COMMONWEALTH OF MASSACHUSETTS SUPREME JUDICIAL COURT SJC-13381

ROBINHOOD FINANCIAL LLC, Plaintiff-Appellee

v.

WILLIAM F. GALVIN, SECRETARY OF THE COMMONWEALTH, and THE MASSACHUSETTS SECURITIES DIVISION OF THE OFFICE OF THE SECRETARY OF THE COMMONWEALTH, Defendants-Appellants

ON APPEAL FROM A FINAL JUDGMENT OF THE SUFFOLK SUPERIOR COURT

BRIEF OF AMICUS CURIAE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. IN SUPPORT OF DEFENDANTS-APPELLANTS WILLIAM F. GALVIN AND THE MASSACHUSETTS SECURITIES DIVISION

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IDENTITY AND INTEREST OF AMICUS CURIAE

Formed in 1919, the North American Securities Administrators Association, Inc. ("NASAA") is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. NASAA has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. The Massachusetts Securities Division, a Defendant-Appellant in this proceeding, is a NASAA member.

The overriding mission of NASAA and its members is to protect investors, particularly retail investors, from fraud and abuse. NASAA supports its members in carrying out their investor protection and regulatory duties by, *inter alia*, promulgating model rules and statutes, coordinating examination sweeps and multistate enforcement actions, and commenting on legislative and rulemaking proposals. NASAA also offers its legal analyses and policy perspectives to state and federal courts as *amicus curiae* in cases involving the interpretation of state and federal securities laws.

At its core, this case is about states' rights to interpret, apply, and enforce their securities laws to ensure that the securities industry is held to the high standards needed to protect investors. Like most states, Massachusetts has enacted a version of the Uniform Securities Act. *See* G.L. c. 110A, inserted by Stat. 1972, c. 694. Accordingly, NASAA and its members have a strong interest in ensuring that the

Massachusetts Uniform Securities Act ("MUSA") is interpreted correctly, in a manner that gives effect to its fundamental remedial purposes and preserves state prerogatives. The Superior Court's decision below impairs the Secretary's ability to administer the MUSA as intended. If allowed to stand, the Superior Court's misguided interpretation of Massachusetts law could undermine the ability of Massachusetts and other jurisdictions to interpret and apply their own laws.

This brief is submitted pursuant to Mass. R. App. P. 17(a) (allowing the filing of amicus briefs when solicited by an appellate court) and this Court's January 20, 2023, amicus announcement in this case.

DECLARATION PURSUANT TO MASS. R. APP. P. 17(C)(5)

No party, party's counsel, or person or entity other than *amicus curiae* and its counsel, authored this brief in whole or in part, or contributed money intended to fund its preparation or submission. Neither *amicus curiae* nor its counsel has either represented any of the parties to this appeal in another proceeding involving similar issues, or been or represented a party in a proceeding or legal transaction at issue in the present appeal.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Mass. R. App. P. 17(a)(1) and SJC Rule 1:21, NASAA states that it is a 26 U.S.C. § 501(c)(3) non-profit membership corporation, incorporated under the laws of the District of Columbia in 1999, with its headquarters in Washington, DC. NASAA does not issue stock or any other form of securities and does not have any parent corporation.

SUMMARY OF ARGUMENT

The Massachusetts Uniform Securities Act ("MUSA") is meant to protect investors from fraudulent, abusive, and otherwise harmful practices involving the offer and sale of securities and investment advice. The Secretary promulgated the Fiduciary Rule to do exactly that. The Court should reverse the Superior Court's decision below and uphold the Fiduciary Rule as a reasonable policy choice and a valid exercise of the Secretary's authority to interpret and apply the MUSA consistent with its purpose.

First, the Fiduciary Rule is a reasonable measure to protect investors from harmful conflicts and other abusive practices. Although broker-dealers and investment advisers once performed distinct functions, the former have increasingly held themselves out as akin to the latter. Investors have trouble distinguishing between them and mistakenly believe that broker-dealers already owe them fiduciary duties of care and loyalty. The resulting confusion and frustrated expectations leaves investors unable to protect themselves from conflicts, which cost them billions of dollars each year. For these and other reasons, the Securities and Exchange Commission ("SEC") staff recommended that the Commission should do substantially what the Secretary has done here; namely, to adopt a uniform fiduciary standard for investment advice. The SEC adopted Reg BI instead. *See infra*, 18-25.

Unfortunately, Reg BI has fallen short in certain key areas and has not lived up to its promise. It does not adequately address investor confusion, as investor testing has shown that Form CRS, one of Reg BI's key disclosure mechanisms, is ineffective. It also does not appear that Reg BI has improved broker-dealer practices. Investor testing indicates that key disclosures are ineffective. Examinations conducted by NASAA members and the SEC indicate that Reg BI has not meaningfully improved broker-dealer practices regarding the products they sell, their disclosures, and how they manage conflicts. The Secretary's choice to establish a fiduciary standard for broker-dealers after the SEC did not is eminently reasonable. The fiduciary duty established under the rule enhances investor protection and mitigates investor confusion, while remaining sufficiently flexible to accommodate a variety of business models, products, and forms of compensation. See infra, 25-31.

Second, promulgating standards of conduct such as the Fiduciary Rule for registrants is a valid exercise of the Secretary's authority to interpret and apply the MUSA. The Secretary's rulemaking authority is broad, particularly with respect to his obligation to further define appropriate ethical obligations for applicants and registrants in Massachusetts. The Secretary acted within that authority when he promulgated the Fiduciary Rule and was not required to wait on the SEC or any other regulator to do so. Further, the Fiduciary Rule neither displaces nor changes

the common law as articulated in *Patsos*. The MUSA is additive to the common law, and *Patsos* says nothing about how broker-dealers are regulated by the Secretary under the MUSA. Moreover, both Robinhood and the Superior Court read *Patsos* too broadly. The Court should read *Patsos* to mean what it says: that discretion is a necessary condition to assign "general" (*i.e.*, ongoing) fiduciary duties to a broker-dealer that extend beyond individual transactions. The Fiduciary Rule is consistent with this principle. *See infra*, 31-38.

Third, the Fiduciary Rule is not preempted by federal law. State and federal securities regulators share responsibility and authority to regulate the conduct of broker-dealers. Congress has consistently recognized and preserved this authority, and nothing in Dodd-Frank indicates any intent for Reg BI to preempt state broker-dealer conduct standards. The SEC likewise expressed no preemptive intent in Reg BI, setting a regulatory floor, not a ceiling. Robinhood cannot meet its burden to show something more than a "hypothetical or potential conflict." On its face, the Fiduciary Rule does nothing to inhibit investor choice between different products and services, nor does the SEC's concern lift the purported conflict out of the realm of potentiality. Finally, Robinhood's reliance on *Geier* does not create a conflict, as that case involves materially different circumstances from those at issue here. *See infra*, 38-46.

The Court should reverse the decision below and uphold the Fiduciary Rule as a valid exercise of the Secretary's authority under the MUSA.

ARGUMENT

I. The Fiduciary Rule is a reasonable policy choice to protect investors from harmful conflicts and other abusive practices.

Like other state and federal securities laws, the Massachusetts Uniform Securities Act ("MUSA"), G.L. c. 110A, is meant to protect investors from fraudulent, abusive, and otherwise harmful practices involving the offer and sale of securities and investment advice. *E.g.*, *Bulldog Invs. Gen. P'ship v. Sec'y of Com.*, 460 Mass. 647, 652 (2011). The Secretary adopted 950 CMR 12.207: Fiduciary Duty of Broker-Dealers and Agents ("Fiduciary Rule") to protect investors from conflicts and other harmful practices when receiving investment advice from broker-dealers. *Cf.* Mass. Sec. Div., *Request for Comment* (Dec. 13, 2019), Brief of the Defendants-Appellants ("Sec. Br."), ADD-124 to ADD-127.

Although retail investors rely on both broker-dealers and investment advisers for advice, they generally do not understand key differences between them, or the legal and financial implications of those distinctions. This is due in large part to the fact that broker-dealers have sought to expand their services and often portray themselves as akin to investment advisers. The resulting confusion and frustrated expectations leaves investors unable to protect themselves from conflicts, which cost them billions of dollars each year.

To remedy this problem, Congress directed the Securities and Exchange Commission ("SEC") to engage in a study to evaluate the effectiveness of the standards of care for broker-dealers, investment advisers and their associated persons, and it gave the SEC the authority to make new rules, including the authority to establish a fiduciary duty for broker-dealers. In response, the SEC staff published a study in which they recommended that the SEC harmonize the different conduct standards for broker-dealers and investment advisers by holding broker-dealers to a fiduciary duty standard.

Instead, the SEC chose to adopt a lesser standard, known as Regulation Best Interest ("Reg BI"), 17 CFR 240.15*l*-1. Unfortunately, Reg BI has not lived up to its promise, nor has it remedied the essential problem that led to its proposal; *i.e.*, investor confusion, frustrated expectations and the resulting harms to their investment objectives. Accordingly, the Secretary made a reasonable policy choice to do what the SEC would not do to protect investors by adopting the Fiduciary Rule, 950 CMR 12.207.¹

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The Court should note that, while Robinhood urges the Court to cede state investor protection prerogatives to the SEC, Robinhood apparently believes that its entire business model is exempt from Reg BI as well. *See* Letter from Robinhood Financial, LLC to SEC, 8-9 (Oct. 1, 2021), https://www.sec.gov/comments/s7-10-21/s71021-9316498-260092.pdf. This raises the question of what duties, if any, Robinhood believes it owes to its customers, as well as the impetus for the relief sought.

A. Broker-dealers have increasingly held themselves out as trusted advisers, but investors have trouble distinguishing them from investment advisers.

Retail investors rely on both investment advisers and broker-dealers for the guidance and expertise they need to make sound investment decisions and safeguard their financial futures. When Congress enacted the federal securities laws in the middle of the last century, each kind of firm performed a distinct role. As the industry evolved, those roles converged in important ways and retail investors have had trouble distinguishing between them.

At the time Congress enacted the Securities Exchange Act of 1934 ("Exchange Act"), broker-dealers performed clearly defined functions: effecting transactions for their customers, and buying and selling securities for their own accounts. See 15 U.S.C. §§ 78c(a)(4), (5); accord G.L. c. 110A, § 401(c). Broker-dealers tended to focus on execution, which was a complicated, hands-on process; advice was secondary. Arthur B. Laby, Selling Advice and Creating Expectations: Why Brokers Should be Fiduciaries, 87 Wash. L. Rev. 707, 729-30 (Oct. 2012). Broker-dealer salespeople often lacked the expertise to offer true advisory services and thus their advice was usually generalized, such as passing along information from the firm's research department. Id. at 730. As a result of the transactional focus of their services, broker-dealers have traditionally been compensated based on the transactions they effect, through commissions, markups, markdowns, and, more

recently, selling customer orders to other entities for execution (*i.e.*, payment for order flow). SEC, Staff Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("913 Study"), 10-11 (Jan. 2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf; SEC, Staff Report on Equity and Options Market Structure Conditions in Early 2021, 2, 9-14 (Oct. 2021), https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf.

Accordingly, broker-dealers have historically been obligated merely to provide "suitable" recommendations.² See FINRA Rule 2111;3 950 CMR 12.204(1)(a)(4). The suitability standard generally requires a broker-dealer to make recommendations that are "consistent with" and not "clearly contrary to" the "best interest" of its customer. See Proposed Rule, Regulation Best Interest ("Reg BI Rel. 34-83062, 2018), Proposal"), SEC No. 14 n.15 (Apr. 18,

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Generally, investment advisers are considered to be in the business of "advising" others, e.g., G.L. c. 110A, § 401(m), while the suitability rules apply to "recommendations" made by broker-dealers, e.g., FINRA Rule 2111. Except when referring to the requirements of specified rules, this brief uses the term "advice" generically to avoid confusion.

The Financial Industry Regulatory Authority was created in 2007 through the consolidation of the National Association of Securities Dealers ("NASD") and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange ("NYSE"). FINRA Rule 2111 is modeled on NASD Rule 2310. See FINRA Reg. Notice 09-25, Suitability and "Know Your Customer" (May 2009).

https://www.sec.gov/rules/proposed/2018/34-83062.pdf. However, the suitability rules neither prohibit conflicts, nor require broker-dealers to eliminate, mitigate, or disclose them. Conflicting incentives flourished under the suitability standard, including sales contests, compensation and other benefits beyond commissions paid by securities issuers and sponsors, differential compensation among similar securities, and the sale of proprietary products. See NASAA, Report and Findings of NASAA's Regulation Best Interest Implementation Committee: National Examination Initiative Phase II(A) ("Phase II(A) Report"), 14 (Nov. 2021), https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021 FINAL.pdf.

The profession of investment advisers arose in the mid-twentieth century in response to rising investor demand for the kind of personal, "competent, unbiased, and continuous advice regarding the sound management of their investments" that they were not receiving from broker-dealers. See Christine Lazaro, The Future of Financial Advice: Eliminating the False Distinction Between Brokers and Investment Advisers, 87 St. John's L. Rev. 381, 391 (2013). In exchange for continuing, personalized services, most investment advisers charge ongoing fees, typically calculated as a percentage of a client's assets under management. 913 Study at 7. Because of the nature of their historic functions, investment advisers are fiduciaries and must strive to provide disinterested advice by eliminating, or at least

disclosing, all conflicts. *See SEC v. Cap. Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 191-92 (1963) (internal quotation omitted); *see also* Letter from Michael Pieciak, NASAA President, to SEC ("Pieciak Letter"), 22-25 (Feb. 19, 2019), https://www.nasaa.org/wp-content/uploads/2019/12/NASAA-Reg-BI-

<u>Supplemental-Comment-Letter-021919.pdf</u> (explaining that states "have taken an expansive view of the fiduciary obligations of state-registered investment advisers, typified by an expectation of undivided loyalty where the adviser acts primarily for the benefit of its clients").

These distinctions were relatively clear in the mid-twentieth century, but they have eroded over time as broker-dealers shifted their focus away from execution and toward personalized advice. For example, the development of electronic trading systems removed much of the complexity from execution and reduced the importance of that aspect of broker-dealers' services. *See* Laby, 87 Wash. L. Rev. at 730. Many broker-dealers thus sought to "enhance[] their value" by providing personalized investment advice. *See id*.

Broker-dealers have also taken pains to be viewed as trustworthy advisers. See Angela A. Hung et al., RAND Corp., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers ("RAND Report"), 78 (2008), https://www.rand.org/pubs/technical reports/TR556.html. This is commonly

reflected in their advertising,⁴ as well as in the widespread use of generic titles like "financial advisor" and "financial consultant" to refer to their agents, which strongly connote a fiduciary-like relationship.⁵ *See id.* at 91; 913 Study at 94 n.447. Further, many firms and professionals are dually registered in both broker-dealer and investment adviser capacities. *See* 2022 FINRA Industry Snapshot, 5 (2022), https://www.finra.org/sites/default/files/2022-03/2022-industry-snapshot.pdf (nearly half of all registered securities industry professionals were dually registered in 2021); RAND Report, Executive Summary at xv-xviii. As the SEC noted in 2018, 68% of customer accounts were held at dually registered firms. *See* Reg BI Proposal at 226.

It is therefore not surprising that investors have trouble distinguishing broker-dealers from investment advisers. *See* RAND Report at 117-18; 913 Study at 101, 107. As a general matter, retail investors incorrectly believe that broker-dealers are required to act like fiduciaries when giving advice. *See* RAND Report at 31-33; 913 Study at 101. The confusion is exacerbated further by the prevalence of dually

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For examples of such advertising, *see*, *e.g.*, Letter from State Attorneys General to SEC ("State AG Letter"), 4 n.5 (Aug. 7, 2018), https://www.sec.gov/comments/s7-07-18/s70718-4185784-172673.pdf; Laby, 87 Wash. L. Rev. at 757; RAND Report at 70; and Letter from Consumer Fed'n of Am. to SEC, 8 (Jan. 13, 2000), https://consumerfed.org/pdfs/SEC_Comments_Broker-Dealer011300.pdf.

Though ubiquitous, these and other similar titles have no independent legal or regulatory significance.

registered firms and professionals, as it may not be apparent to a customer whether they are receiving advice in a broker-customer or adviser-client capacity. Adding another layer of confusion, a customer that has different accounts designated as advisory and brokerage may not understand when the roles – and the standards of conduct – switch.

Investor confusion about key distinctions leaves investors unable to protect themselves from conflicts and other harmful practices. When investors believe that they are receiving advice from someone acting as a fiduciary, they normally have no reason to believe they need to guard against conflicts. When disputes do arise, broker-dealers tend to aggressively disclaim fiduciary responsibility in arbitration. See, e.g., Joseph C. Peiffer and Christine Lazaro, Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty, Public Investors Advocate Bar Association (Mar. 25, 2015), https://piaba.org/piaba-newsroom/report-major-investor-losses-due-conflictedadvice-brokerage-industry-advertising. Conflicted advice drains billions of dollars annually from the accounts of retirement savers. See Jason Furman and Betsey Stevenson, The Effects of Conflicted Investment Advice on Retirement Savings, Obama White House 23. (Feb. 2015), https://obamawhitehouse.archives.gov/blog/2015/02/23/effects-conflicted-investm ent-advice-retirement-savings (estimating that conflicted advice costs Americans

\$17 billion per year); Heidi Shierholz and Ben Zipperer, *Here is what's at stake with the conflict of interest ('fiduciary') rule,* Econ. Policy Institute (Mar. 30, 2017), https://www.epi.org/publication/here-is-whats-at-stake-with-the-conflict-of-interest-fiduciary-rule/ (noting that conflicted advice costs Massachusetts retirement savers more than \$491 million annually).

These longstanding issues have plagued the industry for years and prompted Congress to (1) direct the SEC to study the existing legal and regulatory standards to determine whether they adequately protected investors, and (2) authorize the SEC to harmonize the applicable standards by imposing a fiduciary duty on brokerdealers when providing advice. See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, § 913, 124 Stat. 1376, 1824-29 (July 21, 2010) ("Dodd-Frank"). After completing the study, the SEC's staff recommended in 2011 that the Commission should do substantially what the Secretary has done here; namely, to adopt a fiduciary standard of conduct for broker-dealers and investment advisers to guarantee that "personalized securities advice to retail investors be given in their best interests, without regard to the financial or other interest of the financial professional." 913 Study at 101. The SEC's staff reasoned that investors "should not have to parse through legal distinctions to determine whether the advice they receive was provided in accordance with their expectations," and they should "be protected uniformly" when receiving advice, regardless of the

source. *Id.* As discussed further below, the Commission declined to follow this well-founded recommendation and adopted Reg BI instead.

B. Reg BI has not resolved investor confusion or eliminated harmful practices.

Reg BI has fallen short in certain key areas and has not lived up to its promise. As NASAA and others have described in comments, Reg BI does not go far enough to protect investors from conflicts of interest (such as sales contests), relies too heavily on disclosure to cure conflicts, and confers too much discretion on broker-dealers to decide how to address conflicts. *E.g.*, Letter from Joseph Borg, NASAA President, to SEC (Aug. 23, 2018), https://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Reg-BI-Comment-Letter-8-23-2018.pdf; Pieciak Letter, *supra* page 21; State AG Letter, *supra* note 4. Evidence further suggests that Reg BI does not adequately protect investors.

First, Reg BI does not adequately address investor confusion, which was supposed to be one of its essential goals. The customer relationship summary form ("Form CRS") was adopted along with Reg BI, and is meant to address investor confusion about fees, costs, legal duties, and other key differences between the broker-customer and adviser-client relationships. *See* Final Rule, *Form CRS Relationship Summary; Amendments to Form ADV*, SEC Rel. No. 34-86032 (June 5, 2019), https://www.sec.gov/rules/final/2019/34-86032.pdf.

However, investor testing indicates that Form CRS is ineffective. Multiple surveys have found that overall comprehension of the form is poor and investors have difficulty interpreting and using the disclosures. See Letter from AARP et al. to Jay Clayton, Chair, SEC (Sept. 12, 2018), https://consumerfed.org/wp-content/ uploads/2018/09/letter-to-sec-from-aarp-cfa-fpc-regarding-crs-testing.pdf; Angela A. Hung et al., RAND Corp., Investor Testing of Form CRS Relationship Summary, 48-49 (Nov. 2018), https://www.sec.gov/comments/s7-07-18/s70718-4628415-176399.pdf (finding continued confusion, despite investors' perception that they were better informed). See also Letter from CFA Institute to Allison Herren Lee, (Apr. SEC, 2 14, 2021), https://www.cfainstitute.org/-Acting Chair, /media/documents/comment-letter/2020-2024/20210305.ashx (stating "Form CRS may well be the least effective form ever created by the Commission"); RAND Report at 19-20 (noting the "questionable value of disclosures" to investors).

Second, it does not appear that Reg BI has improved broker-dealer practices. Based on examinations of 443 broker-dealers, NASAA members found that most of the firms examined "continue to operate precisely the same under Reg BI as they had under the suitability rule." Phase II(A) Report at 3. A focal point of the examinations was the sale of some of the most complex, costly, and risky ("CCR")

products available to retail investors. *Id.* at 6.6 Conflicting financial incentives are commonly used to promote the sale of these products and broker-dealers sell them at a much higher rate under Reg BI than investment advisers do under a fiduciary standard. *See id.* at 7-10, 15.

Despite the extensive conflicts associated with these products, more than 75% of examined firms imposed no new product restrictions, including restrictions on the sale of CCR products. *Id.* at 10. NASAA members also observed that few broker-dealers are providing fair and balanced point-of-sale disclosures, especially about potential lower-cost alternatives and other conflicts. *Id.* at 12.

The examinations also revealed that many firms either lacked the tools to adequately consider lower-cost, lower-risk alternatives or simply were not offering or discussing those alternatives with their customers. *Id.* More concerning, the sale of these products, and the extensive financial conflicts associated with them, tend to be more heavily concentrated in broker-dealers that are dually registered with an SEC-registered investment adviser than standalone broker-dealers or those dually registered with a state-registered investment adviser. *See id.* at 7, 15. Ultimately,

⁶ CCR products considered in Phase II(A) include private securities, variable annuities, non-traded REITs, and leveraged or inverse exchange-traded funds. *Id.* at 6. These products tend to have all three characteristics, and routinely appear in investor complaints and state enforcement actions. *Id.*

the firms at which these shortcomings were observed have access to the hard-earned money of as many as 33 million retail customers. *See id.* at 10.

The SEC made similar observations in a January 2023 risk alert. See SEC, Div. of Exams, Observations from Broker-Dealer Examinations Related to Regulation Best Interest (Jan 30, 2023), https://www.sec.gov/file/exams-reg-bi-alert-13023.pdf. More than two years after the Reg BI implementation date, the SEC continues to observe significant deficiencies and weaknesses in all components of Reg BI. Among other things, the SEC observed that firms have failed to fully understand the products sold, failed to ensure that investors receive timely disclosures, failed to establish processes to identify and address conflicts, and failed to ensure that agents consider reasonably available alternatives and cost in making recommendations. See generally id.

In sum, Reg BI has not shown itself to be adequate to resolve the problems it was meant to address.

C. The Fiduciary Rule protects investors while preserving investor choice among differing products and services.

The Secretary believed that investors need and deserve greater protection from conflicts and other harmful practices than they would receive under Reg BI. *See Request for Comment*, Sec. Br. at ADD-124 (stating that the SEC's "approach contradicts years of data and will not protect investors from harmful conflicts"). The Fiduciary Rule accomplishes that goal, and specifically addresses some of the most

significant shortcomings of Reg BI. Among other things, the Fiduciary Rule eliminates all sales contests as contrasted with Reg BI's narrow focus on product-specific, time-limited sales contests and affirmatively requires broker-dealers to "make all reasonable efforts" to avoid or eliminate conflicts before relying on disclosure unlike Reg BI's disclosure-centric approach. *See* 950 CMR 12.207(2)(b)-(d).

The Fiduciary Rule is substantially identical to the uniform fiduciary standard that the SEC staff recommended in 2011. As explained in the 913 Study, a fiduciary standard offers several benefits, including heightened investor protection and awareness, flexibility to accommodate different business models, and preservation of investor choice and access to different products and services. *See* 913 Study, Executive Summary at viii.

Further, the Secretary's reasonable policy choice does nothing to harm broker-dealers or limit investor choice. Nothing about the broker-customer relationship prevents broker-dealers from providing their products and services under a fiduciary standard, nor would a fiduciary standard require broker-dealers to function exactly like investment advisers. As this Court has recognized, the scope of a person's fiduciary obligations is a factual issue that depends on the specifics of the engagement. *See Patsos v. First Albany, Inc.*, 433 Mass. 323, 332-33 (2001). Thus, a broker-dealer providing advice on an episodic basis in a non-discretionary account

will naturally have less extensive fiduciary obligations than an investment adviser providing discretionary advice on an ongoing basis. See Speech by SEC Commissioner Elisse B. Walter to the Mutual Fund Directors Forum Ninth Annual Policy Conference, Regulating Broker-Dealers and Investment Advisers: Demarcation or Harmonization? (May 5, 2009), https://www.sec.gov/news/speech/ 2009/spch050509ebw.htm ("[W]hat a fiduciary duty requires depends on the scope of the engagement. Thus, it will mean one thing for a mere order taker, another thing for someone who provides a one-time financial plan, and yet something else for someone who exercises ongoing investment discretion over an account."). The Fiduciary Rule echoes these principles. Investment advisers have applied the core fiduciary principles of care and loyalty to their businesses for nearly a century, and there is no credible reason why broker-dealers cannot apply these principles to their own business model today.

Moreover, studies have shown that some of the primary arguments against a broker-dealer fiduciary duty lack merit. One multidisciplinary study found "no evidence that the broker-dealer industry is affected significantly by the imposition of a stricter legal fiduciary standard on the conduct of registered representatives" and that "[i]mposition of a universal fiduciary standard among financial advisers may result in a net welfare gain to society, and in particular to consumers who are ill-equipped to reduce agency costs on their own." Michael Finke and Thomas

Langdon, The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice, J. Fin. Planning 28, 36 (July 2012), https://www.financial planningassociation.org/sites/default/files/2020-09/JUL12%20JFP%20Finke.pdf. That is exactly what the Fiduciary Rule is designed to do. Another study found that, although a stricter fiduciary duty may increase certain costs, the resulting increase in the quality of advice tends to raise risk-adjusted returns. See Vivek Bhattacharya et al., Nat'l Bureau of Econ. Rsch. Working Paper 25861, Fiduciary Duty and the for Market Financial Advice (revised May 2020), https://www.nber.org/system/files/working papers/w25861/w25861.pdf.

In sum, the Fiduciary Rule is a reasonable policy choice to protect investors in light of the shortcomings of Reg BI. The rule enhances investor protections while preserving investor access to different products and services.

II. The Fiduciary Rule is a valid exercise of the Secretary's authority to interpret and apply the MUSA.

As explained in the Secretary's brief, the MUSA confers broad authority on the Secretary to make the rules he determines are necessary to carry out the statute's investor protection mandate, including by defining terms. *See* Sec. Br. at 26-30; *see also* G.L. c. 110A, § 412. The Fiduciary Rule is a valid exercise of the Secretary's broad authority under the statute to protect investors by interpreting and enforcing the statute's ethical standards. Nor does the Fiduciary Rule override this Court's articulation of the common law in *Patsos*. For these reasons, explained more fully

below, the Court should uphold the Fiduciary Rule and reject Robinhood's and the Superior Court's excessively narrow interpretation of the Secretary's authority.

A. The Secretary acted within his authority under Section 412 when he promulgated the Fiduciary Rule.

The Secretary has broad authority under the MUSA to carry out its investor protection mandate through rulemaking. See G.L. c. 110A, § 412. This Court has stressed that "[a]n agency's powers to promulgate regulations are shaped by its organic statute taken as a whole and need not necessarily be traced to specific words." Massachusetts Fed'n of Tchrs. v. Bd. of Educ., 436 Mass. 763, 773 (2002) (internal quotation omitted). Federal courts have construed functionally identical provisions in the Exchange Act to authorize the SEC "to adopt those rules and regulations necessary for carrying out the agency's designated functions" and to provide "wide latitude" for the SEC to address "constantly changing conditions" in the securities industry. *Touche Ross & Co. v. SEC*, 609 F.2d 570, 580 (2d Cir. 1979) (construing 15 U.S.C. § 78w(a)(1)). A regulation enacted pursuant to such broad authority should be upheld as long as there is "some rational relation between the regulation and the empowering statute." White Dove, Inc. v. Dir. of Div. of Marine Fisheries, 380 Mass. 471, 477 (1980).

The Fiduciary Rule is a valid exercise of the Secretary's authority under Section 412 to define the term "unethical or dishonest conduct" more fully in light of changing conditions in the securities industry. *See* G.L. c. 110A, § 204(a)(2)(G).

The MUSA does not define "unethical or dishonest conduct," but instead leaves it to the Secretary to "find" that an applicant or registrant has engaged in such conduct. *See* G.L. c. 110A, § 204(a). Although the Secretary could make such findings on a case-by-case basis through enforcement actions, *see id.*, Massachusetts, like many other states, has elected to define the term by rule in the form of a non-exhaustive list. 950 CMR 12.204(1) & (2); *accord* NASAA Model Rule, Dishonest or Unethical Business Practices of Broker-Dealers and Agents at (1)(c) (amended May 16, 2022), https://www.nasaa.org/wp-content/uploads/2022/07/1956-Act-and-2002-Act-Broker-Dealer-Dishonest-or-Unethical-Practices-Rule-20220516.pdf.

Ethical standards like Section 204(a)(2)(G) reflect the challenge of drafting a statute that explicitly deals with every possible evil that might develop. That is why such standards are written broadly to ensure that the law is flexible enough to address practices that are inconsistent with the public interest and investor protection, even if they are not explicitly spelled out in the statute. *Cf.* S. Rep. No. 75-1455, 1938 WL 1589, at *3 (1938) (discussing the need for ethical regulation under the Exchange Act to protect investors from dishonest and unfair practices, even if not explicitly prohibited by statute). In light of the developments discussed above, especially the efforts of broker-dealers to encourage investors to view them as trusted advisers rather than salespeople, it was eminently reasonable for the Secretary to conclude that the failure to adhere to fiduciary duties when providing

advice is "unethical or dishonest." Thus, the Secretary reasonably exercised his authority to define "unethical or dishonest conduct" after the SEC, in his view, failed to adequately protect investors from harmful conflicts and abusive practices.

The Secretary is also correct that the coordination provisions in Sections 412(b) and 415 do not require regulatory homogeneity or otherwise restrict the Secretary's exercise of his own independent judgment and expertise to administer the MUSA. See Sec. Br. at 30 n.2, 40-44. The draftsmen's commentary to Section 415 of the Uniform Securities Act (1956), from which the MUSA is drawn, makes clear that the aim of "coordination at the state and federal levels" is "secondary" to investor protection and only applies "in so far as practicable." Louis Loss, Commentary on the Uniform Securities Act, 165, Draftsmen's Commentary to § 415 (2d printing, 1976). This Court has also been clear that the interpretation given to the securities laws of the federal government and of other states is guidance, not binding precedent. See Hays v. Ellrich, 471 Mass. 592, 603-05 (2015) ("declin[ing] to adopt th[e] Federal standard" and noting that Section 415 "does not mandate that courts adopt the interpretation of comparable Federal securities statutes"). As explained in the Secretary's brief, "[t]hat Robinhood – or the SEC, or anyone else – might choose a different policy approach is immaterial to the Secretary's statutory authority." Sec. Br. at 33. The statutory preference for coordination is not a sound

basis to second-guess the judgment of any individual state securities regulator in interpreting their own state's laws.

B. The Fiduciary Rule neither displaces nor changes the common law as articulated in *Patsos*.

Robinhood contends, and the Superior Court held in its decision below, that the Fiduciary Rule improperly changes or overrides the common law as defined in *Patsos*. This is incorrect for two reasons.

First, Patsos says nothing, and need not be read to say anything, about how broker-dealers are regulated by the Secretary under the MUSA. The common law and the MUSA are related but distinct bodies of law that are fully capable of coexisting alongside each other. The rights and remedies provided under the MUSA "are in addition to any other rights or remedies that may exist at law or in equity." G.L. c. 110A, § 410(h). That includes common law. Further, while the Secretary is empowered to enforce the MUSA, the statute grants him no authority to assert common law claims. Although private plaintiffs can sue under Section 410 or the common law, the MUSA provides no private right of action under Section 204(a)(2)(G). G.L. c. 110A, §§ 410, 204(a)(2)(G). In other words, only the Secretary can sue to enforce the Fiduciary Rule. Thus, the Fiduciary Rule need not affect the common law – there will be no case in which a court would be required to mediate or decide between the two.

Second, both Robinhood and the Superior Court misread *Patsos* as establishing that broker-dealers are not subject to any fiduciary duties unless they have discretion. Sup. Ct. Memorandum of Decision and Order on Cross-Motions for Judgment on the Pleadings (Mar. 30, 2022), Sec. Br. at ADD-078; Brief of Plaintiff-Appellee, 45-47. That is not a natural or logical reading of the case. Instead, the Court should read *Patsos* to mean what it says: that discretion is a necessary condition to assign "general" fiduciary duties that continue beyond individual transactions. *See Patsos*, 433 Mass. at 336.

As the Court recognized, the scope of a broker-dealer's fiduciary duties is a factual issue that turns on the circumstances of each case. *See id.* at 332-33 (last paragraph on 332 and cases cited). The Court identified several factors relevant to that analysis, including discretion, the customer's lack of investment acumen, social or personal ties with the customer, and the provision of investment advice. *See id.* at 334-35. The Court further acknowledged that discretion is especially significant "in determining the scope of the broker's fiduciary obligations." *See id.* at 333 (emphasis added). Accordingly, a broker-dealer "assumes broad fiduciary obligations [in a discretionary account] that extend beyond individual transactions." *Id.* at 333 (emphasis added). In a non-discretionary account, "each transaction is viewed singly" and "all duties to the customer cease when the transaction is closed."

Id. (internal quotation omitted). Thus, the issue is one of the degree and scope of a broker-dealer's fiduciary duties, not their existence.

The Court found it appropriate to "assign[] general fiduciary duties" to brokerdealers that have and exercise investment discretion. *Id.* at 336 (emphasis added). This is sensible because such relationships bear hallmarks of the adviser-client relationship. See Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, SEC Rel. No. IA-5249, 14 (June 5, 2019), https://www.sec.gov/rules/interp/2019/ia-5249.pdf.⁷ Although non-discretionary account holders technically retain control of the investment decisions in their accounts, it is rarely the case that the broker-dealer "merely receives and executes [the] customer's orders," as the Court understood the relationship at the time. *Patsos*, 433 Mass. at 333. To the contrary, it is common for such customers to trust and rely on the broker-dealer's expertise and advice. See id. at 335 (noting that "[a]n inexperienced or naive investor is likely to repose special trust in his stockbroker because he lacks the sophistication to question or criticize the broker's advice or judgment," particularly "where the broker holds himself out

Accordingly, the SEC most recently interpreted the exercise of discretion to be inconsistent with the provisions excluding certain broker-dealers from the definition of "investment adviser," except in certain limited circumstances. *See id.* at 16-18; 15 U.S.C. § 80b-2(a)(11)(C). Thus, in most instances, a broker-dealer exercising discretion will be an "investment adviser" under, and subject to the requirements of, the Advisers Act.

as an expert in a field in which the customer is unsophisticated"). As noted above, broker-dealers have encouraged such trust and reliance through their marketing and their use of titles that strongly suggest an advisory-like relationship. Investors who rely on a broker-dealer's advice are "particularly vulnerable" to harm resulting from conflicted advice, and they should be protected accordingly. *See id.* at 336. The imposition of fiduciary duties on broker-dealers when providing advice in non-discretionary retail accounts is therefore consistent with *Patsos*.

Further, extending fiduciary duties to the provision of investment advice in non-discretionary accounts will not cause broker-dealers to "become insurers of their customers' investments." *See id.* at 336. Neither the Secretary nor anyone else with authority to interpret or apply the Fiduciary Rule has said that the failure of an investment to perform as expected would be a violation of the rule. Nor is that a feature of an adviser-client relationship. By its own terms, the Fiduciary Rule applies at the time that a broker-dealer provides investment advice or recommendations in non-discretionary accounts. 950 CMR 12.207(1)(a). Consistent with *Patsos*, those duties are not ongoing and do not extend beyond the individual transaction, unless the broker-dealer has otherwise assumed continuing obligations. *See* 950 CMR 12.207(1)(b).

III. The Fiduciary Rule is not preempted by federal law.

"Preemption...is not favored" and the Fiduciary Rule "should be upheld unless a conflict with Federal law is clear." *Sawash v. Suburban Welders Supply, Co.*, 407 Mass. 311, 315 (1990). This is particularly true where, as here, Congress has recognized and assented to continued state regulation in a given field. *See Wyeth v. Levine*, 555 U.S. 555, 575 (2009). "The existence of a hypothetical or potential conflict is insufficient to warrant the pre-emption of [a] state [law]." *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982).

Robinhood cannot meet this burden. Nothing in Dodd-Frank or Reg BI suggests that Congress or the SEC intended for Reg BI to preempt state law regarding standards of conduct for broker-dealers. Moreover, Robinhood cannot show that the Fiduciary Rule poses an actual conflict by reducing investor choice.

A. Neither Congress nor the SEC intended to displace the states' longstanding regulation of broker-dealers.

State and federal regulators have shared responsibility and authority to regulate the conduct of broker-dealers since Congress passed the Exchange Act. Congress expressly recognized and preserved state securities regulators' established authority to regulate broker-dealers when it wrote the Exchange Act. *See* 15 U.S.C. § 78bb(a)(1). When Congress has sought to preempt state regulation of broker-dealers in discrete circumstances, it has done so explicitly, narrowly, and precisely. *Compare* 15 U.S.C. § 78o(i)(1) (explicitly preempting state law in the limited

context of broker-dealer "capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements") with 15 U.S.C. § 780(i)(2) (explicitly preempting state law from "enforc[ing] any law, rule, regulation, or other administrative action against a registered funding portal with respect to its business as such").

Although Congress knows how to preempt state law if it desires to do so, there is no evidence of preemptive intent – express or implied – in Dodd-Frank. When Congress is aware of the prevalence of state law in a field of federal interest, its silence as to preemption is "powerful evidence" of its lack of preemptive intent. Wyeth, 555 U.S. at 575. Robinhood would have this Court insert language into Section 913 that does not exist. Among Dodd-Frank's hundreds of provisions, only Section 913 dealt with broker-dealer conduct standards. As part of the study of the existing regulatory landscape mandated by that section, the SEC was directed to consider state regulation of broker-dealers. See Dodd-Frank § 913(c)(1), (5), (8), 124 Stat. at 1825-26. Despite being well-aware of states' longstanding regulation of broker-dealers, nothing in Dodd-Frank suggests any intent to preempt state authority.

The SEC likewise expressed no preemptive intent in Reg BI. In the Reg BI adopting release, the SEC noted that "several commenters" had asked the SEC to include language either preempting state law or affirming that it did not intend to do

so. See Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct ("Reg BI Adopting Release"), SEC Rel. No. 34-86031, 32 n.61 (June 5, 2019), https://www.sec.gov/rules/final/2019/34-86031.pdf. The SEC declined to do either, stating instead that questions of preemption would be resolved by courts in future litigation based on the circumstances. See id. at 43. One Commissioner made the point more directly, stating that the adopting release should have been more clear that Reg BI "sets a federal floor, not a ceiling, for investor protection." Statement of Commissioner Robert J. Jackson Jr. on Final Rules Governing Investment Advice (June 5, 2019), https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd.

Robinhood has failed to show any preemptive intent for the simple reason that none exists. In the absence of preemptive intent, the Court should thus uphold the Fiduciary Rule because Robinhood cannot demonstrate a clear, actual conflict with federal law. *See Sawash*, 407 Mass. at 315.

B. Robinhood cannot show that the Fiduciary Rule reduces investor choice.

In order to succeed on its preemption claim, Robinhood must show more than "the existence of a hypothetical or potential conflict." *Rice*, 458 U.S. at 659. It is not enough to show that that Fiduciary Rule "might" result in some limitation of investor choice. Robinhood cannot meet this burden.

The SEC adopted Reg BI, first and foremost, to "enhance[] the broker-dealer standard of conduct...and align[] the standard with retail customers' reasonable expectations." Reg BI Adopting Release at 373. Secondarily, the SEC intended to preserve, "to the extent possible," retail investors' access to different products and services, particularly the transaction-based advice model provided by broker-dealers. *Id.* at 374-75. Robinhood cannot show that the Fiduciary Rule reduces investor choice.

In fact, the Fiduciary Rule on its face preserves investor choice. Under the Fiduciary Rule, a broker-dealer can provide services and receive compensation on a transactional basis as long as it both discloses and takes steps to address conflicts. See 950 CMR 12.207(1)(a) & (b), (2)(b); Mass. Sec. Div., Adopting Release Re: Amendments to Standard of Conduct Applicable to Broker-Dealers and Agents – 950 CMR 12.200 (Feb. 21, 2020), Sec. Br. at ADD-092 to ADD-094 (describing the scope and duration of the fiduciary duty), ADD-096 (noting that the Fiduciary Rule does not prohibit all conflicts, including transaction-based compensation). Nothing in the Fiduciary Rule prevents broker-dealers from continuing to offer transaction-based services under a fiduciary standard, particularly one which limits the scope of fiduciary obligations to specified activities, which the Fiduciary Rule does.8

⁸ To the extent that the Fiduciary Rule limits access to self-interested sales recommendations presented as advice, this will likely benefit investors overall.

Furthermore, the Fiduciary Rule has been in effect since March 6, 2020, and brokerdealers continue to operate in Massachusetts, with no evidence of significant disruption to investor choice. See, e.g., 2022 FINRA Industry Snapshot at 20-22.

Certain amici posit that the Fiduciary Rule will reduce investor choice by increasing compliance costs and liability risks. See Brief of Amici Curiae U.S. Chamber of Commerce and Greater Boston Chamber of Commerce, 31-36. However, these *amici* appear to base their contention on compliance cost estimates for an unrelated rule (the since-vacated 2016 Department of Labor Fiduciary Rule). Further, although amici acknowledge that Reg BI has already imposed "significant cost," id. at 33, they make no effort to identify, much less quantify, the purported additional costs that would be attributable to the Fiduciary Rule. The Court should give little weight to these unfounded predictions.

Moreover, the SEC's choice not to establish a fiduciary standard does not demonstrate an actual conflict. The agency was concerned that a fiduciary standard could jeopardize access to the broker-dealer business model. See generally Reg BI Adopting Release at 633-56; id. at 634 (stating that "uniformity could come at a cost" and a fiduciary duty "could result in a standard of conduct for broker-dealers

See Finke, supra page 25 and Bhattacharya, supra page 25. See also Monique Morrissey and Heidi Shierholz, *EPI comment to the SEC regarding the fiduciary* rule, Econ. Policy Inst. (Oct. 2017), https://www.epi.org/publication/epi-commentto-the-sec-regarding-the-fiduciary-rule/# ref7.

that is not appropriately tailored") (emphases added). That is not the same as making a finding that it would do so. Further, the SEC admitted that its decision was informed substantially by industry surveys that "are subject to potential selection biases…and methodological limitations" that make their probative value unclear. See Reg BI Adopting Release at 452-53. The Secretary considered the issue of investor choice when proposing the Fiduciary Rule. See Request for Comment, Sec. Br. at ADD-125 to ADD-126. Ultimately, the Secretary reasonably arrived at a different conclusion and disagreed that a fiduciary standard was likely to negatively impact investor choice. See id.

Further, the fact that the Fiduciary Rule better protects investors through a higher standard of conduct does not create a preemptive conflict. Courts frequently uphold heightened state regulatory standards where both the states and the federal government regulate in a given field. See, e.g., Florida Lime and Avocado Growers v. Paul, 373 U.S. 132, 141 (1963) (higher state regulatory standard for avocado oil content was not preempted by a lower federal regulatory standard); Marrache v. Bacardi U.S.A., Inc., 17 F.4th 1084, 1095-96 (11th Cir. 2021) (state law prohibiting alcohol additives was not preempted by federal food safety regulations that permit the additive); Capron v. Atty. Gen. of Mass., 944 F.3d 9, 28 (1st Cir. 2019) (federal regulation of au pair program set a "floor" but not a "ceiling" for related state regulations); Chevron Inc. v. Hammond, 726 F.2d 483, 498-501 (9th Cir. 1984) (state

prohibition on oil tanker discharging of waste water was not preempted by federal law that permitted the activity).

Robinhood's reliance on Geier v. American Honda Motor Co., 529 U.S. 861 (2000), is misplaced and does not suffice to create a conflict where none otherwise exists. At the outset, it is important to note that the "mix" of different passive restraints at issue in Geier was not an end in itself. Rather, the choice furthered the overall goal of safety by allowing manufacturers to experiment with different options and to build the public's confidence in the new technologies. See id. at 879. These considerations are absent from Reg BI. The latter does not purport to offer a "mix" of different standards, nor a "gradual phase-in" of the unitary standard it creates. There is also no evidence that retail investors have rejected advice provided under a fiduciary standard, similar to the anticipated consumer "backlash" against airbags in Geier. See id. To the contrary, investors typically prefer to receive advice under a fiduciary standard. E.g., RAND Report at 31-32. To the extent that investors choose to work with broker-dealers instead of investment advisers, they do so not because broker-dealers are not fiduciaries, but for practical reasons such as account minimums and broker-dealers' transactional compensation structure. E.g., id. at 113. Furthermore, the standards at issue in Geier were established under a very different statutory scheme, which broadly preempted states from establishing "any safety standard...which is not identical to the Federal standard. Geier, 529 U.S. at 895 (internal quotation omitted). The federal securities laws are not so broadly preemptive. Accordingly, the Court should give no weight to *Geier*, especially in light of the absence of preemptive intent by either Congress or the SEC.

In light of the foregoing, this Court should decline to hold that Reg BI preempts the Fiduciary Rule.

CONCLUSION

For the reasons explained above, the Court should reverse the Superior Court's decision below and uphold the Fiduciary Rule as a valid exercise of the Secretary's authority under the MUSA.

Respectfully Submitted

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Certificate of Compliance

Pursuant to Mass. R. App. P. 17(c)(9), undersigned counsel certifies that the above document complies with the requirements of Mass. R. App. P. 17 and Mass. R. App. P. 20, and was rendered in fourteen-point Times New Roman typeface on Word for Microsoft 365 and consists of 7,426 non-excluded words in proportional font.

/s/ James F. Radke

James F. Radke

Certificate of Service

I, James F. Radke, hereby certify that on April 12, 2023, I caused copies of the foregoing *Brief of Amicus Curiae North American Securities Administrators, Inc. in Support of Defendants-Appellants William F. Galvin and the Massachusetts Securities Division* to be filed through eFileMA.com and delivered through the electronic means provided by the clerk on the following registered users and copies to nonregistered users by email to the extent known and otherwise by first-class mail, postage prepaid to.

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