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Christopher W. Gerold
Bureau Chief
Bureau of Securities
Division of Consumer Affairs
153 Halsey Street, 6th Floor
PO Box 47029
Newark, NJ 07101

Submitted Electronically – http://www.njconsumeraffairs.gov/proposals/pages/default.aspx

Re: Comments on NJ Bureau of Securities Proposed Amendment to N.J.A.C. 13:47A-6.3 and Proposed Rule N.J.A.C. 13:47A-6.4

Dear Chief Gerold:

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness ("CCMC" or "the Chamber") along with the New Jersey Chamber of Commerce (collectively, "the Chambers") appreciates the opportunity to comment on the proposed amendment to N.J.A.C. 13:47A-6.3 and the newly proposed rule N.J.A.C. 13:47A-6.4 (collectively, the "Proposal"). The Chamber respectfully reiterates our May 14th request for the New Jersey Bureau of Securities ("the Bureau") to hold public hearings on the Proposal, and we would look forward to testifying at such hearings. The Chambers have serious concerns regarding the Proposal and we believe that if enacted, it would reduce choice and access for New Jersey investors. Our specific concerns are centered on the following:

- The SEC's final Regulation Best Interest and Form CRS Relationship Summary achieve the Bureau's goals in the Proposal, therefore the Bureau should not proceed to a final rule;

- The Proposal would face significant Federal preemption challenges; and

- If the Bureau moves forward, it must:

    - Remove inappropriate restrictions on transaction-based compensation that would cause loss of access to financial services by small investors;

    - Remove the outcome-based standard that is impossible to meet in practice;

    - Expand the episodic fiduciary advice provision that inappropriately limits investor access to transaction-based advice;

    - Rephrase the loyalty language to put the client first and remove the confusing and ambiguous "without regard to" language; and

    - Apply the new standards to recommendations of securities and investment strategies, not to types of accounts.

The SEC's Final Regulation Best Interest and Form CRS Relationship Summary Achieve the Bureau's Goals in the Proposal, Therefore the Bureau Should Not Proceed to a Final Rule.

In our testimony at the hearing on the Pre-Proposal on November 19, 2018, and in our written Pre-Proposal comments to the Bureau dated December 14, 2018, we urged the Bureau to coordinate with the Securities and Exchange Commission ("SEC") before proposing a specific rule. In particular, we noted the harm to consumers that would be caused by a patchwork of state fiduciary or best interest regulations that likely would conflict with one another as well as with Federal standards, especially if these differing standards did not preserve investor access to transaction-based financial services.

The Bureau nonetheless decided to proceed unilaterally, arguing that the "need for additional protection for investors is highlighted by the…Federal appeals court decision vacating the Department of Labor's Fiduciary Rule…"[1] and that "The SEC's response to the 913 Study similarly compels the Bureau to take action to protect New Jersey investors…"[2] because "the [proposed] SEC Regulation Best Interest does not provide sufficient protections…"[3] We question the Bureau's conclusions regarding its need to act unilaterally.[4] The SEC has completed its work, adopting final rules and guidance in its meeting on June 5, 2019. The Bureau should consider the SEC's final Regulation Best Interest and other actions in its rulemaking process.

The SEC's final Regulation Best Interest and Form CRS Relationship Summary final rules fully achieve the investor protection goals of the Bureau's Proposal, but do so without preventing access to transaction-based fee arrangements that are often in the best interest of New Jersey investors. Because the SEC actions provide the comprehensive reform that is the underlying goal of the Proposal, we believe the Bureau should not proceed to a final rule.

The new final Regulation Best Interest requires broker-dealers to act in their clients' best interests and the new final Form CRS disclosure prevents investor confusion regarding the capacity in which an investment professional acts, achieving the intent of the Duty of Care provisions in the Proposal. Further, Regulation Best Interest requires the elimination or mitigation of conflicts of interest, achieving the intent of the Duty of Loyalty provisions in the Proposal. Importantly, these new final SEC regulations achieve these results without limiting consumer choice and access to

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[1] 51 N.J.R. 493(a), Volume 51, Issue 8, April 15, 2019 at 494.

[2] 51 N.J.R. 493(a) at 494.

[3] Id.

[4] As the DOL Fiduciary Rule primarily applied to ERISA-covered retirement plans that the Proposal specifically excludes in Section 13:47A-6.4(d), it is not clear the Proposal provides any "additional protection" for New Jersey investors in this regard. Similarly, it is not clear how the Bureau concluded in April that it was "compelled" to act because Regulation Best Interest "does not provide sufficient protections," given that neither the Bureau nor anyone else outside the SEC knew what the final Regulation Best Interest would provide until its release in June.

the financial professionals and fee arrangements that are in investors' best interests. The final Regulation Best Interest fundamentally improves the regulation of financial professionals recommending securities and investment strategies to protect consumers, and the Bureau's concerns are well-addressed in the new Federal standards.

The Proposal Faces Significant Federal Preemption Challenges

Despite the Proposal's language at the proposed new Section 13:47A-6.4(e) that purports to contain the scope of the Proposal to avoid creating new duties on investment advisers and broker-dealers that are preempted by the National Securities Markets Improvement Act of 1996 ("NSMIA"), we believe that significant portions of the Proposal would be preempted by Federal law. Put simply, financial professionals cannot demonstrate compliance with the Proposal's requirements without taking actions well beyond those required by Federal law, squarely presenting preemption issues.

Further, the Proposal is not an anti-fraud provision of the sort saved from preemption under NSMIA—it is a standard of care addressing conduct that is not fraudulent. The Bureau itself makes this point in the Preamble to the Proposal, noting that broker-dealers operating under the current suitability standard already "…are subject to statutory, SEC and SRO requirements [promoting] business conduct that protects consumers from abusive practices, including practices that may be unethical but may not necessarily be fraudulent. [emphasis added]"[5]

Therefore, if the current standard the Bureau seeks to enhance already goes beyond mere anti-fraud requirements to prohibit other, non-fraudulent practices, then the Proposal's enhanced standard is not addressing fraud, but other, non-fraudulent conduct the Bureau perceives as undesirable. That the Proposal is not intended as an anti-fraud provision is further demonstrated by the Bureau's stated rationale for the Proposal's enhanced standard; to protect "…investors against the abuses that can

[5] Id at 493.

result when financial professionals place their own interests above those of the their customers…to reduce investor confusion, and…to foster public confidence in the financial profession."[6] None of these goals stated by the Bureau involve preventing fraud, because the Bureau correctly understands that the current standard already prohibits fraud. The Proposal addresses other activities.

We believe that investors in New Jersey would be better served by coordinated and complementary Federal and state regulation than by protracted litigation resulting from overbroad state regulations.

Specific Comments on the Proposal

While we would prefer the Bureau to evaluate the SEC's recent new rules rather than proceed with this rulemaking, if the Bureau does move forward with its Proposal, we believe a number of provisions must be revised. We discuss below the very serious concerns we have about a number of provisions in the Proposal that we believe would repeat the mistakes of the DOL fiduciary rule and harm the investors the Proposal is intended to protect.

The Bureau must remove inappropriate restrictions on transaction-based compensation that would cause loss of access to financial services by small investors.

First, we are very concerned that the Proposal would inappropriately reduce access to transaction-based financial services due to the requirement that such compensation, or recommendations resulting in such compensation, are the "best" of the reasonably available options (we separately discuss our additional concerns with the "best" concept in more detail below). This effect would be especially negative for New Jersey investors with a small or moderate amount of investable assets, causing many of them to lose access to their chosen financial professionals.

As we highlighted in our comment on the Pre-Proposal, the effect of the DOL Fiduciary Rule was quite harmful for retirement investors because the DOL Rule

[6] Id. at 494.

made many transaction-based fee arrangements impractical for savers with small account balances. As the Chamber's 2017 report explains, had the DOL Rule been fully implemented, 11 million households would have seen limited or restricted investment products available to them; up to 7 million individual retirement account ("IRA") owners would have lost access to investment advice altogether; nearly three quarters of financial professionals would have stopped providing advice to some of their small accounts, and 35% of those professionals anticipated no longer serving accounts below $25,000.[7]

In fact, the SEC itself determined that the DOL Fiduciary Rule caused significant harm. In the Preamble to Regulation Best Interest, the SEC wrote, "Our concerns about the ramifications for investor access, choice, and cost…are not theoretical. With the adoption of the now vacated Department of Labor ("DOL") Fiduciary Rule, there was a significant reduction in retail investor access to brokerage services, and we believe that the available alternative services were higher priced in many circumstances [citations omitted]."[8]

The Bureau must remove the outcome-based standard that is impossible to meet in practice.

The Proposal, which purports to establish a fiduciary standard of care, actually has, as one of its core elements, an outcome-based standard that is the opposite of a fiduciary standard. The fiduciary's duty to act prudently does not require that a fiduciary decision yield the "best" possible result. Rather, whether evaluating ERISA, the Uniform Prudent Investor Act, or the duty of an investment adviser, courts focus on the process employed to make fiduciary decisions. The core of all fiduciary standards of care is procedural prudence—establishing a process to ensure a consistent, robust approach to decision-making, along with documentation of the

[7] "The Data is In: The Fiduciary Rule will Harm Small Retirement Savers," U.S. Chamber of Commerce, Spring 2017.

[8] Securities and Exchange Commission Release No. 34-86031; File No. S7-07-18, "Regulation Best Interest: The Broker-Dealer Standard of Conduct" at pgs. 20-21, accessed on June 7, 2019 at https://www.sec.gov/rules/final/2019/34-86031.pdf

application of that process each time a decision is made. In other words, the fiduciary standard of care is not concerned with the outcome of the process, but with the process itself—the issue is not whether the decision is the "best" decision, but whether it was made in the proper way. To do otherwise, as the Proposal does, it to attempt to make the fiduciary a guarantor of the outcome. Guaranteeing an outcome is not a fiduciary obligation.

Under the new proposed Sections 13:47A-6.4(b)(2)(i) and (b)(3), the Proposal creates a presumption that the receipt of direct or indirect compensation for opening a specific type of account or recommending a specific security is a fiduciary breach unless that recommendation "is the best of the reasonably available options." Similarly, transaction based-fees are permitted only if they are the "best" of the reasonably available fee options.

Not only is "best" not a fiduciary concept, but the "best" test cannot be met in practice. It is impossible to demonstrate that one has complied with the standard, given the substantial similarities between investments meeting common screening criteria. The use of the superlative "best" indicates that there is only one correct answer for the client. Of all the investments "reasonably available" (which likely includes literally thousands of investment products in most cases), this one, and only this one, is the correct answer. This is simply not true, either in the real world or in the law. As a result, the "best" test invites frivolous litigation or arbitrary enforcement—there can always be an argument that one of the other investments that were nearly identical should have been chosen. Investment recommendations inherently involve making subjective decisions from among similar investment options.

The same is true with regard to fee arrangements. Whether a transaction-based or fee-based arrangement is in the best interest of a client depends on a number of factors, including the frequency of trading and the duration of the investments. These complex decisions are typically not reducible to a single "best" answer.

Finally, additional clarity is essential for what "reasonably available" means. This has particular implications for financial professionals recommending proprietary products, or where investment menus are limited. Reasonably available should be construed very narrowly to minimize the scope of options from which the "best" would be chosen.

<u>The Bureau must expand the episodic fiduciary advice provision that inappropriately limits investor access to transaction-based advice.</u>

While we appreciate that the Proposal acknowledges the fiduciary obligation for a recommended transaction should not automatically be ongoing beyond the execution of the recommended transaction, the circumstances under which the Proposal limits the fiduciary obligation to the specific transaction are too narrow. Under new proposed Section 13:47A-6.4(a)(2), the provision of investment advice "in any capacity" by a broker-dealer would trigger ongoing fiduciary monitoring obligations. This would effectively prohibit dual registrants from being able to provide episodic fiduciary advice.

The Bureau appears to be concerned that investors can be confused when their financial professionals may not consistently be acting only as either as a broker-dealer or an investment adviser. The concerns of the Bureau can best be addressed with clear notice regarding the capacity in which the financial professional is acting, rather than effectively eliminating the investor's option to choose. We further note that Section 913 of the Dodd-Frank Act, which the Bureau favorably cites as one of the factors inspiring the Proposal, specifically states that nothing in its grant of rulemaking authority to the SEC permits the SEC to require of broker-dealers a "continuing duty of care or loyalty" after advice is given.

<u>The Bureau must rephrase the loyalty language to put the client first and remove the confusing and ambiguous "without regard to" language.</u>

The intent of the Proposal is to ensure that financial professionals put the interests of their clients ahead of other considerations. Indeed, even the title of the Bureau's press release announcing the Proposal makes this clear: "New Jersey Bureau of securities Proposes New Rule Requiring NJ Financial Industry to Put Investors' Interests First [emphasis added]"[9]

We agree that the client's interests should come first. Unfortunately, the new proposed Section 13:47A-6.4(b)(2) expresses this concept as a duty of loyalty in which recommendations must be made "without regard to" the financial or any other interest of any persons other than the client. This language is vague and would create significant and unnecessary legal risks and costs that New Jersey investors would ultimately bear. "Without regard to" essentially requires proving a negative. Where there is an allegation, including frivolous and unfounded complaints, how can a financial professional show he or she didn't consider any non-client factors?

We urge the Bureau to instead require that the financial professional "put the client's interests first," an administrable standard ensuring the client's protection.

The Bureau must apply the new standards to recommendations of securities and investment strategies, not to types of accounts.

The new proposed Section 13:47A-6.4(a) would apply the fiduciary standard to a variety of recommendations, including "…the opening of, or transfer of assets to, any type of account…" This would create a number of problems for investors seeking advice related to these transactions, and should be excluded from the scope of the Proposal.

First, this provision would likely trigger the "best" requirement as a recommendation to open or transfer an account would likely result in compensation that is directly or indirectly a result of the recommendation, regardless of the form of that compensation. It will be very difficult to show that one such account is the "best."

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[9] "New Jersey Bureau of Securities Proposes New Rule Requiring NJ Financial Industry to Put Investors' Interests First," Press Release, April 15, 2019, accessed 5/31/19 at https://www.njconsumeraffairs.gov/News/Pages/04152019.aspx.

Second, because the new proposed Section 13:47A-6.4(d) excludes advice to ERISA plan participants from the Proposal, the most common type of account opening or transfer—a rollover from a 401(k) or similar plan to an IRA— would likely not be subject to the standard. While the assets that are the subject of the recommendation are in an ERISA plan, the Proposal would not apply, and a recommendation preceding the transfer of the assets would be outside the scope of the Proposal.

Finally, "any type of account" is overbroad language that likely exceeds the scope of the Bureau's jurisdiction. Does the Bureau have authority over a recommendation of opening or transferring assets to a savings account at a bank? Does it have authority over an individual retirement annuity? Removing these account type recommendations from the Proposal would avoid many significant problems in administering any final rule.

Conclusion

The Chamber supports efficient regulation of financial services to ensure the protection of our members' interests. We have actively engaged in Federal and state regulatory efforts intended to protect consumers, and we will continue to do so. However, strong and efficient regulation cannot be achieved on a state-by-state basis through a patchwork of conflicting state regulations that differ materially with respect to one another as well as to Federal regulations.

Financial professionals simply cannot efficiently serve their clients if they are subject to material differences in regulation in every state regarding their legal obligations, documentation requirements and legal risks. The new Regulation Best Interest represents the best protection for all Americans, including investors in New Jersey, and we urge the Bureau to adopt a final rule that complements, rather than conflicting with, the new Federal Standards.

Sincerely,

Tom Quaadman
Executive Vice President
US Chamber of Commerce
Center for Capital Markets Competitiveness

Laura

Laura M. Hahn
Director, Government Relations
NJ State Chamber of Commerce