

MEMO# 34095

April 5, 2022

Massachusetts Court Invalidates Fiduciary Conduct Standard Regulations

[34095]

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TO: ICI Members

Bank, Trust and Retirement Advisory Committee

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State Issues RE: Massachusetts Court Invalidates Fiduciary Conduct Standard Regulations

On March 30, 2022, the Superior Court of the Commonwealth of Massachusetts issued an order (attached) invalidating the Massachusetts regulation, finalized in 2020, that imposes a fiduciary duty on broker-dealers and agents.[\[1\]](#) The court stayed the order for 30 days to give the Massachusetts Secretary of the Commonwealth, William Galvin, time to pursue an appeal.

Background

In 2020, the Massachusetts Securities Division (the "Division") finalized amendments to its fiduciary conduct standard regulations. As amended, the regulation imposes a fiduciary duty on broker-dealers and agents by providing that the failure to act in accordance with a fiduciary duty when providing investment advice or a recommendation will constitute a dishonest or unethical conduct or practice. These amendments became effective on March 6, 2020, and the Division began enforcing the amended regulation on September 1, 2020. Secretary Galvin's expressed rationale for the amendment is that the SEC's Regulation Best Interest ("Reg BI")[\[2\]](#) is not sufficient because it is not a true fiduciary standard.[\[3\]](#)

In its first enforcement action under the amended regulation, in December 2020, the Division brought an enforcement action against Robinhood Financial LLC alleging, among other things, that Robinhood violated the fiduciary standard in the new rule.[\[4\]](#) In April 2021, Robinhood filed a lawsuit in state court alleging that the amended regulation is invalid under both Massachusetts state law and federal law.

Court Decision

In its recent order, the Massachusetts Superior Court explained that it had three issues under consideration—whether the Division's regulation:

- exceeds the authority that the Massachusetts legislature delegated to the Secretary;
- is an exercise of legislative authority in violation of the Massachusetts Declaration of Rights; or
- is preempted by federal law.[\[5\]](#)

Regarding the first issue, the court concluded that the Secretary's promulgation of the rule was beyond his authority. The court explained that the Massachusetts Supreme Judicial Court had interpreted the common law and outlined the scope of a broker-dealer's fiduciary responsibility to its customer, finding that a broker-dealer's fiduciary obligations only arose in limited circumstances.[\[6\]](#)

The court found that the Division's regulation changes the common law as defined by the Supreme Judicial Court, by imposing a fiduciary duty on broker-dealers even where they lack the type of relationship described in *Patsos*. The court found that nothing in the statute expressly confers a delegation to the Secretary to interpret the Massachusetts Uniform Securities Act (MUSA) contrary to the Supreme Judicial Court's interpretation; nor can the statute be read to implicitly confer this authority. In making this determination, the court noted that the legislature, in MUSA, directed the Secretary to maintain consistency in the securities laws among Massachusetts, the federal government, and the other states that have adopted the Uniform Securities Act that was the foundation for MUSA.

In declaring the amended regulation void, the court stated:

Nothing in [MUSA generally] suggests that the Legislature intended to give the Secretary authority to override existing Supreme Judicial Court precedent or to empower him, in the absence of clear direction, to re-define familiar securities concepts through rulemaking and thereby change, and make non-uniform, the law that applies to broker-dealers operating in Massachusetts. [\[7\]](#)

Because the court made its conclusion on the first issue, (that the promulgation of the regulation was beyond the Secretary's authority), it did not reach the constitutional or preemption issues.

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endnotes

[1] The final regulations are available at <https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/fiduciaryrule-adoption.htm>. For a summary of the regulation, see ICI Memorandum No. 32242, dated February 26, 2020, available at <https://www.ici.org/memo32242>.

[2] For a detailed summary of the SEC's standards of conduct rulemakings, including Reg BI, see ICI Memorandum No. 31815 (June 19, 2019), available at <https://www.ici.org/memo31815>.

[3] See pages 2-5 of the Division's Request for Comment, dated December 13, 2019, issued with the proposed version of the rule and available at <https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf>. Secretary Galvin made similar statements in his comments to the SEC regarding its Reg BI proposal. See letter from William Galvin to SEC Chairman Jay Clayton (August 7, 2018), available at <https://www.sec.gov/comments/s7-07-18/s70718-4177382-172364.pdf> ("If the Commission does not adopt a strong and uniform fiduciary standard, Massachusetts will be forced to adopt its own fiduciary standard to protect our citizens from conflicted advice by broker-dealers.")

[4] The Division alleged that Robinhood used aggressive tactics to attract new, often inexperienced investors; that it used strategies such as gamification to encourage and entice continuous and repetitive use of its trading app; and that it failed to follow its own written supervisory procedures. Notably, the alleged violations might not have been subject to Reg. BI because, according to Robinhood, it does not provide recommendations.

[5] ICI's comment letter in response to the Massachusetts' proposed rule focused on the application of National Securities Markets Improvement Act of 1996 (NSMIA) and its preemptive provisions. The letter also noted the valid reasons SEC had for not making Reg BI a fiduciary standard. See letter from Susan Olson to the Office of the Secretary of the Commonwealth, dated January 6, 2020, available at https://www.ici.org/system/files/attachments/pdf/20_ltr_massfiduciary.pdf.

[6] See *Patsos v. First Albany Corp.*, 433 Mass. 323, 333-336 (2001).

[7] See page 26 of the court's order.