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**DELIVERED AS AN EXHIBIT TO THE RICE SECTION'S SUPPLEMENTAL MEMORANDUM
OF LAW OPPOSING FIDELITY'S SECOND MOTION FOR SUMMARY DECISION**

March 30, 2017

Honorable Herbert Lemelman
Presiding Officer
Office of the Secretary of the Commonwealth
Division of Securities
One Ashburton Place
Boston, Massachusetts 02108

**RE: In the Matter of Fidelity Brokerage Services, LLC (Docket No. E-2015-0078) –
Submission of the North American Securities Administrators Association In
Support of the Massachusetts Securities Division**

Dear Hon. Lemelman,

The North American Securities Administrators Association, Inc. (“NASAA”) is submitting this letter in connection with the pending proceeding over which you are presiding, *In the Matter of Fidelity Brokerage Services* (Docket No. E-2015-0078), brought by the Registration, Inspections, Compliance and Examinations Section (the “RICE Section”) of the Massachusetts Securities Division (the “Division”), to provide NASAA’s views on the important preemption issues raised by the Respondent.¹

NASAA’s U.S. member organizations are responsible for administering state securities laws, commonly known as “Blue Sky Laws.” The Secretary of the Commonwealth of Massachusetts, who oversees the Division and its RICE Section, is the NASAA member

¹ Formed in 1919, NASAA is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada and Mexico. NASAA has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. NASAA supports the work of its members and the investing public by promulgating model rules, providing training opportunities, coordinating multi-state enforcement actions, and commenting on legislative and rulemaking proposals. NASAA also offers its legal analysis and policy perspective to state and federal courts as *amicus curiae* in cases involving the interpretation of state and federal securities laws.

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representative from Massachusetts. NASAA and its U.S. members have an interest in this adjudicatory proceeding because Respondent has raised foundational questions about the scope of federal preemption of state laws and state securities enforcement authority after the National Securities Markets Improvement Act of 1996 (“NSMIA”).² The outcome of this matter could affect not only the Division’s ability to bring enforcement actions in the future but also, potentially, the ability of other NASAA member organizations to do so. Accordingly, in light of the importance of the preemption issues raised by Respondent and at the request of the Division, NASAA respectfully offers its views for your consideration.

I. BACKGROUND AND ISSUES PRESENTED.

The RICE Section filed an Administrative Complaint against Respondent in 2015. The Administrative Complaint charged Respondent with acting in a dishonest and unethical manner in breach of Respondent’s obligations to observe high standards of commercial honor and just and equitable principles of trade under Mass. Gen. Laws ch. 110A, § 204, and 950 Mass. Code Regs. 12.204.³

Respondent raised a NSMIA preemption argument in 2016.⁴ This argument was rejected by a ruling in December 2016, whereupon Respondent renewed this argument in a brief filed February 7, 2017.⁵ Respondent’s February 7 brief asserted the RICE Section’s unethical business practices claim was preempted because the RICE Section sought to impose (i) books and records or operational reporting requirements beyond those required by federal law, and (ii) a duty to analyze customer trading authorizations that was not recognized under federal law. Respondent wrote: “As NSMIA plainly says, this proceeding is[]preempted because the RICE Section seeks to impose requirements that ‘differ from’ and are ‘in addition to’ the federal law regulating broker-dealers.”⁶ Respondent restated its arguments in a further brief filed February 28, 2017, writing in part, “NSMIA preempts this case because the RICE Section accuses Fidelity of violating a requirement that does not exist under federal law.”⁷

The RICE Section’s action is predicated on allegations that Respondent facilitated unregistered investment advisory activity via Respondent’s trading platform. Investment adviser registration is a core requirement of state and federal securities laws. Knowingly allowing violations of law does not raise broker-dealer books and records or operational reporting issues. Thus, Respondent’s preemption argument based on NSMIA books, records, and operational reporting issues has no merit and will not be the focus of this letter. This letter focuses instead on Respondent’s argument that NSMIA precludes the RICE Section

² Pub. Law 104-290, 110 Stat. 3416 (1996).

³ See Administrative Complaint, Oct. 26, 2015.

⁴ See Memorandum of Law in Support of Fidelity’s Motion for Summary Decision, Oct. 14, 2016, at 25-26; Fidelity’s Reply Brief in Further Support of its Motion for Summary Decision, Nov. 30, 2016, at 14.

⁵ See Supplemental Briefing Further Explaining Why Summary Decision Must Enter on Grounds of Federal Preemption, Feb. 7, 2017.

⁶ *Id.* at 9.

⁷ Fidelity’s Reply Brief on Federal Preemption, Feb. 28, 2017, at 1.

from seeking to hold Respondent liable for a duty that Respondent asserts is not recognized by federal law.⁸ As will be shown, NSMIA poses no such limitation. Congress intended the scope of NSMIA's preemption of state regulation of broker-dealers to be extremely narrow. Furthermore, states can – and do – impose duties on broker-dealers, including broker-dealers that are registered with the U.S. Securities and Exchange Commission (“SEC”) and are members of the Financial Industry Regulatory Authority (“FINRA”), which are different from, or even unrecognized by, federal law.

II. CONTRARY TO RESPONDENT’S ASSERTIONS, NSMIA DOES NOT PRECLUDE THE RICE SECTION FROM SEEKING TO HOLD RESPONDENT LIABLE FOR BREACH OF A DUTY NOT RECOGNIZED BY FEDERAL LAW.

A. Overview of Federal Preemption.

There are three potential ways in which federal law may preempt state law. First, Congress may explicitly write into federal legislation that it intends to preempt state laws in a particular field. Second, in the absence of such explicit preemptive intent, Congress may impliedly preempt the states by completely occupying an entire area of law, leaving no room for state regulation. Third, where Congress has not entirely preempted state regulation either expressly or by implication, preemption may nonetheless still exist if state laws conflict with federal law.⁹ In the field of securities law, state laws are preempted only to the extent of conflicts with federal law.¹⁰

As the Massachusetts Supreme Judicial Court has acknowledged, a conflict between federal law and Massachusetts law will result in preemption “when compliance with both state and federal law is impossible, . . . or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress” in enacting the federal law.¹¹ But findings of preemption are “not favored,” and Massachusetts courts must uphold state laws “unless a conflict with Federal law is clear.”¹² The burden of establishing preemption rests with the party seeking to invalidate a state action and must be shown through “hard evidence of conflict based on the record.”¹³ The task for a court or other trier of fact is to discern whether Congress intended for federal law to preempt state law in the

⁸ For purposes of this letter, NASAA assumes *arguendo* Respondent’s contention that the RICE Section is seeking to enforce a duty not recognized under federal law.

⁹ See *Sawash v. Suburban Welders Supply Co.*, 553 N.E.2d 894, 896 (Mass. 1990).

¹⁰ *Chanoff v. U.S. Surgical Corp.*, 857 F. Supp. 1011, 1015 (D. Conn. 1994) (“It is settled, however, that Congress did not act to occupy the field of securities; rather the federal law preserved the states’ broad powers to regulate areas within the field. Thus, to find preemption in this instance, the court must find actual conflict between the state and federal laws . . .”) (citations omitted), *aff’d* 31 F.3d 66 (2d Cir. 1994).

¹¹ *Sawash*, 553 N.E.2d at 896 (internal quotations and citations omitted).

¹² *Id.*

¹³ *Id.*

particular circumstances of the case.¹⁴ In so doing, a trier of fact should consult the structure and purpose of the relevant federal statute(s) and legislative history.¹⁵

B. Congress Intended for NSMIA to Have Limited Preemptive Impact on States' Securities Enforcement Authority Against Broker-Dealers.

The Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (the "Securities Act"), and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (the "Exchange Act"), are the two principal federal statutes regulating securities. To broadly simplify, the Securities Act regulates securities offerings while the Exchange Act regulates broker-dealers and the securities markets.

Section 28(a) of the Exchange Act makes clear that Congress intended to preempt state regulation of broker-dealers only to the extent of conflicts with federal law. "Except as otherwise specifically provided in this chapter, nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations under this chapter."¹⁶ This provision in the Exchange Act has existed virtually unchanged since Congress first adopted the Exchange Act in 1934.¹⁷ Section 18 of the Securities Act as originally adopted in 1933 expressed a similarly limited preemptive intent.¹⁸ This letter will now address the relevant NSMIA amendments to the Securities Act and the Exchange Act.

1. NSMIA's Amendments to Securities Act Section 18.

In 1996, Congress revisited federal and state securities regulation through NSMIA. Congress's primary purpose behind NSMIA was to preempt state laws requiring registration of national securities offerings and eliminate the inefficiencies and burdens on issuers of complying with a multitude of federal and state requirements.¹⁹ In so doing, Congress amended Section 18 of the Securities Act (which had existed since 1933) to the basic form it appears today. Congress wrote these changes into Section 102 of NSMIA.²⁰

Congress included an explicit savings clause in Section 102 to acknowledge that, notwithstanding the significant changes Congress was making to Section 18 of the Securities Act, states retained their enforcement authority to police offering fraud and broker-dealer

¹⁴ See *Commonwealth v. College Pro Painters*, 640 N.E.2d 777, 779 (Mass. 1994).

¹⁵ See *Roberts v. Sw. Bell Mobile Sys.*, 709 N.E.2d 798, 804-05 (Mass. 1999).

¹⁶ 15 U.S.C. § 78bb(a)(1) (2016).

¹⁷ See 73 Cong. Ch. 404, 48 Stat. 881, 903 (June 6, 1934).

¹⁸ See 73 Cong. Ch. 38, 48 Stat. 74, 85 (May 27, 1933) ("Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person.").

¹⁹ *Lander v. Hartford Life & Annuity Ins.*, 251 F.3d 101, 108 (2d Cir. 2001).

²⁰ See Pub. Law 104-290, § 102.

sales practices. Section 102 stated in relevant part: “Consistent with this section, the securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.”²¹

Congress included this savings clause because legislators were concerned that NSMIA might be misinterpreted as preempting states’ enforcement authority, particularly vis-à-vis broker-dealers. A House committee report made this point: “The Committee does not intend . . . [to] limit [states’] ability to investigate, bring actions, or enforce orders, injunctions, judgments or remedies based on alleged violations of State laws that prohibit fraud and deceit or that govern broker-dealer sales practices”²² The issue of NSMIA’s preemptive impact was also discussed during floor debate.

Congressman Moran:	“Mr. Speaker, . . . our State Corporation Commission in Virginia . . . [is afraid] they will not have sufficient enforcement authority [after NSMIA]”
Congressman Bliley:	“Mr. Speaker, reclaiming my time, they have all of that enforcement authority and they retain their fees.”
Congressman Moran:	“They retain their fees and enforcement authority.”
Congressman Bliley:	“That is correct.” ²³

Thus, whereas NSMIA Section 102 substantially limited states’ ability to regulate certain national securities offerings, it did not materially curtail states’ enforcement authority against broker-dealers or others.

2. NSMIA’s Amendments to the Exchange Act.

NSMIA similarly did not materially expand the limited scope of preemption under the Exchange Act. In contrast to the significant amendments Congress made to the Securities Act, Congress did not touch Exchange Act Section 28(a)’s broad state law savings clause. NSMIA did, though, cabin states’ regulatory authority vis-à-vis some specific broker-dealer activities. Section 103 of NSMIA amended the Exchange Act to preempt states from establishing any standards for broker-dealer “capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements” that exceeded federal standards.²⁴

The very limited preemptive nature of Section 103 is apparent. Section 103 expressly preempted states in the enumerated areas of broker-dealer capital, margin, books and records,

²¹ *Id.* (codified as 15 U.S.C. § 77r(c)(1)).

²² H.R. Rep. No. 104-622, 1996 WL 354335, at *30 (1996).

²³ 142 Cong. Rec. H6436-05, 1996 WL 332161, at H6448 (1996).

²⁴ *See* Pub. Law 104-290, § 103.

etc. But this is all that Section 103 did. The plain language of Section 103 shows Congress did not intend to preclude states from potentially adopting different, or even heightened, broker-dealer standards in areas *outside of* capital, margin, books and records, etc. Section 103 thus does not preempt states generally from adopting heightened duties of care or conduct standards for broker-dealers that differ from standards established under federal law.

3. States Retained their Enforcement Authority after NSMIA.

The present adjudicatory proceeding is a clear example of a state exercising its retained broker-dealer regulatory authority after NSMIA. The RICE Section charged Respondent with liability for engaging in a dishonest or unethical business practice within the meaning of 950 Mass. Code Regs. 12.204. Section 12.204 is a long-standing regulation, dating back at least to 1977.²⁵ It is substantially like a 1983 NASAA model rule.²⁶ Many other states also have venerable broker-dealer unethical business practices regulations.²⁷ Had Congress wanted to preempt these well-established state standards when it enacted NSMIA in 1996, Congress would have clearly said so. What is more, the absence of any legal authority in the past twenty years to find that NSMIA preempts these state standards is noteworthy.

Like NASAA's 1983 model rule, Section 12.204 defines certain conduct as dishonest or unethical.²⁸ But the enumerated conduct is not all-encompassing; Section 12.204 makes clear that dishonest or unethical conduct "includ[es], but [is] not limited to," what is expressly enumerated therein.²⁹ And Section 12.204 should be interpreted broadly, in accordance with the fundamentally remedial purposes of federal and state securities laws.³⁰ Triers of fact in Massachusetts accordingly can find that other conduct not expressly named within Section 12.204 is also dishonest or unethical. The RICE Section's Administrative Complaint against

²⁵ See *In re First Fin. Equity Corp.*, Mass. Secs. Div., 1977 WL 39216 (Nov. 23, 1977) (cease and desist order against unregistered broker-dealer for violation of Section 12.204).

²⁶ Compare 950 Mass. Code Regs. 12.204 with Dishonest or Unethical Business Practices of Broker-Dealers and Agents, NASAA Model Rule (adopted May 23, 1983), available at http://www.nasaa.org/wp-content/uploads/2011/07/29-Dishonest_Practices_of_BD_or_Agent.83.pdf.

²⁷ E.g., Dishonest and Unethical Business Practices by Broker-Dealers and Agents, Mo. Code Regs. tit. 15, § 30-51.170 (original rule filed June 25, 1968); Dishonest or Unethical Practices in the Securities Business, Iowa Admin. Code § 191-50.16(502) (original rule filed Aug. 1, 1963).

²⁸ See 950 Mass. Code Regs. 12.204(1)(a) (2016).

²⁹ *Id.* ("Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Acts and practices, *including, but not limited to* the following, are considered contrary to such standards and constitute dishonest or unethical practices . . .") (emphasis added).

³⁰ E.g., *Aaron v. SEC*, 446 U.S. 680, 695 (1980) ("Congress intended securities legislation . . . to be construed not technically and restrictively, but flexibly to effectuate its remedial purposes") (internal citation omitted); *Crown v. Kobrick Offshore Fund*, 8 N.E.3d 281, 295 (Mass. App. Ct. 2014) ("securities laws are a remedial measure intended to encourage the prosecution of securities fraud actions") (internal citation omitted). See also *Johnson-Bowles Co. v. Division of Securities*, 829 P.2d 101, 114 (Utah Ct. App. 1992) (recognizing "a legislative intent to delegate the interpretation of what constitutes dishonest and unethical practices in the securities industry to the Division").

Respondent certainly asserts a potentially dishonest or unethical practice where Respondent allegedly facilitated unregistered investment advisers' unlawful use of its trading platform.³¹

In sum, NSMIA's text and legislative history, along with the development of the law in this area, demonstrate that Congress did not intend to preempt states from exercising their inherent police powers over broker-dealers except as to the specific issues listed in NSMIA Section 103. In accordance with the guidance of the Massachusetts Supreme Judicial Court, therefore, the RICE Section's claim against Respondent is not preempted because Respondent cannot show by hard evidence that either (a) it would have been impossible to comply with Respondent's duties under federal law and the obligations the RICE Section is seeking to enforce, or (b) the obligations the RICE Section is seeking to enforce pose an obstacle to the full execution of Congress's regulatory intent in the Securities Act and the Exchange Act.

III. EXISTING DIFFERENCES IN FEDERAL / STATE BROKER-DEALER REGULATION DISPROVE RESPONDENT'S PREEMPTION ARGUMENT AND RESPONDENT'S ARGUMENT, IF ADOPTED, WOULD DEPRIVE THE MASSACHUSETTS SECURITIES DIVISION OF ITS POLICING POWER.

Respondent's argument that NSMIA preempts this action because the RICE Section is seeking to enforce a duty not recognized by federal law is fallacious. Respondent has cited no federal authority for the proposition that a broker-dealer may permit unregistered investment advisers to offer investment advice for compensation via the broker-dealer's platform. To the contrary, federal law requires investment advisers to register either with the SEC or with a state and broker-dealers have a duty to prevent, rather than facilitate, violations of this requirement. Moreover, as demonstrated above, states may adopt broker-dealer conduct standards that differ from, and are even higher than, federal standards. And states have indeed done so.

For example, there is no universally applicable standard across federal and state securities laws as to the scope of a broker-dealer's duties to a traditional non-discretionary brokerage account. The general standard under federal law is that broker-dealers are not fiduciaries of non-discretionary accounts and owe these customers only transactional duties of care and loyalty.³² This is also the standard in New York state.³³ But this is not the standard everywhere. Georgia and California hold brokers of non-discretionary trading accounts to the heightened duties of a fiduciary.³⁴ In Massachusetts, the nature of a broker's duties appears to

³¹ See Administrative Complaint, Oct. 26, 2015.

³² E.g., *United States v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006) ("there is no general fiduciary duty inherent in an ordinary broker/customer relationship") quoting *Indep. Order of Foresters v. Donald, Lufkin & Jennrette*, 157 F.3d 933, 940 (2d Cir. 1998); *Zazzali v. Alexander Partners, LLC*, Case No. 12-cv-828, 2013 WL 5416871, at *8 (D. Del. Sept. 25, 2013).

³³ E.g., *Celle v. Barclays Bank*, 48 A.D.3d 301, 302 (N.Y. App. Div. 2008) ("brokers for nondiscretionary accounts do not owe clients a fiduciary duty") citing *Fesseha v. TD Waterhouse Inv. Servs.*, 305 A.D.2d 268 (2003).

³⁴ E.g., *Holmes v. Grubman*, 691 S.E.2d 196, 201 (Ga. 2010) ("[a] stock broker's duty to account to its customer is fiduciary in nature") citing *Minor v. E.F. Hutton & Co.*, 409 S.E.2d 262 (Ga. Ct. App. 1991); *Apollo Cap.*

depend upon the unique facts and circumstances of the customer relationship.³⁵ These extant regulatory differences belie Respondent's argument that states cannot establish broker-dealer regulatory standards that are higher than, or even materially different from, federal ones.

As another example, Alabama and Indiana recently enacted legislation establishing a new duty for certain qualifying individuals of broker-dealers or investment advisers to report to state authorities when they suspect certain customers may be the victims of financial exploitation.³⁶ A third state, Vermont, adopted these standards by regulation.³⁷ In so doing, Alabama, Indiana and Vermont created new legal duties for the broker-dealer industries in their states. These three state statutes and regulations were based on model legislation from NASAA, the *NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation* (the "Model Act").³⁸ No such duties to report currently exist under federal law, whether through a statute, SEC regulation, FINRA rule, case law or otherwise.³⁹ The drafters of the NASAA Model Act were well aware of potential federal preemption issues and carefully crafted the Model Act to avoid potential entanglements with federal law. Under Respondent's flawed preemption reasoning, though, the Model Act and related state laws and regulations would be *void ab initio* until and unless a concomitant reporting duty is created under federal law. NASAA, of course, vigorously disagrees.

Respondent's argument essentially rewrites Massachusetts securities law, erasing the clause in Section 12.204 that says dishonest or unethical practices include, *but are not limited to*, the conduct expressly listed therein. This would be contrary to all authority and would divest the Division of authority to pursue claims against broker-dealers. What is more, if Respondent's argument was an accurate reflection of the law, the Division would never be able to bring new types of enforcement actions or raise untested legal theories against broker-

Fund v. Roth Cap. Partners, 158 Cal. App. 4th 226, 246 (Cal. Ct. App. 2007) ("the rule is long settled [in California] that a stockbroker owes a fiduciary duty to his or her customer") citing *Duffy v. Cavalier*, 215 Cal. App. 3d 1517, 1534-35 (Cal. Ct. App. 1989).

³⁵ See *Patsos v. First Albany Corp.*, 741 N.E.2d 841, 848 (Mass. 2001) ("in Massachusetts a relationship between a stockbroker and a customer may be either a fiduciary or an ordinary business relationship, depending on whether the customer provides sufficient evidence to prove a 'full relation of principal and broker'") (citations omitted).

³⁶ See SB 220, Alabama Regular Session 2016, available at <http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2016rs/PrintFiles/SB220-enr.pdf>; SEA 221, Indiana Second Regular Session 2016, available at <http://iga.in.gov/legislative/2016/bills/senate/221#document-72ee118f>.

³⁷ See Vt. Sec. Reg. § 8-5, Protection of Vulnerable Adults from Financial Exploitation, available at <http://dfr.vermont.gov/reg-bul-ord/vermont-securities-regulations>.

³⁸ See NASAA Press Release, NASAA Members Adopt Model Act to Protect Seniors and Vulnerable Adults (Feb. 1, 2016); available at <http://www.nasaa.org/38777/nasaa-members-adopt-model-act-to-protect-seniors-and-vulnerable-adults/>.

³⁹ The SEC recently approved FINRA rule amendments designed to help redress senior financial exploitation. Unlike the Model Act, though, FINRA's rule amendments do not include a mandatory reporting obligation. See Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of the Proposed Rule Change, SEC Release No. 34-79964, File No. SR-FINRA-2016-039 (Feb. 3, 2017), available at <https://www.sec.gov/rules/sro/finra/2017/34-79964.pdf>.

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dealers, whose business models and processes are everchanging. Rather, in any broker-dealer enforcement action, the Division would have to be able to point to some pre-existing federal precedent permitting it. The Division would have no ability to, for instance, lead the way on investigations into market timing or auction rate securities, as the Division and other state securities regulators have in the past. Congress did not intend for NSMIA to so thoroughly geld the states.

IV. CONCLUSION.

For the reasons outlined above, Respondent is wrong to the extent Respondent asserts that the RICE Section's claim against it is preempted for lack of a potentially cognizable legal duty. Congress never intended NSMIA to curtail state enforcement authority in the way Respondent claims. Were you to conclude otherwise, you would strip the Division of its legitimate regulatory authority over broker-dealers operating in the Commonwealth of Massachusetts and potentially do damage to the ability of other states to exercise their legitimate police powers as preserved by Congress.

Sincerely,



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