



10401 North Meridian Street
Suite 202
Indianapolis, IN 46290

317.663.4180 *main*
317.815.0871 *fax*
866.353.8422 *toll free*

www.adisa.org

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Via electronic submission to:
DCAProposal@dca.lps.state.nj.us

Christopher W. Gerold, Bureau Chief
New Jersey Bureau of Securities
153 Halsey Street, 6th 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-6.4¹

Dear Mr. Gerold:

We appreciate your continued engagement with the industry and the opportunity to comment on the proposed fiduciary duty regulations referenced above. The Alternative and Direct Investment Securities Association (“ADISA”),² has particular interest in New Jersey since we have nearly 1,000 members and affiliates, mostly from small and medium-sized businesses, either located or doing business in the state and working with thousands of retail investors.

ADISA agrees with the need to set appropriate standards around advice provided by all financial professionals, whether episodic or on-going in nature. Specifically, as you develop the Bureau of Securities’ final regulation, we encourage you to consider the following:

- 1. "Non-Traded" or non-marketable investment products are distinct from their publicly-traded counterparts in many respects, including cost, liquidity and complexity.**

The duty of care owed by financial professionals to their customers must be capable of being maintained in a manner that is consistent with the unique nature of alternative investments. Characteristics of Alternative Investments include:

- A diversity of non-traded and non-marketable products;

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

² ADISA is the nation’s largest trade association for the non-traded alternative investment space. ADISA represents over 4,500 financial industry members, reaching over 220,000 finance professionals, with sponsor members having raised in excess of \$200 billion in equity in serving more than 1 million investors.

- The non-regular basis of most product recommendations;
- The relationship between buyers and their financial professionals with respect to these securities, which is generally more infrequent than on-going in nature.

Markedly, alternative investments play a crucial role in retail portfolios: 78% of “millennials” and 70% of “Gen X” savers endorse having access to alternatives for their investment accounts.³ Furthermore, these products can have (and historically have had), a significant, positive impact on investor rates of return when incorporated into more traditional liquid portfolios.⁴ The Bureau should account for these crucial distinctions unambiguously in the Final Rule.

2. The Bureau should add the State of Nevada Security Division’s Episodic Fiduciary Duty.

The Nevada State Securities Division has recognized the unique and important nature of episodic transactions and added an “Episodic Fiduciary Duty Exemption” to its proposed fiduciary duty regulations.⁵ Certain products are designed to have durations over several years, and therefore are less liquid investments (in the short term); in other words, some investment ideas are by their nature entered into only episodically and with a long term investment horizon. Indeed, characteristics of alternative securities specifically include:

- A diversity of non-traded and non-marketable investment products;
- The non-regular basis of most transaction or product recommendations; and
- The somewhat atypical relationship between buyers of these products and their financial professionals, which is understood to be infrequent in nature and not on-going.

Allowing a broker-dealer’s duties to effectively reflect these facts (and by creating a regulation that allows such firms to receive one-time or periodic commissions), aligns the interest and, importantly, the expectations and understanding, of the broker-dealer and its representative with that of the client. Such alignment is the essence of a financial professional’s duty toward its clients.

Accordingly, we believe that the duty should be tailored to ensure that broker-dealers and their representatives that recommend transactions on an infrequent basis can satisfy the Rule’s requirements. An “episodic” fiduciary would not be freed from all aspects of fiduciary status – rather the approach would recognize the more limited nature of the duties owed to (and expected from) clients in the more episodic context that relates to the recommendation and sale of alternatives.

Just as importantly, any final rule should allow a broker-dealer to receive transaction-based compensation so long as it is in the client’s best interest to be charged in this manner (as opposed to

³ Natixis Global Asset Management Survey, <http://durableportfolios.com> 2014.

⁴ From 1999-2009 the generic “balanced” (i.e., 60% equity/40% bond) portfolio after fees returned zero percent (0%), while the Yale, Harvard, and Stanford portfolios with alternatives generated returns ranging from 135% to 198% in total (Wildemuth, D. *Wise money: How the Smart Money Invests*. McGraw Hill, 2012, pp. 64-65).

⁵ See Nevada Revised Statutes 90.575, 628.010 and 628.020.

other types of remuneration), and so long as the commission or other compensation charged does not result from the broker-dealer putting its interest ahead of the client's interest.

3. The Bureau should add greater clarity to the "best of" language contained in Subsections (b)2i and (b)3 of the Proposed Rule, providing understanding to retail customers and fair notice of actual requirements to financial professionals.

The Proposal requires that any recommendation must be "the best of the reasonably available options" and that any transaction-based fee received by a broker-dealer must be the "best of the reasonably available fee options...."⁶ No such "best of" standard exists under current federal securities laws, and both the SEC and FINRA have long recognized that there is no single "best" security recommendation. In fact, this is a core tenet of modern portfolio theory. Further, federal agencies and securities regulators have generally accepted the fact that it is not possible to definitively identify a single "best" option.⁷ Indeed, even the DOL conceded as much in connection with its now vacated fiduciary rule.⁸

We believe that the "best of" language should be eliminated, or at a minimum clarified and made unambiguous, so that retail customers can plainly understand the obligations of their financial professionals and, in turn, broker-dealers and their registered representatives who recommend alternatives can align their conduct regarding alternative investments with the Rule. Given the challenges involved in comparing investment products made available by any single broker-dealer, it is important that firms can see a clear and unambiguous path to satisfying their duties of care and loyalty to their clients with respect to securities (and especially alternative investments) that they recommend to their clients.

4. The Proposal should explicitly limit its application to retail investors who are legal residents of New Jersey or who reside in New Jersey.

Given the difficult and potentially harmful consequences associated with the Rule detailed above, it is important that firms can limit the application of the Rule to retail customers who are residents of New Jersey. A financial services firm with a place of business in New Jersey should not owe the fiduciary duty imposed by the Rule to all their clients, regardless of whether they have any nexus to New Jersey. Moreover, the fiduciary duties imposed by the Rule may be inconsistent with duties owed to clients in their state of domicile. Accordingly, we recommend that the Proposal be revised to explicitly limit its application to retail investors who are legal or actual residents of New Jersey.

⁶ Proposal at Section 13:47A-6.4(b)2.i and (b)3.

⁷ See, e.g., *SEC Beginner's Guide to Asset Allocation, Diversification and Rebalancing*, available at <https://www.sec.gov/reportspubs/investor-publications/investorpubsassetallocationhtm.html>. See also *FINRA's Diversifying Your Portfolio*, available at <http://www.finra.org/investors/diversifying-your-portfolio>.

⁸ See Preamble to the BIC Exemption, 81 Fed. Reg. at 21,029 ("... the [DOL] also confirms that the Best Interest standard does not impose an unattainable obligation on Advisers and Financial Institutions to somehow identify the single 'best' investment for the Retirement Investor out of all the investments in the national or international marketplace, assuming such advice were even possible."), available at <https://www.federalregister.gov/documents/2016/04/08/2016-07925/best-interest-contract-exemption>.

Thank you for the opportunity to weigh in on these important issues. We stand ready to meet with you and your colleagues in the Bureau to discuss these issues in more depth if you would find that helpful.

Sincerely,

A handwritten signature in blue ink, appearing to read "Greg Mausz".

Greg Mausz
ADISA President

cc: Drafting Committee: John H. Grady, Thomas Rosenfield