

Statement of Kevin Carroll

On Behalf of the Securities Industry and Financial Markets Association

To the New Jersey Bureau of Securities

November 2, 2018

Thank you for the opportunity to present the views of the Securities Industry and Financial Markets Association (“SIFMA”).¹ SIFMA represents the interests of hundreds of broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. Many of our members do business and serve retail investors in the State of New Jersey.² We appreciate the opportunity to comment on the New Jersey Bureau of Securities’ (the “Bureau”) pre-proposal to establish a state-specific fiduciary duty for broker-dealers.³

We respectfully offer the following comments and recommendations:

The Bureau should await the conclusion of the SEC rulemaking process to establish a uniform, heightened, ‘best interest’ standard of conduct for broker-dealers.

First, we urge the Bureau to await the conclusion of the SEC’s Regulation Best Interest rulemaking process before moving forward with its own fiduciary proposal.

In April 2018, the SEC issued proposed Regulation Best Interest and Form CRS (collectively, “Reg BI”) for public comment.⁴ Reg BI would create a new, nationwide, heightened standard of conduct for broker-dealers. Under the current Reg BI proposal, a broker-dealer making a personalized recommendation about a securities transaction or an investment strategy must:

¹ SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

² Most of SIFMA’s members who serve retail investors are dually registered as both broker-dealers and investment advisers, thereby giving investors choice about the level of service and how to pay for it. Notwithstanding an investment adviser’s fiduciary duty versus a broker’s current, (arguably lower) suitability standard, broker-dealers are generally subject to more extensive regulation, more frequent examination and enforcement by the SEC and FINRA, and greater exposure to private redress through FINRA arbitration.

³ New Jersey Bureau of Securities, Fiduciary Duty Notice of Pre-Proposal (October 15, 2018), available at <https://www.njconsumeraffairs.gov/Proposals/Pages/bos-10152018-proposal.aspx>.

⁴ SEC Regulation Best Interest, Release No. 34-83062; File No. S7-07-18, available at <https://www.sec.gov/rules/proposed/2018/34-83062.pdf>; Form Customer Relationship Summary (“CRS”), Release No. 34-83063; File No. S7-08-18, available at <https://www.sec.gov/rules/proposed/2018/34-83063.pdf>.

- (1) act in the client’s best interest, without placing their financial or other interest ahead of the client’s interest;⁵
- (2) act with diligence, care, skill and prudence, and carefully weigh the cost of the security in determining whether to make the recommendation; and
- (3) disclose and mitigate or eliminate material conflicts of interest.⁶

SIFMA supports proposed Reg BI because it:

- adds meaningful new investor protections;
- preserves investor choice and access to the brokerage “pay as you go” advice model, which is especially important for smaller accounts;
- significantly raises the bar from the existing Financial Industry Regulatory Authority (“FINRA”) suitability standard;
- applies more broadly than the vacated Department of Labor (“DOL”) Fiduciary Rule⁷ because it applies to all retail customer accounts, not just retirement accounts; and
- allows the primary, expert agency – the SEC – to enforce a uniform standard across the industry.

Moreover, while broker-dealers are not subject to a continuous and ongoing fiduciary duty under Reg BI because the best interest obligation applies at a specific point in time (*i.e.*, the time of the recommendation), the obligation imposed by Reg BI at that specific point in time is generally consistent with the fiduciary obligation imposed on an investment adviser when providing personalized investment advice about securities to a client.⁸

⁵ Governor Murphy’s press release described New Jersey’s proposed fiduciary duty as one that would require investment professionals “to place their clients’ interests above their own when recommending investments.” *Governor Murphy Marks 10 Year Anniversary of 2008 Financial Crisis by Announcing Plan to Require NJ Financial Industry to Put Customers’ Interests First* (Oct. 15, 2018), available at <https://nj.gov/governor/news/news/562018/approved/20180917c.shtml>.

⁶ Reg BI’s collective obligations to act in the client’s best interest, carefully weigh costs, and disclose and mitigate or eliminate conflicts would also fully address the allegation leveled in the Governor’s press release that “brokers ... often receive significant undisclosed financial benefits in exchange for steering clients toward certain investment products.” *See id.*

⁷ Reg BI also avoids the many shortcomings that were embedded in the vacated DOL Fiduciary Rule and that threatened to lead to greater cost, less choice, and fewer professional services and options for retirement savers.

⁸ See SIFMA comment letter to SEC re: Reg BI (August 7, 2018), available at <https://www.sifma.org/resources/submissions/regulation-best-interest-reg-bi/>.

Since its publication, the SEC has received thousands of written comments on its proposal, many of them positive and supportive.⁹ Based on our conversations with the SEC staff and SEC Commissioners, we understand that Reg BI remains a top priority for SEC Chairman Clayton, and the SEC staff and Commissioners are working diligently to address the public comment file and publish a final rule as soon as possible. We anticipate that the final rule may be published sometime in the second or third quarter of 2019.¹⁰

Based on the foregoing, we urge the Bureau to await the conclusion of the SEC's Reg BI rulemaking process before moving forward with its own fiduciary proposal. By doing so, the Bureau would then be in a position to properly evaluate whether any state level action would be necessary at all. The Bureau may find that Reg BI – in its final form – satisfies most if not all of its concerns.¹¹

The Bureau should avoid imposing duplicative, different and/or conflicting conduct standards, which will contribute to investor confusion and thereby undermine investor protection.

The optimal approach to protect investors and avoid investor confusion is to allow the SEC – the primary federal regulatory agency – to promulgate a uniform, nationwide, heightened, best interest standard of conduct for broker-dealers. As discussed above, Reg BI already has all the hallmarks of a fiduciary standard, as specifically tailored to the broker-dealer model.

A state-by-state approach, on the other hand, would likely result in an uneven patchwork of laws that in many instances would be duplicative of, different than, and/or in conflict with the federal standard. Such a patchwork approach would introduce an entirely new level of investor confusion, which would undercut not only the new, uniform federal standard, but also the interest of investor protection generally. It is hard to imagine what benefit investors would derive from being subjected to a highly fragmented market of varying protections and standards as they move or transact with broker-dealers across the fifty states.

In addition, it would be exceptionally difficult, if not impossible, for broker-dealers to effectively track, monitor and supervise compliance with fifty different state-specific standards. And, it would be fundamentally unfair to put broker-dealers in the position of deciding whether to comply with federal or state requirements that may impose different or conflicting requirements.

⁹ See SEC comment file, available at <https://www.sec.gov/comments/s7-07-18/s70718.htm>.

¹⁰ See, e.g., SEC Rule List, available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCd=3235&Image58.x=58&Image58.y=9. The DOL has also added a Fall 2019 placeholder on its regulatory calendar for potential action on the vacated DOL Fiduciary Rule. See DOL Rule List, available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=1200.

¹¹ Assuming that is the case, and the Bureau nevertheless proceeds with its rulemaking, the Bureau should allow firms that comply with Reg BI to be deemed in compliance with the New Jersey standard.

With respect to its prospective fiduciary duty, the Bureau requests comment on when such a duty should arise, its duration, and to whom it should be owed, and the types of recommendations that should trigger it. The final version of Reg BI will definitively answer these questions, and any state standard should answer them consistently with the new federal standard. Accordingly, we recommend as follows:

To Whom Owed – A best interest/fiduciary standard should apply for the benefit and protection of “retail investors” as defined by FINRA rules.¹² The FINRA definition is optimal because it is the one that broker-dealers already use to develop policies and procedures, controls, and compliance structures to identify retail investors for purposes of suitability, communications, and disclosure obligations. More importantly, the FINRA definition appropriately captures those persons who need the protections of a heightened standard.¹³

When it Arises – A best interest/fiduciary standard should arise for a broker-dealer when making a recommendation of any securities transaction or investment strategy involving securities to a retail investor. The term securities transaction includes a sale, purchase, and exchange, and may include recommendations to roll over or transfer assets from one type of account to another (such as from an ERISA account to an IRA). It does not include recommendations of account types.

Recommendations Subject to – A best interest/fiduciary standard should apply to any “recommendation” as that term has long been interpreted and applied under FINRA rules and broker-dealer regulation generally.¹⁴ Factors that are considered when determining whether a broker-dealer has made a recommendation include whether the communication “reasonably could be viewed as a ‘call to action’” and whether it “reasonably would influence an investor to trade a particular security or group of securities.”¹⁵

Duration – A best interest/fiduciary standard should apply at the time the recommendation is made. It should not: (a) extend beyond a particular recommendation or require a broker-dealer to have a new, continuous duty to a retail customer or impose a new duty to monitor the performance of the account; (b) require the broker-dealer to refuse to accept a customer’s order that is contrary to the broker-dealer’s recommendation; or (c) apply to self-directed or otherwise unsolicited transactions by a retail investor who may otherwise receive other recommendations from the broker-dealer.

¹² FINRA Rule 2210(a)(6) defines a “retail investor” as “any person other than an institutional investor.” An “institutional investor,” in turn is defined in Rule 2210(a)(4) to include, among others, any “institutional account.” The term “institutional account” is defined in Rule 4512(c) as “the account of: (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.”

¹³ See SIFMA comment letter to SEC re: Reg BI (August 7, 2018) at pp. 10 – 16 for a more detailed discussion.

¹⁴ See FINRA Rule 2111 (Suitability) FAQ, available at <http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq>.

¹⁵ See FINRA Notice to Members 01-23, Suitability Rule and Online Communications (April 2001), available at <http://www.finra.org/industry/notices/01-23>.

Any Bureau standard that imposes a record-keeping obligation that is new or different than those set forth under the Securities Exchange Act is subject to an express federal preemption challenge.

It is difficult to imagine what new requirement(s) a state standard would include that would be additive to the substantive investor protections in Reg BI. Regardless, even if the Bureau identified such requirements, it is equally difficult to imagine how such requirements could be imposed in a manner that did not require broker-dealers to maintain new or different records to demonstrate compliance with such state requirements, thereby subjecting the Bureau to a potential express federal preemption challenge.

An express federal preemption challenge could be made pursuant to Section 103 of the National Securities Markets Improvement Act of 1996 (“NSMIA”). NSMIA amended Section 15 of the Exchange Act to expressly preempt states from enacting regulations relating to making and keeping records “*that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act].*” (emphasis added)¹⁶ NSMIA’s preemption provision is intended to ensure uniform and consistent record-keeping obligations across the fifty States, as established by the SEC and FINRA.

NSMIA not only limits state regulations that directly impose new or different recordkeeping requirements, but also state regulations that by their nature require broker-dealers to make and keep new or different records than those required by federal law. Pursuant to Exchange Act Rule 17(a)-4, for example, broker-dealers are required to keep a record of “*all communications ... by the member ... relating to its business as such....*” (emphasis added)¹⁷ Thus, any state regulation that imposed a new or different communication or disclosure requirement on broker-dealers would in turn trigger a new or different record-keeping obligation, which would in turn be subject to an express federal preemption challenge under NSMIA.

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In sum, SIFMA strongly supports a heightened standard of conduct for broker-dealers. The best way to accomplish that objective is through a national, uniform standard established by the expert federal regulator, the SEC.

The Bureau should await the SEC’s completion of its Reg BI rulemaking in 2019 prior to taking any action. The Bureau should also avoid imposing duplicative, different and/or conflicting conduct standard, as they will add to investor confusion and undermine investor protection.

Finally, the Bureau should be mindful that any requirements it may impose would likely trigger new or different broker-dealer record making and keeping obligations, which would likely be subject to an express federal preemption challenge under NSMIA.

¹⁶ See 15 U.S.C. §78o(i)(1).

¹⁷ See 17 CFR §§ 240.17a-4(b)(4).

Thank you in advance for your consideration of our comments and recommendations. We are happy to answer any questions you may have or to provide any additional information you may need.