

MEMO# 35657

March 26, 2024

Massachusetts Court Validates Fiduciary Conduct Standard Regulations

[35657]

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TO: ICI Members

Bank, Trust and Retirement Advisory Committee

Broker/Dealer Advisory Committee

Investment Advisers Committee

Operations Committee

Pension Committee

Pension Operations Advisory Committee

SEC Rules Committee

Small Funds Committee

Transfer Agent Advisory Committee SUBJECTS: RE: Massachusetts Court Validates
Fiduciary Conduct Standard Regulations

On January 18, 2024, Robinhood Financial LLC settled charges brought by the Massachusetts Securities Division (the "Division") in connection with an August 2023 Massachusetts Supreme Judicial Court ("SJC") decision upholding a Massachusetts rule, finalized in 2020, that imposes a fiduciary duty on broker-dealers and agents (the "Massachusetts Fiduciary Rule", "the rule").[\[1\]](#) The SJC rejected online trading platform Robinhood's challenge to the Massachusetts Secretary of the Commonwealth, William Galvin's authority under the Massachusetts Uniform Securities Act ("MUSA") to promulgate the rule.

Background

In 2020, the Division finalized amendments to its fiduciary conduct standard regulations. As amended, the rule imposes a fiduciary duty on broker-dealers and agents by providing that failure to act in accordance with a fiduciary duty when providing investment advice or a recommendation will constitute dishonest or unethical conduct or practice. The rule became effective on March 6, 2020, and the Division began enforcing the rule on September 1, 2020. Secretary Galvin's expressed rationale for the rule 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 rule, 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 rule.[\[4\]](#) In April 2021, Robinhood filed a lawsuit in state court alleging that the rule is invalid under both Massachusetts state law and federal law. The Massachusetts Superior Court granted Robinhood's requested declaratory judgment, holding that the rule exceeded the Secretary's statutory authority under MUSA. Secretary Galvin appealed to the SJC.[\[5\]](#)

Court Decision

In August 2023, the SJC reversed the Massachusetts Superior Court's decision and upheld the Massachusetts Fiduciary Rule, addressing four of Robinhood's arguments, including that:

- The Secretary exceeded his statutory authority by issuing the rule.
- The rule is invalid because it abrogates the common law.
- If MUSA permits the Secretary to promulgate the rule, then MUSA impermissibly delegates legislative authority in violation of the separation of powers doctrine in the Massachusetts Declaration of Rights.
- The rule is preempted by federal law.[\[6\]](#)

Regarding the first issue, the Court concluded that the Secretary acted within his statutory authority when promulgating the rule and defining terms like "unethical and dishonest" conduct in MUSA.

The legislature's silence as to what particular "'conduct or practice'" should be deemed "'unethical or dishonest'" coupled with the "wide authorization" given to the Secretary under MUSA constituted the legislature's invitation for the Secretary to "'fill the gap'" in crafting definitions that allow the Secretary to revoke broker-dealers' registrations if they fail to adhere to the rule.[\[7\]](#)

Rejecting Robinhood's argument that the legislature intended to adopt traditional broker-dealer and investment adviser standards of care, the court said the Secretary permissibly adapted "the standard of care required of these new-age broker-dealers, who have themselves adopted new business models inconsistent with their traditional roles and prior industry norms".[\[8\]](#) The Court also rejected Robinhood's argument that the rule conflicted with a statutory uniformity requirement, holding that the plain text of the statute does not require uniformity in the Secretary's determination of substantive policy.[\[9\]](#)

The Court next rejected Robinhood's argument that the rule abrogated the common

law as set forth in *Patsos v. First Albany*,[\[10\]](#) holding that the rule is of equal status to and "stand[s] shoulder-to-shoulder with" the common law.[\[11\]](#) For example, an investor injured by a fiduciary duty breach may have a claim under the *Patsos* inquiry, whereas the Massachusetts Fiduciary Rule provides a separate and distinct regulatory tool to protect investors under MUSA.[\[12\]](#)

Next, the Court outlined three relevant considerations to reject Robinhood's argument that the rule, if properly promulgated, violates the Massachusetts Declaration of Rights' separation of powers doctrine. First, "[s]uch a delegation permissibly draws on the Secretary's expertise to adapt to the real-world context of evolving practices in the securities industry, including, as relevant here, the changes resulting from broker-dealers increasingly choosing to give investment advice and blurring the line that traditionally separated broker-dealers from investment advisers".[\[13\]](#) Second, MUSA provided guidance

in defining the proscribed practices and "an intelligible principle to direct the Secretary's exercise of his authority."^[14] Third, MUSA provided safeguards to control for abuse of discretion by requiring certain finding from the Secretary and a mechanism for notice and hearing and judicial review of administrative actions.^[15]

Lastly, the Court rejected Robinhood's argument that federal law under Reg BI preempts the rule. The Court cited instances where Congress and the SEC declined to express an intent to preempt state laws imposing fiduciary obligations on broker-dealers.^[16]

The SJC addressed only the parties' legal questions and so remanded the case to the Superior Court for consideration of any remaining fact-dependent issues.

Robinhood Settlement

Given the SJC's adverse decision, in January 2024, Robinhood settled with the Division and agreed to pay \$7.5 million and make substantial changes to its operations, including overhauling its digital engagement practices.^[17]

Robinhood neither admitted to nor denied certain factual allegations by the Division that it did not provide enough controls to protect customers, while admitting to facts connected to a 2021 data breach also addressed in the consent order.^[18]

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Notes

^[1] See Consent Order, In the Matter of Robinhood Financial, LLP (2024) available at <https://www.sec.state.ma.us/divisions/securities/download/RH-Consent-Order.pdf>. See also Robinhood Financial v. Secretary of Commonwealth, 492 Mass. 698 (Aug. 25, 2023). 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] On March 30, 2022, the Superior Court of the Commonwealth of Massachusetts had issued an order invalidating the Massachusetts regulation, finalized in 2020, that imposes a fiduciary duty on broker-dealers and agents. See ICI Memorandum No. 34095, dated April 5, 2022, available at <https://www.ici.org/memo34095>.

[6] Robinhood, 492 Mass. at 707-716.

[7] Id. at 708-09.

[8] Id. at 710-11.

[9] Id. at 711-12.

[10] See *Patsos v. First Albany Corp.*, 433 Mass. 323, 741 N.E.2d 841 (2001).

[11] Robinhood, 492 Mass. at 713.

[12] Id.

[13] Id. at 715.

[14] Id.

[15] See id. at 716

[16] See id. at 718-20.

[17] See Consent Order, In The Matter of Robinhood Financial LLC.

[18] See id. at 2.