Supreme Judicial Court

FOR THE COMMONWEALTH OF MASSACHUSETTS

SJC-13381

ROBINHOOD FINANCIAL LLC;
Plaintiff-Appellee,
v.

WILLIAM F. GALVIN, SECRETARY OF THE COMMONWEALTH, IN HIS OFFICIAL CAPACITY, 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* BETTER MARKETS, INC.
IN SUPPORT OF DEFENDANTS-APPELLANTS AND REVERSAL

BETTER MARKETS, INC.

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Judicial Court Rule 1:21, *amicus curiae* Better Markets, Inc. ("Better Markets") states that it has no parent corporation and that there is no publicly held corporation that owns any stock in Better Markets.

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IDENTITY AND INTEREST OF THE *AMICUS CURIAE*[1]

Better Markets, Inc. is a nonprofit, nonpartisan organization that promotes the public interest in the financial markets through comment letters, litigation, independent research, and public advocacy. It fights for reforms that create a stronger, safer financial system; protect individual investors from fraud, abuse, and conflicts of interest; and promote the economic prosperity of all Americans. Better Markets has submitted hundreds of comment letters to the financial regulators advocating for strong rules in the securities, commodities, and credit markets. It has also filed many *amicus curiae* briefs in cases challenging agency rules.

Better Markets was heavily involved in the rulemaking process that resulted in the SEC's promulgation of Regulation Best Interest ("Regulation BI"), 84 Fed. Reg. 33,318 (2019), and it submitted extensive comment letters highlighting the weaknesses in the rule proposal and urging the SEC to strengthen it. Better Markets also filed an *amicus curiae* brief in support of the petitioners in *XY Planning Network, LLC v. SEC*, 963 F.3d 244 (D.C. Cir. 2020), a petition for review of

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[1] In accordance with Mass. R. App. P. 17, Better Markets states that (i) no counsel for any party authored this brief in whole or in part; (ii) no party, party's counsel, or any other person or entity (other than the *amicus curiae* and its counsel) contributed money that was intended to fund preparing or submitting this brief; and (iii) neither the *amicus curiae* nor its counsel represents or has represented one of the parties to the present appeal in another proceeding involving similar issues, or was a party or represented a party in a proceeding or legal transaction that is at issue in the present appeal.

Regulation BI. Better Markets continues to advocate for the application of stronger standards, including the fiduciary duty, to all financial advisers, many of whom continue to reap handsome fees and commissions by recommending high-cost, high-risk, and under-performing investments to the detriment of their clients.

SUMMARY OF ARGUMENT

When it issued Regulation BI in 2019, the U.S. Securities and Exchange Commission ("Commission") sought to require broker-dealers like Robinhood to act in the "best interests" of ordinary, "retail" investors who are vulnerable to the powerful conflicts of interest motivating many advisers when they recommend securities investments to their clients. Now, Robinhood asks this Court to wield Regulation BI to protect its own "best interests" against the Secretary's definition of unethical and deceptive practices, 950 Code Mass. Regs. § 12.207 ("State Rule"). That request is a perversion of federal and state policy objectives and a misreading of the current law of preemption.

State law must yield to federal law when the latter expressly preempts the former, when the latter occupies an entire regulatory field, or, as Robinhood contends here, when state law poses an obstacle to significant federal policies. *See infra* 12–14. At times, some courts have struggled to define in what sense state regulation can be an "obstacle" to overlapping federal law and when any such overlap becomes a true conflict. But the U.S. Supreme Court has recently imposed more analytical rigor on this issue. Not only must a court's inquiry focus on the text and structure of statutes or regulations—rather than amorphous goals or interests inferred by judges—but that inquiry can only sustain preemption when it finds concrete and irreconcilable rights and duties. More specifically, federal law must

create some affirmative right for which there is a correlative and conflicting state duty, or there must be some state right that a correlative federal duty overrides. *See infra* 14–15.

This framework for obstacle preemption allows this Court to dispose of Robinhood's attack on the State Rule. Nothing in the text or structure of Regulation BI creates *rights* in broker-dealers; it imposes only duties on those entities. The State Rule does the same thing, and the duties it creates only complement and reinforce Regulation BI. There can be no preemption-sustaining conflict because federal and state law point in the same direction. *See infra* 15–18.

While that fact alone is dispositive on preemption, additional factors further undercut any evidence of preemptive intent behind Regulation BI. Massachusetts and its sister States have long enjoyed a presumption against preemption when exercising their historic police powers against fraud, deception, or other misconduct against consumers and investors. That presumption has special force where both Congress and the Commission fully understood that several States already had analogues to the State Rule at the time Regulation BI was promulgated and yet expressed no intention to limit or displace those state standards. And the Court must be especially vigilant to observe Congress's explicit preservation of state authority to regulate fraud and deceit, found in the National Securities Markets Improvements Act of 1996 ("NSMIA"). *See infra* 18–23.

A properly rigorous view of preemption also disposes of counterarguments favoring preemption in this case. Stray remarks in the preamble to Regulation BI cannot insert any affirmative right in the text and structure of the regulation itself. Nor do they even suggest such a right on their own merits. *See infra* 23–24.

Robinhood also hopes to rely on *Geier v. American Honda Motor Co.*, 529 U.S. 861 (2000). But *Geier* simply supports the need to identify an endangered right in the text and structure of federal regulation. If neither the right nor any conflict with state law is significant or even present, as here, then preemption will not follow. *See infra* 24–27.

Finally, the Court must keep in mind the real-world stakes that underlie this case. Broker-dealers have, for far too long, extracted revenue from retail investors' frequent but mistaken assumption that brokers will act as fiduciaries, much like investment advisers. Congress pushed the Commission to address this problem through the Dodd-Frank Act, but the Commission's ultimate response in Regulation BI has proven insufficient to remedy this harm. The toll on investors has been huge, and it is ongoing. The State Rule and analogous duties imposed by other States are therefore vital to filling the gap left by Regulation BI and more fully protecting the investing public. Empirical evidence confirms the importance of the State Rule. *See infra* 27–37.

ARGUMENT

I. Regulation BI Does Not Preempt the State Rule.

A. The Preemption Framework.

"Federalism, central to the constitutional design, adopts the principle that both the National and State Governments have elements of sovereignty the other is bound to respect." *Arizona v. United States*, 567 U.S. 387, 398 (2012). When these two sovereign spheres might overlap, the Supreme Court has developed a three-part test under the Supremacy Clause to determine whether federal or state law applies. *Kansas v. Garcia*, 140 S. Ct. 791, 801 (2020) (citing U.S. CONST. art. VI, cl. 2). Federal law will control over, or preempt, state law in one of three circumstances: (1) when Congress expressly preempts state law through statute, (2) when Congress has occupied an entire field of law, and (3) when state law conflicts with federal law. *Arizona*, 567 U.S. at 399. Two principles inform all three types of preemption cases.

First, preemption cannot occur without some positive source of federal law to interpret. *Kansas*, 140 S. Ct. at 801 ("There is no federal preemption *in vacuo* . . . .]") (internal quotation marks omitted). When that federal law is a statute, *e.g.*, *id.*, congressional intent becomes the "touchstone" of any preemption analysis. *Wyeth v. Levine*, 555 U.S. 555, 565 (2009) (internal quotation marks omitted); *accord Bay Colony R.R. Corp. v. Town of Yarmouth*, 470 Mass. 515, 518 (2015). Discerning congressional intent, in turn, entails a review of the "text, structure, and

history" of the federal statute. *Arizona*, 567 U.S. at 406. Federal regulations may also preempt state law. *E.g.*, *Hillsborough Cnty., Fla. v. Automated Med. Labs., Inc.*, 471 U.S. 707, 713 (1985). In such cases, the preemption analysis turns on the intent of the agency issuing the rule to displace state law, as well as whether the agency acted within the authority delegated to it. *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 154 (1982).

Second, courts will presume that federal law does *not* preempt "the historic police powers of the States." *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) (internal quotation marks omitted); *accord Bay Colony R.R. Corp.*, 470 Mass. at 520. This presumption applies against both the intent to preempt at all and the scope of any preemption, *id.*, and it is not overcome simply because the federal government has also had some role in the same fields subject to traditional state police powers, *Wyeth*, 555 U.S. at 565 n.3 ("The presumption" against preemption "does not rely on the absence of federal regulation."). Only a "clear and manifest" intent to preempt state law will overcome the presumption against preemption. *Medtronic, Inc.*, 518 U.S. at 485 (internal quotation marks omitted); *see also Boston Hous. Auth. v. Garcia*, 449 Mass. 727, 733 (2007) ("Preemption is not to be lightly presumed.") (internal quotation marks omitted).

B. **Conflict Preemption**.

This case involves a claim of conflict preemption. *See* Appellee Br. 55–64. Conflict preemption can occur in two situations: (1) where compliance with both federal and state law is impossible and (2) "where the challenged state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" *Arizona*, 567 U.S. at 399 (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)). Robinhood invokes obstacle preemption. *See* Appellee Br. 57.

At times, the U.S. Supreme Court has framed the identification of a federal "obstacle" as a "matter of judgment." *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 373 (2000). "Recently, though, several Justices have questioned the wisdom and legitimacy of grounding preemption" on such a loose concept unmoored from congressional or agency intent. *Me. Forest Prods. Council v. Cormier*, 51 F.4th 1, 8 (1st Cir. 2022). Thus, partly out of concerns for federalism and partly out of concerns for the separation of powers, the Supreme Court has cautioned against obstacle preemption as a "'freewheeling judicial inquiry'" that might conjure "'some brooding federal interest or . . . judicial policy preference.'" *Kansas*, 140 S. Ct. at 801 (quoting *Chamber of Com. of the U.S. v. Whiting*, 563 U.S. 582, 607 (2011)

(plurality opinion), and *Va. Uranium, Inc. v. Warren*, 139 S. Ct. 1894, 1901 (2019) (Gorsuch, J., concurring), respectively).

Accordingly, recent jurisprudence focuses the intent inquiry on the restrictions and rights, if any, found within the text and structure of federal law: "the [U.S. Supreme] Court's recent cases have subtly reframed the obstacle preemption analysis as limited to cases in which . . . [federal] 'law . . . imposes restrictions or confers rights on private actors' and 'a state law confers rights or imposes restrictions that conflict with the federal law.'" *Me. Forest Prods. Council*, 51 F.4th at 8 (quoting *Murphy v. Nat'l Collegiate Athletics Ass'n*, 138 S. Ct. 1461, 1480 (2018)). And "mere . . . overlap" between federal and state law does not support preemption; "in the vast majority of cases where federal and state laws overlap, allowing the States to prosecute is entirely consistent with federal interests." *Kansas*, 140 S. Ct. at 806. Rather, the state law must impose some right or duty that is "inconsistent—*i.e.*, in conflict—with" its counterpart or correlative in federal law, *Murphy*, 138 S. Ct. at 1480.

C. The State Rule Poses No Obstacle to Regulation BI.

The text of Regulation BI is the starting point for identifying any right or restriction that might conflict with the State Rule. *See Kansas*, 140 S. Ct. at 801; *Arizona*, 567 U.S. at 406. And here it should be the end point for the Court's inquiry as well. Nothing in the rule "confers rights" on broker-dealers like Robinhood.

Murphy, 138 S. Ct. at 1480. In fact, Regulation BI "entirely lack[s] the sort of 'rights-creating' language" necessary to show some entitlement held by brokers-dealers. *Gonzaga Univ. v. Doe*, 536 U.S. 273, 287 (2002) (quoting *Alexander v. Sandoval*, 532 U.S. 275, 288–289 (2001)) (offering as an example of rights-creating language "No person shall . . . be subjected to discrimination"); *see also Fidelity Fed. Sav. & Loan Ass'n*, 458 U.S. at 146–47 (federal regulation gave private entities explicit "power to include" certain contractual provisions). The text instead offers a central command that broker-dealers "*shall* act in the best interest of the retail customer," 17 C.F.R. § 240.15*l*-1(a) (emphasis added)—language clearly imposing a duty, not a right, *see, e.g.*, *Me. Cmty. Health Options v. United States*, 140 S. Ct. 1308, 1321 (2020) ("[I]t is generally clear that 'shall' imposes a mandatory duty."). The rule then simply disaggregates this central duty into four constituent duties or "obligations" of disclosure, care, conflicts of interest, and compliance. *See* 17 C.F.R. § 240.15*l*-1(a)(2)(i)–(iv).

These duties are of course "restrictions . . . on private actors" like Robinhood, but they are not the type that "that conflict with" the State Rule. *Murphy*, 138 S. Ct. at 1480. That much is clear because the State Rule itself imposes only a supplemental duty on broker-dealers. *See* 950 Code Mass. Regs. § 12.207(1)(a). Thus, there is no state right that would conflict with a federal duty or a federal right

incompatible with a state duty.[2] *See Murphy*, 138 S. Ct. at 1480; *Me. Forest Prods. Council*, 51 F.4th at 8 ("[W]e frame the question before us as follows: have the [plaintiffs] shown that they are likely to succeed in their claim that the federally enacted . . . program confers a right on private actors (either explicitly or implicitly) that conflicts with [state] restrictions?").

In this case, the obligations of each rule, both state and federal, point in the *same* direction; they are not in any way "inconsistent." *Murphy*, 138 S. Ct. at 1480. There is nothing about the fiduciary duties of care and loyalty under the State Rule that in any way impedes fulfillment of Regulation BI's duties around disclosure, care, conflicts, and compliance. If anything, the State Rule will promote better compliance with Regulation BI, and *vice versa*. For example, the state duty to "disclose all material conflicts of interest," 950 Code Mass. Regs. § 12.207(2)(b)1,

[2] The order of the terms "restrictions" and "rights" is critical to understanding the rule articulated in *Murphy*. The Court there used a reverse-parallelism comparing federal restrictions (duties) to state rights, and federal rights to state restrictions: "Congress enacts a law that imposes *restrictions* or confers *rights* on private actors; a state law confers *rights* or imposes *restrictions* that conflict with the federal law; and therefore the federal law takes precedence and the state law is preempted." 138 S. Ct. at 1480 (emphasis added). This ordering is a nod towards the correlative nature of opposing rights and duties. A state duty not to do some act is the opposite of, and thus opposed to, a federal right to the same act, and the same is true for state rights and federal duties. This emphasis on correlatives ensures that the reviewing court identifies a true "'logical contradiction'" between federal and state law, not merely some overlap. *See Kansas*, 140 S. Ct. at 808 (Thomas, J., concurring) (quoting *Merck, Sharp & Dohme Corp. v. Albrecht*, 139 S. Ct. 1668, 1681 (2019) (Thomas, J., concurring)).

will only reinforce the federal duty to give "full and fair disclosure" of "[a]ll material facts relating to conflicts of interest that are associated with [a] recommendation," 17 C.F.R. § 240.15*l*-1(a)(2)(i)(B). More generally, the Commission noted in the preamble to Regulation BI that "key elements of the standard of conduct that applies to broker-dealers under Regulation Best Interest will be *substantially similar* to key elements of the standard of conduct" for investment adviser fiduciaries—and by extension, to fiduciaries under the State Rule. 84 Fed. Reg. at 33,330 (emphasis added).

Similarity, and especially mutually reinforcing similarity, does not suggest conflict; quite the contrary. To hold otherwise would be to ignore the Supreme Court's admonition that "[t]he mere fact that state laws . . . overlap to some degree with federal . . . provisions does not even begin to make a case for conflict preemption." *Kansas*, 140 S. Ct. at 806.

D. Three Additional Factors Undermine Any Intent to Preempt the State Rule.

Comparing the text of the two rules is more than enough to dispel any claims that state law poses an obstacle to Regulation BI. *See id.* at 801 (discouraging preemption based on "freewheeling judicial inquir[ies]" and "brooding federal interest[s]") (internal quotation marks omitted). Yet there is more, as at least three factors that bear on regulatory intent further defeat any claim of obstacle preemption.

First, this Court must presume that federal law does not intend to disturb "'the historic police powers of the States.'" *Medtronic, Inc.*, 518 U.S. at 485 (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). "The 'police power' includes the power to adopt regulations designed and reasonably adapted to promote the general prosperity by safeguarding contract or property rights, or to protect the public generally, or a class or classes of citizens, from fraud or criminal misconduct." *Schick v. City of New Orleans*, 49 F.2d 870, 872 (5th Cir. 1931). More succinctly, "consumer protection is a field that states have traditionally occupied" through their police powers. *Pennsylvania v. Navient Corp.*, 967 F.3d 273, 294 (3d Cir. 2020) (collecting cases). The State Rule easily falls within these descriptions; it protects ordinary retail investors, the consumers of brokerage services, from losing their property to the fraud or other misconduct of broker-dealers, especially advice animated by hidden conflicts of interest. Thus, the signs of an intent to preempt state law must be especially clear in this case. *Medtronic, Inc.*, 518 U.S. at 485.

It is true, of course, that the federal government has also involved itself in protecting ordinary investors at least since the passage of the Securities Act of 1933. *See* 15 U.S.C. § 77a *et seq.* But this fact has no bearing on the presumption against preemption. The Supreme Court has sustained that presumption even where the federal government has regulated a field "for more than a century"; what matters

here is "the historic presence of state law," not the simultaneous presence or duration of federal regulation. *Wyeth*, 555 U.S. at 565 n.3.

Second, preemptive intent is especially unlikely where the federal government acts against the backdrop of well-known state law—but nonetheless declines to preempt that law explicitly. *See id.* at 575 ("'The case for federal pre-emption is particularly weak where Congress has indicated its awareness of the operation of state law in a field of federal interest, and has nonetheless decided to stand by both concepts and to tolerate whatever tension there [is] between them.'") (quoting *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 166–167 (1989)). Well before the Commission proposed Regulation BI, several States had "been clear about uniformly imposing fiduciary duty under common law." Yerv Melkonyan, *Regulation Best Interest and the State-Agency Conflict*, 120 COLUM. L. REV. 1591, 1598–99 (2020) (describing pre-2018 case law in California, Missouri, South Carolina, South Dakota, and Delaware that imposed a fiduciary duty on broker-dealers); *see also* Maria E. Vaz Ferreira, *Staying True to NSMIA: A Roadmap for Successful State Fiduciary Rules After Reg BI*, 94 ST. JOHN'S L. REV. 55, 567–68 (2020) (describing similar case law in Georgia). The Commission was clearly aware of these state-law duties when adopting Regulation BI. *See* 84 Fed. Reg. at 33,419 ("[S]ome states provide . . . that broker-dealers have some form of state-specific fiduciary duty to their customers in at least some circumstances. Substantial

variation exists among states' fiduciary standards, ranging from states with express fiduciary standards that apply to broker-dealers to those with limited or no such standards."). Despite this awareness, the Commission took no steps in Regulation BI to displace these laws,[3] and the Court should not infer an intent to do so as to this State Rule, either.

Third, no agency action to preempt state law can exceed the bounds of authority granted to that agency by Congress. *See Fidelity Fed. Sav. & Loan Ass'n*, 458 U.S. at 154 (preemptive effect of regulation requires not only review of intent but also "whether that [regulation] is within the scope of the [agency]'s delegated authority"). Here, Congress placed firm limits on the Commission's preemption authority through the National Securities Markets Improvements Act of 1996, better known as NSMIA. Preempting the State Rule requires an interpretation of Regulation BI that would push it beyond the Commission's power. Thus, to the extent Regulation BI could possibly be read as preempting the State Rule, NSMIA would preclude that interpretation.

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[3] Commenting parties explicitly asked the Commission to preempt state law. *See* 84 Fed. Reg. at 33,325. Nonetheless, the Commission included no suggestion of preemption in the final text of Regulation BI, and it remained studiously non-committal on any preemptive *effect* in its preamble to the final rule. *See id.* at 33,326, 33,435 n.1163 ("Whether Regulation Best Interest would have a preemptive effect on any state law would be determined in future judicial proceedings, and would depend on the language and operation of the particular state law at issue.").

NSMIA holds that "the securities commission . . . of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions, in connection with securities or securities transactions . . . with respect to (i) fraud or deceit; or (ii) unlawful conduct by a broker, dealer, or funding portal." 15 U.S.C. § 77r(c)(1)(A)(i)–(ii). This language in NSMIA is an express preservation of state authority against other federal laws. *See, e.g.*, *Shorey v. Ariz. Corp. Comm'n*, 359 P.3d 997, 1006 (2015) (NSMIA protects "state authority to regulate against fraud" from a Commerce Clause challenge).

Moreover, the authority preserved by NSMIA clearly embraces the State Rule. The legislative history of NSMIA clarifies that Congress meant to preserve the States' regulation not only of common-law fraud but also "broker-dealer sales practice *abuses*, such as *churning accounts* or *misleading customers*." H.R. Rep. No. 104-864, at 40 (1996) (Conf. Rep.) (emphasis added). Churning, of course, violates a duty of loyalty, fundamentally the same duty of loyalty that requires advice "without regard to the financial . . . interest of" the broker (among other obligations). 950 Code Mass. Regs. § 12.207(2)(b)3; *see also Davis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 906 F.2d 1206, 1212 (8th Cir. 1990) (affirming a jury instruction that "[c]hurning . . . is a deceptive device . . . and constitutes . . . a violation of a broker's fiduciary duty to his customer"). Misleading customers would also violate the State Rule's duty of care. 950 Code Mass. Regs.

§ 12.207(2)(a); *see also SEC v. Cap. Gains Rsch. Bureau*, 375 U.S. 180, 194 (1963) ("Courts have imposed on a fiduciary . . . an affirmative obligation 'to employ reasonable care to avoid misleading' his clients.").

The statutory context also confirms that NSMIA shelters state fiduciary duties similar to those of the State Rule. NSMIA preserves authority to regulate "fraud or deceit," 15 U.S.C. § 77r(c)(1)(A)(i), language almost identical to federal statutory duties imposed on investment advisers, *see id.* § 80b-6(2) (barring any "transaction, practice, or course of business which operates as a fraud or deceit upon any client"). The Supreme Court has instructed that the latter provision must be read liberally, to extend beyond traditional "fraud" claims, precisely because Congress intended to incorporate the fiduciary duties owed by investment advisers to their clients. *Cap. Gains Rsch. Bureau*, 375 U.S. at 191–95. Congress presumably used the same language in NSMIA to accommodate state law fiduciary duties as well.

Simply put, because NSMIA's preservation clause covers the duties set forth in the State Rule, Regulation BI cannot be construed to preempt the State Rule. A contrary result would be untenable, *see, e.g.*, *Fidelity Fed. Sav. & Loan Ass'n*, 458 U.S. at 154.

E. Preamble Remarks Alone Do Not Support Preemption.

Instead of grounding preemption in the text and structure of Regulation BI, Robinhood leans on a handful of statements in the 175-page preamble to the final

rule. *See* Appellee Br. 60–61. Robinhood specifically invokes vague, high-level values like "'choice'" or "'access'" mentioned in the preamble. *See, e.g.*, *id.* at 60 (quoting 84 Fed. Reg. at 33,322).

But these are precisely the sort of "'brooding federal interest[s]'" that invite a "'freewheeling judicial inquiry'" against which the Supreme Court has warned. *Kansas*, 140 S. Ct. at 801 (quoting *Chamber of Com. of the U.S. v. Whiting*, 563 U.S. 582, 607 (2011) (plurality opinion), and *Va. Uranium, Inc. v. Warren*, 139 S. Ct. 1894, 1901 (2019) (Gorsuch, J., concurring), respectively); *see also Me. Forest Prods. Council*, 51 F.4th at 8. Robinhood cannot show an endangered federal right in the text or structure of Regulation BI. *Id.* at 804.

II. *Geier* Does Not Support Preemption Here.

Robinhood grounds its obstacle preemption claim on *Geier v. American Honda Motor Co.*, 529 U.S. 861 (2000). *See* Appellee Br. 61. But *Geier* fails to support Robinhood's claim; moreover, that decision helps elucidate the lack of preemptive intent behind Regulation BI.

Geier stands for nothing more than the proposition that, when the regulatory text, structure, and history all point to an explicit *right* of regulated entities to choose between two compliance options, state law may not remove that right. In this sense, *Geier* is perfectly compatible with a holding that Regulation BI does not preempt

the State Rule because Regulation BI establishes no rights in broker-dealers at all. *See supra* 15–18.

The holding in *Geier* follows from the starting point of "all preemption arguments," namely, the "'text and structure'" of federal law. *Kansas*, 140 S. Ct. at 804 (quoting *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 664 (1993)). In 1984, the National Highway Traffic Safety Administration amended Federal Motor Vehicle Safety Standard No. 208, "Occupant Crash Protection." 49 Fed. Reg. 28,962, 28,962, 29,009 (1984) (then codified at 49 C.F.R. § 571.208). Standard No. 208 begins with a duty: All passenger cars manufactured up to September 1, 1986 "shall meet the requirements" for occupant crash protection in one of the subsections of S4.1.2. *Id.* at 29,009 (¶ S4.1.2). But Standard No. 208 then immediately provides manufacturers with a *right* to choose between compliance options: "A protection system that meets the requirements of S4.1.2.1 or S4.1.2.2 *may be installed* at one or more designated seating positions of a vehicle that otherwise meets the requirements of S4.1.2.3." *Id.* (emphasis added). This permissive language, like other federal rules, confers on the regulated entity a "'power'"—a legal right—to take a particular course of action. *Fidelity Fed. Sav. & Loan Ass'n*, 458 U.S. at 146–47 (regulated lender "continues to have the power to include" due-on-sale clauses in contracts) (quoting 12 C.F.R. § 545.8-3(f) (1982)). In this case, that right included the choice between compliance through automatic protection methods like airbags

(paragraph S4.1.2.1) or less costly measures that still required some passenger action, like detachable seat belts (paragraph S4.1.2.2). *See Geier v. Am. Honda Motor Co.*, 166 F.3d 1236, 1237 (D.C. Cir. 1999) ("For cars manufactured between September 1, 1986, and September 1, 1987, the inclusion of a driver-side airbag was one of several passive restraint 'options' from which car manufacturers could choose in order to comply with Standard 208."); *compare* 49 Fed. Reg. at 28,963, 28,996 (summarizing "phase-in schedule" for "automatic occupant" protection like air bags), *with* 49 Fed. Reg. at 29,009–10 (formalizing the phase-in schedule for automatic systems in ¶ S4.1.3 based on dates for meeting the requirements of S4.1.2.1).

The structure of Standard No. 208 confirms that this language is not merely idle speculation about how manufacturers might behave but in fact vests them with an "entitlement" in their chosen compliance decisions. *Gonzaga Univ.*, 536 U.S. at 287. The rule labels each potential compliance solution, paragraphs S4.1.2.1 and S4.1.2.2, as an "option." 49 Fed. Reg. at 29,009. Manufacturers retained the right to choose their preferred technology over some portion of their new vehicles through late 1989, when the rule required a complete "phase in" of automatic protection. *See id.* at 29,009–10 (¶¶ S4.13.3–S4.1.4).

In *Geier*, the plaintiff was injured in a 1987 vehicle equipped with manual seat belts and built at a time when Standard No. 208 required only 10% of a fleet to use

automatic protection methods; she sued under the theory that Honda nonetheless had a state-law duty to install *airbags* specifically on all vehicles. *See* 529 U.S. at 864–65, 881. But this duty necessarily conflicted with the federal rule "deliberately provid[ing] the manufacturer with a range of choices," *id.* at 874–75, including a right to those choices as to 90% of its fleet in 1987, *id.* at 879, so the putative state-law duty had to give way as an obstacle to federal law, *id.* at 881. The "option" granted by Standard No. 208 could not have survived otherwise. *See id.* (citing *Fidelity Fed. Sav. & Loan Ass'n*, 458 U.S. at 156).

In contrast here, Regulation BI confers no rights on broker-dealers whatsoever. Its text enshrines no affirmative grant of an "option" or right to choose, *id.*, nor does it confer any more general authority, "'power,'" or discretion to broker-dealers, *Fidelity Fed. Sav. & Loan Ass'n*, 458 U.S. at 146–47 (quoting 12 C.F.R. § 545.8-3(f) (1982)). This aspect alone distinguishes Regulation BI from the federal regulations at issue in *Geier*. *See supra* 15–18.

III. <u>The State Rule Addresses Important Policy Problems.</u>

In addition to the legal framework and arguments against preemption, we urge the Court to consider the ultimate policy implications of its holding.

A. Conflicts of Broker-Dealers Harm Ordinary Investors.

Historically, investment advisers provided advice in positions of trust and confidence, while broker-dealers provided arms-length product sales. *See* Arthur B.

Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 THE BUS. LAWYER 395 (2010). These different professionals were regulated based on their different roles under different statutory frameworks: Investment advisers have been subject to a fiduciary duty under the Investment Advisers Act of 1940 while broker-dealers have been subject to a more relaxed sales-based suitability standard under the Securities Exchange Act of 1934.

Over the last three decades, however, broker-dealers have blurred the traditionally clear line between sales and advice, and they have done so with the SEC's knowledge, acquiescence, and in some respects, endorsement. Brokers have increasingly functioned as investment advisers and marketed their services as advisory in nature, without being regulated according to their advisory role. *See id.* at 404 ("The tidy separation between brokers and advisers began to crumble initially in the 1980s when brokers started to offer financial planning services, and more significantly in the 1990s when brokerage firms began to use titles such as 'adviser' or 'financial adviser' for their broker-dealer registered representatives and even encouraged customers to think of the registered representative more as an adviser than a stockbroker.").

All aspects of brokers' communication with the investing public are designed to send the message that they are trusted advisers, committed to providing objective, trustworthy investment advice, rather than mere sales pitches. For example, they

routinely use titles such as "financial advisor," "financial consultant," or "wealth manager," creating the impression they have specialized advisory expertise. They commonly describe their services as "investment advice" or "retirement planning" and market those services as designed to serve customers' best interests. In holding themselves out as impartial experts, they seek to occupy positions of trust and confidence with their customers. *See* MICAH HAUPTMAN & BARBARA ROPER, CONSUMER FEDERATION OF AMERICA, FINANCIAL ADVISOR OR INVESTMENT SALESPERSON? BROKERS AND INSURERS WANT TO HAVE IT BOTH WAYS (2017), https://consumerfed.org/wp-content/uploads/2017/01/1-18-17-Advisor-or-Salesperson_Report.pdf; *see also* Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 753–58 (2012).

Extensive research dating back years—including research that the Commission itself initiated—has repeatedly shown that investors do not distinguish between broker-dealers and investment advisers. Nor do they understand the different legal standards that apply to their advisory activities or the implications of working with different financial professionals who operate under these different legal frameworks. *See, e.g.*, SIEGEL & GALE, LLC, & GELB CONSULTING GROUP, INC., RESULTS OF INVESTOR FOCUS GROUP INTERVIEWS ABOUT PROPOSED BROKERAGE ACCOUNT DISCLOSURES: REPORT TO THE SECURITIES AND EXCHANGE

COMMISSION (2005), https://www.sec.gov/rules/proposed/s72599/fcrpt031005.pdf; *see also* ANGELA A. HUNG, ET AL., RAND INSTITUTE FOR CIVIL JUSTICE, INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS 111 (2008), https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

More recent survey research by the RAND Corporation, commissioned by the SEC as part of this rulemaking, confirms these findings—in fact, it suggests that investor knowledge about key differences between broker-dealers and investment advisers appears to be *lower* than it was a decade ago. *See* BRIAN SCHOLL, OFFICE OF THE INVESTOR ADVOCATE & ANGELA A. HUNG, RAND CORP., THE RETAIL MARKET FOR INVESTMENT ADVICE 59–60 (2018), https://www.sec.gov/files/retail-market-for-investment-advice.pdf.

When investors place their trust in brokers and rely on their highly-conflicted sales recommendations as if they constituted trustworthy advice, investors suffer enormous harm. This includes broker-dealers' selling unsuspecting investors high-cost, low-quality investments that enrich the broker-dealer firm and its registered representatives but undermine investors' financial security. Such conflicts of interest take a huge financial toll on investors, on both an individual and systemic basis, costing them tens of billions of dollars in lost savings every year.

There is a wealth of evidence, including peer-reviewed academic studies, demonstrating that conflicts of interest influence broker-dealers' recommendations

and often do so in ways that are harmful to investors. This evidence was thoroughly documented and analyzed in a 2015 RAND study, on behalf of the U.S. Department of Labor ("DOL"). JEREMY BURKE, ANGELA A. HUNG, JACK W. CLIFT, STEVEN GARBER, & JOANNE K. YOONG, IMPACTS OF CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES INDUSTRY, RAND WORKING PAPER (2015), https://www.rand.org/content/dam/rand/pubs/working_papers/WR1000/WR1076/RAND_WR1076.pdf. According to the RAND researchers, "[w]e find empirical evidence suggesting that financial advisors [brokers] act opportunistically to the detriment of their clients." *Id*. at 2. The report continued, "[o]ur review of the literature finds there is substantial empirical evidence that financial advisors [brokers] are influenced by their compensation schemes and that investors who purchase through advisors [brokers] earn lower returns than those who invest autonomously." *Id*. at 20.

The higher fees that investors pay and lower returns that they receive as a result of conflicts of interest can be very costly for individual investors. According to an SEC Investor Bulletin, for example, an investor who starts with $100,000 and pays a 1% additional fee (or receives a 1% lower return) every year would end up with a portfolio balance that has almost $30,000 less after 20 years. *See* SEC OFFICE OF INVESTOR EDUCATION AND ADVOCACY, UPDATED INVESTOR BULLETIN: HOW FEES AND EXPENSES AFFECT YOUR INVESTMENT PORTFOLIO (2016). Thus, instead

of growing from $100,000 to approximately $210,000, the investor would end up with only approximately $180,000. Even paying a 0.5% additional fee (or receiving a 0.5% lower return) would have a significant impact on the investor's portfolio, reducing the portfolio by $10,000. *Id*. Of course, the financial damage is far greater and sometimes ruinous when the fees and commission are much higher or when a broker urges a particularly risky investment product upon a client who subsequently loses all or most of their investment.

As these examples show, conflicted advice resulting in higher fees and expenses and lower returns has a huge impact on financial security. Furthermore, those with small accounts have fewer economic resources, and consequently any additional costs or losses diminish what little savings they have worked so hard to set aside. Lower- and middle-income investors need every penny of their savings. Sadly, they are among those likely to be most hurt by the detrimental effects of conflicted advice.

B. Regulation BI Has Failed to Curb Broker-Dealer Conflicts.

Unfortunately, Regulation BI is widely understood to be ineffective at preventing this type of harm to retail investors. *See, e.g.*, Kelly Anne Smith, *What Regulation Best Interest Means For Your Financial Advisor*, FORBES (Mar. 5, 2021) ("Geoffrey Brown, CEO of the National Association of Personal Financial Advisors (NAPFA), is even more critical. Brown believes Regulation Best Interest's

disclosures are too subjective and potentially misleading.”), https://www.forbes.com/advisor/investing/regulation-best-interest/. Then-Commissioner Robert Jackson, in fact, explained the pitfalls of the final rule on the day of its adoption. *See* Comm’r Robert J. Jackson Jr., *Statement on Final Rules Governing Investment Advice*, SEC. & EXCH. COMM’N (June 5, 2019), https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd. In his words,

> [T]he core standard of conduct set forth in Regulation Best Interest remains far too ambiguous about a question on which there should be no confusion. As a result, conflicts will continue to taint the advice American investors receive from brokers. Moreover, the rule relies on a weak mix of measures that are unlikely to make much difference in improving the advice ordinary Americans receive from brokers. . . . I cannot see why our rules should permit pay practices that create *any* pressure for brokers to harm investors.

Id. The Commission’s Investor Advocate echoed his concerns on the same day:

> The most worrisome aspect of Reg BI is that it will allow broker-dealers and their associated persons to market themselves as acting in the best interest of their customers. If Reg BI is not enforced rigorously enough to demand behavior that matches customers’ expectations, then customers will be harmed by the new standard.

Rick Fleming, *Statement Regarding the SEC’s Rulemaking Package for Investment Advisers and Broker-Dealers*, SEC. & EXCH. COMM’N (June 5, 2019), https://www.sec.gov/news/public-statement/statement-regarding-sec-rulemaking-package-investment-advisers-broker-dealers.

Unsurprisingly, Regulation BI was immediately challenged in court by a broad coalition of States, public interest *amici* (including Better Markets), and even more investor-friendly industry interests. *See generally XY Plan. Network, LLC v. SEC*, 963 F.3d 244 (D.C. Cir. 2020). These challenges were grounded, in part, on the strong evidence that ordinary investors misunderstood and were misled about the distinction between broker-dealers and investment advisers. *See id.* at 256. A federal court nonetheless sustained Regulation Best Interest under the deferential standards of the Administrative Procedure Act. *See id.* at 256–57.

Yet, since then, the Commission seems to have more fully appreciated the failures of its own rule. Commission staff have issued two bulletins to clarify and fortify Regulation BI with respect to conflicts of interest in account recommendations.[4] Even Chair Gensler has publicly cited the need to "get the best out of best interest." Chair Gary Gensler, Remarks Before the 2022 NASAA Spring Meeting & Public Policy Symposium: "Investor Protection in a Digital Age," SEC. & EXCH. COMM'N (May 17, 2022), https://www.sec.gov/news/speech/gensler-remarks-nasaa-spring-meeting-051722. And three years after the final rule, the

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[4] *See Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest*, SEC. & EXCH. COMM'N (Aug. 3, 2022), https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest; *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors*, SEC. & EXCH. COMM'N (Mar. 30, 2022), https://www.sec.gov/tm/iabd-staff-bulletin.

Commission finally brought its *first and only* enforcement action under Regulation Best Interest. *See SEC Charges Firm and Five Brokers with Violations of Reg BI*, SEC. & EXCH. COMM'N (June 16, 2022), https://www.sec.gov/news/press-release/2022-110. All of these developments represent at least an implicit concession by the Commission that Regulation Best Interest has fallen far short of the genuine investor protection it purports to supply. *See* Stephen W. Hall, Better Markets, *2 threats facing today's investors—and the regulatory response*, NAPFA ADVISOR (Sept. 20, 2022), https://www.naylornetwork.com/napf-nwl/articles/index.asp?aid=743560&issueID=94952. Had the rule truly remedied the weak standard of conduct and the depths of investor confusion over broker-dealer duties, we would have seen far more enforcement and far less need for post-rule guidance.

The most recent empirical evidence shows very little benefit to Regulation BI. As Better Markets has explained,

> In November 2021, the North American Securities Administrators Association (NASAA) announced the results of a nationwide survey conducted by state securities regulators that assessed broker-dealer policies and practices following implementation of Reg BI. NASAA found that a full year after the rule's compliance deadline of June 30, 2020, little has changed when it comes to the powerful influence that advisor conflicts of interest exert on investment advice. It concludes that Reg BI firms have steadily increased their participation in complex, costly, and risky products; they continue to rely on financial incentives that Reg BI was intended to curb; and they still place their financial interests ahead of their retail customers' in violation of the rule's chief directive. These findings are consistent with FINRA's own exam

> results, which identify a wide range of compliance failures under Reg BI.

Id.; *see also* FIN. INDUS. REGUL. AUTH., 2022 REPORT ON FINRA'S EXAMINATION AND RISK MONITORING PROGRAM 24–29 (2022), https://www.finra.org/sites/default/files/2022-02/2022-report-finras-examination-risk-monitoring-program.pdf.

C. The State Rule Fills Critical Regulatory Gaps to Protect Investors.

The State Rule provides the clearest and likely only means of adequately shielding investors from broker-dealer conflicts of interest and exploitation. It alone is a true mandate to act in the investors' best interest by providing the "utmost care and loyalty." 950 Code Mass. Regs. § 12.207(2). If a broker-dealer fails to meet that standard, the Secretary has real enforcement authority to punish the violation and deter future misconduct. *See* G.L. c. 110A, § 204(a)(2)(G).

Empirical evidence bears out the benefits of the State Rule's approach. Perhaps the leading study examined broker-dealers operating near the borders of States with and without common-law fiduciary duties. *See* VIVEK BHATTACHARYA ET AL., FIDUCIARY DUTY AND THE MARKET FOR FINANCIAL ADVICE, NBER WORKING PAPER NO. 25861 2 (2020). The authors focused on how the change in state law influenced these brokers in their selection and sale of annuities, among the most lucrative products for brokers but expensive and damaging for investors. They found that fiduciary duties resulted in products with higher risk-adjusted returns. *Id.*

at 1–2. These savings would certainly be material to an ordinary investor's portfolio over time, *see supra* 31–32, and the aggregate benefits across the State would be highly significant.

These benefits, moreover, do not come at significant social cost. As one observer notes, broker-dealers will likely find cost-effective ways to comply" with state-law fiduciary duties because they "have strong incentives to continue providing services in the states where they operate." Ferreira, *Staying True to NSMIA*, *supra*, at 584. That incentive holds true for Massachusetts as much as it does for any other state; there is simply too much potential profit to be made from growing demand for financial advice. *See id.* Again, empirical evidence supports the cost-effectiveness of the State Rule and the industry's continued viability: A second study examining cross-state differences in fiduciary duties found no statistically significant impact on the cost of compliance. *See* Michael Finke & Thomas P. Langdon, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Planning*, J. FIN. PLAN., July 2012, at 28. The same study concluded that stricter duties had no impact on the number of broker-dealers "as a percentage of total households" within a state. *Id.* Thus, there is little reason to accept industry predictions of harm from the State Rule.

CONCLUSION

The Court should hold that Regulation BI does not preempt the State Rule and should reverse the Superior Court's judgment below.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that the foregoing brief complies with the requirements of Massachusetts Rules of Appellate Procedure 17 and 20. The brief complies with the length requirements of Rule 20(a)(2)(C) because it is prepared in a proportionally spaced font (Times New Roman) and contains 6,850 words, excluding parts of the brief other than those required by Rule 16(a)(5)–(11).

/s/ Dennis M. Kelleher

Dated: April 12, 2023

CERTIFICATE OF SERVICE

Robinhood Financial LLC v. Galvin
Supreme Judicial Court
SJC-13381
Brief of *Amicus Curiae* Better Markets, Inc.
In Support of Defendants-Appellants and Reversal

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