INVESTMENT COMPANY INSTITUTE

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November 9, 2018

Mr. Christopher W. Gerold, Chief
New Jersey Bureau of Securities
PO Box 47029
Newark, New Jersey 07101

Sent Electronically to http://www.njconsumeraffairs.gov/Proposals/Pages/default.aspx

Re: Fiduciary Duty Notice of Pre-Proposal

Dear Mr. Gerold:

The Investment Company Institute* appreciates the opportunity to provide comment to the New Jersey Bureau of Securities on the Bureau's Notice of Pre-Proposal relating to a fiduciary duty. According to the Notice, the Bureau proposes to add a new item to its current list of dishonest or unethical business practices for broker-dealers, agents, investment advisers, and investment adviser representatives. This new item would be failing to act in accordance with a fiduciary duty when recommending to a customer an investment strategy or the purchase, sale, or exchange of a security; or providing investment adviser services to a customer. While the Institute expresses no view on the merits of the Bureau's proposal, we strongly recommend that, should the Bureau proceed with its proposal, it do so in a manner that is consistent with the Bureau's authority under the National Securities Markets Improvement Act of 1996 (NSMIA), as discussed in more detail below.

I. OVERVIEW OF NSMIA

Effective October 1996, NSMIA revised the states' authority over investment advisers and broker-dealers. In addition to preempting the states' authority to regulate Federally-registered investment advisers, it also limited the authority that states may assert over

* The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$22.7 trillion in the United States, serving more than 100 million US shareholders,

state-registered investment advisers and Federally-registered broker-dealers. As a result of these limits, which are detailed below, if New Jersey's proposed fiduciary duty would require state-registered investment advisers and Federally-registered broker-dealers to maintain books and records to document compliance with it, the Bureau's rule may run afoul of Sections 222 of the Investment Advisers Act (Advisers Act) of 1940 and Section 15(i) of the Securities Exchange Act of 1934 (the Exchange Act) as enacted by the NSMIA.

II. SECTION 222 OF THE INVESTMENT ADVISERS ACT OF 1940

Section 222(b) of the Advisers Act prohibits any state from enforcing any law or regulation "that would require an investment adviser to maintain any books or records in addition to those required under the laws of the State in which it maintains its principal office and place of business if the investment adviser (1) is registered or licensed in the State in which it maintains its principal office and place of business; and (2) is in compliance with the applicable books and records requirements of the State in which it maintains its principal office and place of business." Accordingly, if the Bureau intends to impose a fiduciary duty on investment advisers that do not maintain a principal place of business in New Jersey, it needs to ensure that, in doing so, it does not violate Section 222. While Section 222 only prohibits a state from *enforcing* any law or regulation relating to recordkeeping, we believe it prudent for any state to avoid adopting a law or rule that the state is legally prohibited from enforcing.

III. SECTION 15(I) OF THE SECURITIES EXCHANGE ACT OF 1934

Section 15(i) of the Exchange Act prohibits any state from establishing "capital, custody, margin, financial responsibility, *making and keeping records*, bonding, or financial or operational reporting requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers that differ from, or are in addition to, the requirements in those areas established [under Federal law]." [Emphasis added.] As you may know, there are no recordkeeping requirements imposed on Federally-registered broker-dealers under Federal law (including FINRA's rules) that require them to maintain records relating to a fiduciary duty. Accordingly, to be lawful under NSMIA, any fiduciary duty the Bureau imposes on a Federally-registered broker-dealer cannot require the broker-dealer to maintain records that are unique to New Jersey. Just as we encourage the Bureau to respect the limits of Section 222 of the Advisers Act, we also strongly encourage it to respect the limits imposed by Section 15(i) of the Exchange Act.

IV. ENACTING A FIDUCIARY DUTY CONSISTENT WITH NSMIA'S LIMITATIONS

A. Avoiding Imposing an Impermissible Recordkeeping Requirement

The above discussed provisions in NSMIA do not preclude the Bureau from imposing a fiduciary duty on investment adviser or broker-dealer registrants. Instead, they merely require that, to withstand legal and constitutional scrutiny, the Bureau draft its fiduciary duty with precision. This can be done in one of two ways. The first way would be for the Bureau to impose a fiduciary duty without defining what information a registrant must maintain to demonstrate compliance with the duty. This would avoid the Bureau running afoul of NSMIA by ensuring that it does not impose recordkeeping requirements on out-of-state investment advisers or Federally-registered broker-dealers that are unique to New Jersey and not required under Federal law or by the investment adviser's home state.

B. Drafting with Precision

Alternatively, the Bureau could require a registrant to document compliance with a fiduciary duty by imposing recordkeeping requirements, but such a provision must be drafted with precision. The Oregon Securities Division provides a guide to how to impose a new regulatory requirement on securities professionals without running afoul of NSMIA. In 2017, the Division promoted legislation to revise the Oregon Securities Act to add a new subsection (4)(a) to Section 59.175 of the Act. This new provision required all applicants for registration as a broker-dealer or state investment adviser to "file with the director a corporate surety bond or irrevocable letter of credit issued by an insured institution . . . or such other security as the director may approve by rule . . ." Cognizant and respectful of the limits on Oregon's authority under Section 222 of the Advisers Act and Section 15(i) of the Exchange Act, the amendments to Section 59.175(4)(a) included the following:

> (4)(a) Except as otherwise provided in paragraph (b) or (c) of this subsection, every applicant for a license as a broker-dealer or state investment adviser shall file with the director a corporate surety bond or irrevocable letter of credit issued by an insured institution as defined in ORS 706.008 or such other security as the director may approve by rule running to the State of Oregon in a sum to be established by rule of the director, but in no event more than $100,000.
>
> (b) Licensed broker-dealers subject to section 15 of the Securities Exchange Act of 1934, as amended, are not required to comply with paragraph (a) of this subsection, nor are such licensed broker-dealers required to comply with any net capital requirements imposed by the director by rule or otherwise.
>
> (c) A licensed state investment adviser who has its principal place of business in a state other than this state shall be exempt from the requirements of paragraph (a) of this subsection and shall be further exempt from any net capital requirements imposed by the director by rule or otherwise, provided

> that any such licensed state investment adviser is registered or licensed as a state investment adviser in the state where it maintains its principal place of business and is in compliance with such state's bonding or net capital requirements. [Highlighting added for emphasis.]

We believe Oregon has provided an excellent example of how states can enact laws or rules that impose regulatory requirements to protect their citizens without running afoul of NSMIA.

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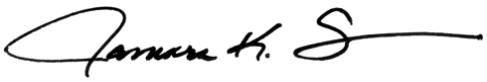
As the Bureau contemplates adopting a fiduciary duty applicable to investment advisers and Federally-registered broker-dealers, we strongly encourage it to be cognizant of and respect the above limitations imposed by NSMIA and draft its rule in conformity with these limitations.

The Institute appreciates the opportunity to provide these comments to the Bureau. If you have any questions concerning them or if we can be of any assistance to you on this proposal, please do not hesitate to contact me. I may be reached by phone at 202-326-5825 or email at tamara@ici.org.

Sincerely,



Tamara K. Salmon
Associate General Counsel