December 20, 2024

Via E-mail to comments@sos.mo.gov

The Honorable John R. Ashcroft
Secretary of State
P.O. Box 1767
Jefferson City, MO 65102

Douglas Jacoby
Securities Commissioner
600 West Main Street
Jefferson City, MO 65101

RE: Proposed amendments to repeal: Sections 3 and 4 of 15 CSR 30-51.170 (Dishonest or Unethical Business Practices of Broker-Dealers and Agents); and Section 4 of 15 CSR 30-51.172 (Dishonest or Unethical Business Practices of Investment Advisers and Investment Adviser Representatives); and

Proposed amendments to add: Section 1(I) to 15 CSR 30-51.169 (Fraudulent Practices of Broker-Dealers and Agents); and 15 CSR 30-51.174 (Fraudulent Practices of Investment Advisers and Investment Adviser Representatives) (each a Proposed Rule and collectively, the Proposals)

Dear Secretary Ashcroft and Commissioner Jacoby:

The Securities Industry and Financial Markets Association (SIFMA)[1] is a national trade association representing over 350 large, medium, and small broker-dealers, investment banks and asset managers, many of whom have a strong presence in Missouri. In fact, almost 145,000 people in the state work in the finance and insurance industries, more than 18,000 of them work at securities firms, and 48 broker-dealer main offices call Missouri home.[2]

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] *See* SIFMA, State-By-State: Capital Markets in the U.S. (https://states.sifma.org/#state/mo.)

SIFMA appreciates the opportunity to comment on the Secretary of State's latest rulemaking Proposals, which were published in the Missouri Register on December 2, 2024.[3] The Proposals would repeal the above-referenced sections addressing dishonest or unethical business practices for broker-dealers (BDs), agents, investment advisers (IAs), and investment adviser representatives (IARs) to comply with a federal court order.[4] The Proposals would also add to what constitutes fraudulent and deceitful practices of BDs, agents, IAs, and IARs to include "effecting any transaction with an investment objective that the customer has not authorized…."

SIFMA has substantial concerns with the Proposals. We believe they: (1) are unnecessary as existing law already requires securities professionals to act in their customers' best interest; (2) are federally preempted if they impose obligations beyond existing federal securities law; (3) are unconstitutionally vague; (4) require both public and private fiscal notes; and (5) should not jeopardize individuals' livelihoods by characterizing certain conduct as fraudulent or deceitful.

We strongly encourage you to withdraw the Proposals and work with us so that we can address improper conduct together. If you choose to move forward, the Proposals should characterize the offending conduct as "dishonest or unethical" rather than "fraudulent and deceitful." Hard-working professionals should not have their careers destroyed based on innocent mistakes, misunderstandings, or unproven allegations with no demonstration of actual harm or fraudulent intent.

I. The Proposals are unnecessary because robust existing securities laws already govern securities recommendations and investment advice.

The Proposals would prohibit BDs and registered investment advisers (RIAs) from "effecting any transaction with an investment objective that the customer has not authorized."

Federal securities laws (i.e., Regulation Best Interest (Reg BI) for BDs[5] and the Investment Advisers Act of 1940 (Advisers Act) fiduciary duty for RIAs)[6] already require securities firms and their agents to act in the best interest of their customers. Under these laws, BDs and RIAs are not permitted to make securities recommendations or give investment advice to retail customers that are inconsistent with the customer's investment objectives. Securities firms who fail to comply are subject to fines, penalties, restitution, additional oversight, and other remedies.

Generally speaking, financial professionals do not intentionally effect transactions with an investment objective that the customer has not authorized and if they do, they are already subject to the significant disciplinary consequences outlined above. Moreover, we are unaware of any specific complaints or documented regulatory actions that suggest that this is a problem that requires a unique and unprecedented state regulatory solution.

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3 *See* https://www.sos.mo.gov/CMSImages/AdRules/moreg/2024/v49n23Dec2/v49n23.pdf at p. 1818.

4 *See* Order dated Oct. 17, 2024, https://www.sifma.org/wp-content/uploads/2024/10/FINAL-JUDGMENT-ORDER-2024.10.17.pdf.

5 *See* eCFR :: 17 CFR 240.15l-1 -- Regulation best interest.

6 *See* https://www.sec.gov/files/rules/interp/2019/ia-5248.pdf.

The Proposals are thus unnecessary and likely to cause confusion for BDs, RIAs, and their retail customers. Accordingly, we respectfully request that you withdraw the Proposals and instead exercise your existing regulatory authority if the situation requires.

To the extent that you interpret the Proposals as imposing additional or different regulatory obligations on BDs and RIAs than are required under current federal securities laws, we respectfully request that you state what those additional or different regulatory obligations are, and what additional or different compliance measures they require.

II. To the extent you interpret the Proposals as imposing additional or different regulatory obligations, the Proposals are preempted.

If you interpret and apply the Proposed Rules in a manner that requires BDs and RIAs to do something more or different than current federal securities laws, then a court would likely find that the rules are conflict preempted by Reg BI with respect to BDs and by the Adviser Act with respect to RIAs. With respect to Reg BI, as the SEC explained, "the preemptive effect of [Reg BI] on any state law governing the relationship between regulated entities and their customers would be determined in future judicial proceedings based on the specific language *and effect* of that state law."[7]

In addition, as you know, the Missouri federal court found that the prior rules are preempted by the National Securities Markets Improvement Act of 1996 (NSMIA). We note that the new Proposed Rule for BDs includes a NSMIA savings clause which states that "Nothing in subsection (1)(I) shall require broker-dealers or their agents to create or retain any record memorializing the required customer authorization." This clause, however, does not relieve the agency of, or legally insulate it from, its obligation to avoid imposing, directly or indirectly, NSMIA-preempted books and records requirements on BDs.

NSMIA not only limits state regulations that *directly* impose new or different recordkeeping requirements, but also state regulations that by their nature require BDs to make and keep new or different records than those required by federal law and FINRA rules.[8] In this case, the Proposed Rules are ambiguous and unclear about how to navigate the investment objectives of a transaction versus the investment objectives of the retail customer, and how to establish that a transaction is in fact "authorized." Under the Proposed Rules, a securities recommendation could be perceived as having multiple objectives, including those attributable to the "transaction" and those attributable to the retail customer, such as the proverbial Tesla example from the prior rule proposal. As a practical matter, BDs would effectively be required to create and implement new supervisory and compliance procedures, and make and keep new records that are not otherwise required to be kept under the federal securities laws, in order to demonstrate and defend their compliance with the Proposed Rule for BDs. Consequently, a court would likely find the Proposed Rule for BDs to be preempted by NSMIA.

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7 Adopting Release at p. 43 and p. 514, fn 1163 (emphasis added).

8 *See* Exchange Act Rule 17(a)-4, requiring broker-dealers to keep a record of *"all communications … by the member … relating to its business as such…"* (emphasis added). 17 CFR §§ 240.17a-4(b)(4).

The case for NSMIA preemption of the Proposed Rule for RIAs is even stronger. NSMIA broadly preempts state regulation of federally registered investment advisers and their supervised persons.[9] Congress established this provision because it wanted to "divid[e] regulatory responsibility" over investment advisers between the SEC and the states.[10] Accordingly, NSMIA creates "a clear division of labor between the states and the federal government for supervision of investment advisers."[11]

States have plenary regulatory authority over smaller advisers,[12] while the SEC alone is tasked with regulating larger national firms.[13] Congress intended that "states should play an important and logical role in regulating small investment advisers whose activities are likely to be concentrated in their home state," while "[l]arger advisers, with national businesses, should be registered with the [SEC] and be subject to national rules" alone.[14] The SEC described this framework in promulgating its implementing regulations related to NSMIA preemption under the Advisers Act:

> The Coordination Act gives the Commission primary responsibility to regulate advisers that remain registered with the Commission by preempting state regulation of those advisers. … States retain authority over Commission-registered advisers under state investment adviser statutes to investigate and bring enforcement actions with respect to fraud or deceit against an investment adviser or a person associated with an investment adviser; to require filings, for notice purposes only, of documents filed with the Commission; and to require payment of state filing, registration, and licensing fees.[15]

The SEC recognized that NSMIA preempts "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 the Coordination Act."[16]

III. The Proposed Rules are unconstitutionally vague.

The Proposed Rules deviate significantly from typical state agency rulemaking in several troubling respects. The Proposed Rules include no preamble, no background, no explanatory or interpretive text, and no explanation of the process by which they came about. The Proposed Rules include no cost-benefit analysis, no data, no justification, and no explanation – or proof – of the alleged issue they seek to address. The Proposals provide none of these critical elements that a state agency is obligated to provide in order to allow the public a meaningful opportunity to comment. The Proposals provide only the bare text of the Proposed Rules – and that text raises more questions than it answers.

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[9] *See* 15 U.S.C. § 80b-3a(b)(1)(A).
[10] S. Rep. No. 104-293 at 2.
[11] *Id.*
[12] *See id.* § 80b-3a(a)
[13] See id. § 80b-3a(b).
[14] S. Rep. No. 104-293 at 4 (emphasis added).
[15] Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 1633 at 69, 62 Fed. Reg. 28,112, 28,125 (May 15, 1997).
[16] *Id.*

The language of the Proposed Rules – i.e., "effecting any transaction with an investment objective that the customer has not authorized at or prior to the time such transaction is effected" – suffers from numerous ambiguities and uncertainties. For example, while the language speaks of a "transaction's" investment objective, only the retail investor's investment objectives are relevant. Under federal securities laws, there is no concept or allowance for a recommended or advised transaction to have an investment objective that is separate and distinct from the retail investor's investment objectives. Notwithstanding, the Proposed Rules could be interpreted as creating a new legal standard for analyzing, comparing, and resolving any and all discrepancies between a transaction's potential investment objectives and the retail customer's investment objectives.

The term "authorization" is likewise undefined and unclear and raises a number of unanswered interpretive questions. For example, do the Proposed Rules require an explicit authorization for each new transaction? Or is it sufficient that the transaction is consistent with the retail customer's existing, previously furnished customer profile information? From a practical perspective, how does a firm or securities professional prove that the transaction was "authorized" if no additional documentation demonstrating compliance is required?

Thus, the plain language of the Proposed Rules leaves firms and their agents/representatives guessing as to what the language actually means and requires, how they can comply, and how they can monitor for compliance.

The problem is exacerbated by characterizing the improper behavior as fraudulent or deceitful, which is further described below.

The prior rules (Sections 3 and 4 of 15 CSR 30-51.170 and Section 4 of 15 CSR 30-51.172) were similarly ambiguous and uncertain and in October 2024, a Missouri federal court found those rules unconstitutionally void for vagueness, among other things. Those rules are now being repealed to comply with the federal court order.

Under Constitutional due process principles limiting state regulation, "[i]t is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined."[17] "The due process clause thus prevents . . . deference [to administrative agencies] from validating the application of a regulation that fails to give fair warning of the conduct it prohibits or requires. . . . In the absence of notice—for example, where the regulation is not sufficiently clear to warn a party about what is expected of it—an agency may not deprive a party of property by imposing civil or criminal liability."[18]

A state rule is unconstitutionally vague if it fails to "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he act accordingly."[19] "If, by reviewing the regulations and other public statements issued by the agency, a regulated party acting in good faith" would be unable to "identify, with 'ascertainable certainty,' the standards with which the agency expects parties to conform," a regulation may be void for vagueness.[20]

[17] *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972).
[18] *Gen. Elec. Co. v. U.S. Env't. Prot. Agency*, 53 F.3d 1324, 1328–29 (D.C. Cir. 1995) (internal quotation marks omitted).
[19] *Grayned*, 408 U.S. at 108.
[20] *Gen. Elec. Co.*, 53 F.3d at 1329.

In this case, the Proposed Rules fall far short of providing regulated persons with the ability to ascertain with certainty how to distinguish between or reconcile a "transaction's" investment objective versus the retail customer's investment objective, or how to ascertain or document whether a transaction or its investment objective was "authorized." Accordingly, the Proposed Rules, as drafted, are unconstitutionally vague.

IV. The Proposed Rules could be costly to implement and trigger Administrative Procedures Act requirements.

Under the Missouri Administrative Procedures Act, agencies are required to file a <u>private</u> fiscal note if a proposed or emergency rule will cost any person or entity more than $500 over the lifetime of the rule.[21] Agencies are similarly required to file a <u>public</u> fiscal note if a proposed or emergency rule will cost state agencies or political subdivisions more than $500 over the rule's life span.

In this instance, the agency indicated that both the emergency rules and the Proposed Rules fall under this $500 trigger, meaning that no public or private fiscal notes are required. Because the emergency rules and the Proposed Rules are so vague, however, the associated costs are hard to assess. That said, our members have already spent substantial time trying to understand both the emergency rules and the Proposed Rules. Staff costs alone have likely exceeded the lifetime amount for many of our firms.

Moreover, the operational and compliance costs for securities firms would jump exponentially if the emergency rules and Proposed Rules are interpreted as imposing obligations that are different from or in addition to federal securities laws. If no additional obligations are being imposed, then the agency should so state, and also reconsider the need for and benefits of the Proposals.

Similarly, the Proposals will impose public costs. The Securities Division will spend considerable time and resources responding to questions in connection with the amendments and include compliance with these provisions as part of exams it conducts moving forward.

V. The Proposed Rules should not characterize an alleged failure to comply with a customer's investment objective as "fraudulent or deceitful."

We note that the Proposals characterize a failure to comply with a customer's investment objectives as "fraudulent or deceitful" rather than "dishonest or unethical." Intentional misconduct and actual harm are typically and properly key elements of fraud, yet they do not seem to be required under the emergency rules or the Proposed Rules. Accidental conduct, innocent mistakes, miscommunications, and misunderstandings are just a few of the scenarios which could result in alleged failures to comply with 15 CSR 30-51.169 or 15 CSR 30-51.174 – regardless of whether intentional misconduct or actual harm is alleged or proven.

The impact of such an alleged "fraudulent or deceitful" practice against a securities firm or securities professional would be potentially devastating. The repercussions include prospective collateral consequences under both federal and state law, including without limitation, statutory

[21] 2024RulemakingManual.pdf

disqualification. At a minimum, the reputational damage and damage to future business opportunities for firms and individuals alike would be significant.

For securities professionals, the mere allegation could be career-ending. Even if the claim is settled, as many claims are regardless of merit, it would need to be disclosed on the individual's CRD and/or IARD record and would appear in routine internet searches. Existing and potential clients are understandably unlikely to want to work with a professional accused of fraudulent or deceitful practices. States and federal regulators are (also understandably) less likely to approve their registrations. Investors would also be meaningfully impacted if their trusted financial professional is subject to a claim and subsequently unable to continue providing financial assistance.

Accordingly, if the Proposals proceed to final rulemaking, we strongly recommend that you move them from the fraudulent practices' provisions (15 CSR 30-51.169 and 15 CSR 30-51.174) to the dishonest or unethical business practices provisions (15 CSR 30-51.170 and 15 CSR 30-51.172). Doing so would appropriately balance investor protection considerations with the potential impact on financial professionals, particularly where the alleged failure to comply is not in fact fraudulent in nature, much less a proven allegation.

For the foregoing reasons, we urge you to withdraw the Proposed Rules.

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We appreciate the opportunity to provide comments on these proposals. Please do not hesitate to contact me at 202-962-7411 or SIFMA's lobbyist, Jon Dalton of Armstrong Teasdale at 314-486-9991 with any comments or questions. We would be happy to discuss any or all of these issues with you at your earliest convenience.

Sincerely,

Kim Chamberlain

Kim Chamberlain
Managing Director & Associate General Counsel
SIFMA