

Mass. High Court Plays Wild Card: Upholds Broad Fiduciary Duty for Broker-Dealers

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On August 25, 2023, the Massachusetts Supreme Judicial Court upheld the validity of a rule promulgated in 2020 by the secretary of the commonwealth that imposes a broad fiduciary duty upon securities broker-dealers and their agents. Robinhood Financial LLC had challenged the validity of the Massachusetts rule as part of its defense against charges by the secretary that Robinhood had failed to comply with the rule and the Massachusetts Uniform Securities Act, pursuant to which the secretary had adopted the rule. The court's August 25 opinion reversed a previous lower court decision that had deemed the rule invalid. **The Massachusetts Rule** The Massachusetts rule, as now in force, omits language from the rule as proposed that would have extended its coverage to include investment advisers and advice regarding insurance and commodities. But broker-dealers and their agents, who are covered by the rule, will be subject to more extensive requirements in Massachusetts governing securities-related advice than otherwise would apply. For example, while many requirements imposed by the Massachusetts rule are similar to those currently applicable to covered persons under the SEC's Regulation Best Interest, the Massachusetts rule imposes its requirements if a covered person provides any advice concerning securities investing, whereas Regulation Best Interest imposes such requirements more narrowly: i.e., only when such a person makes a recommendation. Similarly, although Regulation Best Interest applies only to recommendations made to "retail" customers and the Massachusetts rule does not apply to advice rendered to specified types of institutions, advice to other types of institutions may require compliance with the Massachusetts rule notwithstanding that they could be considered to be non-retail investors for purposes of Regulation Best Interest. Although Regulation Best Interest does not impose a broad fiduciary duty on broker-dealers, it does impose very significant care, conflicts of interest, compliance, and disclosure obligations. Among other things, Regulation Best Interest requires a covered person to have a reasonable basis for believing a recommendation is in the best interest of the retail customer, without putting the covered person's financial interest ahead of the customer's. In imposing a broad fiduciary duty on covered persons, however, the Massachusetts rule imposes a stricter requirement: i.e., the covered person must act without regard to the financial or

any other interest of any party other than the customer. The Massachusetts rule also treats investment recommendations made in connection with sales contests differently from Regulation Best Interest. For example, the Massachusetts rule creates a presumption that sales contests, whether product-specific or not, constitute a breach of a covered person's duty in connection with any securities recommendation relevant to the contest. In contrast, the prohibition on sales contests in Regulation Best Interest applies only to sales contests that are based on the sale of specific securities or specific types of securities within a limited timeframe. **The Court's Opinion** The court concluded that the secretary's promulgation of the Massachusetts rule was within the broad authority and deference afforded to the secretary to adopt regulations in furtherance of the objectives of the Massachusetts Uniform Securities Act. The court specifically rejected, among others, arguments that the rule is invalid because:

- It upsets the basic structure of the Massachusetts Uniform Securities Act, as well as historic industry norms, for regulating broker-dealers differently from investment advisers.
- It contradicts language in the statute stating that the act "shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this chapter with the related federal regulation."
- It abrogates relevant principles of common law.
- It constitutes a form of legislation whose enactment may not, under the Massachusetts Declaration of Rights, be delegated to the secretary.
- It has been preempted, inasmuch as the SEC intended Regulation Best Interest to establish a "ceiling" on the standard of conduct for broker-dealers.

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