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Rule Proposals  
October 15, 2018  
Law and Public Safety

## **Fiduciary Duty; Notice of Pre-Proposal**

Take notice that the New Jersey Bureau of Securities (Bureau) is soliciting comments regarding amendments to its rules to require that broker-dealers, agents, investment advisers, and investment adviser representatives be subject to a fiduciary duty. 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 to a customer, an investment strategy, or the purchase, sale, or exchange of any security or securities, or providing investment advisory services to a customer.

N.J.A.C. 13:47A-6.3

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## **LAW AND PUBLIC SAFETY**

### **DIVISION OF CONSUMER AFFAIRS**

### **BUREAU OF SECURITIES**

#### **Fiduciary Duty**

#### **Notice of Pre-Proposal**

#### **Pre-Proposed Amendment: N.J.A.C. 13:47A-6.3**

Authorized By: Christopher W. Gerold, Bureau Chief, Bureau of Securities.

Authority: N.J.S.A. 49:3-67(a).

Pre-Proposal Number: PPR 2018-001

**Take notice** that the New Jersey Bureau of Securities (Bureau) is soliciting comments regarding amendments to its rules to require that broker-dealers, agents, investment advisers, and investment adviser representatives be subject to a fiduciary duty. 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 to a customer, an investment strategy, or the purchase, sale, or exchange of any security or securities, or providing investment advisory services to a customer.

Under case law, it is well established that investment advisers owe a fiduciary duty to their customers. Broker-dealers, however, by rule are subject to a suitability standard, which means having reasonable grounds to believe that the strategy, transaction, or recommendation is suitable for the customer based upon reasonable inquiry concerning the customers' investment objectives, financial situation, and needs, and any other relevant information known by the broker-dealer.

In the wake of the 2008 financial crisis, Congress recognized the need to ensure that retail investors can readily access unbiased advice from all financial professionals, regardless of whether that advice comes from an investment adviser or broker-dealer. Specifically, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) to remedy a number of regulatory and statutory shortcomings that were understood to have contributed to, or exacerbated, the crisis. Section 913 of Dodd-Frank directed the Securities and Exchange Commission (SEC) to evaluate the effectiveness of existing standards of care owed by broker-dealers to retail investors, whether there were any “legal or regulatory gaps” in those existing frameworks, and to propose changes to remedy shortcomings it identified. Section 913 also authorized the SEC to promulgate rules that would impose a uniform standard of conduct for all brokers, dealers, and investment advisers. In 2011, the SEC staff released a comprehensive study (913 Study) in which it recommended that the SEC engage in rulemaking to implement a “uniform fiduciary standard” for investment advisers and broker-dealers when providing investment advice about securities to retail customers that is consistent with the standard that currently applies to investment advisers. A uniform standard would reduce investor confusion and harmonize regulatory enforcement across these industries.

In 2016, in response to the 913 Study findings, the United States Department of Labor promulgated a rule under ERISA requiring that those providing financial advice related to retirement accounts act as fiduciaries to their clients (DOL Fiduciary Rule). Multiple legal challenges to the DOL Fiduciary Rule failed, but in March of 2018, the United States Court of Appeals for the Fifth Circuit vacated the DOL Fiduciary Rule in a 2-1 decision. The Federal government declined to appeal that ruling, notwithstanding the favorable rulings in other courts.

More recently, in May 2018, the SEC proposed “Regulation Best Interest,” which would require, among other things, broker-dealers to act in their clients’ “best interest.” The best interest standard is purportedly a higher standard of conduct than the current suitability standard for broker-dealers set out in Financial Industry Regulatory Authority (FINRA) Rule 2111. Currently, broker-dealers and their agents are required to have a reasonable basis to believe a recommended transaction or investment strategy involving securities is suitable for the customer. The reasonable basis is based on information obtained through reasonable diligence of the broker-dealer or agent to ascertain the customer’s investment profile. At this time, it is unknown whether the SEC will adopt the rule as proposed, adopt a different rule based on its proposal, or pursue a different course of action.

In light of these Federal developments, 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 interests when making investment recommendations. The 913 Study reflected that retail investors do not understand the differences between investment advisers and broker-dealers or the standards of care applicable to broker-dealers and investment advisers. Many find the different standards of care confusing, and are uncertain about the meaning of the various titles and designations used by investment advisers and broker-dealers. Many expect that both investment advisers and broker-dealers are obligated to act in the investors’ best interests. Moreover, many retail investors expect, and incorrectly believe, that their financial advisers, including broker-dealers, are acting in a fiduciary type relationship of trust. As a result of the confusion that exists in the marketplace, coupled with the regulatory gap that currently exists with regard to broker-dealers and their agents, investors are often unaware of whether and to what extent those they trust to make financial recommendations are receiving undisclosed financial benefits in exchange for steering their clients to certain products.

The Bureau is soliciting comments regarding amendments to its rules to require that broker-dealers, agents, investment advisers, and investment adviser representatives be subject to a fiduciary duty. The Bureau believes that this uniform standard protects investors against the abuses that can result when financial professionals place their own interests above those of their customers. In order to ensure that its review of this issue is as thorough and fulsome as possible, the Bureau invites comment on the legal and factual bases for applying a fiduciary standard to all financial services professionals; the scope of the duty in terms of duration and when it arises; the types of recommendations that would trigger the duty; and the scope of the duty in terms of to whom it is owed.

Comments on this pre-proposal should be sent by December 14, 2018, to: Christopher W. Gerold, Bureau Chief, Bureau of Securities, PO Box 47029, Newark, New Jersey, 07101, or electronically at: <http://www.njconsumeraffairs.gov/Proposals/Pages/default.aspx>.

In addition, in connection with this notice of pre-proposal, the Bureau of Securities will hold two informal conferences to take testimony from interested parties to gather facts to inform a rulemaking and to afford ample opportunity for the receipt of public comment from the regulated communities, industry representatives, and the public at large.

The conferences will be held on Friday, November 2, 2018, and Monday, November 19, 2018. The informal conferences will be held each day from 9:30 A.M. to 4:30 P.M., with a recess for lunch. The conferences will be held at 124 Halsey Street, 6th Floor, Morris Room, Newark, NJ 07101. A court reporter will be present to record the proceedings. Requests to speak, indicating which conference the individual wishes to attend, should be submitted in writing to Maryann Sheehan, Director of Legislative and Regulatory Affairs, Division of Consumer Affairs, PO Box 45027, Newark, NJ 07101 or electronically at: [www.njconsumeraffairs.gov/Proposals/Pages/default.aspx](http://www.njconsumeraffairs.gov/Proposals/Pages/default.aspx) no later than one week prior to each conference. Individual speakers are requested to provide a copy of their prepared remarks to the Bureau at the time of registration and on the day of the conference. Individuals will not be permitted to pre-register for, or speak at, more than one conference. Specific presentation times will be assigned. Individual presentations will be limited to 10 minutes. Based upon the number of individuals who request to speak, the Bureau reserves the right to reduce the allotted time to speak and/or to schedule additional conferences on future dates. Those who do not pre-register to speak will be given an opportunity to do so only as time permits.

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