December 14, 2018

Christopher W. Gerold
Bureau Chief
Bureau of Securities
PO Box 47029
Newark, NJ 07101

Re: Notice of Pre-Proposal, PPR 2018-004 (issued October 15, 2018); 50 N.J. Reg. 2142 (Oct. 15, 2018).

Dear Mr. Gerold:

We appreciate the opportunity to comment on the pre-proposal captioned above ("Pre-Proposal").[1] We commend the New Jersey Bureau of Securities ("Bureau") for this initiative and we strongly endorse the adoption of a fiduciary standard that would apply to all financial advisers under the Bureau's jurisdiction, including broker-dealers ("brokers"), who provide investment advisory services to their clients.

IDENTITY OF BETTER MARKETS

Better Markets' advocacy focuses not only on ensuring stability and transparency in the financial markets but also on fairness and accountability. For the past several years, we have been heavily engaged in supporting the application of a strong fiduciary standard under federal law to all financial advisers, including brokers. For example, we commented extensively on the Department of Labor's ("DOL's") fiduciary duty rule and we helped lead a coalition of public interest organizations dedicated to its final adoption and its defense in court.[2] In addition, we have

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more. *See generally* www.bettermarkets.com.

2 *See, e.g.*, Comment Letter of Better Markets to DOL on Proposed Definition of the Term "Fiduciary"; Conflict of Interest Rule — Retirement Investment Advice (July 21, 2015), https://bettermarkets.com/rulemaking/better-markets-comment-letter-dols-proposed-fiduciary-duty-rule.

submitted multiple comment letters to the Securities and Exchange Commission ("SEC") on its so-called "best interest" rule proposal, in an effort to strengthen what is unfortunately an exceptionally weak and disappointing regulatory response to the deeply ingrained problem of adviser conflicts of interest.[3]

We now wish to wholeheartedly support New Jersey's effort to better protect its citizens from the adviser conflicts of interest that have taken an enormous toll on millions of everyday American investors for decades.

OVERVIEW OF THE PRE-PROPOSAL

The Bureau is considering amendments to its rules to require that all brokers, broker agents, investment advisers, and investment adviser representatives adhere to a fiduciary duty when providing investment advice to clients. More specifically, the Bureau is considering making it a dishonest or unethical business practice for failing to act in accordance with a fiduciary duty when recommending an investment strategy; recommending the purchase, sale, or exchange of any security; or providing investment advisory services to a customer.

In its notice of the Pre-Proposal ("Notice"), the Bureau invites comment on a range of issues, including the factual and legal bases for applying a fiduciary standard to all financial services professionals, as well as the appropriate scope of such a duty. The Notice explains that the Bureau seeks this input to ensure that its review of the issues surrounding the Pre-Proposal is as thorough and complete as possible.

SUMMARY OF COMMENTS

In this letter, we address five topics, highlighting the need for additional measures to protect investors from adviser conflicts of interest; the important role that New Jersey and other states can play in establishing those protections; and the broad scope that any fiduciary standard applicable to advisers should have. In summary, we argue that—

- The Pre-Proposal has an ample factual basis because investors are suffering ongoing, widespread, and demonstrable financial harm from adviser conflicts of interest.

- Federal regulation has failed to solve the problem, with little promise of meaningful action in the foreseeable future.

- New Jersey, as well as other states, can and should exercise its regulatory authority to help ensure that investors are adequately protected from adviser conflicts of interest.

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3 Comment Letter of Better Markets to the SEC on Proposed Regulation Best Interest (Aug. 7, 2018), https://bettermarkets.com/rulemaking/better-markets-comment-letter-sec-regulation-best-interest; Comment Letter of Better Markets to the SEC on Proposed Form CRS (Aug. 7, 2018), https://bettermarkets.com/rulemaking/better-markets-comment-letter-sec-form-crs.

  - The states have a long history regulating the securities markets, including brokers and investment advisers.

  - New Jersey has broad authority to regulate financial advisers, its law can readily accommodate a fiduciary standard for advisers, and the state is not preempted by federal law from acting.

  - Other industry counterarguments carry little weight.

  - New Jersey is not alone, as other states have commenced similar initiatives.

- To ensure that New Jersey achieves its investor protection goals, any fiduciary rule should include certain essential provisions.

  - Establish a true fiduciary duty, without relying on disclosure as the principal safeguard.

  - Require the elimination of some conflicts of interest.

  - Expand the class of investors protected under the rule as well as the covered products.

  - Clarify the duration of the fiduciary duty.

- New Jersey should take enforcement action against advisers who use misleading titles.

COMMENTS ON THE PRE-PROPOSAL

1. The Pre-Proposal has an ample factual basis because investors are suffering ongoing, widespread, and demonstrable financial harm from adviser conflicts of interest.

The evidence of harm that adviser conflicts of interest inflict on American investors is clear and incontrovertible. For decades, many advisers, including brokers and insurance agents, have been allowed to recommend over-priced, underperforming, illiquid, and high-risk investments to their clients to generate high commissions and fees that enrich the adviser while siphoning away a huge portion of Americans' hard-earned savings.

The DOL produced an exhaustive economic analysis to support its rulemaking, showing that conflicts of interest are costing investors tens of billions of dollars every year in lost retirement savings.[4] That estimate was extremely conservative, since it only examined the impact of conflicts

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[4] *See* DOL, Regulating Advice Markets, Definition of the Term "Fiduciary," Conflicts of Interest - Retirement Investment Advice, Regulatory Impact Analysis for Final Rule and Exemptions (Apr. 2016), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-

of interest on one type of account (IRAs) and one type of investment (front-load mutual funds). Were the analysis expanded to encompass all types of investment accounts (retirement and non-retirement alike) and all types of securities products (from other types of mutual funds, to individual securities, to variable annuities, to non-traded REITS), the magnitude of harm would be revealed as even more staggering.

A separate study issued by the Council of Economic Advisers in February of 2015 confirms the point, analyzing and quantifying the destructive effects of adviser conflicts of interest on investors.[5] The 9 million citizens of New Jersey obviously suffer a disproportionately large share of that nationally-based estimate of damage. Meanwhile, no persuasive evidence to the contrary has ever been produced by members of the financial services industry who are vehemently opposed to the broad application of the fiduciary duty to all advisers, including brokers.

2. <u>Federal regulation has failed to solve the problem, with little promise of meaningful action in the foreseeable future.</u>

Federal regulators have allowed adviser conflicts of interest to persist for far too long, and the prospects for a meaningful solution at the federal level are currently dim. To its credit, the DOL finalized a strong fiduciary duty rule in 2016 that would have substantially strengthened the standards of care and loyalty that financial advisers owe to their clients when providing advice about assets in retirement accounts.[6] But the broker-dealer and insurance industries launched a relentless series of attacks on the rule in a variety of federal courts around the country, advancing a wide range of legal arguments. Unfortunately, after the DOL's rule enjoyed an unbroken string of victories in numerous federal district and circuit courts, the industry successfully forum-shopped its way to an ideologically biased panel of judges in the Fifth Circuit, which vacated the rule over a strong but unavailing dissent from the Fifth Circuit's chief judge.[7] Although the majority's decision was rife with appealable errors, the Trump Administration abandoned its defense of the rule, content to see it nullified.

For its part, the SEC inexcusably delayed taking any action to address adviser conflicts of interest for decades. Even after Congress explicitly authorized the SEC to establish a uniform

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regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf. We hereby incorporate by reference, as if fully set forth herein, the entire rulemaking record developed in connection with the DOL's fiduciary rule, including, without limitation, the Regulatory Impact Analysis cited above, the original rule release and accompanying analysis, and the final rule release and accompanying analysis.

5 Council of Economic Advisers, "The Effects of Conflicted Investment Advice on Retirement Savings" (Feb. 2015) (estimating that conflicts cost at least $17 billion annually in lost retirement savings), https://obamawhitehouse.archives.gov/administration/eop/cea/factsheets-reports (hereby incorporated by reference as if fully set forth herein).

6 DOL, Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,945 (Apr. 8, 2016).

7 *Chamber of Commerce of United States of Am. v. United States Dep't of Labor*, 885 F.3d 360, 363 (5th Cir. 2018).

fiduciary standard for brokers and investment advisers in the Dodd-Frank Act in 2010,[8] and even after the SEC's own staff promptly recommended that the agency move forward with such a uniform standard,[9] the SEC sat on its hands for years. It was not until May of this year that the SEC finally issued its own proposal, which is neither a uniform fiduciary duty nor even a genuine best interest standard.[10]

Unfortunately, the SEC's proposal is deeply flawed in almost every material respect. Better Markets and other organizations have detailed the many gaps and weaknesses in the rule in a series of extensive comment letters. For example, as Better Markets demonstrated in its letter, the SEC's proposal, among other things—

- Fails to impose a genuine best interest standard, let alone a fiduciary duty;
- Essentially preserves the status quo in the form of the current suitability requirement that has allowed brokers to put their interests ahead of their clients' best interest for years;
- Imposes no affirmative obligation to eliminate even the most intense conflicts of interest, such as artificially created conflicts arising from sales contests and quotas;
- Relies primarily on disclosures, which can never substitute for strong affirmative standards of care and loyalty, and which, as proposed, are so confusing and ill-timed that they are likely to make matters worse for investors;
- Affords the industry almost unfettered discretion in determining how to comply with almost all aspects of the proposal; and
- Strives to protect and accommodate brokers' business interests, at the expense of investors and in derogation of the agency's primary investor-protection mandate.[11]

Unfortunately, the Proposal is so flawed that it threatens to do more harm than good, as it will create a false sense of comfort among investors. If the rule is finalized as is, brokers will be positioned to claim that they are subject to a best interest obligation when in reality, the standard falls well short of that mark.

As correctly observed in the Notice, it is unclear whether, when, and in what form the SEC will finalize its rule proposal. In any event, there is little reason to believe that any final rule

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8 Dodd–Frank Wall Street Reform and Consumer Protection Act, § 913, Pub. L. 111-203, 124 Stat. 1376 (codified in scattered sections of 15 U.S.C.).

9 *See* Sec. & Exch. Comm'n, Study on Investment Advisers and Broker-Dealers (2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf.

10 *See* Proposed Rule, Regulation Best Interest, 83 Fed. Reg. 21574 (May 9, 2018).

11 *See* Comment Letter of Better Markets to the SEC on Proposed Regulation Best Interest (Aug. 7, 2018), https://bettermarkets.com/rulemaking/better-markets-comment-letter-sec-regulation-best-interest.

emerging from the SEC will be significantly improved. Consequently, as also observed in the Notice, "investors remain without adequate protection from broker-dealers who, under the suitability standard, are permitted to consider their own interests ahead of their client's interest when making investment recommendations."[12] For this reason, New Jersey and other states have a critical role to play in filling this major regulatory gap at the federal level.

3. New Jersey, as well as other states, can and should exercise their regulatory authority to help ensure that investors are adequately protected from adviser conflicts of interest.

We do not presume to offer the same level of expertise that the Bureau possesses on the subject of New Jersey's specific legal authority to fortify its rules governing investment advice. However, we believe it is important to emphasize the important role the states generally have played for over a century in protecting investors from fraud, abuse, and conflicts of interest; the expertise they bring to the task of enforcing investor protection measures, including the fiduciary standard; the leeway they enjoy under existing federal law to establish a fiduciary duty for brokers; and the fallacious arguments that industry opponents have raised generally against a fiduciary duty for brokers and more specifically against a *state* fiduciary standard.

A. The states have a long history regulating the securities markets, including brokers and investment advisers.

The states have been heavily involved in regulating the securities markets for over a century, beginning at least twenty-two years before the SEC even came into existence. Kansas adopted the first state securities law in 1911, which included securities registration and agent licensing requirements aimed at combatting speculative securities schemes that had no more basis than "so many feet of blue sky." After Congress established the federal securities laws in the 1930s, the states continued to play a major and parallel role in regulating the securities markets and securities market participants. While Congress has cordoned off certain specific regulatory activities from state jurisdiction—principally the review and registration of nationally-traded securities—federal law allows and in fact relies heavily upon the states to remain fully engaged in registering firms and individuals, examining brokers and investments advisers, and above all, protecting investors from fraud and abuse through enforcement actions.

The states are also experienced at administering the fiduciary standard, as the SEC and the states have long shared oversight responsibility for investment advisers. Years ago, the states assumed jurisdiction over the smaller investment adviser firms, defined as those with up to $25 million in client assets under management. The Dodd-Frank Act actually expanded the states' jurisdiction to include mid-sized advisers, defined as those with between $25 and $100 million in assets under management. And the states currently are the primary regulatory authority overseeing the licensing of all individual representatives of investment advisers, regardless of the size of the firm.

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[12] Notice at 2142.

B. New Jersey has broad authority to regulate financial advisers, its law can readily accommodate a fiduciary standard for all advisers, and the state is not preempted by federal law from acting.

The Bureau has broad authority under New Jersey law to establish a fiduciary standard for all advisers, including brokers. For example, the New Jersey Uniform Securities Law ("NJUSL") confers broad authority on the state to regulate brokers. The NJUSL generally prohibits fraud[13] and it gives the Bureau broad power to regulate "dishonest or unethical practices" by brokers.[14] The NJUSL also confers general rulemaking authority on the Bureau "to carry out the provisions" of the statute, including specifically the authority to adopt rules "for the protection of investors."[15] A rule requiring that financial advisers, including brokers, put the interests of their clients ahead of their own when offering investment advice would certainly be "for the protection of investors." Thus, the Bureau has ample authority under state law to establish fiduciary standards for brokers and other investment professionals, and doing so would further the investor protection and anti-fraud purposes of New Jersey's securities laws. Accordingly, no statutory amendment would be necessary.

Nor would federal law preempt the type of carefully crafted fiduciary rule contemplated in the Pre-Proposal. As a general matter, courts apply a presumption *against* preemption, and courts will not determine that Congress intended to preempt the "police powers of the States…unless that was the *clear and manifest* purpose of Congress."[16] Accordingly, state laws are only preempted in three narrow circumstances: (1) where a statute includes an express preemption provision that would apply to the state law; (2) where Congress has legislated so comprehensively on an issue as to occupy an entire field of regulation; or (3) where compliance with both the federal and state standards is impossible, or where compliance with the state law would be an obstacle to the accomplishment of the objectives of Congress.[17]

Under these principles, a rule that imposes a fiduciary duty on brokers and other investment professionals should not be deemed preempted by federal securities laws. Neither the Securities Act, the Exchange Act, nor the National Securities Markets Improvement Act of 1996 ("NSMIA") contains any express preemption provisions related to the standard of conduct for brokers or other investment professionals when providing investment advice to clients. Moreover, federal law plainly has never occupied the field of securities regulation, as reflected in the long history of concurrent state and federal oversight of the securities markets.

In addition, the federal securities laws expressly preserve broad swaths of state authority. For example, the Securities Act provides that "the rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity."[18]

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13 N.J. Stat. Ann. § 49:3-52.
14 N.J. Stat. Ann. § 49:3-58(a)(vii).
15 N.J. Stat. Ann. § 49:3-67.
16 *New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 654 (1995) (emphasis added).
17 *Abdullah v. Am. Airlines, Inc.*,181 F.3d 363, 367 (3d Cir. 1999).
18 15 U.S.C. § 77p(a).

The Exchange Act contains a similar provision and goes further by providing that "nothing in this chapter shall affect the jurisdiction of the securities commission . . . of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations under this chapter."[19] And NSMIA provides that "the securities commission…of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions, in connection with securities or securities transactions…with respect to fraud or deceit; or unlawful conduct by a broker [or] dealer."[20] A fiduciary standard as contemplated in the Pre-Proposal would create no conflict with federal law as it would supplement, not conflict with, broker obligations under the federal standard. Finally, imposition of such a standard would promote, rather than serve as an obstacle to, the investor protection objectives of the federal securities laws.

To the extent NSMIA expressly preempts state law, its focus is far afield from the regulation of adviser conduct. It was aimed principally at limiting the states' role in the registration of some securities and the financial operations of brokers.[21] While NSMIA also limited the states' authority to establish different or additional books and records requirements for brokers,[22] the Bureau's Pre-Proposal does not appear to contemplate such provisions, thereby avoiding a potential preemption conflict.

Notwithstanding this analysis, staunch industry opponents of any effort to establish fiduciary standards for all advisers, and brokers in particular, may well file legal challenges to any state initiatives in this area. But New Jersey and other states are nevertheless justified in advancing such investor protections and, if they establish a genuine fiduciary duty for all advisers, could expect strong support from allies such as Better Markets and other organizations who have long fought for the basic principle that investors deserve advice that is in their best interest, not biased and conflict-ridden recommendations that enrich advisers at their clients' expense.

C. <u>Other industry counterarguments carry little weight.</u>

Beyond the matter of preemption, industry opponents of the fiduciary standard for advisers can be expected to advance a familiar array of sky-is-falling arguments to thwart New Jersey's initiative outlined in the Notice. None of them are persuasive. For example, the industry has long argued that a fiduciary duty will destroy the broker business model, choke off the supply of investment advice to those with small-balance accounts, and raise prices for advisory services. These arguments are weak on their face, devoid of persuasive support, and belied by experience. A compelling refutation lies in the impact of the DOL's fiduciary duty rule: As a direct result of

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19 15 U.S.C. § 78bb(a).

20 15 U.S.C. § 77r(c)(1).

21 15 U.S.C. § 77r(b)(1)(A)–(B) (registration of exchange-traded offerings); 15 U.S.C. § 77r(b)(4) (registration of certain private offerings); 15 U.S.C. § 78o(i)(1) (requirements relating to capital, margin, and financial responsibility).

22 The statute provides that: "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." 15 U.S.C. § 78o(i)(1) (emphasis added).

that rule, the adviser industry serving retirement accounts began to adapt readily, new and better investment products began to emerge, prices began to fall, and advice remained widely available under both commission-based and fee-based compensation models, for accounts of all sizes.

The industry also typically attacks state regulation with the argument that it will lead to a patchwork of requirements and an unmanageable compliance burden. This argument is hypocritical as well as specious. As a threshold matter, a slavish desire for regulatory uniformity can never justify exposing investors to a heightened risk of fraud, abuse, or other harmful practices—in this case, investment advice contaminated by conflicts of interest. This is especially true where the law, both state and federal, was clearly written and intended to provide maximal protections to investors.

The argument is hypocritical in that the financial services industry has for years fought tooth and nail to preserve, rather than harmonize, two very different regulatory standards for essentially the same advisory activity, one for brokers (the suitability standard administered by FINRA) and one for investment advisers (the fiduciary duty under the Investment Advisers Act, as interpreted by the SEC and the courts). When their self-interest is served, members of the financial services industry will happily live with and in fact assiduously protect different regulatory standards and requirements.

Finally, the so-called "patchwork" argument is simply false. The states generally have achieved an enormous degree of uniformity in securities regulation through the development and wide adoption of uniform securities acts, the coordinating work of the North American Securities Administrators Association ("NASAA"), and close cooperation with the SEC and FINRA with respect to the licensing of brokers and investment advisers and other regulatory and enforcement matters.

The hard facts also belie the specific contention that a state fiduciary duty imposed on brokers would have disruptive or unmanageable effects. A number of states already apply the fiduciary standard to brokers, yet the evidence shows no evidence of undue burden on the industry. In a 2012 study, the authors concluded as follows:

> We find that the number of registered representatives doing business within a state as a percentage of total households *does not vary significantly among states with stricter fiduciary standards.* A sample of advisers in states that have either a strict fiduciary standard or no fiduciary standard are asked whether they are constrained in their ability to recommend products or serve lower-wealth clients. We find no statistical differences between the two groups in the percentage of lower-income and high-wealth clients, the ability to provide a broad range of products including those that provide commission compensation, the ability to provide tailored advice, and the cost of compliance.[23]

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23 MICHAEL FINKE & THOMAS LANGDON, THE IMPACT OF THE BROKER-DEALER FIDUCIARY STANDARD ON FINANCIAL ADVICE 1 (2012), https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=887851 (emphasis added).

D. New Jersey is not alone, as other states are beginning to take similar steps.

If New Jersey imposes a fiduciary duty on investment professionals that provide advice to clients, it will be joining a number of states that have recently adopted similarly enhanced investor protections. Nevada, for example, recently passed legislation classifying investment advisers and brokers alike as "financial planners" and subjecting them to the fiduciary duties required of financial planners.[24] Those duties include requirements that financial planners "disclose to a client, at the time advice is given, any gain the financial planner may receive, such as profit or commission, if the advice is followed," and "make diligent inquiry of each client to ascertain initially, and keep currently informed concerning," the client's financial circumstances and goals.[25]

Similarly, in July 2018, the New York Department of Financial Services issued a rule establishing suitability and best interest standards for life insurance and annuity transactions.[26] The rule provides that an insurer recommending a particular transaction to a consumer must act in the "best interest" of the consumer,[27] and that any compensation or incentives received by the insurer may not influence the recommendation.[28] As Superintendent Maria T. Vullo noted, because "the federal government continues to roll back essential financial services regulations," action was necessary so that consumers "are assured that their financial services providers are acting in their best interest when providing advice."[29]

In at least four other states, the courts have imposed fiduciary duties on brokers. California courts, for example, have held that "the duty between broker and principal is fiduciary in nature and imposes on the broker the duty of acting in the highest good faith toward the principal."[30] Missouri courts define a broker's fiduciary duty to include the obligations "to manage the account as dictated by the customer's needs and objectives, to inform of risks in particular investments, to refrain from self-dealing, to follow order instructions, to disclose any self-interest, to stay abreast of market changes, and to explain strategies."[31] South Dakota has held that brokers owe clients a fiduciary duty of "utmost good faith, integrity and loyalty."[32] Finally, South Carolina has held that brokers owe to their clients a "duty to account for all funds and property belonging to the buyer, to refrain from acting adversely to the buyer's interest, to avoid engaging in fraudulent conduct, and to communicate any information he or she may acquire that would be to the buyers advantage."[33]

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24 2017 Nev. Stat. 1796.

25 Nev. Rev. Stat. § 628A.020.

26 40 N.Y. Reg. 19 (Aug. 1, 2018).

27 N.Y. Comp. Codes R. & Regs. Tit. 11, § 224.4.

28 *Id.*

29 Press Release, N.Y. Dep't of Fin. Serv., DFS Issues Final Life Insurance and Annuity Suitability and Best Interests Regulation Protecting Consumers from Conflicts of Interest (July 18, 2018), https://www.dfs.ny.gov/about/press/pr1807181.htm.

30 *Hobbs v. Bateman Eichler, Hill Richards, Inc.*, 210 Cal. Rptr. 387 (1985), *quoting Twomey v. Mitchum, Jones & Templeton, Inc.*, 69 Cal. Rptr. 222 (1968).

31 *State* ex rel. *PaineWebber, Inc. v. Voorhees*, 891 S.W.2d 126, 130 (Mo. 1995).

32 *Dinsmore v. Piper Jaffray, Inc.*, 593 N.W.2d 41, 46 (S.D. 1999), *quoting Davis v. Merrill Lynch, Pierce, Fenner, and Smith*, 906 F.2d 1206, 1215 (8th Cir.1990).

33 *Cowburn v. Leventis*, 619 S.E.2d 437 (S.C. 2005).

4. To ensure that New Jersey achieves its investor protection goals, any fiduciary rule should include certain essential provisions.

To help ensure that investors are adequately protected from adviser conflicts of interest, any fiduciary standard adopted by the Bureau for application to financial advisers should contain certain critical elements.

A. Establish a true fiduciary duty, without relying on disclosure as the principal safeguard.

To be effective, the core duty must be to act in the best interest of the customer, without regard to the financial or other interest of the adviser providing the advice. The rule should also make clear that the adviser must at all times put the client's interest **ahead** of its own, and it must further provide that brokers may never allow conflicts of interest to influence their recommendations. In addition, the standard must not allow firms and financial professionals to rely on disclosures alone or primarily to satisfy their duty of loyalty. There is simply no evidence that disclosure is effective in protecting investors from the harmful impact of adviser conflicts of interest.

B. Require the elimination of some conflicts of interest.

The rule should also require advisers to eliminate certain artificially created conflicts of interest that are too powerful to be mitigated effectively. Included among the prohibited incentives should be—

- sales contests, prizes, bonuses, or other cash and non-cash incentives awarded when advisors achieve any type of sales quota or goal, whether for specific products, for classes of products (such as in-house or proprietary products), or for overall sales volume;

- salary or commission increases or the award of other benefits for achieving benchmarks on ratcheted pay-out compensation grids;

- cash or non-cash awards, bonuses, or other incentives for recommending the type of account a client should open or maintain, including managed accounts, or the services the client should receive—recommendations that can have a particularly long-lasting and profoundly negative impact on a client's financial well-being; and

- any other incentives that encourage and reward brokers for making recommendations that are not in the client's best interest.

C. Expand the class of investors protected under the rule as well as the covered products.

The scope of the rule should be broad. For example, many institutional investors need the protections afforded by the fiduciary duty. Therefore, for optimal effect, the rule should cover recommendations made to institutional investors, not only individual investors for personal, family, or household purposes. There is a similar need to broaden the scope of the rule to cover a broad range of products, including insurance products, where the investor's best interest is often sacrificed to the best interest of the broker or insurance agent. To the extent possible, the Bureau should cover certain insurance products such as fixed indexed annuities that are in fact securities, even though exempt from regulation by the SEC. Perhaps at a minimum, the Bureau could work with the New Jersey insurance authorities to develop parallel protections under a fiduciary standard.

D. Clarify the duration of the fiduciary duty.

One of the hallmarks of a genuine fiduciary duty is its ongoing nature. In contrast with the SEC's approach in Regulation Best Interest, the Bureau should make clear that brokers have a continuing duty of care, unless the facts and circumstances surrounding the relationship between the broker and the customer, including the communications between them, clearly show that the duty has ended and the client fully understands that fact.

5. New Jersey should take enforcement action against advisers who use misleading titles.

Even if the Bureau is unable to establish a fiduciary duty for brokers and other advisers, it should consider expanding its enforcement efforts. Specifically, it should use its authority to prohibit firms and financial professionals from using misleading titles and marketing techniques that have become all too common in the brokerage industry. For example, firms today routinely use various titles, such as financial advisor, financial consultant, or wealth manager, which suggest they are advice providers rather than salespeople. Moreover, in their advertising, they describe their services as investment advice and retirement planning, not product sales, and they cultivate the notion that they will serve as trusted advisers. If brokerage firms portray themselves as advisers who occupy a position of trust and confidence with their customers, while disavowing that they owe a fiduciary duty, then the Bureau should regard these business practices as dishonest and unethical and take appropriate enforcement action.

CONCLUSION

We appreciate your leadership in addressing the need for stronger protections against adviser conflicts of interest, and we hope our comments are helpful as you evaluate the best approach for advancing that goal under New Jersey law. Please let us know if we can be of further assistance or if you would like to discuss any of the issues we have addressed in our letter.

Sincerely,

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