

SUPREME JUDICIAL COURT
FOR THE COMMONWEALTH OF MASSACHUSETTS
NO. SJC-13381

ROBINHOOD FINANCIAL, LLC,
Plaintiff-Appellee,

v.

WILLIAM F. GALVIN, IN HIS OFFICIAL CAPACITY AS
SECRETARY OF THE COMMONWEALTH, AND THE MASSACHUSETTS
SECURITIES DIVISION,
Defendant-Appellants.

ON APPEAL FROM A FINAL JUDGMENT OF THE SUPERIOR COURT

**BRIEF OF *AMICI CURIAE* THE INSTITUTE FOR THE FIDUCIARY
STANDARD AND PROFESSOR EMERITA TAMAR FRANKEL IN
SUPPORT OF DEFENDANTS-APPELLANTS FOR REVERSAL**

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FIDUCIARY STANDARD AND
PROFESSOR EMERITA TAMAR
FRANKEL,

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CORPORATE DISCLOSURE STATEMENT

Amicus curiae the Institute for the Fiduciary Standard ("Institute") states, pursuant to S.J.C. Rule 1:21, that it is a nonstock corporation incorporated in Virginia, with its headquarters in Virginia. The Institute does not issue stock or any other form of securities and does not have any parent corporation. The Institute is governed by a self-perpetuating Board of Directors, the members of which serve solely in their personal capacities.

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ISSUES PRESENTED

Amici curiae the Institute for the Fiduciary Standard and Professor Emerita Tamar Frankel address the question presented by this Court in its amicus announcement of January 20, 2023:

whether the rule conflicts with and is preempted by Federal law or regulations promulgated by the Securities and Exchange Commission.

INTEREST OF AMICUS CURIAE

Founded in 2011, the Institute for the Fiduciary Standard is a non-profit research and education institution whose sole purpose is to promote the fiduciary standard in investment and financial advice.¹ The Institute seeks to inform and assist investors, policymakers, researchers, and the industry about the impact of the fiduciary standard on capital markets and the economy at large. The vision of the Institute is a society where fiduciary principles and practices

¹ The Institute for the Fiduciary Standard's past or current Board of Advisors include: John C. Bogle (founder, The Vanguard Group), Tamar Frankel (Professor of Law Emerita at Boston University School of Law and Chairwoman of the Institute's Board of Advisors), Luis Aguilar (eighth longest-serving Commissioner in SEC history), and Phyllis Borzi (former Assistant Secretary for Employee Benefits Security of the U.S. Department of Labor).

permeate the investment and financial adviser professions, and all advice serves investors' best interests. The Institute's long-term objective is that the fiduciary standard becomes everyday practice for industry professionals, including broker-dealers and sales professionals, who render investment or financial advice. Each year, the Institute awards the Frankel Fiduciary Prize to an individual in the public or private sectors who has made significant contributions to preserving, advancing, or educating others on fiduciary principles. Past nominees and recipients include regulators, political leaders, academics, journalists, advocates, and practitioners.

Professor Emerita Tamar Frankel is a leading expert on fiduciary law, corporate governance, and the regulation of the financial system.² The Institute and Professor Frankel have an interest in this case because it raises fundamental questions of the scope of state securities regulators' authority to require financial professionals to meet the fiduciary

² Professor Tamar Frankel has published more than seventy articles and book chapters, in addition to her own books: *Fiduciary Law, Trust and Honesty*, and *America's Business Culture at a Crossroad*, among others.

standard. This standard sits at the very heart of why the Institute exists and serves to protect millions of investors in the Commonwealth of Massachusetts.³

³ The Institute would like to recognize the student attorneys in the Thomas & Mack Public Policy Clinic at the William S. Boyd School of Law for assistance in drafting this brief.

SUMMARY OF THE ARGUMENT

The Massachusetts Securities Division ("Division") promulgated the Fiduciary Rule to ensure a minimum level of protection for the Commonwealth's citizens not guaranteed by the U.S. Securities and Exchange Commission's ("SEC") disclosure-oriented Regulation Best Interest ("Reg BI"). The Division aims to hold persons giving investment advice to retail investors about securities in exchange for compensation to the same standard when they give advice. Appellee incorrectly asserts that Massachusetts lacks authority to regulate conduct in Massachusetts (see Section I). This assertion is not supported by law or fact.

As Section II explains, the Division's Fiduciary Rule serves a valuable purpose in addressing conduct not covered by Reg BI. For its part, Reg BI requires disclosures and sets a minimal floor for brokerage behavior. Reg BI currently permits brokerages to profit from conflicted investment advice by exploiting retail investors' trust. The Fiduciary Rule addresses this regulatory gap. Section III explains that client trust supports a well-functioning economy. Allowing trusted advisers to betray this trust risks creating

broader economic problems. The Division's Fiduciary Rule prevents these problems from continuing to harm the economy. Section IV explains the costs that flow from conflicted advice and how firms, like Robinhood, have complied with other fiduciary rules in the past.

ARGUMENT

I. THE FIDUCIARY RULE DOES NOT CONFLICT WITH FEDERAL LAW, NOR MASSACHUSETTS COMMON LAW.

The Appellee incorrectly argues that federal law preempts Massachusetts's Fiduciary Rule (the "Rule").⁴ The Rule simply requires brokerages to give retail investors honest and untainted advice with only the investors' interests in mind.⁵ To escape fiduciary obligations as applied to its own registered professionals, Appellee incorrectly argues both that: (A) the U.S. Securities and Exchange Commission's ("SEC") Regulation Best Interest ("Reg BI") somehow strips states of the power to regulate conduct, and (B) that Massachusetts common law requires state

⁴ Appellee's Appl. for Direct Review at 21-22.

⁵ 950 C.M.R. 12.207(2)(b)(1)-(3) (2020) (the Rule reads in relevant part:

(b) The duty of loyalty requires a broker-dealer or agent to:

1. Disclose all material conflicts of interest;
2. Make all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts that cannot reasonably be avoided, and mitigate conflicts that cannot reasonably be avoided or eliminated; and
3. Make recommendations and provide investment advice without regard to the financial or any other interest of any party other than the customer).

regulators to tolerate conflicted advice.⁶ As explained below, these arguments are incorrect.

A. Federal Law Does Not Preempt the Fiduciary Rule.

The Supreme Court disfavors federal preemption unless Congress manifests a clear intent to prevent states from acting.⁷ Securities law has historically been regulated at both the federal and state level and courts recognize that state regulation plays a vital role.⁸ Nothing in the Dodd-Frank Wall Street Reform and Protection Act of 2010 (“Dodd-Frank”) altered that baseline. Indeed, Dodd-Frank specifically instructed the SEC to consider “the existing legal or regulatory standards of State securities regulators and other regulators intended to protect retail customers” in the area of securities law when fashioning its rules.⁹ An exercise of state police power in this context is only superseded where “the repugnance or conflict is

⁶ Appellee’s Appl. for Direct Review at 16, 22.

⁷ *Rice v. Sante Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

⁸ See *Baker, Watts Co. v. Miles Stockbridge*, 876 F.2d 1101, 1107 (4th Cir. 1989) (explaining that federal law does not enjoy complete preemptive force in the field” and “Congress has expressly preserved the role of the states in securities regulation”).

⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(c)(8), 124 Stat. 1376, 1826 (2010).

so 'direct and positive' that the two acts cannot 'be reconciled or consistently stand together.'"¹⁰

No conflict or repugnance exists between the challenged Fiduciary Rule and Reg BI. Appellee manufactures a false conflict by mischaracterizing Reg BI as a regulatory ceiling, as opposed to the regulatory floor that it is.¹¹ Prior to Reg BI's enactment, other states' statutory or common laws already imposed a higher standard.¹² Notably, Nevada imposed a statutory fiduciary duty for brokerages years before Reg BI.¹³ Nevada passed its fiduciary statute in 2017, two years before the SEC issued Reg

¹⁰ See *Madeira v. Affordable Housing Found.*, 469 F.3d 219, 241-242 (2d Cir. 2006) (quoting *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977)).

¹¹ Appellee's Appl. for Direct Review at 8-12; see also Regulation Best Interest: The Broker-Dealer Standard of Conduct, U.S. Sec. & Exch. Comm'n, 17 C.F.R. Part 240, Release No. 34-86031, File No. S7-07-18 33318, 33418 (2019). (Plaintiff writes, "In Reg BI, the SEC specifically rejected a uniform fiduciary standard for broker-dealers and investment advisers" but leaves out the SEC's recognition that "Broker-dealers' current standards of conduct are governed by federal and state law and regulation as well as the rules and guidance of SROs... Together, these laws and regulations comprise the regulatory baseline" within the same release.)

¹² See, e.g., Nev. Rev. Stat. 628A.020 (2017); *Apollo Capital Fund v. Roth Capital Partners*, 158 Cal.App. 4th 226, 246 (Cal. Ct. App. 2007); *Holmes v. Grubman*, 691 S.E.2d 196, 201 (Ga. 2010).

¹³ Nev. Rev. Stat. 628A.020.

BI. Had the SEC somehow intended to invalidate state laws, it would have said as much. Moreover, nothing in Reg BI in any way prohibits brokerages from giving advice solely in the interest of the investor.

B. Preemption Is Similarly Unwarranted at the State Level.

Appellee gamely contends that the Rule abrogates Massachusetts common law by misconstruing *Patsos v. First Albany Corp.*¹⁴ In *Patsos*, this Court stated that a stockbroker and its client may have *either* a fiduciary or an ordinary business relationship.¹⁵ Appellee then twists *Patsos* to argue that Massachusetts distinguishes between RIAs, who are fiduciaries of their customer, and broker-dealers who are not.¹⁶ This is not accurate. *Patsos* acknowledged that brokers may owe fiduciary duties in some instances.¹⁷ There, the Court noted that the scope of a broker's fiduciary duty depends on the circumstances such as when a customer trusts a broker.¹⁸ Ultimately,

¹⁴ *Patsos v. First Albany Corp.*, 741 N.E.2d 841 (Mass. 2001).

¹⁵ *Id.* at 848.

¹⁶ Appellee's Appl. for Direct Review at 6-7.

¹⁷ *Patsos*, 741 N.E.2d at 848-850.

¹⁸ *Id.* at 849, 851 (the court elaborates on when broker-dealers assume fiduciary duties based on their conduct stating "Assigning general fiduciary duties

Patsos does not limit the Division's ability to create predictability by subjecting brokerages to fiduciary duties when they offer investment advice to their clients.

II. THE FIDUCIARY RULE PROTECTS INVESTORS.

The Fiduciary Rule serves to protect investors by ensuring that they receive advice in their best interest. In the securities realm, persons giving advice may be fiduciary registered investment advisers ("RIAs") subject to the Investment Advisers Act of 1940, or brokers regulated by the Fiduciary Rule and Reg BI.

A. Brokers Have Increasingly Held Themselves Out as Investment Advisers.

Research shows an overwhelming majority of retail investors do not understand brokers are in the business of selling, not in the business of financial advice.¹⁹ This is not surprising given brokers have

only to those stockbrokers who have the ability to, and in fact do, make most if not all of the investment decisions for their customers properly provides appropriate protection only for those customers who are particularly vulnerable to a broker's wrongful activities").

¹⁹ See generally Joshua Brown, *What is a Stockbroker? America Has No Clue*, FORBES (Sept. 20, 2010), <https://www.forbes.com/sites/streettalk/2010/09/20/what-is-a-stockbroker-america-has-no->

increasingly marketed themselves as 'advisers' to investors.²⁰

Traditionally, brokers executed agreements to facilitate transactions, with advice being limited or "incidental".²¹ Now, brokers generate their income by advising investors to complete transactions.²² Many of these transactions are peddled pursuant to a conflict-riddled business model.²³

Despite this shift, the legal landscape governing brokerage activities has largely failed to keep pace with changing practices.²⁴ For these reasons, investors

clue/?sh=5d587fba68de; see also Survey: Vast Majority of U.S. Investors Support Clear "Fiduciary Standard" for Financial Professionals, Widespread Confusion Seen Linked to Current SEC Rules, CONSUMER FED'N AM. (Sept. 15, 2010), https://consumerfed.org/press_release/survey-vast-majority-of-u-s-investors-support-clear-fiduciary-standard-for-financial-professionals-widespread-confusion-seen-linked-to-current-sec-rules/ [hereinafter "Fiduciary Study"].

²⁰ See Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 *Bus. Law.* 395, 404 (2010).

²¹ *Id.*

²² Knut A. Rostad & Javier Garcia, *The Case to Fix Form CRS Disclosure*, INST. FIDUCIARY STANDARD (Sept. 22, 2021), <https://thefiduciaryinstitute.org/wp-content/uploads/2023/01/Testing-CRS-of-29-BDs-Final-Nov-10-PLG.pdf>.

²³ Laby, *supra* note 20, at 405.

²⁴ See Benjamin P. Edwards, *Financial advice is a thicket of conflicts. Wall Street wants to keep it that way.*, WASH. POST. (Dec. 28, 2016),

often mistakenly operate under assumptions that brokers and RIAs owe similar duties.²⁵ One survey found that over 75% of investors believed that persons labeling themselves “financial advisers” owed fiduciary duties.²⁶

While brokers present themselves as trustworthy financial advisers, real differences exist between them and RIAs. Most RIAs collect fees exclusively from their customers on an ongoing basis, and as such, owe ongoing fiduciary duties to them.²⁷ Conversely, brokers’ duties are limited to the time of the transaction.²⁸ Additionally, brokers often collect fees indirectly from interested third parties which pay brokerages for moving products.²⁹

Critically, brokers generally make more money per transaction by selling complex, costly, and risky

https://www.washingtonpost.com/opinions/financial-advice-is-a-thicket-of-conflicts-wall-street-wants-to-keep-it-that-way/2016/12/28/0ec72e34-c6f0-11e6-bf4b-2c064d32a4bf_story.html (discussing the need to update the law).

²⁵ Fiduciary Study, *supra* note 19.

²⁶ *Id.*

²⁷ U.S. Sec. & Exch. Comm'n, *Study On Investment Advisers and Broker-Dealers*, 7-11 (Jan. 2011), <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>

²⁸ *Id.* at 10-11.

²⁹ *Id.* at 57 (discussing third-party remuneration a broker-dealer receives as compensation).

("CCR") products, even if the products are not best suited for their customers.³⁰ In contrast, RIAs owing fiduciary duties have been obligated to eliminate or disclose conflicts to their customers.³¹ Despite the differences, the public has not understood how RIAs and brokers differ because brokerages have not been required to effectively educate their customers on this.³² Yet the differences matter. The Rule recognizes these distinctions and limits brokers' fiduciary obligations to the time when they give advice, unless the broker becomes subject to an ongoing obligation.³³

B. Regulation Best Interest Allows Brokers To Consider Their Own Interests When Giving Advice.

In the wake of the 2008 financial crisis, Congress passed Dodd-Frank. Alongside financial stability reforms, Congress asked the SEC to study

³⁰ Ron A. Rhoades, Comment Letter to U.S. Sec. & Exch. Comm'n, at 11 (Aug. 6, 2018) (available at <https://www.sec.gov/comments/s7-07-18/s70718-4174268-172351.pdf>).

³¹ Sec. & Exch. Comm'n v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 191-192 (1963) (explaining that Congress recognized the "delicate fiduciary nature of an investment advisory relationship, as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline as investment adviser—consciously or unconsciously—to render advice which was not disinterested").

³² See Micah Hauptman, *Financial Advisor or Investment Salesperson?*, CONSUMER FED'N AM., 3 (2017).

³³ 950 C.M.R. 12.207(1).

differences between brokers and RIAs.³⁴ It also authorized the SEC to require that brokerage-channel advice be “no less stringent than the standard applicable to investment advisers.”³⁵

Instead of exercising its full authority to raise the brokerage advice standard, the SEC promulgated Reg BI.³⁶ Reg BI vaguely directs brokerages to act in the “best interest” of their customers and prohibits brokerages from placing their own interests above the investor’s.³⁷ This vague standard allows firms to consider their own interests when making personalized investment recommendations to investors.³⁸

³⁴ *Testimony on “Wall Street Reform: Assessing and Enhancing the Financial Regulatory System” Before the United States S. Comm. on Banking, Housing, and Urban Affairs*, 113 Cong. 84, (2014) (statement of Mary Jo White, Chairwoman, U.S. Sec. & Exch. Comm’n) (stating over 90 provisions in the Act require SEC rulemaking, studies, and reports).

³⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o).

³⁶ Regulation Best Interest, *supra* note 11; See also 17 C.F.R. § 240.151-1 (Reg BI regulates brokerage firms by imposing four general obligations: (1) a disclosure obligation (2) a care obligation (3) a conflict-of-interest obligation, and (4) a compliance obligation).

³⁷ 17 C.F.R § 240.151-1(a)(1).

³⁸ See generally Barbra Roper & Micah Hauptman, Letter to Brent J. Fields, Secretary, U.S. Sec. & Exch. Comm’n (August 7, 2018) (available at <https://consumerfed.org/wp->

Functionally, Reg BI operates through four core obligations: (1) a disclosure obligation; (2) a care obligation; (3) a conflict of interest obligation; and (4) a compliance obligation. Under Reg BI's terms, acting in a customer's best interest must be understood as checking these regulatory boxes—not as actually putting an investors' interest first.³⁹

Reg BI did not meaningfully change brokerage advice standards because brokerages were already subject to a vague "best interest" standard under FINRA's suitability rule.⁴⁰ In 2012, FINRA issued a notice interpreting its Suitability Rule.⁴¹ The notice explained that brokers recommendations must be

content/uploads/2018/08/cfa-comment-reg-best-interest-form-crs-ia-guidance.pdf).

³⁹ See Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest, U.S. Sec. & Exch. Comm'n, <https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest#:~:text=Reg%20BI's%20obligation%20to%20act,Conflict%20of%20Interest%2C%20and%20Compliance> (updated Aug. 3, 2022) ("Reg BI's obligation to act in the retail customer's best interest is satisfied by complying with the rule's four component obligations: Disclosure, Care, Conflict of Interest, and Compliance").

⁴⁰ See, e.g., SR-FINRA-2111(a)-(b) (2012); FINRA-2011-016; SR-FINRA-2012-027 (2012).

⁴¹ Reg. Notice 12-25, *Additional Guidance on FINRA's New Suitability Rule*, FIN. INDUS. REGUL. AUTH. (FINRA), May 18, 2012 (available at <https://www.finra.org/rules-guidance/notices/12-25>).

consistent with their customers' "best interests."⁴² Much like Reg BI, the FINRA notice provided little clarity about what this meant in practice. Instead, FINRA simply stated brokers could not place their interests *ahead* of their customers'.⁴³

Reg BI replicates these problems. It imposes vague obligations and misleads the investors who would understand a best interest obligation as being associated with the duties of care and loyalty inherent to a fiduciary relationship.⁴⁴

Conflicted brokerage advice generates profits by abusing the information asymmetry between trusting investors and brokerage firms.⁴⁵ Conflicts skew advice when the broker makes a recommendation motivated by self-interest or to benefit a third party, rather than the customer.⁴⁶ The customer may or may not be aware of the conflict and the broker's disloyalty in a given transaction.⁴⁷ Often, customers will not inquire about these conflicts because they operate under reasonable

⁴² *Id.*

⁴³ *Id.*

⁴⁴ Rhoades, *supra* note 30, at 10.

⁴⁵ Arthur B. Laby, *Advisors as Fiduciaries*, 72 FLA. L. REV. 953, 955-6 (2020).

⁴⁶ *Id.* at 1007.

⁴⁷ *Id.* at 1007-8.

yet false assumptions that brokers are actually required under Reg BI to put their interests first.⁴⁸

C. Regulation Best Interest Has Not Improved Advice Quality.

To the extent that Reg BI aimed to improve the quality of advice brokerages provide to investors, it has fallen short.⁴⁹ Instead, the record shows that: (i) brokerages continue to peddle the products which pay them the most; and (ii) firms' internal policies and training procedures fail to adequately reduce investor harms stemming from the conflicts of interest that skew their advice toward high fee products.

i. Conflicted Advice Continues to Harm Consumers.

In 2021, one year after Reg BI went into effect, the North American Securities Administrators Association ("NASAA") surveyed over 2,000 firms, analyzing broker-dealer practices before and after Reg BI.⁵⁰ NASAA's post-Reg BI study found that most firms examined "have remained fairly stagnant and continue

⁴⁸ *Id.* at 1007.

⁴⁹ *Report and Findings of NASAA's Regulation Best Interest Implementation Committee*, N. AM. SEC. ADMIN. ASS'N (NASAA), Nov. 2021, at 1 (available at https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021_FINAL.pdf) [*hereinafter* "NASAA Post-Reg BI Report"].

⁵⁰ *Id.*

to operate precisely the same under Reg BI as they had under FINRA's suitability rule."⁵¹

The harm a brokerage firm inflicts from conflicted advice largely depends on the firm's product mix. Yet, after Reg BI, more than three-quarters of the firms surveyed failed to employ any new restrictions on the offering and sale of conflicted products.⁵² Only seven percent of the surveyed firms reported eliminating such offerings.⁵³

Even more concerning, of the four CCR products that routinely appear in FINRA-related investor complaints, NASAA found that more firms participated in these product offerings after the SEC enacted Reg BI.⁵⁴ The increase in CCR offerings presents clear evidence that Reg BI's goal of protecting investors has done little to improve the quality of advice investors receive.

ii. Reviews Expose Numerous Deficiencies in Firms' Overall Compliance with Reg BI.

⁵¹ *Id.* at 3.

⁵² *Id.* at 4-5.

⁵³ *Id.*

⁵⁴ *Id.* (summarizing the offering of cryptocurrency, highly leveraged products, special-purpose acquisition companies (SPACs), and unit investment trusts, among others)

The SEC, like NASAA, similarly noted deficiencies with respect to all four of the Reg BI's cornerstone obligations when analyzing firms' written policies and procedures.⁵⁵ As for the Care Obligation, Reg BI requires firms to "understand the potential risks, rewards, and costs associated with a recommendation."⁵⁶ Yet, brokerages largely failed to provide any training or guidance on how broker-dealers might find alternatives better-suited to their customers.⁵⁷ NASAA found that of the firms which do offer product-specific training, only half offer or discuss lower-risk alternatives.⁵⁸ In sum, a large number of the SEC and NASAA-surveyed firms fail to educate brokers on alternatives.⁵⁹ This means that many brokerages now fail to exercise reasonable care in recommending products.

⁵⁵ *Observations from Broker-Dealer Examinations Related to Regulation Best Interest*, U.S. Sec. & Exch. Comm'n, January 30, 2023, at 1-2 (available at <https://www.sec.gov/file/exams-reg-bi-alert-13023.pdf>) [hereinafter "SEC Risk Alert"].

⁵⁶ *Id.* at 2.

⁵⁷ *Id.* at 3-4.

⁵⁸ NASAA Post-Reg BI Report, at 10.

⁵⁹ SEC Risk Alert, at 3-4; see also NASAA Post-Reg BI Report, at 3.

The SEC also observed disclosure shortfalls.⁶⁰ For example, some firms disclosed conflicts of interest via hyperlink, taking an “access equals delivery” approach to inform consumers about conflicts.⁶¹

The evidence and experience shows that Reg BI has not meaningfully improved broker-dealer conduct.⁶² Absent real change, investors will continue to suffer.⁶³

The Division’s Fiduciary Rule serves to give clarity to Massachusetts investors, while simultaneously protecting them from the conflicted financial advice that Reg BI left in place.

III. THE ECONOMICS OF INTEGRITY: A UNIFORM FIDUCIARY STANDARD IS CRITICAL TO INVESTOR PROTECTION, TRUST IN THE MARKET, AND THE INDUSTRY AT LARGE.

From big decisions about how we invest our money to small choices about the food we buy, trust pervades almost every purchase we make.⁶⁴ Likewise, trust plays

⁶⁰ SEC Risk Alert, at 5-6.

⁶¹ *Id.* at 6.

⁶² See generally Commissioner Robert J. Jackson Jr., *Statement on Final Rules Governing Investment Advice*, U.S. Sec. & Exch. Comm’n (June 5, 2019), <https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd>.

⁶³ *Id.*

⁶⁴ See ANNA BERNASEK, *THE ECONOMICS OF INTEGRITY* 2 (2010).

a crucial role in financial markets.⁶⁵ Given the sophistication gap between brokers and customers,⁶⁶ customers must trust brokers given their lack of means to verify a broker's integrity.⁶⁷ The trust inherent in this relationship creates opportunities for abuse.⁶⁸ A fiduciary standard serves to let investors to reasonably trust their broker or adviser.

**A. A Uniform Fiduciary Standard Instills Trust
Between Investors and Financial Professionals**

Trust plays a key role in markets for services and advice where the public must trust the person giving them advice.⁶⁹ The law imposes real obligations on lawyers, doctors, and other professionals because the public must be able to trust their advice.⁷⁰ These are "goods and services where an expert knows more about the quality a consumer needs than the consumer"

⁶⁵ See Tamar Frankel, *Regulation and Investors' Trust in the Securities Market*, 68 BROOK. L. REV. 439, 442 (2002).

⁶⁶ See Michael Finke, Ph.D. & Thomas Langdon, *The Impact of the Broker Dealer Fiduciary Standard on Financial Advice*, J. FIN. PLAN. 28, 28-9 (2012).

⁶⁷ See Tamar Frankel, *Trust, Honesty, and Ethics in Business*, DANS FIN. & BIEN COMMUN 1, 5-6 (2008).

⁶⁸ Laby, *supra* note 45, at 1007.

⁶⁹ *Id.* at 999-1001.

⁷⁰ *Id.* at 970-5.

does.⁷¹ Consumers seek advice from professionals precisely because they trust that they know more than the consumer does.⁷²

In financial services, this information asymmetry poses danger because, unlike other professionals, brokers have not been consistently held to a fiduciary standard.⁷³ Despite this uncertain legal backdrop, most investors expect that brokers act as fiduciaries.⁷⁴ In reality, many brokerages operate as sales operations. Brokers sell products with an eye toward earning commissions, often at the customer's expense.

Yet brokers giving advice do not have an ordinary sales relationship with their customers because their customers depend on them. In contrast, customers walking into a department store for a pair of pants can try it on to see if it fits their waistline and needs. Customers in a department store come in with a

⁷¹ Uwe Dulleck & Rudolf Kerschbamer, *On Doctors, Mechanics, and Computer Specialists: The Economics of Credence Goods*, 44 J. ECON. LITERATURE 5, 5-6 (2006) (economists generally refer to these services as "credence goods").

⁷² See Tamar Frankel, *Trust, Honesty, and Ethics in Business*, DANS FIN. & BIEN COMMUN 1, 6 (2008).

⁷³ See generally Regulation Best Interest, *supra* note 11.

⁷⁴ See Fiduciary Study, *supra* note 19.

product already in-mind and roughly know which of the available products suits them best.

Conversely, most people do not understand the options before them when meeting with a financial adviser. Americans are overwhelmingly vulnerable in this respect, especially where self-education is time consuming.⁷⁵ While an ordinary person will know to reject suggestions to buy an ill-fitted or overpriced pair of pants, most will not know whether they actually need a high-fee variable annuity and not the other complex product brokers push them to purchase. And once a client transfers funds, they have no choice but to trust the broker.⁷⁶ This inclination to trust is not inherent to ordinary consumer goods, like the pants.

It is nearly impossible for the client to effectively monitor how a broker manages their money "without negating the very usefulness of [the] service."⁷⁷ For the financial markets to function effectively, customers must trust their financial

⁷⁵ See Frankel, *supra* note 72, at 15.

⁷⁶ *Id.* at 6.

⁷⁷ *Id.*

advisers and the financial market at large.⁷⁸ The Fiduciary Rule makes this possible.

B. Trust Is Fragile and Subject to Abuse.

While trust is critical to our financial system, it remains fragile.⁷⁹ A single instance of broken trust weakens decades of confidence in the system.⁸⁰ As recently observed with the collapse of Silicon Valley Bank, when people lose trust in the financial system, panic ensues and they become distrustful, opting to withdraw their funds from the system.⁸¹

The Fiduciary Rule serves to protect investor trust and confidence in the advice they receive. This facilitates continued investment and, in turn, drives sustainable economic growth.⁸² As Professor Tamar Frankel explained, a real relationship exists between investor trust and government regulation.⁸³ Regulations like the Fiduciary Rule create trust and

⁷⁸ *Id.* at 1.

⁷⁹ BERNASEK, *supra* note 64, at 14.

⁸⁰ *Id.* at 14.

⁸¹ Peter Santilli & James Benedict, *Silicon Valley Bank's Meltdown Visualized*, WALL ST. J. (Mar. 11, 2023, 8:27 PM), <https://www.wsj.com/articles/silicon-valley-banks-meltdown-visualized-3da2263b>.

⁸² Frankel, *supra* note 65, at 443-4.

⁸³ *Id.*

encourage investors to put their capital at risk, without fear that brokers will abuse it.

IV. DUBIOUS CLAIMS THAT THE RULE DRIVES COSTS AND HARMS APPEAR UNTRUE.

The Appellee paints the Fiduciary Rule as driving higher costs to investors and ultimately causing broad harm to the market.⁸⁴ This contention rests on speculation that the Rule would limit investor access and drive costs to an unreasonable and harmful extent. The better evidence shows the opposite.

A. Operations Continue Under Fiduciary Standards.

The Rule is not the first of its kind, and other fiduciary rules of this nature have been enacted before. These examples consistently show that no *actual* harm materializes from requiring broker-dealers to put investor interests first.

Much of the opposition to the Fiduciary Rule appears to be the same Chicken Little defense brokerage industry firms have run before.⁸⁵ Industry firms overstate the potential disruption regulation will cause to protect profit margins supported by

⁸⁴ Appellee's Appl. for Direct Review, at 9-10.

⁸⁵ See CHICKEN LITTLE (Mark Dindal dir., 2005).

conflicts of interest and abusive practices. These dire predictions may not pan out.

By way of example, in 2016, the Department of Labor (“DOL”) promulgated its own fiduciary rule to streamline retirement investment advice upon extensive consideration of the rule’s implications (the “DOL Rule”).⁸⁶ While short-lived, the market response to the DOL Rule offers a case study rebutting Appellee’s argument.

Despite overheated claims about how a fiduciary rule would destroy access to investment advice, financial firms swiftly shifted practices with minimal disruption.⁸⁷ When the DOL Rule was first proposed, Metlife’s CEO claimed the DOL Rule “effectively makes it a conflict of interest to sell your own products.”⁸⁸ A Fidelity Executive Vice President blustered that the

⁸⁶ *Definition of the Term Fiduciary; Conflict of Interest Rule-Retirement Investment Advice*, EMP. BENEFITS SEC. ADMIN., 81 Fed. Reg. 20945, 20945 (Apr. 8, 2016).

⁸⁷ CONSUMER FED’N AM., Comment Letter to Emp. Benefits Sec. Admin., 102 (Apr. 17, 2017) (available at <https://consumerfed.org/wp-content/uploads/2017/04/CFA-DOL-Fiduciary-Reexam-Comment.pdf>).

⁸⁸ CONGRESSIONAL RESEARCH SERVICE, *Department of Labor’s 2015 Proposed Fiduciary Rule: Background and Issues*, 16 (Apr. 1, 2016) (available at <https://sgp.fas.org/crs/misc/R44207.pdf>).

DOL Rule was “completely unworkable, would confuse workers, and do nothing to help [investors] better understand potential conflicts.”⁸⁹

After the DOL Rule’s implementation, firms quickly changed their tune, complying with the rule in a variety of ways.⁹⁰ Suddenly, businesses expressed confidence that they were prepared to comply without disruption.⁹¹ Firms’ public announcements recognized that the DOL Rule would not disrupt their businesses.⁹² This history reveals that financial firms have adjusted to past fiduciary rules with little difficulty.⁹³

B. The Conflicted Practices the Fiduciary Rule Targets Actually Drives Costs to Investors.

Implementing the Fiduciary Rule would likely result in cost reductions for investors. Conflicts drive real costs for investors and cause serious harm. In 2016, the White House estimated that conflicted

⁸⁹ Testimony of John F. “Jack” Haley, Jr. Executive Vice President, Fidelity Investments Before a hearing of the House Committee on Education and the Workforce Subcommittee on Health, Education, Labor, and Pensions, 3 (June 15, 2015) (available at http://edworkforce.house.gov/uploadedfiles/testimony_haley.pdf).

⁹⁰ CONSUMER FED’N AM., *supra* note 87, at 101-2.

⁹¹ *Id.* at 102-117.

⁹² *Id.*

⁹³ *See generally Id.*

advice cost American families \$17 billion a year.⁹⁴ More recently, Morningstar's recent 2021 U.S. Fund Fee Study shows little change, with some costs diminishing "while others have taken new shape" often resulting in decreased returns for investors.⁹⁵

The Fiduciary Rule offers much-needed clarity to investors and eases the burden of conflict mitigation on brokerages. To truly limit conflicts—and in turn, limit costs on the investor—firms should embrace fiduciary practices.

CONCLUSION

For the foregoing reasons, the Institute and Professor Frankel respectfully request that the Court reverse the judgment of the Superior Court.

⁹⁴ Press Release, White House: Office of the Press Secretary, *Fact Sheet: Middle Class Economics: Strengthening Retirement Security by Cracking Down on Conflicts of Interest in Retirement Savings*, (April 6, 2017) (available at <https://obamawhitehouse.archives.gov/the-press-office/2016/04/06/fact-sheet-middle-class-economics-strengthening-retirement-security>).

⁹⁵ Bryan Armour, Zachary Evens, & Ben Johnson, *2021 U.S. Fund Fee Study*, MORNINGSTAR (July 2022), https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt36de8b5594de0582/62c6e888181754349ea2fa66/U.S._Fund_Fee_Study_2021.pdf; See also Bryan Armour, *Fund Fees Continued Decline Is a Win for Investors*, MORNINGSTAR (Jul. 12, 2022), <https://www.morningstar.com/articles/1055229/fund-fees-continued-decline-is-a-win-for-investors>.