June 14, 2019

Christopher W. Gerold
Bureau Chief
Bureau of Securities
153 Halsey Street, 6th Floor
PO Box 47029
Newark, New Jersey 07101

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

Dear Mr. Gerold:

The undersigned organizations write in response to the Securities Bureau's proposal to apply a state-based common law fiduciary standard to broker-dealers' and investment advisers' advisory activities. Given the unfortunate demise of the Department of Labor (DOL) Fiduciary Rule and the glaring deficiencies in the Securities and Exchange Commission's (SEC's) Regulation Best Interest,[1] we greatly appreciate states such as New Jersey that are willing to step in to fill the regulatory void by providing the protections investors need and expect. Contrary to arguments from industry groups, New Jersey is well within its authority in proposing this rule.

Several aspects of the Bureau's proposal are vastly more protective of investors than corresponding provisions in Regulation Best Interest. These include the provisions in the proposal that would apply a uniform fiduciary standard across an appropriately broad range of advisory activities. They also include the specific formulation of the fiduciary standard, which would ensure that brokers' and adviser's advisory activities alike are not tainted by conflicts of interest, to investors' detriment. We urge the Division to retain these critical protections in a final rule.

We also appreciate the fact that the Bureau has sought to address concerns about dual registrants' "switching hats" when dealing with the same customer. However, we urge the Bureau to broaden and strengthen this aspect of the rule by applying a fiduciary duty that follows the contours of the relationship, irrespective of whether hat-switching occurs. Doing so would better match investors' reasonable expectations about the nature and scope of their relationship with their financial professional and limit the possibility of investors' being misled.[2]

Finally, we appreciate the Governor's recent clarification that insurance producers are subject to a fiduciary duty.[3] However, given the prevalence of sales of annuities of questionable value in the state, we question whether insurance producers are complying with their fiduciary

[1] *See* SEC Commissioner Robert J. Jackson Jr., Statement on Final Rules Governing Investment Advice, June 5, 2019, https://bit.ly/2XJsaSp.
[2] *See* Letter from Jill I Gross, to the SEC, Regulation Best Interest, March 11, 2019, https://bit.ly/31v15os.
[3] Letter from Philip D. Murphy, Governor, New Jersey, to the New Jersey Senate, Returning Senate Bill No. 2475 (Second Reprint) With Recommendations for Reconsideration, May 13, 2019, https://bit.ly/2JCAXm7.

duty or whether the standard is being enforced in any meaningful way.[4] Lack of compliance and enforcement leaves investors vulnerable to harmful conflicted advice from purveyors of some of the highest-cost, most complex and opaque investment products on the market. Accordingly, we urge the Department of Banking and Insurance to step up its enforcement in the annuity context in order to give the fiduciary duty real meaning. That way, regardless of the various products New Jersey investors purchase, they would receive the protections that a fiduciary duty offers.

I. Broker-dealers hold themselves out and function as investment advice providers who are in positions of trust and confidence with their customers. Applying a common law fiduciary duty to these relationships is entirely appropriate.

There are myriad ways in which broker-dealers seek to persuade the investing public that they are providing objective, trustworthy investment advice rather than mere sales pitches.[5] For example, brokerage firms and their registered representatives routinely market themselves as "financial advisors," "financial consultants," or "wealth managers," giving the impression of specialized advisory expertise. They commonly describe their services as "investment advice" or "retirement planning" and market those services as designed to serve customers' best interests. In holding themselves out as impartial experts, they seek to occupy positions of trust and confidence with their customers. The clear intent of this marketing is to convince investors that they should trust that their "advisor" will be looking out for their best interests and to encourage them to rely on their expertise and recommendations. And investors place their trust in their financial professionals to provide them advice that is genuinely in their best interests and that will maximize the value of their investments.[6]

The harm to investors is immense when they reasonably, but mistakenly believe they are getting advice that's in their best interest based on a trusted relationship with their financial professional. In addition to paying higher costs, investors who rely on biased sales recommendations as if they constituted unbiased advice can end up facing unnecessary risks or receiving substandard returns. Cumulatively, these industry practices drain tens of billions of dollars every year out of investors' pockets and into the pockets of firms and their financial professionals. According to one study, New Jersey IRA investors alone lose approximately $610 million a year as a result of conflicted advice.[7] The losses are even larger when considering all types of accounts (retirement and non-retirement) and the full range of products sold within these accounts.

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[4] *See, e.g.,* Insured Retirement Institute, Variable Annuity Total Sales by State, 2014, https://bit.ly/30BIZRm; National Association of Fixed Annuities, 2016 State-By-State Fixed Annuity Sales Study, https://bit.ly/2QeNA77.

[5] *See* Micah Hauptman and Barbara Roper, *Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways*, CONSUMER FEDERATION OF AMERICA, January 18, 2017, http://bit.ly/2jKUbFD.

[6] *See* Regulation Best Interest, Section III.B.4.a, at 496-500, https://bit.ly/2Xfudkq ("In seeking financial advice, a retail investor places not only money but also trust in a financial professional….one industry study of over 800 investors notes that '96% of U.S. investors report that they trust their financial professional and 97% believe their financial professional has their best interest in mind.'").

[7] Heidi Shierholz and Ben Zipperer, *Here is what's at stake with the conflict of interest ('fiduciary') rule*, ECONOMIC POLICY INSTITUTE, May 30, 2017, https://bit.ly/2EQJ9gE.

Given how broker-dealers advertise and function as advisers in position of trust and confidence with their customers, it is entirely appropriate to apply a common law fiduciary duty to their advisory activities.

II. We strongly support the provisions in the proposal that would impose a uniform fiduciary standard on broker-dealers and investment advisers and apply that standard across a broad range of advisory activities.

Consistent with the advisory role that they play, the proposal requires both broker-dealers and investment advisers to comply with a common law fiduciary duty and applies that standard across a broad range of advisory activities. Specifically, the proposal would make it a dishonest and unethical business practice if a broker-dealer or investment adviser provides advisory services while failing to act in accordance with a fiduciary duty.

The proposed uniform fiduciary standard stands in stark contrast to the SEC's Regulation Best Interest, which maintains different standards for investment advisers' and broker-dealers' advice -- one standard that is called a fiduciary duty and one that is not, though neither standard provides the protections associated with a meaningful fiduciary duty. By applying a strong uniform fiduciary standard to both types of advisory relationship, the New Jersey proposal would ensure that, regardless of what type of professional an investor works with or the type of account they use, they would be protected by the same strong protections. This is vitally important, since repeated studies have shown that investors do not distinguish between broker-dealers and investment advisers and expect both types of financial professionals to act in their best interests when providing investment advice.[8]

A. Definition of Investment Advice

The SEC's Regulation Best Interest provides a narrow application of its non-fiduciary standard, which more closely resembles FINRA's suitability rule than a true best interest standard. In contrast, this proposal applies a strong fiduciary standard across a range of advisory activities. The fiduciary duty is triggered when a broker-dealer or its agent or investment adviser or its representative recommends to a customer an investment strategy, the opening of, or transfer of assets to, any type of account, or the purchase, sale, or exchange of a security. We strongly support this broad definition. However, we urge the Bureau to make a minor clarification to make clear that recommendations to hold securities are also within the scope of the rule.

B. Standard of Conduct

Unlike the SEC's Regulation Best Interest, which would merely codify the FINRA suitability standard and its related guidance and case law for broker-dealers,[9] this proposal would

[8] S*ee, e.g.,* Brian Scholl, Office of the Investor Advocate, and Angela A. Hung, RAND Corporation, The Retail Market for Investment Advice, October 2018, https://bit.ly/2PwCPz8.

[9] *See* footnote 7 of proposed Regulation Best Interest, stating that the proposed rule's information collection requirement, the fact that the duty can't be satisfied through disclosure alone, and the requirement to make recommendations that are consistent with the customers' best interests all "reflect obligations that already exist under the FINRA suitability rule or have been articulated in related FINRA interpretations and case law." https://bit.ly/2vqxvEL. *See also* footnote 572 of the final Regulation Best Interest, citing FINRA's 2018 comment acknowledging that FINRA suitability rules and related guidance already require brokers' recommendations to be

apply a common law fiduciary duty to the advisory activities of broker-dealers and investment advisers alike. At common law, a fiduciary duty includes both a duty of care to act with prudence and a duty of loyalty to refrain from engaging in self-dealing. The proposed fiduciary standard of conduct includes these two critical obligations and defines these obligations in a way that clearly and meaningfully improves protections for investors beyond those provided under FINRA rules and the new SEC standard.

Importantly, the proposed standard's duty of loyalty requires that the advice be made "without regard to the financial or any other interest of the broker-dealer, agent, adviser, any affiliated or related entity and its officers, directors, agents, employees, or contractors, or any other third party." This language comes directly from the standard Congress identified in section 913(g) of the Dodd-Frank Act as the appropriate standard for a uniform fiduciary rulemaking. Furthermore, the Bureau has made clear that its intent with this language is to limit incentives that encourage and reward harmful advice that results from conflicts of interest. We strongly support this language and urge the Bureau to retain it in a final rule.

In addition, the proposal includes a provision that establishes a presumption of a breach of the duty of loyalty if a broker or adviser provides advice that is not the best of the reasonably available options for the investor. We strongly support this provision, which is notably absent from both the SEC's Regulation Best Interest and its interpretation of the Investment Advisers Act fiduciary standard. As discussed above, investors reasonably expect that any advice they receive will be in their best interest, meaning the financial professional will recommend the investment options they reasonably believe are the best of the available options and will maximize the value of their investments. Whereas the SEC rules will mislead investors into expecting protections the rules do not deliver, this provision would help match investors' reasonable expectations about the quality of advice they receive.

As part of this analysis, we expect that brokers and advisers would be required to consider the relative costs and risks to the customer whenever they are considering various investment alternatives or investment strategies to achieve the customer's goals. This does not mean that a broker or adviser would always be required to recommend the lowest cost or lowest risk option. But it does mean that a broker or adviser would be required to take costs into account in a meaningful way when determining what to recommend. Where a broker or adviser has two or more similar products or strategies reasonably available that accomplish the same goals, and otherwise present comparable risks and benefits, but where one product or strategy has lower costs, under this standard, the broker or adviser must recommend the product or strategy with the lower cost. That is the appropriate approach in our view.

"consistent with customers' best interests," which FINRA has in turn interpreted as prohibiting a broker-dealer from putting its interests ahead of the interests of its customers, and that Reg BI would make this existing requirement "explicit." The letter also acknowledges that existing case law and FINRA guidance establish cost and available alternatives as factors to consider as part of a FINRA suitability assessment, but again, Reg BI would make them more "explicit." However, the SEC never discusses how making existing requirements more "explicit" would change firms' understanding of their regulatory obligations or their practices.

This proposal also makes clear that disclosure alone won't satisfy the duty of loyalty. As the Bureau is well-aware, there is simply no evidence that disclosure alone is effective in protecting investors from the harmful impact of conflicts. We urge the Bureau to retain this provision in a final rule.

III. The Bureau should apply a fiduciary duty that follows the contours of the relationship to fully protect investors and match their reasonable expectations.

We appreciate the fact that the Bureau has sought to address concerns about dual registrants' "switching hats" when dealing with the same customer. Hat-switching occurs when a dual registrant provides both brokerage and investment advisory services to the same customer. Because the firm and financial professional are regulated under different standards for the different accounts they serve, switching hats can confuse investors about the services they are being provided and the duties they are owed for each account. For example, the recently adopted federal standards apply different requirements on brokerage and advisory accounts with regard to account monitoring, treatment of conflicts, and the scope of services to which the duty applies. In addition, firms and financial professionals can take advantage of investors by acting in whatever capacity is best for them rather than the investor, taking off their brokerage hat and putting on their advisory hat when it best suits them and vice versa. Dual registrants often put on their brokerage hat when they don't want to provide ongoing services, such as portfolio monitoring, and they put on their advisory hat when they want to collect ongoing fees. It remains to be seen whether the new SEC rules will be effective in addressing these concerns.

This proposal would adopt a more rigorous approach to address hat switching, by requiring dual registrants to comply with an ongoing fiduciary duty when dealing with the same customer who has both brokerage and advisory accounts with the dual registrant. Under the proposed framework, regardless of what type of account the firm and financial professional are serving, the investor would receive the benefits of strong fiduciary protections for all of their accounts and wouldn't have to determine when she is owed protections that are ongoing and when she would receive a potentially lower level of protections that end when the transaction is completed. This is an improvement from Reg BI, which would continue to allow hat switching so long as the dual registrant provides disclosures about the capacity they are acting in. Research, including previous testing conducted by the SEC, indicates such disclosures are likely to be meaningless to investors who do not understand basic differences between brokers and advisers or why those differences matter.

However, in a glaring shortcoming it shares with the SEC's Regulation Best Interest, the proposal would not apply an ongoing fiduciary duty to exclusively brokerage relationships, even when they are long-term relationships of trust and confidence. According to Professor Jill Gross, who is Associate Dean for Academic Affairs and Professor of Law at the Elisabeth Haub School of Law at Pace University and who is a coauthor of the Broker-Dealer Law and Regulation Handbook, state common law typically recognizes that brokers have a fiduciary duty to their customers under certain circumstances, including where the broker has de facto control over an account.[10] This includes circumstances in which the investor routinely approves the broker's

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[10] Letter from Jill I Gross, to the SEC, Regulation Best Interest, March 11, 2019, https://bit.ly/31v15os ("Many retail investors are incapable of evaluating recommendations on their own, rely on those individuals as "trusted advisors"

recommendations because the investor lacks the experience or sophistication necessary to exercise her own judgment. As currently drafted, the proposal could deprive investors of these badly needed protections.

Given the generally low levels of financial literacy and the high degree of dependence investors place on their brokers, we believe that the circumstances that give rise to a common law fiduciary duty, including a duty to monitor the account, are quite common. Indeed, brokers' marketing of their services as long-term relationships of trust and confidence is commonplace. The following are a few typical examples:

- "Selecting a financial advisor and firm when seeking a long-term financial relationship built on trust and experience is one of the greatest decisions you will make." (Janney)
- "The ongoing relationship between you and your advisor is at the heart of what we do, to help you track your progress and adapt to changes in your life." / "We regularly reach out to you with meaningful information and ideas." (Ameriprise)
- "We are committed to establishing and maintaining long-term relationships based on integrity and trust and delivering long-term results based on deep research and independent thinking." (Stephens)
- "You'll build an ongoing, one-on-one relationship as your advisor gets to know you and your situation, and you can work together to tailor financial advice specifically to meet your needs." (Voya)
- "[I]t's developing a long-term relationship built on understanding and trust. Your advisor is there for you throughout the planning and investing process, giving you objective and unbiased advice along the way." (Raymond James)
- "If this sounds to you like a fairly close relationship, you're right. Many people develop lifelong friendships with their financial advisors. After all, these are people that you entrust with your financial future." (Securian Financial)[11]

In such cases, courts have held that the broker has a duty to manage the account in a manner directly comporting with the needs and objectives of the customer, to keep informed regarding changes in the market which affect the client's interests, and to act responsively to protect those interests, among other things.

In contrast, the proposal would limit a broker's duty to the customer to the point of transaction, regardless of the nature of the relationship and the extent of customer reliance on the broker's advice. We urge the Bureau to broaden and strengthen this aspect of the rule by applying a fiduciary duty that follows the contours of the relationship, irrespective of whether hat-switching occurs.

(in fact they are told by broker-dealers' marketing materials to rely on them), and follow their advice without questioning what is best for them. They reasonably believe they are in long-term relationships of trust and confidence and that their "advisor" will monitor their account and keep them apprised of any changes that should be made. Based on how these relationships are marketed and work in practice, it is entirely understandable why investors expect that they will receive ongoing services from broker-dealers.").

[11] *See* Micah Hauptman and Barbara Roper, *Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways*, CONSUMER FEDERATION OF AMERICA, January 18, 2017, http://bit.ly/2jKUbFD.

Under such an approach, brokers who truly do offer a one-time recommendation to a customer with no suggestion that the recommendation is being offered as part of an ongoing relationship would have no ongoing duty. In such circumstances, however, the broker should not be permitted to recommend investments that the customer is not capable of monitoring on her own. On the other hand, a broker that has an ongoing relationship with the customer that includes periodic recommendations should have an ongoing duty appropriate to that role. This might include an obligation to review the customer account once or twice a year, for example, to make sure that everything continues to perform as expected, to ascertain whether the customer's circumstances have changed, and to ensure that the investments continue to be in the best interests of the customer based on that evaluation. This approach is consistent with both the transaction-based broker-dealer business model and investors' reasonable expectations based on brokerage firms' marketing of their services as ongoing relationships of trust and confidence.

IV. Applying a strong fiduciary duty to insurance recommendations

In our previous comment, we urged the Securities Bureau to work with the Department of Banking and Insurance to include insurance under its new standard. In this regard, we appreciate Governor's recent clarification that insurance producers are subject to a fiduciary duty. [12] However, given the prevalence of sales of annuities of questionable value in New Jersey, we question whether insurance producers are complying with their fiduciary duty or whether the standard is being enforced in any meaningful way.[13] Lack of compliance and enforcement leaves investors vulnerable to harmful conflicted advice from purveyors of some of the highest-cost, most complex and opaque investment products on the market. Accordingly, we urge the Department of Banking and Insurance to step up its enforcement in the annuity context in order to give the fiduciary duty real meaning. That way, regardless of the various products New Jersey investors purchase, they would receive the protections that a fiduciary duty offers.

V. Arguments that this proposal would be preempted if it were enacted have no merit.

We expect that members of the industry will argue that the proposal would be preempted by federal law. However, the National Securities Markets Improvement Act (NSMIA) preempts states only in specifically enumerated areas, none of which are implicated here.[14]

The Securities Industry and Financial Markets Association (SIFMA), the Financial Services Institute (FSI), and other industry groups incorrectly argue that the reference to recordkeeping in NSMIA precludes states from promulgating a fiduciary duty for brokers' advice. They erroneously claim that any heightened state-based standard of conduct that might cause a firm to *voluntarily* keep a record that isn't also required under federal law would be preempted. This is clearly wrong. Merely because a firm may *voluntarily* choose to adopt more

[12] Letter from Philip D. Murphy, Governor, New Jersey, to the New Jersey Senate, Returning Senate Bill No. 2475 (Second Reprint) With Recommendations for Reconsideration, May 13, 2019, https://bit.ly/2JCAXm7.
[13] *See, e.g.*, Insured Retirement Institute, Variable Annuity Total Sales by State, 2014, https://bit.ly/30BIZRm; National Association of Fixed Annuities, 2016 State-By-State Fixed Annuity Sales Study, https://bit.ly/2QeNA77.
[14] *See* Letter from A. Valerie Mirko, Esq., General Counsel, North American Securities Administrators Association, Inc., to Honorable Herbert Lemelman, Presiding Officer Office of the Secretary of the Commonwealth of Massachusetts, March 30, 2017, https://bit.ly/2GC1Wg5.

rigorous recordkeeping practices for their own business purposes does not mean that the firm is legally required to do so. Nothing in the proposal imposes an affirmative obligation on broker-dealers to keep new or additional records. To the contrary, the proposal makes abundantly clear that, "Nothing in this section shall be construed to establish any … making or keeping of records...for any broker-dealer or agent of any broker-dealer that differ from, or are in addition to, the requirements established under 15 U.S.C. Section 78o(i)."

And the simple fact is that existing recordkeeping requirements under federal law should provide more than an adequate basis to determine whether a firm complied with or violated this fiduciary proposal. Moreover, states can and often do impose fiduciary duties on brokers in specific circumstances, despite the fact that there is no federal fiduciary duty for brokers.[15] This further demonstrates that their interpretation of NSMIA's preemptive effect is misguided.

Similarly, the proposal is crafted narrowly to avoid ERISA preemption concerns. The ERISA case law makes clear the purpose of ERISA's preemption provisions are to ensure plans and plan sponsors are subject to a uniform body of benefits law. It has nothing to do, however, with ensuring third parties that are not subject to ERISA's mandates escape state-based regulation of general applicability. Given that the proposal makes clear that it would not apply to any person **"**acting in the capacity of a fiduciary to an employee benefit plan, its participants or beneficiaries, as those terms are defined in the Employee Retirement Income Security Act (ERISA)," we believe the proposal would not be preempted by ERISA**.**

V. Conclusion

With our suggested changes, the Bureau's proposal will provide a model for how to extend a fiduciary standard to the broad array of services that investors reasonably rely on as fiduciary investment advice. In so doing, it would help to ensure that New Jersey investors will receive uniform protections regardless of whether they rely on a broker-dealer or investment adviser for investment advice. In the absence of a strong, uniform federal standard, the need for state action is stronger than ever.

Thank you for your consideration of our views.

Alliance for Retired Americans
Americans for Financial Reform Education Fund
Better Markets
Center for American Progress
Center for Economic Justice
Consumer Action

[15] The SEC acknowledges this in its proposed Regulation Best Interest, stating, "[A] broker-dealer may have a fiduciary duty under certain circumstances. This duty may arise under state common law, which varies by state." Proposed Regulation Best Interest footnote 15 at 14. It reiterates this in its final rule, stating, "[W]e emphasize that Regulation Best Interest is separate from any common law analysis of whether a broker-dealer has fiduciary duties." Final Regulation Best interest at 68. *See also* footnote 137 at 69, stating, "Generally, courts have found that broker-dealers that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, owe customers a fiduciary duty."

Consumer Federation of America
Committee for the Fiduciary Standard
EPI Policy Center
Fund Democracy
Make the Road New Jersey
National Employment Law Project
New Jersey Citizen Action
New Jersey Policy Perspective
NJ NAACP
NJPIRG
Woodstock Institute