

Morgan Lewis

MEMORANDUM

TO: Morgan Lewis Fiduciary Standards Working Group

FROM: Lindsay B. Jackson
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DATE: March 5, 2020

SUBJECT: Comparison of Massachusetts, Iowa, Nevada and New Jersey Brokerage Standards of Conduct and the SEC’s Regulation Best Interest

The table below compares the requirements of the proposed Massachusetts, Iowa, Nevada and New Jersey fiduciary duty rules and the SEC’s Regulation Best Interest as applied to broker-dealers and their registered representatives, along with select observations.¹

Requirement	Reg. Best Interest - Final	Massachusetts - Final	Iowa - Proposed	Nevada - Proposed	New Jersey - Proposed	Observations
Covered Customers/ Clients	“Retail customer”—a natural person, or legal representative of such natural person, who receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer (or natural person who is an associated person) and uses the recommendation primarily for personal, family, or household purposes.	“Customer” is not defined, but includes both <i>current and prospective</i> customers. Rule expressly <i>excludes</i> recommendations and advice to: <ul style="list-style-type: none"> • a bank, savings and loan association, insurance company, trust company or registered investment company • a broker-dealer registered with a state securities commission 	“Retail investor”—same as “retail customer” under SEC Reg. BI.	“Client”—A person who receives advice from a “financial planner”.	“Customer” is not defined under the proposed regulation or NJ securities statute and regulations. Regulation expressly excludes recommendations and advice to: <ul style="list-style-type: none"> • a bank, savings and loan association, insurance company, or registered investment company • a broker-dealer registered with a state securities commission 	The Massachusetts rule and the New Jersey proposal both include an express carve-out for advice to certain types of institutional/ sophisticated investors. Massachusetts does not include any exceptions that would cover natural persons based on sophistication. New Jersey’s proposal is modeled on the DOL fiduciary rule’s carveout, but would also encompass

¹ This comparison does not cover Oklahoma’s proposed fiduciary standards as they would only apply to Oklahoma registered investment advisers and their representatives. Iowa’s proposal also includes separate provisions that would apply to insurers and producers.

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		<p>(or agency or office performing like function);</p> <ul style="list-style-type: none"> • an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or agency or office performing like function); • any other institutional buyer as defined in 950 CMR 12.205(1)(a)6 and 14.401 (which includes qualified institutional buyers and various other entities). <p>The final rule also does not apply to “a person” acting in the capacity of a fiduciary to an ERISA-covered employee benefit plan, its participants, or beneficiaries.</p>			<p>(or agency or office performing like function)</p> <ul style="list-style-type: none"> • an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or agency or office performing like function) • a person (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$ 50 million. <p>The proposal also excludes a person acting in the capacity of a fiduciary to an ERISA-covered employee benefit plan, its participants, or beneficiaries.</p>	<p>advice given to an individual investor with assets over \$50 million.</p> <p>The New Jersey proposal and Massachusetts final rule both also exclude persons who act as ERISA fiduciaries, though note that ERISA would likely preempt state regulation of ERISA fiduciaries regardless.</p> <p>The SEC declined to provide an exception for natural persons based on assets, income, or sophistication. While recommendations to ERISA plan fiduciaries would generally not be subject to Reg BI, advice to plan participants generally would.</p> <p>In adopting the final rule, Massachusetts declined to clarify the scope of the rule to be limited to investors with a legal address in Massachusetts or who reside in Massachusetts, stating instead that the “Massachusetts Uniform Securities Act is clear as to</p>

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						<p>the scope and applicability of the Final Regulations.”</p> <p>Iowa’s definition generally aligns with Reg. BI’s.</p>
Covered transactions	<p>Recommending:</p> <ul style="list-style-type: none"> • securities transactions, or • investment strategies involving securities (including account recommendations) 	<ul style="list-style-type: none"> • Providing investment advice, or • Recommending: <ul style="list-style-type: none"> ○ an investment strategy; ○ the opening of any type of account; ○ the transfer of assets to any type of account; or ○ the purchase, sale, or exchange of any security. 	<p>Recommending:</p> <ul style="list-style-type: none"> • securities transactions, or • investment strategies involving securities (including account recommendations) 	<p>Providing:</p> <ul style="list-style-type: none"> • “investment advice” • managing assets • performing discretionary trading • acting in a fiduciary capacity • disclosing fees or gains • through the completion of any contract, and • through the term of engagement of services. <p>“Investment advice” includes providing:</p> <ul style="list-style-type: none"> • buy, hold, or sell a security advice/recommendation • advice/recommendation regarding value of a security • analyses or reports regarding a security • account monitoring • advice/recommendation regarding account type • advice/recommendation regarding fee options • information on a personalized investment strategy • financial plan that includes consideration 	<p>Recommending:</p> <ul style="list-style-type: none"> • an investment strategy • the opening of any type of account • transfer of assets to any type of account • the purchase, sale, or exchange of any security <p>Having discretionary authority or a contractual fiduciary duty.</p>	<p>All rules encompass rollovers/transfers and account type recommendations.</p> <p>Massachusetts’s final rule removed the provisions from the proposal that would have expressly covered insurance and commodities, but there are some open questions here. The adopting release further notes that variable annuities and insurance products are excluded from the definition of “security” under the Massachusetts law.</p> <p>Massachusetts also provides that only the duty of care (and not the duty of loyalty) applies to sales of municipal securities.</p> <p>Nevada’s proposal broadly encompasses many activities that are not currently subject to FINRA’s suitability rule.</p>

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				<p>of buying, holding, or selling a security</p> <ul style="list-style-type: none"> • limited list of securities • information not in a securities offering documents • recommendation of a broker, investment adviser, or financial planner • advice/recommendation regarding insurance products buy comparison to a security, or that includes buy, sale, or hold of a security <p>Subject to certain requirements (good faith, compliance with applicable law, etc.), the following transactions are exempt from fiduciary duty obligations:</p> <ul style="list-style-type: none"> • Unsolicited trades, unless client receives investment advice, discretionary trading, ongoing contractual services, or a financial plan, or B-D uses restricted titles. • Executing a trade recommended by an investment adviser is exempt, unless broker-dealer provides 		<p>Iowa's coverage aligns with Reg. BI's.</p>

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				<p>investment advice, asset management, discretionary trading services, or a financial plan, or B-D uses restricted titles.</p> <ul style="list-style-type: none"> • Clearing services, unless use restricted titles. <p>Additionally, subject to certain conditions, providing information in offering documents or general investment strategies and ranking to the general public are not considered investment advice.</p>		
Standard of conduct	"best interest"	"fiduciary"	"best interest"	"fiduciary"	"fiduciary"	
Loyalty/ Conflicts	<p>Act <i>without placing the financial or other interest</i> of the broker, dealer, or natural person who is an associated person from making the recommendation <i>ahead of</i> the interest of the retail customer.</p> <p>Must establish, maintain, and enforce written policies and procedures reasonably designed to:</p>	<p>Must <i>disclose all material conflicts</i>.</p> <p>Must make <i>reasonably practicable efforts</i> to <i>avoid</i> conflicts of interest, <i>eliminate</i> conflicts that <i>reasonably</i> cannot be avoided, <i>and mitigate</i> conflicts that cannot <i>reasonably</i> be avoided or eliminated.</p> <p>Must make recommendations and provide advice <i>without</i></p>	<p>Have a reasonable basis to believe that the recommendation "does <i>not place the financial or other interests</i> of the broker-dealer or agent ... <i>ahead of</i> the interest of the retail investor."</p> <p>Must "establish, maintain or enforce" policies and procedures reasonably designed to:</p> <ul style="list-style-type: none"> • Identify and <i>eliminate or, at a minimum,</i> 	<p>Fiduciary duty breached if broker-dealer or representative:</p> <ul style="list-style-type: none"> • <i>puts their own interest</i>, other client's interest, or the firm's interest <i>ahead of</i> the client, or • fails to disclose all information regarding a potential conflict of interest. <p>Sales of <i>proprietary products</i> are not breaches if:</p>	<p>Recommendation or advice must be made <i>without regard to</i> the financial or any other interest of the broker-dealer, agent, adviser, any affiliated or related entity and its officers, directors, agents, employees, or contractors, or any other third-party.</p> <p><i>No presumption that disclosing a conflict</i> of interest satisfies the duty of loyalty.</p>	<p>All rules raise questions as to the extent to which disclosure can address a conflict of interest, and, if not, what additional steps to mitigate the conflict are required, or whether the conflict must be eliminated.</p> <p>Regulation Best Interest requires certain conflicts of natural/associated persons to be both disclosed and mitigated, while others may be disclosed, and</p>

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	<ul style="list-style-type: none"> Identify and at a minimum disclose, or eliminate, all conflicts of interest that are associated with such recommendations. Identify and mitigate any conflicts that create an incentive for a natural person who is an associated person of a broker-dealer to place the broker-dealer's or associated person's interests ahead of the retail customer's interests. Identify and disclose any material limitations placed on recommendations of securities or investment strategies and any conflicts of interest associated with such limitations. Prevent such limitations and associated conflicts of interest from causing the broker, dealer, or natural person who is an associated person to make recommendations that places their interest ahead of the retail customer. 	<p>regard to the financial or any other interest of any party other than the customer.</p> <p>Disclosing a conflict of interest alone does not meet or demonstrate the duty of loyalty.</p> <p>Presumes a breach of the duty of loyalty for any recommendation of an investment strategy, opening or transferring assets to a specific type of account, or purchase sale, or exchange of a security that is made in connection with any sales contest.</p>	<p>disclose all conflicts that are associated with a recommendation;</p> <ul style="list-style-type: none"> Mitigate any conflicts that create an incentive for an agent to place the interest of the broker-dealer or agent ahead of the retail investor's interest; Identify and disclose any material limitations placed on the securities or investment strategies that may be recommended to a retail investor and any conflicts of interest associated with such limitations and prevent such limitations and associated conflicts of interest from causing the broker-dealer or agent to make recommendations that place their interest ahead of the retail investor; and Identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities 	<ul style="list-style-type: none"> conduct does not otherwise violate law or SRO rule, and client advised that product is proprietary and of all risks associated with the product. <p>Transaction based commission for sales is not a breach, so long as it is in the client's best interest to be charged by transaction and commission is reasonable.</p>	<p>Presumption of a breach of the duty of loyalty for offering or receiving compensation for a recommendation to open or transfer assets to a specific type of account, or purchase sale, or exchange of a security that is not the "best of the reasonably available options"</p> <p>Transaction-based fees are not deemed a breach provided that the fee is reasonable and is the best of the reasonably available fee options, and the duty of care is satisfied.</p>	<p>certain sales contests that focus on specific investment products or types of products must be eliminated.</p> <p>New Jersey and Massachusetts use "without regard to" formulation from DOL's fiduciary rule, which many found to be problematic to operationalize.</p> <p>Massachusetts's adopting release indicated that the "without regard to" language does not prohibit the existence of conflicts, specifically discussing the receipt of compensation in connection with a recommendation, as well as principal trade and proprietary products. The Division noted that these conflicts cannot reasonably be avoided or eliminated, and may instead be mitigated by "ensuring that the fee earned for the recommendation is reasonable and complying with the remainder of the fiduciary duty."</p>

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	<ul style="list-style-type: none"> Identify and <i>eliminate</i> any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time. 		within a limited period of time.			<p>New Jersey and Nevada require that transaction-based compensation be in the client's "best interest" or "best of the reasonably available" options.</p> <p>The Massachusetts final rule prohibits both product- and non-product specific sales contests, beyond the limitations under Reg. BI.</p> <p>New Jersey indicated in its proposal, a concern regarding sales contests, but did not elaborate on or define the types of sales contests that are problematic, or which practices need to be eliminated, as opposed to disclosed and/or mitigated.</p> <p>Iowa aligns with Reg. BI.</p>
Care	<p>Must act in the retail customer's best interest and exercise reasonable diligence, care, and skill to:</p> <ul style="list-style-type: none"> <i>Understand</i> the potential <i>risks, rewards, and costs</i> associated with the recommendation and 	<p>Must:</p> <ul style="list-style-type: none"> Use the care, skill, <i>prudence</i>, and diligence that a prudent person acting in a like capacity and familiar with such matters would use taking into consideration of all the 	<p>Must act in the retail investor's best interest and exercise reasonable diligence, care and skill too:</p> <ul style="list-style-type: none"> <i>Know and understand</i> the retail investor's <i>investment profile</i>; 	<p>Fiduciary duty breached if broker-dealer or representative:</p> <ul style="list-style-type: none"> <i>Fails to perform adequate and reasonable due diligence</i> on a product or strategy prior to sale or advice, including all risks or features. 	<p>Must:</p> <ul style="list-style-type: none"> Use the care, skill, <i>prudence</i>, and diligence that a prudent person acting in a like capacity and familiar with such matters would use taking into consideration of all the 	<p>Massachusetts and New Jersey both use a "prudence" duty of care, consistent with ERISA/DOL fiduciary rule.</p> <p>Iowa generally aligns with Reg. BI.</p>

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	<p>have a reasonable basis to believe the recommendation could be in the best interest of at least some retail customers;</p> <ul style="list-style-type: none"> • Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards and costs associated with the recommendation and does not place financial or other interests ahead of retail customer's interests; and • Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place financial or other interests ahead 	<p>facts and circumstances, and</p> <ul style="list-style-type: none"> • Make reasonable inquiry, including: <ul style="list-style-type: none"> ○ risks, costs, and conflicts of interest related to all recommendations made and investment advice given ○ customer's investment objectives, financial situation, and needs, and ○ any other relevant information. 	<ul style="list-style-type: none"> • Know and understand the potential risks, rewards, and costs associated with the recommendation; • Have a reasonable basis to believe the recommendation effectively addresses the retail investor's investment profile and does not place the financial or other interest of the broker-dealer or agent ahead of the interest of the retail investor; • Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and effectively addresses the retail investor's investment profile and does not place the financial or other interest of the broker-dealer or agent ahead of the interest of the retail investor; • Have a reasonable basis to believe that 	<ul style="list-style-type: none"> • Fails to understand and convey all risks or features of the product or strategy. • Recommends a security or that is not in the client's best interest. • Limits availability of securities to certain clients unless based on investment goals or strategy, or limitations on quantity or type of investment that can be sold, or security's own limitations. • Fails to comply with best execution rules. 	<p>facts and circumstances, and</p> <ul style="list-style-type: none"> • Make reasonable inquiry, including risks, costs, and conflicts of interest related to the recommendation or investment advice, and the customer's investment objectives, financial situation, and needs, and any other relevant information. 	

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	of retail customer's interests.		<i>prior to or at the time of the recommendation</i> the retail investor has been <i>reasonably informed</i> of the <i>basis of the recommendation and the potential risks, rewards, and costs</i> .			
Compensation	No specific requirement; SEC noted in proposed Regulation Best Interest that broker-dealers already required to receive only fair and reasonable compensation.	No specific requirement; broker-dealers are required to receive only fair and reasonable compensation under current law.	No specific requirement, receiving an unreasonable commission or profit prohibited as a dishonest or unethical practice under current law.	Fiduciary duty breached if broker-dealer or representative recommends or charges a fee that is unreasonable.	Receiving an unreasonable commission or profit prohibited as a dishonest or unethical practice under current law.	
On-going/ episodic	Obligation applies <i>at the time recommendation is made</i> .	The obligation applies at the time a recommendation is made, but is ongoing during <i>any period</i> the firm or financial professional: <ul style="list-style-type: none"> • has or exercises <i>discretion</i> over a customer account (other than time or price of execution); • has a <i>contractual</i> fiduciary duty; or • has a <i>contractual obligation to regularly or periodically</i> monitor a customer's account. 	Obligation applies <i>at the time recommendation is made</i> .	Obligation is <i>ongoing</i> , unless conditions of <i>Episodic Duty Exemption</i> are satisfied, including: <ul style="list-style-type: none"> • Broker-dealer does not: <ul style="list-style-type: none"> ○ manage client assets ○ create periodic financial plans ○ provide ongoing advice ○ enter into a contract to provide investment advice ○ perform discretionary trading ○ otherwise develop a fiduciary relationship from 	Obligation extends through the <i>execution of the transaction</i> , and is not ongoing, <i>unless the broker-dealer also provides in any capacity "investment advice"</i> to the customer.	Reg. BI, the Massachusetts final rule, and Iowa's proposed rule recognize that a broker-dealer's obligations are generally limited to the time a recommendation is made, and not ongoing, unless agreed to with the customer. The adopting release to Massachusetts's final rule clarified that if a broker-dealer or agent contracts to monitor the fiduciary duty would be determined by the agreement with the customer. For example, if the agreement with the customer is to monitor the account four times a year,

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				<ul style="list-style-type: none"> previous or concurrent services <ul style="list-style-type: none"> ○ use specified titles • Facts and circumstances do not indicate client reasonably expects additional or ongoing advice • Client solicited the investment advice 		<p>the fiduciary duty will commence and end each quarter period when the review is performed.</p> <p>The Massachusetts rule clarifies that discretion over time and price will not result in an ongoing duty, but it is unclear what other types of discretion may trigger the ongoing duty.</p> <p>Many consider Nevada's Episodic Exemption to be too limited/difficult to satisfy to be workable for traditional brokerage services.</p> <p>New Jersey's proposal would extend the obligation beyond the time of recommendation to the time of execution.</p> <p>Additionally, while New Jersey's preamble suggests that an ongoing obligation is intended to apply to dual-hatted B-Ds and RIAs, it is not clear how broadly "investment advice" could be interpreted.</p>

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<p>Disclosures</p>	<p>Must disclose <i>prior to or at the time</i> of the recommendation <i>all material facts</i> relating to the scope and terms of the relationship with the retail customer, including broker-dealer capacity, material fees and costs, type and scope of services (including any material limitations) and all material facts regarding conflicts of interest associated with the recommendation.</p> <p>Must provide disclosure in writing either prior to or at time of the recommendation.</p>	<p>Must <i>disclose all material conflicts</i> to satisfy the duty of loyalty (see above).</p>	<p>Must disclose <i>prior to or at the time</i> of the recommendation <i>all material facts</i> relating to the scope and terms of the relationship with the retail investor, including broker-dealer capacity, material fees and costs, type and scope of services (including any material limitations) and all material facts regarding conflicts of interest.</p>	<p>Must disclose:</p> <ul style="list-style-type: none"> • "Gains" which includes: <ul style="list-style-type: none"> ○ Percentage of assets fee ○ Sales commissions ○ Mark ups and mark downs ○ Market maker commissions (Electronic Communication Network rebates or credits) ○ Transaction volume discounts ○ Management fees ○ Trailed or deferred fees or commissions ○ Front and back end loads ○ Service fees ○ Payment for order flow • All information regarding potential conflicts of interest • Current offering documents • That a product was is proprietary or advice is based on a limited pool of assets • All material risks or features of a product • Bad actor disqualification 	<p>No specific disclosure requirements under proposal; certain disclosures required under current law.</p>	<p>Additional disclosures apply to broker-dealers under SEC's Form CRS.</p> <p>Many view Nevada's disclosure obligations as problematic to operationalize.</p>

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				Must also comply with FINRA requirements on customer communications and disclosures.		
Titles	Disclosure obligation presumed to be breached if a broker-dealer or representative uses the terms "adviser" or "advisor" unless dually registered as an investment adviser.	No express restrictions.	No restrictions.	Additional limitations and obligations apply where broker-dealer or representative uses the titles: <ul style="list-style-type: none"> • Advisor, adviser • Financial planner, financial consultant • Retirement consultant, retirement planner • Wealth manager • Counselor • Other titles the administrator may by order deem appropriate 	No restrictions.	While the Massachusetts Securities Division eliminated their titling restriction in the final rule, the adopting release states that the Division disagrees with comments that the use of titles alone does not create an expectation to monitor, that broker-dealers should be held to a fiduciary duty, and that certain titles imply that broker-dealers provide much more than incidental advice. The adopting release goes on to say that given the protections provided under the final rule, it removed the titling provision.
Presumptions of status	None	None	None	Broker-dealers presumed to owe a fiduciary duty and has burden of proving otherwise. Dual-hatted broker-dealer/investment advisers are presumed to be acting as an investment adviser and may not rely on episodic advice exemption.	None	

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Effective Date	June 30, 2020	Effective date March 6, 2020; Enforcement date September 1, 2020	Not specified, but related amendments to insurance rules would be effective January 1, 2021.	TBD	Effective 90 days after the effective date of final rule.	