FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

June 14, 2019

Submitted electronically to DCAproposal@dca.lps.state.nj.us

Christopher W. Gerold
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153 Halsey Street, 6th Floor
P.O. Box 47029
Newark, New Jersey 07101

Re: Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives (Proposal Number: PRN 2019-044)

Dear Chief Gerold:

On April 15, 2019, the New Jersey Bureau of Securities (the "Bureau") issued its request for public comment on proposed amendments to N.J.A.C. 13:47A-6.3 and newly proposed rule N.J.A.C. 13:47A-6.4 (collectively, the "Proposal"). The Proposal would establish, by regulation, the common law fiduciary duty to be applicable to broker-dealers and their agents and codify the common law fiduciary duty for investment advisers and investment adviser representatives. The Bureau has stated that the purpose of the Proposal is to "establish a uniform standard for financial professionals and rectify investor confusion that results from the lack of uniformity."[1]

The Financial Services Institute[2] (FSI) appreciates the opportunity to comment on this important proposal. FSI members have long supported a best interest standard of care that is applicable to all professionals providing personalized investment advice to retail clients. We believe that such a standard should also require reasonable and streamlined disclosures to ensure industry participants effectively communicate information material to their clients and prospective clients. We are confident that the U.S. Securities and Exchange Commission (the "SEC") has achieved this goal through its most recent rulemaking package, which includes Regulation Best Interest, a best interest standard of conduct applicable to broker-dealers, and a separate interpretive guidance on the fiduciary duty applicable to investment advisers.[3] Regulation Best Interest maintains the meaningful distinctions between brokerage services and advisory services,

[1] Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019).

[2] The **Financial Services Institute (FSI)** is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 100 independent financial services firm members and their 160,000+ affiliated financial advisors – which comprise over 60% of all producing registered representatives. We effect change through involvement in FINRA governance as well as constructive engagement in the regulatory and legislative processes, working to create a healthier regulatory environment for our members so they can provide affordable, objective advice to hard-working Main Street Americans. For more information, please click here.

[3] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Release No. 34-86031 (June 5, 2019) (the "Regulation Best Interest Adopting Release"); *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Release No. 5248 (June 5, 2019).

which preserve investor choice and access to investment products, services and advice. Regulation Best Interest achieves many of the goals set forth in the Bureau's Proposal, namely, a broker-dealer: (i) must provide a description of its applicable standard of conduct using prescribed wording; and (ii) must not place their own interests ahead of their customers' interests. In addition, Regulation Best Interest provides a framework for disclosure which ensures that retail investors are informed of all material facts about (i) the scope and terms of their relationship with a broker-dealer (i.e., that the firm or representative is acting in a broker-dealer capacity); (ii) fees and costs; and (iii) conflicts of interest.[4] Regulation Best Interest generally imposes more specific obligations on broker-dealers than the principles-based requirements of investment advisers' common law fiduciary duty.[5] For these reasons, FSI members believe that the Proposal would unnecessarily duplicate and potentially conflict with the requirements of Regulation Best Interest.

FSI understands that the Bureau considered the standard of conduct under proposed Regulation Best Interest to fall short. However, FSI believes that significant changes to the adopted SEC rule requires the Bureau to reevaluate the Proposal. Specifically, Regulation Best Interest provides a model for the types of disclosures that allow retail investors to make informed decisions about the services and products they choose. FSI recommends that the Bureau consider aligning its proposal with Regulation Best Interest or alternatively providing that a broker-dealer's substantial compliance with Regulation Best Interest would satisfy the requirements under the Proposal.

In the event that the Bureau elects to proceed with its Proposal, FSI appreciates the opportunity to provide the following background and comments.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives.[6] These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

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[4] Exchange Act Rule 15l-1(a)(2)(i).

[5] Regulation Best Interest Adopting Release at p. 60.

[6] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment adviser firm. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

Discussion

Since 2009, FSI has publicly supported a carefully crafted best interest standard of care that is applicable to all professionals providing personalized investment advice to retail investors.[7] FSI has been actively engaged in discussions surrounding the standard of care, including providing the SEC with detailed comments in response to requests for information and the rule proposal for Regulation Best Interest. FSI believes that several key issues must be addressed in any standard of care rulemaking, including defining a standard of care and ensuring investors retain access to investment products, services and advice.

In our view, the Proposal would impose a new regulatory structure that varies significantly from the current framework and would drastically alter the relationship between broker-dealers and their retail clients in New Jersey. FSI believes that significant changes in the adopted Regulation Best Interest necessitates a reevaluation of the Proposal. Should the Bureau choose to move forward with the Proposal, FSI urges the Bureau to consider the burden that the Proposal will have on access to advice for many Main Street Americans, and the limitations that it will impose on products and services offered by financial advisors. Beyond this overriding concern, we offer specific constructive feedback and suggestions below.

I. Inconsistencies with Federal and State Securities Laws

As noted above, FSI members have reservations about the Bureau's Proposal, which would establish a fiduciary duty for broker-dealers. We believe doing so will detrimentally blur the meaningful distinctions between brokerage services and advisory services in New Jersey.

A broker-dealer's relationship with its customers is fundamentally different from that of an investment adviser's relationship with its clients. Broker-dealers play a critical role in helping retail investors achieve important long-term goals, such as accumulating retirement savings, buying a home or funding a child's college education.[8] "Specifically, the brokerage services provided to retail customers range from execution-only services to providing personalized investment advice in the form of recommendations of securities transactions or investment strategies involving securities to customers."[9] Broker-dealers are typically compensated based on transaction-specific recommendations and receive compensation based on the transactions executed for their retail customers. This type of arrangement is particularly useful to low- and middle-income investors who would otherwise be unable to afford financial advice and services.

Investment advisers also play a similar but distinct role, offering a variety of advisory services, which are geared towards helping retail clients achieve the same long-term goals. Specifically, advisory services provided to retail clients range from financial planning and consulting to discretionary management of a client's assets and are often hallmarked by ongoing advice and monitoring. Investment advisers are typically compensated based on a percentage of total assets managed for a client. This type of arrangement can be particularly useful for middle- and high-income retail investors who can afford to pay an ongoing fee for services.

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[7] *See, e.g.*, Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Jay Clayton, Chairman, U.S. Securities and Exchange Commission (October 30, 2017) (responding to request for Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker Dealers), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2657870-161400.pdf.

[8] Regulation Best Interest Adopting Release at 6.

[9] Regulation Best Interest Adopting Release at 6.

Imposing a fiduciary duty on a customer's relationship with its broker-dealer is artificial and confuses the fundamental purpose of the brokerage relationship with that of an advisory relationship. The Proposal will serve to disadvantage the basic brokerage model, and result in harm to New Jersey's retail investors, with a predominant impact on those low- to middle-income retail investors who are residents of New Jersey. For these reasons, FSI urges the Bureau to adopt a standard of care that acknowledges the critical differences between brokerage and advisory relationships and services.

A. Broker-Dealer Exclusions for Solely Incidental Investment Advice

The majority of FSI's IBD member firms are registered as both broker-dealers and investment advisers (i.e., dual registrants). As a dual registrant, an IBD member firm may provide brokerage services to retail customers in its capacity as a broker-dealer, advisory services to retail clients in its capacity as an investment adviser, or both brokerage and advisory services. The Proposal is especially harsh with respect to the dual-registrant model in that it contemplates holding a broker-dealer (or its agent) who also provides, in any capacity, investment advice to a retail investor, to an ongoing fiduciary duty standard. The fiduciary duty would be applicable to the broker-dealer's (or its agent's) entire relationship with the retail investor, regardless of the type of account that the retail investor holds.[10]

The Proposal takes a position that significantly differs from the position taken by the New Jersey Uniform Securities Law and the SEC, both of which embrace the fundamental differences between brokerage services provided in a broker-dealer capacity and advisory services provided in an investment adviser capacity. For example, the New Jersey Uniform Securities Law explicitly excludes broker-dealers from the definition of an investment adviser.[11] Similarly, the Investment Advisers Act of 1940, as amended, provides an exclusion from its definition of an investment adviser for broker-dealers who provide advisory services that are "solely incidental to the conduct of their business as [brokers- dealers]," so long as they do not receive any special compensation for their advisory services.[12] The SEC recently confirmed and clarified the "solely incidental" exclusion in an interpretive release accompanying Regulation Best Interest.[13] In its release, the SEC acknowledges the congressional intent of the Advisers Act to specifically exclude persons "to the extent that such persons rendered investment advice incidental to their primary business."[14] Furthermore, the Solely Incidental Interpretive Release provides guidance on the extent to which (i) a broker-dealer's exercise of investment discretion over a customer's accounts could be considered solely incidental to the business of the broker-dealer and (ii) a broker-dealer monitoring the status and performance of a customer's accounts could be considered solely incidental to the business of the broker-dealer.

With its adoption of Regulation Best Interest, the SEC notes the key differences between broker-dealers and investment advisers, which generally include the nature of customer/client relationships, services offered and compensation models. FSI agrees that any advice provided by a broker-dealer that is not "solely incidental" and for which special compensation is received would likely subject a broker-dealer to adviser registration requirements. However, FSI believes

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[10] Proposed N.J. Admin. Code § 13:47A-6.4(a)1ii, Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019).
[11] N.J. Stat. Ann. § 49:3-49(g)(2)(iii).
[12] 15 U.S.C. § 80b-2(a)(11)(C).
[13] *Commission interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser*, Advisers Act Release No. 5249 (June 5, 2019) (the "Solely Incidental Interpretive Release").
[14] See Solely Incidental Interpretive Release, Advisers Act Release No. 5249 (June 5, 2019).

that the Proposal goes against well-established law and guidance and would unnecessarily blur the meaningful distinction between brokerage and advisory services provided by dual registrants by holding them to a fiduciary standard even when they provide brokerage services.[15] For these reasons, FSI urges the Bureau to reconsider its approach on dual registrants.

B. The Duration of a Broker-Dealer's Duty to a Customer

As noted above, the Proposal contemplates holding a broker-dealer (or its agent) who also provides, in any capacity, investment advice to a retail investor, to an ongoing fiduciary duty standard. The fiduciary duty would be applicable to the broker-dealer's (or its agent's) entire relationship with the retail investor, regardless of the type of account that the retail investor holds.[16] As noted above, imposing a fiduciary duty on a customer's relationship with its broker-dealer is artificial and confuses the fundamental purpose of the brokerage relationship with that of an advisory relationship.

The federal securities laws define "broker" and ""dealer" in the context of "effecting transactions" and "buying and selling securities," respectively.[17] Similarly, the State of New Jersey defines a "broker-dealer" in the context of "effecting or attempting to effect purchases or sales of securities."[18] The SEC's Regulation BI[19] acknowledges that a broker-dealer who is a "dual registrant is an investment adviser solely with respect to accounts for which a dual-registrant provides advice and receives compensation that subjects it to the Advisers Act."[20]

Obligating a broker-dealer (or its agent) who also provides, in any capacity, solely incidental investment advice to a retail customer, to an ongoing fiduciary duty standard ignores the existing federal and state laws that differentiate between broker-dealers and investment advisers. Furthermore, an ongoing fiduciary duty standard for a broker-dealer would deprive retail customers of the opportunity to choose the relationship, services, and fees and costs that suit their needs and investment objectives by (i) placing them in an ongoing advice relationship with a broker-dealer whom they did not seek ongoing advice from or (ii) effectively pricing out customers from receiving investment advice in connection with their brokerage accounts. FSI respectfully requests that the Bureau adhere to SEC and FINRA rules regarding the point in time duration of a broker-dealer's obligation to its customer and include an explicit exemption from the fiduciary duty for unsolicited transactions and self-directed accounts.

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[15] *See, e.g.*, Certain Broker-Dealers Deemed Not To Be Investment Advisers, Investment Advisers Act Release No. 2376 (Apr. 12, 2005) ("Release 2376"), http://www.sec.gov/rules/final/34-51523.pdf; see also S. Rep. No. 76-1775 at 22; H.R. Rep. No. 76-2639 at 28 (the term "investment adviser" was "so defined as specifically to exclude . . . brokers (insofar as their advice is merely incidental to brokerage transactions for which they receive only brokerage commissions.")).

[16] Proposed N.J. Admin. Code § 13:47A-6.4(a)1ii, Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019).

[17] 15 U.S.C. § 78c(a)(4) and (a)(5).

[18] N.J. Stat. Ann. § 49:3-49(c).

[19] Regulation Best Interest Adopting Release at p. 13 (noting that Reg BI "enhances the existing standard of conduct applicable to broker-dealers and their associated persons at the time they recommend to a retail customer a securities transaction or investment strategy involving securities.").

[20] Regulation Best Interest Adopting Release at p. 35.

II. Conflicts of Interest

A. "Without Regard To"

Under the Proposal, a broker-dealer's or investment adviser's duty of loyalty is satisfied when recommendations or advice are made *without regard to* the financial or any other interest of the broker-dealer or investment adviser, any affiliated or related entity, or any other third party. This language originated with the Dodd-Frank Wall Street Reform and Consumer Protection Act[21] (the "Dodd-Frank Act") and the subsequent SEC study pursuant to section 913 of the Dodd-Frank Act.[22] However, the SEC provides sound reasoning for adopting alternative language in Regulation Best Interest.[23] Specifically, Regulation Best Interest requires a broker-dealer to "act in the best interest of the retail customer at the time the recommendation is made, *without placing* the financial or other interest of the [broker-dealer] . . . ahead of the interest of the retail customer."[24] The SEC acknowledges its change in course from the Dodd-Frank Act and the 913 Study, by noting that the best interest standard of conduct is intended to align with an investment adviser's fiduciary duty.[25]

Moreover, the SEC notes that the Dodd-Frank Act and 913 Study did not intend to require a broker-dealer to provide conflict-free recommendations.[26] The SEC substituted "without regard to" for fear that it would be "inappropriately construed to require a broker-dealer to eliminate all of its conflicts when making a recommendation (i.e., require recommendations that are conflict free), which [the SEC believes] could ultimately harm retail investors by reducing their access to differing types of investment services and products and by increasing their costs."[27] For consistency and clarity, and to avoid potential harm to retail investors in New Jersey, we encourage the Bureau to adopt standard of care language that is similar to Regulation Best Interest.

B. Disclosure Obligations

As noted above, the Proposal does not explicitly require broker-dealers and investment adviser to provide disclosures of their material conflicts of interest, although the summary to the Proposal notes that an investment adviser does have a duty to eliminate or fully disclose material conflicts of interest. The Proposal does note, however, that there would be no presumption that

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[21] Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5301 (2010).
[22] Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("913 Study"), www.sec.gov/news/studies/2011/913studyfinal.pdf.
[23] Regulation Best Interest Adopting Release at pp. 62-63.
[24] Exchange Act Rule 15l-1(a)(1).
[25] Regulation Best Interest Adopting Release at p. 63. ("By replacing the "without regard to" language of Section 913(g) and the 913 Study with the "without placing the financial or other interest of the [broker-dealer] . . . ahead of the interest of the retail customer" phrasing, we did not intend to create a "lower" or "weaker" standard compared to the language of Section 913(g) and the 913 Study. Rather, we are adopting a standard that reflects that a broker-dealer should not put its interests ahead of the retail customer's interest, and thereby aligns with (and in certain areas imposes more specific obligations than) the investment adviser fiduciary duty, at the time a broker-dealer makes a recommendation to a retail customer.").
[26] *See* Section 913(g) of the Dodd-Frank Act (permitting the SEC to adopt a fiduciary duty for broker-dealers that requires "disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest.").
[27] Regulation Best Interest Adopting Release at p. 64.

disclosing a conflict of interest in and of itself would satisfy a broker-dealer's or investment adviser's duty of loyalty.

To promote consistency with current federal securities laws and Regulation Best Interest, we suggest striking this provision from the Proposal to instead require the disclosure of *material* conflicts of interest.[28] This amendment would also align the Proposal with the antifraud provisions under the Securities Exchange Act of 1934 (the "Exchange Act").[29] Lastly, FSI urges the Bureau to add a provision that explicitly states that a broker-dealer's (or agent's) duty of loyalty is satisfied by disclosing "all material conflicts of interest that are associated with a recommendation."

C. Principal Transactions, Proprietary Products and Limited Product Offerings

The Bureau's summary only notes that the Proposal may impact broker-dealer agents' financial compensation to the extent that there are changes in the financial incentives or bonus programs for financial professionals to recommend proprietary products and services over third-party or non-proprietary products, or the types of accounts in which they enroll their customers. However, the Proposal does not explicitly address a broker-dealer's recommendation of principal transactions, affiliated and proprietary products, and limited product offerings. Principal transactions represent a clear benefit to retail investors, as they provide retail investors with the ability to purchase municipal bonds in brokerage accounts and sell back to the broker-dealer those brokerage products that are often considered to be illiquid (i.e., less frequently traded).

FSI requests clarification on the extent to which the Proposal permits principal transactions, affiliated and proprietary products, and limited product offerings. Specifically, FSI requests clarification as to whether a broker-dealer's duty of loyalty would prohibit principal transactions, the sale of affiliated and proprietary products and limited product offerings. In the adopting release for Regulation Best Interest, the SEC acknowledges that the Dodd-Frank Act does not require a prohibition on broker-dealers engaging in principal trades.[30] In addition, the SEC notes that a broker-dealer "would be required to disclose all material facts relating to conflicts of interest associated with the recommendation that might incline the broker-dealer to make a recommendation that is not disinterested, including but not limited to conflicts associated with the sale of affiliated and proprietary products and limited product offerings.[31] We urge the Bureau to align the Proposal with Regulation Best Interest by explicitly permitting principal transactions, the sale of affiliated and proprietary products and limited product offerings, with disclosures of any material conflicts of interest such transactions and products create.[32]

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[28] *See Basic v. Levinson*, 485 U.S. 224, 230-32 (Mar. 7, 1988) (adopting a standard of materiality in the context of Exchange Act Rule 10b-5 that an omitted fact is material if there is a substantial likelihood that a reasonable investor would consider it significant).

[29] *See* Exchange Act Rule 10b-5 ("It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange . . . (b) To make any untrue statement of a *material* fact or to omit to state a *material* fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . .") (emphasis added).

[30] Regulation Best Interest Adopting Release at p. 64 n. 128.

[31] Regulation Best Interest Adopting Release at p. 75 n. 148.

[32] We note that this disclosure-based approach also aligns with an investment adviser's fiduciary duty of loyalty, which requires the adviser to "eliminate or make full and fair disclosure of all conflicts of interest which might incline an investment adviser— consciously or unconsciously—to render advice which is not disinterested such that a client can provide informed consent to the conflict." *See Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Release No. 5248 (June 5, 2019).

D. Sales Contests, Sales Quotas, Bonuses and Non-Cash Compensation

The Proposal creates a presumption of a breach of the duty of loyalty for offering, or receiving, direct or indirect compensation to or from the broker-dealer or investment adviser for recommending, among other things, "the purchase, sale, or exchange of a specific security that is not *the best of the reasonably available options*."[33] The Bureau notes that this presumption is a result of concerns about "harmful incentives, such as sales contests, that encourage and reward conflicted advice."[34] FSI agrees with the Bureau's position and recommends that the Bureau align with Regulation Best Interest by explicitly prohibiting sales contests, sales quotas, bonuses and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.[35]

III. Preserving Investor Access and Choice

Under the Proposal, a broker-dealer (or its agent) who is a dual registrant would be subject to an ongoing fiduciary standard if, in its capacity as a broker-dealer, it provides "solely incidental" investment advice to a customer. Under the Proposal, it appears that solely incidental investment advice would impose an obligation on a broker-dealer who is a dual registrant to monitor its customer's portfolios, investment strategies, and investments on an ongoing basis. In other words, a broker-dealer who is a dual registrant would be required to provide ongoing advisory services to its brokerage customers pursuant to a brokerage account agreement that likely provides for transaction-based compensation.

Obligating broker-dealers (and their agents) who are dual registrants to an ongoing fiduciary standard for solely incidental investment advice provided to a brokerage customer, as contemplated by the Proposal, could result in many New Jersey investors with a small or moderate amount of investable assets to lose access to their chosen financial professional. When faced with the increased costs associated with monitoring customers' accounts on an ongoing basis, a broker-dealer would be forced to either move their brokerage customers to fee-based advisory accounts (but only if it is the "best of the reasonably available options") or cease providing brokerage services to those customers' accounts altogether.

Many negative unintended consequences will result if New Jersey investors lose access to financial professionals as a result of the Proposal. Financial advisors are instrumental in assisting retail investors with saving more for retirement and preparing retail investors for unexpected life events that would otherwise be financially devastating.[36] In addition, financial advisors guard retail investors against emotional financial decisions, such as reacting to volatility in the stock market, by keeping retail investors focused on their individual financial goals. Moreover, financial advisors are often the first line of defense against financial exploitation and this first line of defense will be lost for those New Jersey residents.

As noted above, FSI respectfully requests that the Bureau adhere to SEC and FINRA rules regarding the point in time duration of a broker-dealer's obligation to its customer and include an

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[33] Proposed N.J. Admin. Code § 13:47A-6.4(b)2i, Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019).
[34] Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019).
[35] *See* Exchange Act Rule 15l-1(a)(2)(iii)(D).
[36] Jamie Hopkins, *Not Enough People Have Financial Advisers and New Research Shows They Should*, Forbes (Aug. 28, 2014), https://www.forbes.com/sites/jamiehopkins/2014/08/28/not-enough-people-have-financial-advisers-and-new-research-shows-they-should/#749da13552e5.

explicit exemption from the fiduciary duty for solely incidental investment advice for which special compensation is not received. In addition, we recommend that the Bureau include an explicit exemption from the fiduciary duty for unsolicited transactions and self-directed accounts.

IV. Interstate Application of Various Standards of Care

FSI urges the Bureau to also consider the Proposal's impact to retail investors with respect to interstate issues. For example, the Proposal does not address how a broker-dealer's fiduciary duty would apply to retail customer relationships when the customer is located or employed in, or moves to, other states where different (and potentially inconsistent) standards of care and related rules govern relationships between broker-dealers and their retail customers.

V. Adapting and Defining Key Terms

FSI believes that the Proposal would benefit from the addition of definitions for certain key terms that are a central part of its proposed fiduciary duty standard.

A. "Recommendation;" "Investment Advice;" "Investment Strategy"

FSI notes the use of the term "recommendation" or some variation thereof throughout the Proposal.[37] Additionally, the terms "investment advice" and "investment strategy" are used throughout the Proposal.[38] To the extent possible, and for purposes of efficiency and transparency, FSI urges the Bureau to consider revising the Proposal to introduce key terms that are used by the SEC and FINRA, and drafting definitions for such key terms to align with SEC and FINRA rules and guidance.[39]

For example, the adopting release for Regulation Best Interest notes that "[f]actors considered in determining whether a recommendation has taken place include whether the communication 'reasonably could be viewed as a 'call to action' and 'reasonably would influence an investor to trade a particular security or group of securities.'"[40] FSI also believes that the term "investment strategy" should clearly align with Regulation Best Interest's use of the term "investment strategy involving securities." The SEC notes that an "investment strategy involving securities" includes recommendations by broker-dealers of securities account types generally and recommendations to roll over or transfer assets from one type of account to another (e.g., 401(k) retirement plan to IRA).[41] Moreover, the SEC provides that the term "any securities transaction or investment strategy involving securities" includes explicit hold recommendations and implicit hold recommendations that are the result of agreed-upon account monitoring between the broker-

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[37] *See, e.g.*, Proposed N.J. Admin. Code § 13:47A-6.4(a)1, (a)1i, (b)2i, Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019) (emphasis added).
[38] *See, e.g.*, Proposed N.J. Admin. Code § 13:47A-6.4(b)1, Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019) (emphasis added).
[39] *See, e.g.*, Financial Industry Regulatory Authority, Inc., FINRA Rule 2111 (Suitability) FAQ, (noting that "[a]lthough FINRA does not define the term "recommendation," it has offered several guiding principles that firms and brokers should consider when determining whether particular communications could be viewed as recommendations."), https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq#_edn1.
[40] Regulation Best Interest Adopting Release at pp. 79-80 (citing FINRA rules and guidance).
[41] Regulation Best Interest Adopting Release at pp. 93-94.

dealer and retail customer.[42] While terms under Regulation Best Interest differ in some instances from current FINRA guidance, we encourage the Bureau to defer to Regulation Best Interest when defining or providing guidance on key terms, given that there may be forthcoming changes to FINRA rules and guidance.

B. "Best of the reasonably available options"

The Proposal creates a presumption of a breach of the duty of loyalty for offering, or receiving, direct or indirect compensation to or from the broker-dealer, agent or investment adviser for recommending, among other things, "the purchase, sale, or exchange of a specific security that is not *the best of the reasonably available options*."[43] However, the Proposal permits a broker-dealer or agent to receive transaction-based fees so long as: (i) the fee is reasonable; (ii) the fee is the "*best of the reasonably available fee options*"; and (iii) the broker-dealer's duty of care is satisfied.[44]

FSI believes that any presumption of a breach of the duty of loyalty or any requirement for overcoming a presumption of a breach of the duty of loyalty should set forth clear and obvious standards for compliance. Unfortunately, the "best of" standards set forth in the proposal do not set forth clear and obvious standards for broker-dealers and investment advisers to comply.

FSI believes that the Proposal would benefit from clarification on how the Bureau would expect broker-dealers and investment advisers to determine and document for compliance, prior to making a recommendation to a retail customer to purchase, sell, or exchange a specific security, that the specific security is "the best of the reasonably available options." For example, does a "reasonably available option" include a product offered by a broker-dealer's clearing firm even if the broker-dealer does not offer the product through its agents? Does a "reasonably available option" include any product that is readily available on the market, but that a broker-dealer has not performed diligence or signed a selling agreement to sell?

Similarly, FSI believes that the Proposal would also benefit from clarification on how the Bureau would expect broker-dealers to determine and document for compliance that a transaction-based fee is the best of the reasonably available fee options for the customer. FSI does not believe that these provisions are intended to require a broker-dealer to determine whether a brokerage account that charges transaction-based fees is appropriate for a retail customer prior to every single transaction that is effected for the retail customer. To the extent that the Bureau does not agree that the "best of" standards should be eliminated altogether, FSI requests clarification on these provisions, including examples of the analysis that the Bureau would expect.

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[42] Regulation Best Interest Adopting Release at p. 94.
[43] Proposed N.J. Admin. Code § 13:47A-6.4(b)2i, Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019).
[44] Proposed N.J. Admin. Code § 13:47A-6.4(b)3, Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 493(a) (April 15, 2019).

VI. Preemption under the National Securities Markets Improvement Act

As expressed in the joint letter to which FSI is a signatory, FSI believes that the Proposal has both preemption issues and legal deficiencies.

Under the National Securities Markets Improvements Act ("NSMIA"), states are prohibited from requiring broker-dealers to among other things, make and keep records that differ from, or are in addition to, the records required under the federal rules.[45] In addition, states are pre-empted from imposing specific registration, licensing, and qualification requirements on SEC-registered investment advisers, with the exception of those provisions relating to enforcement of anti-fraud prohibitions.[46]

As a practical matter, the Proposal would have the effect of imposing new recordkeeping requirements on broker-dealers, as they seek to develop, implement and document policies and procedures to demonstrate compliance with the Proposal's requirements. For example, broker-dealers who receive commissions for effecting securities transactions that result from their solely incidental investment advice would be required to overcome a presumption of a breach of the duty of loyalty. Specifically, broker-dealers and agents would be required to keep records that document and demonstrate why their recommendations are the "best of the reasonably available options." For these reasons, we believe the Proposal extends into the limitations invoked under NSMIA.

VII. The Economic Impact of a Fiduciary Standard in New Jersey

As noted above, FSI members also make significant contributions to the State of New Jersey. FSI members generate $2.2 billion of economic activity in the State of New Jersey. This activity, in turn, supports 22,761 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly $10 million annually to New Jersey and local government taxes. FSI members account for approximately 11 percent of the total financial services industry contribution to New Jersey economic activity.[47]

If FSI members are held to a unique standard of care in New Jersey, particularly if the requested clarification and exemptions are not provided, these financial advisors may have to cease doing business with or cut back on financial services provided to retail investors in New Jersey. This would undoubtedly have a negative impact on New Jersey investors, particularly those low- to middle-income retail investors who are residents of New Jersey.

VIII. Extension of the Effective Date

The Proposal affects many of the interactions broker-dealers and investment advisers have with retail investors. One particular challenge FSI members have identified is the substantial amount of time that is dedicated to developing proper education and training for representatives

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[45] 15 U.S.C. § 78o(i)(1) ("No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers that differ from, or are in addition to, the requirements in those areas established under this chapter.").

[46] 15 U.S.C. § 80b-3a(b)(1).

[47] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

and then administering it. This process of educating and training representatives on any new standard of care, procedures, and disclosures cannot commence until firms have made decisions about any changes that must be made to the products and services offered as well as their written supervisory procedures. This is especially critical if the procedures differ from Regulation Best Interest, current FINRA rules and other state standards of care.

Specifically, FSI members will be challenged to implement the policies, procedures, forms and training required by Regulation Best Interest by June 2020. After that time, FSI members will be able to address the Bureau's final rule and any potentially inconsistent requirements among the Bureau's final rule, new FINRA rules[48] and Regulation Best Interest. Moreover, these decisions cannot be made until firms' legal, compliance, and business units review and evaluate the final rule's impact on firms' business models. Therefore, we urge the Bureau to provide an 18-month implementation period, as opposed to the proposed 90-day implementation period, between the Proposal's final adoption and its eventual effective date.

Conclusion

In conclusion, FSI believes that the SEC's Regulation Best Interest strikes the right balance between the Bureau's stated goal of protecting investors against the abuses of conflicted recommendations and retail investors' interests in preserving access to investment advice and products. The Bureau's adoption of an additional and different standard of care with requirements that vary from federal and state laws and regulations only results in increased costs to and decreased access for New Jersey's retail investors.

Thank you in advance for considering this request. If you have questions about anything in this letter, or if we can be of any further assistance in connection with this rulemaking, please feel free to contact me at robin.traxler@financialservices.org or (202) 393-0022.

Respectfully submitted,

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[48] *See, e.g.*, Regulation Best Interest Adopting Release at p. 163 (noting that the SEC "anticipate[s] that FINRA will be reviewing the application of [its communication] rules in light of [Regulation Best Interest] disclosure obligations.").