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Via electronic submission to: http://www.njconsumeraffairs.gov/proposals/pages/default.aspx

Christopher W. Gerold, Bureau Chief
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Newark, New Jersey 07101

Re: Fiduciary Duty of Broker-Dealers and Investment Advisers (Proposal Number: PRN 2019-044); Proposed New Rule N.J.A.C. 13:47A-6.4[1]

Dear Mr. Gerold:

We the undersigned trade associations appreciate your continued engagement with the industry and the opportunity to comment on the proposed fiduciary duty regulations referenced above. We, as a group, represent a cross-section of the financial services industry and all of us have members serving retail investors in New Jersey. Many of us of have sent separate letters and would like to take this opportunity to highlight some key universal concerns applicable across all our membership.

Specifically, as you consider the comments and develop the Bureau of Securities' final regulation, we encourage you to consider the following:

1. The Bureau should await the conclusion of the SEC's rulemaking to establish a uniform, heightened, best interest standard for broker-dealers.

As we have suggested in previous testimony, comments and at informal meetings, it is important for New Jersey to wait for the Securities and Exchange Commission ("SEC") to finalize the proposed Regulation Best Interest and the accompanying disclosure form(s) ("Reg BI"). Reg BI would create a new, nationwide, heightened standard of conduct for broker-dealers ("BDs"). Under the current Reg BI proposal, a BD making a personalized recommendation about a securities transaction or an investment strategy must: (1) act in the client's best interest, without placing its financial or other interest ahead of the client's interest; (2) act with diligence, care, skill and prudence; and (3) disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with the recommendation.
Based on our conversations with the SEC Commissioners and staff, we understand that Reg BI remains a top priority for SEC Chairman Clayton, and the SEC is working diligently to publish a final rule as soon as possible.

[1] Available at: https://www.njconsumeraffairs.gov/Proposals/Pages/bos-04152019-proposal.aspx.

We anticipate that the final rule may be published sometime in the third quarter of 2019,[2] or perhaps even sooner.

Based on the foregoing, we urge the Bureau to await the conclusion of the SEC's Reg BI rulemaking process before moving forward with any final regulations. Doing so would give the Bureau an opportunity to determine if there are material gaps between Reg BI and its proposed regulation. If the Bureau nevertheless proceeds with the Proposal, then the Proposal should be revised to clarify that firms that comply with Reg BI shall be deemed in compliance with the New Jersey standard.

The above represents what we believe to be some key problems with the draft regulations. We appreciate the opportunity to provide input, and we thank you for your time and consideration.

2. <u>The duration of the duty should be limited to the point in time when a recommendation is made</u>.

Under federal laws, the duration of a BD's suitability or best interest obligation is limited to the point in time when a recommendation is made. Under this Proposal, with respect to dually-registered individuals and firms with customers who maintain both a brokerage and an advisory account, "the fiduciary duty [in the BD account] shall be deemed an ongoing obligation to that customer."[3] As a practical matter, this requirement would impose on dually-registered BDs a new duty to monitor the performance of its customers' accounts.

BD accounts and supervisory systems were never designed or intended to provide continuous monitoring. Rather, the primary purpose of a BD account is to execute episodic transactions as directed by the customer, which is the limited function for which the BD is compensated. If BDs were forced to provide such monitoring, they would be unable to do so in a BD account without completely re-engineering existing supervisory systems and procedures. They likely would be required to either migrate their BD brokerage clients to fee-based advisory accounts, if appropriate, or cease servicing those brokerage accounts.[4] That outcome would be a major disservice to the hundreds of thousands of New Jersey investors who hold BD accounts today and who want to continue to receive episodic brokerage advice.

Further, there is no basis in the securities laws for effectively imposing a presumption that dually registered BDs or dually licensed representatives shall be deemed to be acting in an advisory capacity in servicing their brokerage accounts – or that a firm that carries a customer's advisory accounts should be deemed to be acting as an investment adviser for that customer's brokerage accounts.

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[2] *See, e.g.,* SEC Rule List, available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCd=3235&Image58.x=58&Image58.y=9. The DOL has also added a Fall 2019 placeholder on its regulatory calendar for potential action on the vacated DOL Fiduciary Rule. *See* DOL Rule List, available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=1200.

[3] Proposal at Section 13:47A-6.4(a)1.ii ("If a broker-dealer or agent also provides, in any capacity, investment advice to the customer, the fiduciary duty shall be deemed an ongoing obligation to that customer."). The preamble states that this provision is intended to impose an ongoing fiduciary duty in a brokerage account in situations where a dual registrant acts as both an IA and a BD to the same customer.

[4] Similarly, the US DOL's fiduciary rule directly caused the migration of brokerage retirement accounts to fee-based accounts, and a marked contraction of service offerings.

For the above reasons, we recommend that the Proposal conform the duration of the duty to be consistent and in harmony with current Financial Industry Regulatory Authority ("FINRA") rules and the SEC's forthcoming Reg BI and include an explicit exemption from the fiduciary duty for unsolicited transactions and self-directed accounts.

3. The "best of" standard for account types, securities, and transaction-based compensation is impermissibly vague and fails to provide a sufficiently defined standard to put advisors on fair notice of what it requires.

The Proposal requires that a recommended security or account type must be "the best of the reasonably available options" and that any transaction-based fee received by the BD must be both "reasonable"[5] and "the best of the reasonably available fee options…."[6] No such "best of" standard exists under current federal securities laws. Both provisions are impermissibly vague and fail to provide fair notice to BDs and IAs of how to comply with the new regulations for a multitude of reasons raised in our individual comment letters. As a group, we believe that the "best of" standard should be eliminated.

4. The scope of the proposed fiduciary duty should be limited to recommendations of securities transactions or investments strategies.

As discussed above, under current FINRA rules and prospective Reg BI, a BD's best interest obligation applies only when making recommendations about a securities transaction or investment strategy involving securities to a retail customer. The term "securities transaction" includes a sale, purchase, and exchange, and may, for example, include recommendations to roll over or transfer assets from an ERISA account to an IRA.[7] The term "recommendation" has the meaning long-interpreted and applied under FINRA rules and broker-dealer regulation generally.[8]

As such, a BD's best interest obligation does not apply to recommendations about account types. Under the Proposal, however, the scope of the fiduciary duty extends more broadly to recommendations about "the opening of, or transfer of assets to, any type of account…."[9]

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[5] FINRA rules already require that BD commissions and fees be fair and reasonable. *See* FINRA Rules 2100 et seq. Accordingly, we recommend that the Proposal adopt the definition and interpretation of "reasonableness" as set forth under FINRA rules and associated guidance.

[6] Proposal at Section 13:47A-6.4(b)2.i and (b)3.

[7] *See* FINRA Regulatory Notice 13-45, *Rollovers to Individual Retirement Accounts: FINRA Reminds Firms of Their Responsibilities Concerning IRA Rollovers* (Dec. 2013), available at http://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf.

[8] *See* FINRA Rule 2111 (Suitability) FAQ, available at http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq. Factors that are considered when determining whether a broker-dealer has made a recommendation include whether the communication "reasonably could be viewed as a 'call to action'" and whether it "reasonably would influence an investor to trade a particular security or group of securities." *See* FINRA Notice to Members 01-23, *Suitability Rule and Online Communications* (April 2001), available at http://www.finra.org/industry/notices/01-23.

[9] Proposal at Section 13:47A-6.4(a) and (b)2.i.

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Imposing such an obligation would put firms in the untenable position of owing a duty to *prospective* clients, individuals with whom the firm has no existing relationship. That outcome would be unworkable and inconsistent with the common law for the reasons set out in our individual comment letters. As such, we recommend that the scope of the fiduciary duty for BDs should apply only when making a recommendation of a securities transaction or investment strategy involving securities to a retail customer and should not apply to recommendations about account types.

5. The duty of loyalty should: (i) strike the "without regard to …" formulation and use the SEC's formulation instead; (ii) provide additional guidance on the types of products and compensation that are permissible; and (iii) clarify the disclosure obligation.

a. "Without regard to …" The Proposal's duty of loyalty requires that recommendations be made "without regard to the financial or any other interest of the [BD] …"[10] Notably, in its Reg BI proposal, the SEC replaced the foregoing phrase with the phrase "without placing the financial or other interest … ahead of the interest of the retail customer."[11] The SEC did so out of concern that the "without regard to" language could be inappropriately construed to require a BD to eliminate *all* of its conflicts and because the SEC believed that its own formulation appropriately reflects the underlying intent of the "without regard to" formulation." We agree.

The "without regard to" formulation lacks clarity. The SEC formulation does not. The SEC formulation accomplishes the identical purpose as the "without regard to" formulation, but with greater clarity and less confusion and uncertainty regarding the expectations associated with the obligation. For these reasons, we recommend that the Proposal strike the "without regard to" formulation and replace it with the SEC's formulation.

b. Principal transactions, affiliated and proprietary products, and limited range of products. Neither the preamble nor the text of the proposed rule make any reference to recommendations of principal transactions, affiliated or proprietary products, or from among a limited range of products. Both Congress in the Dodd-Frank Act[12] and the SEC in proposed Reg BI,[13] however, explicitly call-out these categories of recommendations as ones that may well be consistent with a fiduciary and/or best interest standard, respectively. The Proposal's failure to address these specific types of recommendations in any manner raises concern and creates uncertainty about whether these types of recommendations would breach the Proposal's fiduciary duty.

These types of transactions represent a clear benefit to retail investors, as they provide the ability to buy initial public offerings (IPO) shares and municipal bonds in brokerage accounts and equally important, the ability to sell back to the brokerage firm products such as structured notes, and thereby maintain liquidity. We therefore recommend that the Proposal be amended to explicitly acknowledge that it does not prohibit such activity.

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[10] Proposal at Section 13:47A-6.4(b)2.

[11] 83 FR 21586, available at https://www.federalregister.gov/documents/2018/05/09/2018-08582/regulation-best-interest.

[12] Dodd-Frank Act, § 913, available at http://www.dodd-frank-act.us/Dodd_Frank_Act_Text_Section_913.html.

[13] 83 FR 21586, 21609, and 21620, available at https://www.federalregister.gov/documents/2018/05/09/2018-08582/regulation-best-interest.

c. ***Direct and indirect compensation.*** Because the Proposal specifically targets "harmful incentives" such as "sales contest," the Proposal should be revised to specify the particular incentives that trigger a breach, so that the many other forms of unobjectionable "direct or indirect compensation" do not get inadvertently caught-up in this provision. The Proposal could specify, for example, that sales contests that are focused on the sale of specific securities would trigger a breach, whereas rewards for gathering and growing assets, for example, whether in the form of recruiting bonuses or as part of annual compensation – which are fundamental to our industry's compensation structure, would not trigger a breach.

d. ***Disclosure obligation.*** For the reasons we outline in our individual letters, and to be consistent with current federal securities laws and proposed Reg BI, the Proposal should: (i) strike the provision that "disclosing a conflict … does not presumptive satisfy the duty; (ii) clarify that disclosures obligations are limited to *material* conflicts of interest (as such term was defined by the U.S. Supreme Court in *Basic v. Levinson*) thereby making the Proposal consistent with the Securities Exchange Act of 1934 (the "Exchange Act"); and (iii) explicitly state that the disclosure obligation of an associated person of a BD is satisfied by disclosing "all material conflicts of interest that are associated with the recommendation."

6. The Proposal Raises Pre-Emption and Other Legal Concerns.

As outlined in more detail in our individual letters, we believe the draft regulations have both pre-emption issues and legal deficiencies. We find there to be conflicts with the National Securities Markets Improvements Act ("NSMIA"), the Advisers Act, the Employee Retirement Income Security Act of 1974 ("ERISA") and the Federal Arbitration Act, among others.

Specifically, the State is pre-empted from imposing regulatory requirements on Registered Investment Advisers as its jurisdiction is limited to enforcement of antifraud provisions.[14] The law and draft regulations go well beyond the State's legal authority.

The State is also pre-empted from imposing different or additional recordkeeping requirements.[15] The draft regulations would impose new recordkeeping requirements on BDs.
The draft regulations state that they should be "interpreted and applied in harmony with [NSMIA]." This simply is not possible as the regulations are currently drafted.

7. The Proposal must properly account for its economic impact.

[14] 15 U.S.C. §80b-3a(b)(1). Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA–1633, File No. S7–31–96, (May 22, 1997), available at https://www.govinfo.gov/content/pkg/FR-1997-05-22/pdf/97-13284.pdf ("On its face, section 203A(b)(2) preserves only a state's authority to investigate and bring enforcement actions under its antifraud laws with respect to Commission-registered advisers. The Coordination Act does not limit state enforcement of laws prohibiting fraud. Rather, states are denied the ability to reinstitute the system of overlapping and duplicative regulation of investment advisers that Congress sought to end." (text at nn.155-56)).

[15] Section 15(i)(1) of the Securities Exchange Act of 1934 precludes a State from enacting regulations relating to the making and keeping of records "that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act]" (emphasis added). 15 U.S.C. §78o(i)(1). In addition, under the Exchange Act, Rule 17(a)-4 requires BDs to keep a record of *"*all communications … by the member … relating to its business as such….*"* 17 CFR §§ 240.17a-4(b)(4).

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In support of its economic impact analysis, the Proposal cites a study published in the Journal of Financial Planning entitled, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice*, by Michael Finke, Ph.D., CFP, and Thomas P. Langdon, J.D., LL.M., CFP, CFA (the "Finke Langdon study"). The Finke Langdon study explored the proposed application of a universal fiduciary standard and the impact on the financial adviser industry and we do not believe this study to be relevant to the Proposal. In contrast, our individual letters highlight relevant data for your consideration.

8. <u>The Proposal should specify an appropriate future effective date and provide for a sufficient implementation period prior to such date.</u>

The Proposal states that "[t]he provisions of this section shall take effect on (90 days from the effective date of this new rule)."[16] This appears to mean that the new rule would become applicable 90 days after publication as a final rule.

Ninety days is an insufficient transition period for such a serious regulatory change. Firms will require a significantly longer implementation period and thus a much later, more appropriate future effective date.

In order to comply with the Proposal's potential requirements, firms would need to develop significant new infrastructure and policies and procedures, which would be a complex and resource intensive undertaking, particularly considering the range of business models that would be subject to the proposed regulations. Firms would also need enough time to implement training programs and to build systems to comply with the prospective new regulations, including those necessary to create new books and records.

Firms would also likely need time to determine whether they will change or scale back their New Jersey activity as part of their compliance strategy. Since there is no grandfathering provision in the current Proposal, Broker-Dealers ("BDs") and their representatives cannot limit their fiduciary duty by ceasing to make recommendations to existing New Jersey brokerage account clients. Firms will therefore need time to determine whether and how to either scale-back or terminate these relationships.

Based on the foregoing, we recommend that the Bureau provide an implementation period of at least eighteen months, followed by an initial effective date thereafter.

Sincerely,

Craig D. Pfeiffer
President & CEO
Money Management Institute

[16] Proposal at Section 13:47A-6.4(f).