

October 16, 2018

A Striking Shot Across the Bow: New Jersey Launches Uniform Fiduciary Standard Rulemaking



New Jersey can be credited as the first state to take up a uniform fiduciary standard applicable to broker-dealers and investment advisers in the wake of Regulation Best Interest and the rest of the Securities and Exchange Commission's (SEC) major standard of care proposal. On October 15, the New Jersey Bureau of Securities (Bureau) announced, in the form of a notice of pre-proposal, that it is soliciting comments on whether to adopt rule amendments to require that broker-dealers, agents, investment advisers, and investment adviser representatives be subject to an express fiduciary duty. The rule amendments likely would apply to all persons who conduct brokerage services in New Jersey, including federally registered broker-dealers. It likely would also apply to state-registered investment advisers, but it is not clear whether the rule amendments would apply to SEC-registered investment advisers.

According to the notice, while investment advisers already owe a fiduciary duty to their clients under case law,¹ broker-dealers are held only to a suitability standard² (i.e., 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).³ The notice expresses concern that 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.⁴ In particular, the notice warns that 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 pre-proposal does not include specific regulatory language, but the notice indicates that 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." The Bureau contemplates a uniform standard that would protect investors against the abuses that can result when financial professionals place their own interests above those of their customers, but does not set out the precise scope of the duties that would apply.

By opening up a comment period before issuing a rule proposal, and holding two public hearings in November, New Jersey appears to recognize the complexities associated with a uniform fiduciary rule. Specifically, the Bureau is seeking comment on:

1. The legal and factual bases for applying a fiduciary standard to all financial services professionals;
2. The scope of the duty in terms of duration and when it arises;
3. The types of recommendations that would trigger the duty; and
4. The scope of the duty in terms of to whom it is owed.

Comments 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](#).

¹ A fiduciary duty for investment advisers has been implied under the Investment Advisers Act of 1940. See *Transamerica Mortgage Advisors v. Lewis*, 444 U.S. 11, 17 (1979); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).

² In fact, available case law in New Jersey, following precedent from other states, says that broker-dealers generally are not fiduciaries, but do have fiduciary duties if they have investment discretion. See *McAdam v. Dean Witter Reynolds*, 896 F.2d 750, 767 (3d Cir. 1990); *Estate of Parr v. Buontempo Insurance Services*, 2006 WL 2620504, at *5 (N.J. Super. Ct. App. Div. 2006) (unpublished opinion).

³ Both New Jersey and FINRA rules require securities recommendations to meet a suitability standard. See N.J. Admin. Code § 13:47A-6.3(a)(3); FINRA Rule 2111.

⁴ Although the notice states that broker-dealers can consider their own interests ahead of their client's interests when making investment recommendations, FINRA has stated that the suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests. FINRA Regulatory Notice 12-25 (May 2012).

The Bureau will also host 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.” These conferences will take place on November 2 and November 19 from 9:30 am - 4:30 pm at 124 Halsey Street, 6th Floor, Morris Room, Newark, NJ 07101.

We expect that, following its consideration of public comments, the Bureau will issue a formal rule proposal, which will be subject to notice and comment.

A copy of the pre-proposal can be found [here](#).

This is not the first time New Jersey has waded into these waters post-Department of Labor (DOL) fiduciary rule. Earlier this year, the New Jersey Senate considered a bill that would impose a disclosure obligation on “non-fiduciary investment advisors,” including broker-dealers, that would consist of a Plain English declaratory statement that those entities do not owe fiduciary duties to their clients. This legislation has since stalled. A nearly identical bill was introduced in the New York Assembly and has similarly stalled.

New Jersey Governor Phil Murphy, a Democrat, [announced last month](#) that the Bureau would initiate a rulemaking that “would impose a fiduciary duty on all New Jersey investment professionals, requiring them to place their clients’ interests above their own when recommending investments.” While the October 15 pre-proposal merely solicits comments on what a uniform fiduciary standard should look like under New Jersey law, it comes at a time when the SEC is currently working to address federal standards of conduct. [As we noted recently](#), the SEC could issue a final rule in the first half of next year. Though it remains to be seen how the SEC will ultimately address the numerous concerns stakeholders have over Regulation Best Interest and other aspects of the rulemaking, the Governor and the Bureau are not waiting for the SEC to address these concerns.

As with some other states and public officials, the Governor may be holding up the DOL fiduciary rule as a model. He charged the DOL with “abandoning” its controversial fiduciary rule [by not appealing the decision of the Fifth Circuit Court of Appeals to vacate the rule](#). It is possible that this apparent affinity for the DOL rule could presage what a final New Jersey rule could look like.

It is also possible that other states will move forward with disparate fiduciary standards and duties before the SEC has the chance to publish a final rule. Ever since the President’s Inauguration, a handful of blue states have cast the Trump Administration as being adverse to Main Street investors, even though both SEC Chairman Jay Clayton and DOL Secretary Alex Acosta have solicited state participation. Nevertheless, several state bills, including those of Illinois, Massachusetts and New York (nearly all of which failed), attempted to address the different standards of conduct of investment advisers and broker-dealers. Enforcement efforts, [particularly out of Massachusetts](#), have also been active during this period.

Not all state efforts in imposing a uniform fiduciary standard, however, have stalled. Nevada, for instance, amended its financial planner statute in 2017 to impose a fiduciary standard on broker-dealers. [As we previously noted](#), Nevada’s amended law raises a number of material interpretive issues, which were supposed to have been addressed in a regulation. To date, no such regulation has been proposed.

Standards of care applicable to broker-dealers and investment advisers remain an entirely fluid area at the federal and state levels. We expect ongoing state regulatory and enforcement developments while the SEC continues to work on its own rulemaking, with the DOL most likely awaiting a final SEC rule before issuing any new guidance in this area. The question then becomes not if a major fiduciary standard of care development will occur in the near future, but *by whom and when*.

The authors would like to thank Michael Wallace for his assistance in preparing this alert.

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