1. If adopted, the Proposal would result in a patchwork of state regulations that create confusion and an uneven playing field for investors.**
- 2. The definition of “recommendation” under the Proposal is more expansive than Reg BI and would cover basic communications between broker-dealers and their clients.**
- 3. Similar to the SEC’s predictive data analytics rule, the Proposal would mandate that broker-dealers “neutralize” certain conflicts of interests, a standard that does not currently exist under Reg BI.**
- 4. The Proposal would effectively prohibit the receipt of any compensation other than commissions.**
- 5. There appears to be no economic analysis accompanying the Proposal to support NASAA’s recommendations.**

These concerns and observations are discussed in greater detail below.

### **1. If adopted, the Proposal would result in a patchwork of state regulations that create confusion and an uneven playing field for investors.**

The adopting release for Reg BI states that a primary purpose of Reg BI is “establishing greater consistency in the level of retail customer protections provided and easing compliance across the regulatory landscape and the spectrum of investment professionals and products.”<sup>4</sup> Retail investors have a right to expect clarity and consistency when it comes to the rules and standards that apply to financial professionals who provide them with advice and investment recommendations.

However, NASAA’s Proposal runs contrary to Reg BI’s goal of greater consistency. Instead of seeking harmony with Reg BI, the Proposal provides states with a “menu” of options states can use to “define, clarify, or emphasize” the components of Reg BI that “matter most” to each jurisdiction.” While the Proposal does not say so explicitly, any encouragement to “define” or “clarify” certain Reg BI obligations can only be read as invitation to wholly rewrite aspects of Reg BI that an individual state regulator may not like. To be clear, state regulators have no authority to redefine terms or obligations that have been established by a federal regulator with longstanding and clear jurisdiction over broker-dealers. It is also impossible to determine what it would mean for a state to “emphasize” certain requirements or how they would decide what parts of Reg BI “matter most” to them.

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<sup>4</sup> Reg BI adopting release (June 5, 2019) at 43.

The section of the Proposal describing the menu of options for states also contains the following sentence: *“This approach provides flexibility while also promoting uniformity through standardized options.”* The inherent contradictions and nonsensical nature of this aspirational statement leads reasonable observers to assume that NASAA’s proposed standards will be impossibly complex for brokers and their clients to navigate.

It is exactly these kinds of uncertainties and impossible standards that Reg BI sought to avoid. The Proposal – if adopted – would be the start of a process that ends up with multiple and often conflicting broker-dealer standards across various states. This is not an outcome that Congress, the SEC, or any reasonable regulator or market participant would view as particularly beneficial for investors.

Additionally, the Proposal would create a legal minefield for any state that sought to implement rules that differ from Reg BI. Specifically, the National Securities Markets Improvement Act of 1996 (“NSMIA”) preempts any state regulation that mandates recordkeeping requirements which “differ from, or are in addition to,” federal law.<sup>5</sup> Congress felt compelled to pass NSMIA in order to avoid the “patchwork quilt of state regulation.”<sup>6</sup> The Congressional conference committee on NSMIA stated in its report that “[t]he system of dual Federal and state securities regulation has resulted in a degree of duplicative and unnecessary regulation...that, in many instances, is redundant, costly, and ineffective.”<sup>7</sup>

Congressional intent and the plain text of NSMIA and other federal laws are clear – Congress has sought to avoid the exact type of scenario that would ensue if NASAA’s proposed standards were permitted to go into effect. NASAA and its state regulator members must consider the plain text of the law and federal preemption statutes before making any further decisions regarding the Proposal.

## **2. The definition of “recommendation” under the Proposal is more expansive than Reg BI and would cover basic communications between broker-dealers and their clients.**

The Proposal would redefine a broker recommendation to include “any means, method or mechanism to feature or promote an account type, specific security or investment strategy to a retail customer, whether directly or through a third-party.”<sup>8</sup> Reg BI applies in cases of a “recommendation of a securities transaction or investment strategy involving securities (including account recommendations) to a retail customer.”<sup>9</sup>

In other words, Reg BI’s definition is tied to a communication to a customer about a specific recommendation intended for that customer. The Proposal’s definition, by contrast, could be read to include a firm’s website or other communication methods that provide basic descriptions of a firm’s services or products that they may offer. The Proposal offers no

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<sup>5</sup> 15 U.S.C. § 78o.

<sup>6</sup> Speech by then-SEC enforcement director Stephen Cutler (February 21, 2003), available at <https://www.sec.gov/news/speech/spch022103smc.htm>.

<sup>7</sup> National Securities Markets Improvement Act of 1996, HR 3005 Conference Report House Conf. Rep. No. 104-864 (Sept. 28, 1996).

<sup>8</sup> Subpart 1d(5) of Proposal.

<sup>9</sup> 17 CFR § 240.15l-1.

explanation or analysis into why Reg BI's concept of a recommendation is somehow insufficient and must be supplanted by the proposed language developed by NASAA.

Further, unlike Reg BI, the Proposal mandates that broker-dealers must consider "reasonably available alternatives" which would consist of investment alternatives that a state regulator determines to have lower cost and lower risk. This is a direct conflict with Reg BI, which stipulates a more holistic examination of alternatives by broker-dealers that includes an assessment of potential benefits, risks, and compatibility of the security that was recommended. In fact, Reg BI *prohibits* a broker-dealer from focusing solely on cost and "risk" of either a recommendation or a potential alternative. In this sense, Reg BI is appropriately product-agnostic and the standard in practice applies to all products that may be considered in connection with a recommendation. The Proposal would effectively preclude broker-dealers from recommending certain securities including NAV REITs, non-traded business development companies (BDCs), or other private offerings that could provide superior portfolio diversification and performance.

### **3. Similar to the SEC's predictive data analytics rule, the Proposal would mandate that broker-dealers "neutralize" certain conflicts of interests, a standard that does not currently exist under Reg BI.**

The Proposal would introduce a new requirement for brokers when dealing with conflicts of interest that does not exist under Reg BI. Under the Proposal, mitigating a conflict of interest means "neutralizing or reducing the potential harm or adverse impact of the conflict to the retail customer."<sup>10</sup> However, the word "neutralize" does not appear anywhere in the securities laws or in SEC regulation and can only be construed to mean that brokers would have to eliminate certain activities that could be perceived by regulators to present a conflict of interest.

Notably, the term "neutralize" in the context of conflicts is also a feature of the SEC's recently proposed predictive data analytics rule, suggesting that NASAA may be relying on a legally questionable SEC *proposal* as the basis for this new mandate. This further weakens the credibility of the Proposal and calls into question the process and analysis used by NASAA in developing these proposed revisions.

As explained in a recent joint trade association letter to the SEC regarding its predictive analytics rule:

Relying on its plain English meaning, "neutralization" is "to counteract the activity or effect of," "to render (something) ineffective or harmless by applying an opposite force or effect," or "to kill, destroy." It is unclear how this is substantively different in effect from eliminate, which means "to put an end to or get rid of;" to the extent the standard is substantively different, the release fails to articulate how it would work in practice. Therefore, with respect to all conflicts of interests associated with the use of covered technologies that place the firm's interest above investors' interests, the Commission would require elimination.<sup>11</sup>

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<sup>10</sup> Subpart 1d(2) of Proposal.

<sup>11</sup> Joint Trade Association Letter to the SEC regarding its proposed rulemaking "Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers" (September 11, 2023), available at [Trade-Associations-PDA-Comment-Letter-Final.pdf](https://www.centerforcapitalmarkets.com/Trade-Associations-PDA-Comment-Letter-Final.pdf) ([centerforcapitalmarkets.com](https://www.centerforcapitalmarkets.com)).

If states were to similarly adopt a rule that brokers “neutralize” activities perceived as conflicts, it would have wide-ranging ramifications and many firms would eliminate services or products that are necessary to properly serve their clients. “Neutralizing” conflicts is also a longstanding departure from SEC regulation and practice, which is grounded in a disclosure-based regime. Neither the SEC with its predictive data analytics rulemaking nor NASAA with this Proposal has adequately explained why disclosure of certain conflicts would be insufficient to protect investors. Such an explanation is necessary because disclosure is the preferred method for the important act of providing investment advice under the Investment Advisers Act and Reg BI.

#### **4. The Proposal would effectively prohibit the receipt of any compensation other than commissions.**

NASAA’s proposed revisions included a statement that a “broker-dealer or agent will be presumed to have placed its financial interest ahead of the interest of the retail customer where the broker-dealer or agent...rewards the broker-dealer or agent with additional cash or non-cash compensation beyond the sales commission as the result of that recommendation.”<sup>12</sup>

The effect of this prohibition would be to prohibit brokers from providing bonuses or other incentives that are not tied to the sale of specific securities or products. When adopting Reg BI, the SEC was careful to focus the prohibition on sales contest and sales bonuses to those involving the sale of specific securities within a certain period of time. The SEC specifically noted that incentives related to activities such as asset accumulation and growth are less likely to compromise compliance with Reg BI’s care obligation and conflict of interest obligation. By establishing this standard in Reg BI, the SEC rejected arguments that NASAA had made in its Reg BI comment letter regarding broad prohibitions against incentive-based compensation.<sup>13</sup>

Prohibiting any incentive or bonus payments “beyond the sales commission as the result of that recommendation” effectively means that NASAA is treating all pay aside commissions as presumptively illegal. Further, NASAA did not establish any type of connection between certain compensation arrangements and misaligned incentives to support a broad prohibition against any type of compensation other than a sales commission. Brokers will find it challenging to operate in states that elect to adopt this prohibition and will likely have to curtail their services and presence in those states. Again, this would be another harmful outcome for investors, particularly those with a modest level of savings who may be cut off from receiving financial advice from an investment professional.

#### **5. There is no economic analysis accompanying the Proposal to support NASAA’s recommendations.**

The Proposal would fundamentally alter the business practices of broker-dealers, affect the market for retail investor advice, alter the types of services and products available to investors, and raise compliance costs particularly for small broker-dealers and those firms focused on serving lower and moderate-income households. However, it appears that NASAA has not conducted any type of cost-benefit or economic impact analysis to assess the overall costs of compliance that

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<sup>12</sup> Subpart 1d(2) of Proposal.

<sup>13</sup> August 23, 2018 NASAA comment letter to the SEC on Regulation Best Interest proposal.

would be borne by broker-dealers, or the impact the Proposal will have on the retail investor advice market and individual investors.

It also appears that NASAA has not considered ongoing efforts at the federal level and state level – including the SEC’s predictive data analytics rule, the DOL’s fiduciary proposal, and the National Association of Insurance Commissioners’ (“NAIC”) Best Interest Model Rule – that affect the same regulated entities targeted by the Proposal. As the Chamber noted in our recent comment letter on the SEC’s predictive data analytics rule, the costs for many firms of that single rulemaking are likely to run into millions of dollars per year without producing any clear benefit.<sup>14</sup> It is imperative that NASAA at least gain a basic understanding of the economic effect of its proposed revisions across the 50 states where they could potentially be implemented.

### **Conclusion**

Much is at stake regarding NASAA’s proposals and other efforts by regulators to create divergent standards of care for retail investors. Millions of Main Street investors rely on the advice and professionalism of broker-dealers to help guide them through some of the most important financial decisions of their lives. Regulatory efforts that limit the ability of financial professionals to provide advice do not serve the best interests of retail investors. The Chamber urges NASAA to withdraw this Proposal and instead strive towards full alignment with Reg BI.

Sincerely,



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Center for Capital Markets Competitiveness  
U.S. Chamber of Commerce

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<sup>14</sup> U.S. Chamber of Commerce, Comment Letter to the SEC regarding its proposed rulemaking “Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers” (October 10, 2023), available at <https://www.centerforcapitalmarkets.com/letter/conflicts-of-interest-associated-with-the-use-of-predictive-data-analytics-by-broker-dealers-and-investment-advisers/>.