

## **Testimony in Opposition to HB 1469**

**North Dakota Securities Commissioner Karen Tyler**

**House Industry, Business and Labor Committee**

**February 6, 2023**

Good morning Mr. Chairman and members of the Committee, I am Karen Tyler, the state securities commissioner, and I am providing opposition testimony on HB 1469.

The North Dakota Securities Department is a regulatory agency responsible for, among other things, regulating investment industry firms and professionals who do business in the state – the firms and professionals who provide investment advice and other investment services to North Dakota clients. These firms and professionals can be broken down into two categories:

**Broker-Dealers and their BD Agents (stockbrokers)**

**Investment Advisers and their Investment Adviser Representatives**

My testimony will largely be focused on the latter category – Investment Adviser firms. These are the asset managers that the SIB selects and RIO contracts with to manage assets for various retirement programs and the Legacy Fund.

I will briefly cover industry conduct standards and the authority of regulators to enforce those standards, regulatory uniformity, split jurisdiction over investment advisers, and most importantly from a regulatory perspective, the fiduciary duty owed to investors by investment advisers, and how this principle is interpreted and enforced under federal and state securities law and rules.

While much of my testimony pertains to Investment Adviser firms and the asset management services they provide to investor clients like our state pension fund and the legacy fund, many large firms that offer Advisory services also offer bond underwriting services and play an important role as underwriters and investors in the process of financing critical infrastructure in the state.

I have also included some data related to the investment adviser industry in the US, how much money they manage overall, and how much they are managing to an ESG or sustainable finance objective.

### **Investment Industry Conduct Standards Created Outside of the Securities Act**

The laws and rules governing the conduct of Investment Advisers and Broker-Dealers are set forth in and under state and federal securities laws. Here in North Dakota the Securities Act is chapter 10-04 of the NDCC. At the federal level,

relevant law is the Securities Act of 1933, the Securities and Exchange Act of 1934, the Investment Advisers Act of 1940 and the Investment Company Act of 1940. HB 1469 imposes conduct standards for the investment industry that reside outside of securities laws and rules.

Creating investment industry conduct requirements outside of a securities law construct is non-uniform and also raises questions of enforceability. I refer specifically to:

Page 1, Section 1, Subsection 1, Lines 9-17

And Page 2, Section 1, Subsection 2, Lines 9-18

Page 2, Subsection 5, Lines 29 and 30, continuing on Page 3, Lines 1 and 2

I am not commenting on the substance of the language, only that it resides outside of the body of laws and rules that govern the conduct of this industry.

Notably, up to this point ESG or Anti-ESG proposals by states have placed limitations or conduct standards on the state entity responsible for hiring the asset manager. This bill departs from that approach, and instead places the conduct requirement on the investment firm, and does so outside of the Securities Act.

## **Lack of Uniformity**

The investment firms that RIO contracts with conduct business in many if not all states. Some aspects of their business are regulated concurrently by both state and federal securities regulators, and some aspects of their business are regulated by either the state regulator or the SEC. As such, uniformity among states, and between the state and federal regulatory systems, is a critical issue for this industry. The conduct provisions of this bill are non-uniform as they reside outside of securities laws and rules.

## **Split Jurisdiction Over Investment Advisers**

Regulatory jurisdiction over Investment Adviser firms is split between state securities regulators and the SEC at the \$100 million of AUM level. Generally, firms with less than \$100 million of AUM are regulated by state securities regulators, and firms with greater than \$100 million AUM are regulated by the Securities and Exchange Commission. Investment Adviser firms hired by the SIB to provide asset management services are SEC regulated entities. As such, the ability to enforce the conduct requirements of this bill could reasonably be called into question. If the SIB had basis to file a complaint against an adviser, the

complaint would be filed with the SEC, and the applicable regulatory governance would be the Investment Advisers Act of 1940, not state law.

### **Fiduciary Duty under State and Federal Securities Law**

The term “fiduciary duty” is not defined in federal securities law and is not defined under the North Dakota Securities Act. Its definition is based on equitable common law principles that provide for a fluid and elastic interpretation to be decided by the relevant governing body in each case based on principals of fairness. In any given situation, an investment adviser’s fiduciary duty is determined by reasonableness under the particular circumstances – taking into consideration the terms of the advisory agreement, the complexity of the investments, the client’s investment profile and objectives, and investment policy statements, among other factors.

Creating a prescriptive set of conduct requirements for a fiduciary as set forth in this bill is not necessarily in conflict with the precedent of applying a principles-based interpretation of the of duty of care and duty of loyalty owed by a fiduciary to their client under the terms of a contract and in a fiduciary relationship. It does however, appear to be an unnecessary duplicative requirement, and the enforceability of the conditions, as I mentioned earlier, is not clear given the fact

that enforcement powers of securities regulators are set forth under securities laws.

### **List of Ineligible Institutions**

As states take up legislation to support or oppose ESG factors related to state assets, the primary focus has been on investment methodologies deployed by asset managers, and in some states laws have passed that create lists of institutions ineligible to provide those services.

There are of course other considerations for policy makers to weigh. Investment firms that provide asset management services may also play an important role in building out critical infrastructure and supporting the development of much needed housing inventory through their bond underwriting services and willingness to invest in the state.

In the last 3 years, over \$1 billion of bonds have been issued collectively by our Housing Finance Agency, Public Finance Authority and Building Authority. The majority of these bonds were issued on a competitive bid basis which means the investment bank buys the entire issuance up front, injecting capital into the state to be used for state building and infrastructure projects. As an example, since

2020 JP Morgan has purchased close to \$900,000,000 in bonds from our agencies, the proceeds of which are being used to fund building projects and water projects including clean water projects in Fargo, Jamestown, Cavalier, Center, Stanton, Stanley, Arnegard plus many more, and this investment by JP Morgan included the purchase of all of the Legacy Bonds the proceeds of which are being used to fund, among other things, the Fargo flood diversion project and highway bridge projects across the state. The same firms that are being deemed ineligible in other states have underwritten and invested in North Dakota to fund projects like the Science Center at NDSU, the Performing Arts Center at Valley City State, and Pulver Hall at Dickinson State.

Investment firms also buy the Mortgage Revenue Bonds and other bond issuances that support our single-family housing programs and multi-family affordable housing programs that are so critical to our lower and moderate income residents, and so critical to attracting workforce to the state.

These investment firms are also positioned to provide the necessary outside capital that will fund the development of a carbon management infrastructure that will support our fossil fuels industry and extend by decades the economic life and financial impact of the Bakken.

