

**Testimony of Knut A. Rostad . President & Co-Founder
Institute for the Fiduciary Standard
November 19, 2018**

**To the New Jersey Bureau of Securities on the Fiduciary / Pre-proposal
“Legal and factual basis” to apply a fiduciary Standard to financial services reps**

Good morning. I am Knut Rostad, president and co-founder of the Institute for the Fiduciary Standard. The Institute is a nonprofit formed in 2011 to research, educate and advocate to advance fiduciary principles and practices. The Institute is proud to advocate unequivocally for robust fiduciary duties as expressed in our Best Practices, and count many of the country’s leading practitioners among supporters and industry luminaries among our advisors. I am delighted to be joined here with professor Frankel, a leading expert on fiduciary law recognized world-wide, and an advisor to the Institute!

Thank you, Chief Gerold for seeking a state fiduciary duty. As your pre-proposal notes, we are in a precarious time for fiduciary duties at the federal level. Confusion among investors, financial reps and some regulators is clear and deeply worrying. Leadership from New Jersey is timely and vital.

Proposal Reg BI, I call RBI, can be thought as nine years, five months and one day in the making. Why? On June 18, 2009 then SEC Chair and former FINRA head, Mary Schapiro, spoke on the proposed Obama reforms and the legal duties of advisers and brokers. And of “appearances.” And that the BD and IA “industries were merging.”

Chair Schapiro’s remarks matter. They kicked off the Obama administrations fiduciary efforts. They also interjected a new and, frankly, troubling view about the importance of IA and BD “appearances” to their legal their duties. Similar titles and dissimilar legal duties are conflated. Chair Schapiro’s remarks were reinforced by SEC Chairs, Commissioners and senior staff who followed.

Now, nine years later, RBI embodies these sentiments and is in the process of becoming law. This, despite, bi-partisan views on the Commission that RBI does NOT equal a best interest standard. Commissioner Peirce, “Suitability plus;” Stein, “Reg status quo.”

This background is vital to understand what’s at stake in 2018 and the importance of New Jersey’s role. We are on the verge of enacting a suitability-type standard federal rule that holds out as fiduciary. This would be game changing.

RBI fails to explain best interest; however, it explains why conflicts can be beneficial

RBI is ambiguous on defining best interest and clear that conflicted advice can be good.

- There is ambiguity in defining best interest. There's no best interest definition; no concrete guidance on policies and procedures to address conflicts. BDs have wide latitude to continue to do under RBI what they do now. As a result, ambiguity in Form CRS makes it incomprehensible, according to investors' comments in the SEC's roundtables. Then, just two weeks ago the SEC RAND report on the disclosure conceded RAND's research, "Was not designed to objectively assess comprehension." It was designed to gather "opinions" or the likeability.
- There is clarity in defining conflicts benefits. RBI worries that the cost to "Establish, maintain and enforce written policies and procedures to mitigate or eliminate certain" conflicts may mean BDs drop certain services, and forgo "some revenue stream." RBI then worries customers will be harmed by either not buying these products or by brokers who may not, "Expend effort in providing quality advice." (See page 274).

The Institute offers two main ways to strengthen Reg BI

First, adopt fiduciary principles and clear language that require rigor. The DOL Rule language on loyalty and care is excellent. It states:

"Investment advice is in the "Best Interest" of the investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity....without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party."

Second, require policies and procedures to enforce the principles and address conflicts.

This means seeking to avoid conflicts – if possible, per the mandate reflected in the 40 Act and is plainly set out in the Supreme Court's Capital Gains Research case.

If avoiding the conflict is not possible, disclosing and mitigating conflicts is vital. Casual disclosure alone isn't enough. The means:

- The disclosure is affirmative and includes all specific and material facts of the conflict and their implication for the client. The adviser ensures it is timely and understood by the client.
- The client provides written consent that is informed, intelligent and independent.
- The transaction is fair and reasonable to the client. Professor Frankel writes, “Courts will generally not enforce an unfair and unreasonable bargain.”

Broker Dealers say the SEC’s Reg BI is just fine

At your November 2 conference, FSI said the SEC’s RBI makes state action unnecessary. SIFMA urged you, Chief Gerold, to NOT impose, “duplicative, different and / or conflicting conduct standards” because, SIFMA asserts, they will cause investor confusion. SIFMA urged you to let the SEC pass RBI, as “It is difficult to imagine what new requirements a state standard would include that would be additive to the substantive investor protections in Reg BI.”

Broker Dealers’ longstanding position against a fiduciary standard is plain

BD views are contrary to the views of leading jurists in history; those who crafted the 40 Act as expressed in the Supreme Court in SEC V. Capital Gains Research and, also, to simple notions of logic and common sense about advice and commercial sales. BD assertions of support for best interest or fiduciary duties are plainly not credible.

If there’s any question that BDs’ case is un-serious, ask this: Is there a credible independent expert who substantively refutes the research and case of fiduciary scholars and investor advocates – and who also supports RBI?

New Jersey has a unique opportunity

We live in precarious times. New Jersey has a unique opportunity to make an important difference in the journey of fiduciary duties in the early 21st century.

Chief Gerold, thank you for this opportunity for the Institute to express its views.

Knut A. Rostad