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When New Investor-Protection Rules Come Up Short, States Step In

Client's win in Nevada shows how stronger state-level securities laws can take hold as federal rules change

An investor protection clinic at UNLV William S. Boyd School of Law in Las Vegas, where students and a law professor successfully argued a case using Nevada's fiduciary rule. PHOTO: ROGER KISBY FOR THE WALL STREET JOURNAL

By Lisa Beilfuss

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A Nevada investor's recent victory against her former Wells Fargo WFC -0.27% ▼ broker highlights the efforts by some states to enact tougher investor protections.

Ann De Jong, a 43-year-old emergency room doctor in Las Vegas, hired Wells Fargo in 2018 to manage her savings. She said she asked that the money be managed conservatively, kept mainly in money-market accounts for safety with quick access to cash. But during a bout of volatility, she lost $41,000, or roughly 6% of her portfolio. The broker handling Ms. De Jong's account had put the money in riskier products meant to boost returns.

"It was my life savings," Ms. De Jong said. "It was a nightmare."

Ms. De Jong's case appears to be the first time a customer invoked Nevada's fiduciary rule and won.

"The company is disappointed with the results of this matter," a Wells Fargo spokeswoman said.

Brokers, usually paid in sales commissions and management fees based on assets in a client's account, often face conflicts of interest. Last year the Fifth U.S. Circuit Court of Appeals in New Orleans invalidated the Labor Department's fiduciary rule, an Obama-era regulation meant to address such conflicts for brokers. Since then, the U.S. Securities and Exchange Commission has put forth new conduct rules.

Law professor Benjamin Edwards argued a Nevada investor's case against Wells Fargo. PHOTO: ROGER KISBY FOR THE WALL STREET JOURNAL

Investor advocates say the new rules don't go far enough, because brokers can still pick products that are more lucrative for them so long as those conflicts are disclosed. Some state legislators and regulators have meanwhile moved to strengthen their own securities laws, citing insufficient federal protections. Since 2017, Nevada has led the way by requiring financial advisers of all stripes to act as fiduciaries, meaning they must put clients' interests before their own.

Complaints against brokers for breaching a fiduciary duty aren't uncommon. So far this year, there have been 1,138 arbitration cases—about half the number of new cases filed at the Financial Industry Regulatory Authority this year—alleging such a violation. These complaints aren't always easy to win, partly because of murky standards of conduct around investment professionals.

Ms. De Jong turned to the free student law clinic at the University of Nevada, Las Vegas, after other attorneys turned her away. The team of law students, led by law professor Benjamin Edwards, argued that the Wells Fargo broker violated Nevada's fiduciary duty, among other things.

"It was a huge arrow in our arsenal that we could deploy," Garrett Logan, a student who worked on Ms. De Jong's case, said of Nevada's statute. The team recovered the full amount lost.

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Ms. De Jong's victory shows that state rules can influence arbitration decisions to the benefit of investors. When brokerage clients assert wrongdoing, they typically have to do so in private arbitration hearings, as opposed to public courts.

In addition to Nevada, Massachusetts and Florida have relatively strong securities laws, attorneys say. States including New Jersey, Connecticut and New York have also taken steps to implement versions of a fiduciary standard for some types of accounts and products.

Critics have suggested the SEC's Best Interest Rule would pre-empt any individual state rules, but some attorneys say otherwise.

"In my experience, arbitrators take state securities acts seriously," said Ross Intelisano, a New York attorney who represents customers in brokerage disputes. "If states like Nevada implement a fiduciary duty, it would be extremely beneficial for investors," he said.

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