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Via email to: DCAProposal@dca.lps.state.nj.us

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

Re: Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives (Proposal Number: PRN 2019-044); Proposed Amendment: N.J.A.C. 13:47A-6.3; Proposed New Rule: N.J.A.C. 13:47A-6.4

Dear Chief Gerold:

LPL Financial LLC ("LPL") appreciates the opportunity to submit this supplementary comment letter on the New Jersey Bureau of Securities ("Bureau") proposed fiduciary duty regulations ("Fiduciary Duty Regulations" or "Regulations"). We thank the Bureau for its efforts to consider the many comments and suggestions it has received on the Regulations and to hold a public hearing. We remain committed to working with the Bureau to achieve its goal of ensuring strong protections for New Jersey's investors, while minimizing unintended consequences that could limit investors' access to the investment services they need to help them achieve their financial goals.

Our supplemental comments should be considered in conjunction with our prior letter and our testimony at the public hearing.[1] We hope the Bureau finds our comments helpful and we remain willing to provide additional information or clarification upon request.

I. New Jersey Should Wait Until the SEC's New Rules Have Been Implemented Before Considering Adding More Complexity to the Regulatory Landscape

The Securities and Exchange Commission ("SEC") adopted enhancements to the federal standards and disclosure requirements on June 5, 2019, shortly before the first comment period on the Regulations ended.[2] These enhancements comprise some of the most significant changes in the last century to the

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[1] *See* Letter from Michelle B. Oroschakoff, Chief Legal Officer, LPL Financial LLC, to Christopher W. Gerold, Bureau Chief, N.J. Bureau of Securities (Jun. 14, 2019); N.J. Bureau of Securities. *Hearing on Proposed Fiduciary Duty Regulation*, Jul. 17, 2019 (statement of Kate Winters, VP Product Management, LPL Financial LLC).

[2] *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (Jul. 12 2019) (to be codified at 17 CFR pt. 240), available https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf (hereinafter, "Regulation Best Interest Adopting Release"); Form Customer Relationship Summary ("CRS"); Amendments to Form ADV, 84 Fed. Reg. 33,492 (Jul. 12, 2019) (to be codified at 17 CFR pt. 200, 240, 249, 275, and 279), available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12376.pdf (hereinafter, "Form CRS Adopting Release"); Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669 (Ju1. 12, 2019) (to be codified at 17 CFR pt. 276), available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12208.pdf (hereinafter, "IA Standard Interpretation"); Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer, 84 Red. Reg. 33,681(Jul. 12, 2019) (to be codified at 17 CFR pt. 276), available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12209.pdf (hereinafter, "Solely Incidental Interpretation").

regulations that apply to the advice and services that federally registered broker-dealers and investment advisers provide to retail investors, and will significantly change how broker-dealers and advisers provide investment advice and services to retail investors.

Many have been quick to pre-judge the standards of conduct in the SEC's Regulation Best Interest as deficient because the SEC did not call the standards "fiduciary". Others have incorrectly suggested that, in adopting the Interpretation Regarding Standard of Conduct for Investment Advisers ("Advisers Act Interpretation"), the SEC lowered the standards that apply to investment advisers. As the SEC has, and continues to emphasize, Regulation Best Interest is founded upon the same fiduciary principles that apply to investment advisers under the Investment Advisers Act of 1940, while being appropriately tailored to accommodate distinguishing aspects of the broker-dealer service model.[3] Moreover, the SEC has explained that guidance provided in Advisers Act Interpretation is designed to more fully outline the obligations of investment advisers under their fiduciary duty, and in no way diminishes the significance of these obligations.[4]

We firmly agree that these changes significantly increase investor protections while preserving investor choice and access to investment products and services, including through the important brokerage model. Under the enhanced standards, both broker-dealers and investment advisers must:

- **Best Interest:** Act in the best interest of the investor.
- **Duty of Loyalty:** Not put their interests ahead of the investor's interest.
- **Duty of Care:** Understand risks, rewards, and costs of a recommended investment product or strategy.
- **Personalized:** Understand the investor's individual investment profile.
- **Conflicts:** Address conflicts—in many cases, disclosure alone will not be enough.
- **Effective Disclosures:** Disclose material facts about the relationship with the investor in a short, easy-to-read disclosure, so the investor can make better, more informed decisions.
- **Transparency:** Be more transparent with investors about services, fees, costs, and conflicts.

We believe these are potent changes that will improve the quality of advice investors receive, while preserving access and choice. These enhancements are scheduled to become fully effective in less than a year, on June 30, 2020.

As documented in the SEC's rulemakings, the Commission undertook a deliberate and thoughtful process to assess, balance, and implement a way for retail investors to continue to access the brokerage model (i.e., transaction-based compensation with episodic recommendations) under a better defined and articulated standard. The SEC recognized the vacated DOL Fiduciary Rule's unintended consequences, including the unworkable and unnecessary limitations it placed on the brokerage model, that precipitated

[3] *See* SEC Chairman Jay Clayton, "Regulation Best Interest and the Investment Adviser Fiduciary Duty: Two Strong Standards that Protect and Provide Choice for Main Street Investors," July 8, 2019, *available at* https://www.sec.gov/news/speech/clayton-regulation-best-interest-investment-adviser-fiduciary-duty.

[4] *Id.*

the migration of assets to the advisory model, as well as higher fees and less choice for middle income savers. We are concerned that rushing to adopt the Regulations, before seeing how the industry will implement the SEC's rules, will at best cause investor disruption, confusion, and expense, and at worst will result in a significant reduction in choice for New Jersey investors.

Based on our experience observing the changes that took place during the implementation of the DOL Fiduciary Rule, firms are only just now in the beginning stages of understanding and implementing the SEC's new rules. Compliance with Regulation Best Interest will be challenging, and firms like LPL are working diligently to prepare for all of the new requirements by the June 30, 2020 deadline. Over the coming months, firms will be undertaking the following implementation steps:

1. ***Review and assess current business models.*** Perform a comprehensive and holistic review of current business models, including product and service offerings, fee structures and compensation arrangements, and current client and customer agreements and disclosures.

2. ***Determine supervision and compliance approach.*** Based on the business model assessments, design appropriate supervision and compliance approaches, which may require structuring and restructuring relationships with product providers and distributors.

3. ***Consider technology changes.*** Build tools and technological approaches to support compliance with the rules, including to prevent violations of the best interest and other standards, and to deliver disclosures to investors in a timely manner.

4. ***Develop policies and procedures.*** Develop policies and procedures necessary to support supervision and compliance, and integrate them with the firm's comprehensive supervision and compliance programs.

5. ***Develop and update disclosures and contracts.*** Develop new disclosures, and consider changes to current disclosures and agreements. Consider how and when disclosures are provided to investors, and, in many cases, make any necessary operational changes.

6. ***Train financial professionals.*** Financial professional training is a key element to compliance with the new rules. Create and update appropriate training modules.

7. ***Communicate changes to investors and deliver disclosures.*** Communicate the new standards and service changes to investors to ensure a smooth transition.

Each of these steps is likely to require significant time and resources, and will result in changes in how firms engage with retail investors. Moreover, these are just the steps to initial implementation—the start of an ongoing evolution in how financial services and products are delivered to retail investors.

Of course, SEC enforcement will be critical to making sure the rules have teeth and are effective in addressing potential bad actors and bad practices, and we believe that the SEC should have the chance to demonstrate its effectiveness in enforcing its rules before concluding that additional state-level regulations are necessary. In the meantime, even without adopting new Regulations, New Jersey would continue to retain its independent authority to enforce any New Jersey securities law violations—including fraud—in cases of unlawful activities by firms and their investment professionals.

Given the breadth of the new SEC rules, and that the industry is only in the early stage of implementing them, we do not believe it is possible to fairly assess whether these significant changes fall short in protecting New Jersey investors. Therefore, we respectfully request that the Bureau pause before adding to the overall regulatory framework under which financial institutions operate, at least until after the effective date of the SEC rules when the Bureau can better understand the changes resulting from the these new rules. At that point, we urge New Jersey to consider reproposing its standards, taking into consideration these additional protections to ensure the Regulations are appropriately harmonized with federal standards (and to avoid unnecessary duplication). As we witnessed under the DOL Fiduciary Rule, unintended consequences should be avoided and they tend to harm investors.

II. "Best Of" is an Unworkable Standard

The Regulations essentially require firms to recommend the "best of the reasonably available options" and only permit firms to receive transaction-based compensation if it is "the best of the reasonably available fee options". Absent a dramatic reduction of product and service offerings, these standards are practically unworkable as they appear to expose firms to unmanageable regulatory risks and second-guessing. We believe that firms will ultimately decide to again, as with the DOL Fiduciary Rule, migrate away from the brokerage model to better avoid this subjective standard, which we believe will be an unintended consequence of the Regulations.

Broker-dealers and investment advisers typically offer access to thousands of equity and debt securities, mutual funds, and other investment funds and products, all with different financial attributes, costs and uses in a comprehensive asset allocation or portfolio. Without being able to predict accurately future performance, it is impossible to operationalize a way for a firm determine which option (or mix of options) will be the "best" at the time it is recommended to the investor. The concept of "best of" implies a singular solution, without appropriately recognizing and balancing the subjectivity inherent in the investment process and, more importantly, investor preferences. Our concern is that it is unclear how the Bureau intends to enforce this standard and on what basis it will determine that a particular recommendation was the best or was not the best. A standard that will ultimately be viewed in hindsight will, from practical standpoint, be unworkable.

Consistent with our prior comment letter, we urge the Bureau to consider the SEC rulemaking process and note the issues and concerns the SEC raised and balanced. To the extent it deems necessary, we urge the Bureau to adopt a more clearly defined standard that requires firms and financial professionals to act in investors' best interests, comply with an articulated standard of care, not place their financial interests ahead of the interests of the retail investor, and establish, maintain, and enforce written policies and procedures reasonably designed to identify, disclose, and mitigate material conflicts of interest associated with a recommendation.

III. The Regulations May Conflict with the Federal Securities Laws

We are concerned that, as proposed, the Regulations will be viewed as being in direct conflict with the federal securities laws and unintentionally may cause firms and financial professionals who comply to violate federal law. In particular, our concerns are summarized as follows:

- ***Ongoing fiduciary duty obligation could require broker-dealers to register as investment advisers.*** The Investment Advisers Act of 1940 does not require broker-dealers to register as

investment advisers when they provide advisory services that are "solely incidental" to the conduct of the broker-dealer's business and when such services are provided for no "special compensation".

The SEC recently clarified its view that a broker-dealer who provides "continuous monitoring" would be viewed as providing an advisory service that is not "solely incidental" to its brokerage business.[5] As New Jersey would broadly require broker-dealers who provide advice "in any capacity" to comply with an ongoing fiduciary duty, it would seem that they would need to continuously monitor customer accounts. As such, broker-dealers would be required to register as investment advisers under federal law—effectively bringing an end to the full service brokerage model in New Jersey.

To avoid this potential conflict with federal law, New Jersey should again consider the SEC's approach to monitoring, which permits the investor and firm to agree on the terms and limitations applicable to ongoing monitoring services in brokerage arrangements.

- ***The "best of" standards could cause broker-dealers to violate FINRA rules prohibiting guarantees and implicating that past performance will recur.*** FINRA Rule 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts) provides that: "No member or person associated with a member shall guarantee a customer against loss in connection with any securities transaction or in any securities account of such customer." Additionally, FINRA Rule 2210 (Communications with the Public) requires that communications must be fair and balanced and generally cannot predict or project performance or imply that past performance will recur.

  As discussed above, we are concerned that, in practice, applying the "best of" standard will result in a hindsight review of actual performance against the performance of a different investment option that was available at the time of the recommendation and performed better. Such a hindsight review could be viewed as providing an investor a performance guarantee as investors would be looking to the firm to make up investment losses as compared to the other "better" investment. This could be deemed a violation of FINRA's rules. We do not believe the Bureau intended this result and therefore urge the Bureau to eliminate the "best of" standard in lieu of a more aptly defined and workable standard, to the extent necessary after implementation of the SEC rules.

These are merely examples of the potential conflicts the Regulations may have with federal laws and illustrate that layering regulations, or creating a regulatory patchwork, can be costly, confusing, and complicated and result in overlapping and contradictory requirements. Of course, we respect New Jersey's sovereignty and authority to regulate, but we urge the Bureau to exercise this authority with precision as necessary and to avoid complications that may unintentionally harm the investors it is mandated to protect.

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[5] Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser, 84 Fed. Reg. 33681, 33687 (July 12, 2019).

Thank you for considering our comments on the Regulations. Again, we urge the Bureau to wait to decide whether, and to what extent, it is necessary to take action. We very much appreciate and support New Jersey's goal of protecting investors and look forward to continuing to work with you towards achieving that goal, while preserving choice and access to investment and financial services in New Jersey.

Sincerely,

Michelle Bryan Oroschakoff
Chief Legal Officer