



June 14, 2019

Via electronic submission to: <http://www.njconsumeraffairs.gov/Proposals/Pages/default.aspx>

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

Re: Fiduciary Duty of Broker-Dealers and Investment Advisers (Proposal Number: PRN 2019-044);  
Proposed New Rule N.J.A.C. 13:47A-6.4<sup>1</sup>

Dear Mr. Gerold:

The Institute for Portfolio Alternatives (“IPA”) 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”). We support the Bureau’s consideration of a public hearing on the Proposal and would look forward to testifying at such hearing.

As stated in our letter on December 14, 2018,<sup>2</sup> the IPA has an immediate interest in applicable standards of conduct for financial professionals in New Jersey as our members include both regulated broker-dealer firms and their investment professionals in your state and nationwide. IPA member firms support individual investor access to a wide variety of asset classes with low correlation to the traded markets and historically available only to institutional investors. These investment products have been held in the accounts of more than 3 million individual investors. With over \$135 billion in capital investments, they remain a critical component of an effectively balanced investment portfolio and serve an essential capital formation function for national, state and local economies.<sup>3</sup>

As a preliminary matter, we strongly encourage the Bureau to consider as part of its rulemaking process the U.S. Securities and Exchange Commission’s (“SEC”) final Regulation Best Interest

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<sup>1</sup> See <https://www.njconsumeraffairs.gov/Proposals/Pages/bos-04152019-proposal.aspx>.

<sup>2</sup> IPA Letter to the New Jersey Bureau on Notice of Pre-Proposal, December 14, 2018, *available at* <http://www.ipa.com/wp-content/uploads/2018/12/IPA-Letter-to-NJ-Securities-Bureau-FINAL-12.14.18.pdf>.

<sup>3</sup> For over 30 years the IPA has raised awareness of portfolio diversifying investment (PDI) products among stakeholders and market participants, including investment professionals, policymakers and the investing public. We support increased access to investment strategies with low correlation to the equity markets: lifecycle real estate investment trusts (Lifecycle REITs), net asset value REITs (NAV REITs), business development companies (BDCs), interval funds and direct participation programs (DPPs). Through advocacy and industry-leading education, the IPA is committed to ensuring that all investors have access to real assets and the opportunity to effectively diversify their investment portfolios.

rulemaking.<sup>4</sup> The IPA is concerned about the significant compliance and operational costs of implementing both the new federal standard along with additional state standards. We are similarly concerned about conflicting federal and state requirements that create confusion and uncertainty among firms, advisors and clients, and therefore do not further the goals of investor protection. Increased costs in providing quality investment advice will have a direct impact on the availability and cost of financial advice for New Jersey investors, particularly those with small dollar accounts.

As you review comments in developing a final regulation, we respectfully request you consider the following points:

The IPA is concerned about the effect of the “best of” standard used in the Proposal, requiring that the recommended security or account type be the “best of the reasonably available options” and that the broker-dealer or agent may receive a transaction-based fee only if it “is reasonable and is the best of the reasonably available fee options.” The Bureau does not explain how a broker-dealer can demonstrate that the recommended security, account type or fee is the “best” of reasonably available options. The term “best” creates uncertainty and liability for financial firms given the universe of available and comparable investments. We are also concerned that the post-sale outcome of a recommendation or investment strategy, as opposed to the process or procedures undertaken prior to a sale, may be used to justify whether the “best” standard was met. The IPA believes that the practical effect of the “best of” standard will be to reduce or even eliminate transaction-based fee arrangements for New Jersey investors. This will have a detrimental effect on investors who may not have sufficient account minimums to maintain fee-based accounts or who will not receive personalized advice on self-directed accounts. We urge the Bureau to remove the term “best” and, in addition, provide greater clarity on what constitutes “reasonably available” options.

The IPA is also concerned that an ongoing fiduciary duty applies to the broker-dealer or agent that “provides, *in any capacity*, investment advice” to the customer (emphasis added). This broad application would effectively prohibit dual registrants from acting in a broker-dealer capacity. In other words, if the customer receives investment advice through an affiliated investment adviser or a dual registered broker-dealer/investment adviser or registered representative/investment adviser representative, then the fiduciary duty applies on an ongoing basis and across all accounts of the customer. This would require broker-dealers and registered representatives to monitor a customer’s account after a trade is executed, which is contrary to the episodic nature and intent of the brokerage relationship. This would have the unintended consequence of limiting episodic brokerage services for New Jersey investors. We recommend that the Proposal instead provide that clear notice be provided regarding the capacity in which the financial professional is acting, and that the duty for broker-dealers, whenever acting in such capacity, apply only through the execution of the recommendation.

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<sup>4</sup> On June 5, 2019, the SEC will hold an Open Meeting to vote on its Regulation Best Interest proposals. See <https://www.sec.gov/news/openmeetings/2019/agenda060519.htm>.

As an example of the impact of the loss of episodic brokerage services for New Jersey investors, suppose Mr. and Mrs. Smith, 55 and 57 years old, respectively, inherit \$50,000, which they intend to keep invested for at least 7 years until their retirement. They want to invest in a diversified portfolio of mutual funds with a combination of stocks and bonds, and have two options: (1) a brokerage account paying a one-time average commission of 5%, or (2) a fee based account where they will pay 1.5% per year as the standard rate for smaller accounts. Mr. and Mrs. Smith will pay a one-time commission of approximately \$2,500 to invest through a brokerage account at the time the investment is made versus an annual fee of approximately \$750 per year for a total of \$5,250 (more than double the one-time brokerage fee) in an advisory account over the next seven years. If the account increases in value over the seven years, then the annual fees paid will increase as well. Preserving the option of transaction-based brokerage services is critical for many investors with smaller accounts or with specific circumstances where a one-time commission may be better for the investor both in New Jersey and nationwide.

We also suggest that the Proposal be consistent with current FINRA rules and guidance and the SEC's Regulation Best Interest rulemaking. First, the broker-dealer's obligations should apply to recommendations<sup>5</sup> about a securities transaction or an investment strategy involving securities and, with regard to the opening or transfer of assets to an account, be consistent with similar treatment under Regulation Best Interest. Otherwise, a broker-dealer would in all cases owe a fiduciary duty (and potentially an ongoing duty) to all prospective customers. In addition, we suggest that the "without regard to" language in the Proposal's duty of loyalty be replaced with "without placing the financial or other interest . . . ahead of the interest of the retail customer."<sup>6</sup> This provides greater clarity around broker-dealer conflicts and supports the intent of the Proposal to put the customer's best interest first. It also aligns with the new federal standard that broker-dealers will be implementing. We also request that the Proposal clarify the distinction between sales contests and other rewards such as overall asset growth or annual compensation that are part of the brokerage compensation structure.

Finally, the IPA is concerned that the Bureau's rulemaking will run counter to federal standards for broker-dealers and require the making and keeping of records that are different or in addition to those required to be made and kept under the federal securities laws, which would be preempted. In other words, in order to comply with the Proposal, broker-dealers will have to take actions and keep new records beyond those required under federal law. In addition to preemption concerns, this additional cost of compliance could cause broker-dealers to decide not to provide advice to New Jersey investors.

We respectfully request that the Bureau consider all of the points discussed above. We also encourage the Bureau to continue to evaluate the economic impact of this Proposal in light of its stated need to "protect the welfare of investors." We believe the unintended consequence will be significant increased compliance costs for New Jersey registrants and decreased options for New Jersey investors. We also ask the Bureau to consider the potential impact of the Proposal on the broader securities regulatory regime as it makes a significant departure from the long-standing full and fair "disclosure-

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<sup>5</sup> See FINRA Rule 2111 (Suitability) FAQ, Q1.1; FINRA Regulatory Notice 11-02.

<sup>6</sup> Regulation Best Interest, 17 CFR Part 240, Release No. 34-86031; File No. S7-07-18 (June 5, 2019).

based” system both for broker-dealers and investment advisers.

If the IPA may be of any assistance, please do not hesitate to contact me or Anya Coverman, IPA’s Senior Vice President, Government Affairs and General Counsel, at (202) 548-7190.

Sincerely,

A handwritten signature in black ink, appearing to read 'A. Chereso', with a horizontal line extending to the left.

Anthony Chereso  
President & CEO, Institute for Portfolio Alternatives