

Massachusetts Adopts Fiduciary Rule for Broker-Dealers

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March 10, 2020

States Seek to Expand upon SEC Regulation Best Interest

In a rebuke of the U.S. Securities and Exchange Commission (the “SEC”), the Massachusetts Securities Division recently announced its own fiduciary rule for broker-dealers and their agents when making investment recommendations to retail clients. Massachusetts’ new fiduciary rule (the “Massachusetts Fiduciary Rule” or “Rule”) implements a standard of conduct stricter than that set forth by the SEC in its Regulation Best Interest (“Reg BI”), which the agency announced last summer. (The final Rule is [available here](#).)

Massachusetts is the first state to issue a final fiduciary rule in response to the SEC’s regulation, which opponents have criticized as a failure by the SEC to provide clear and meaningful protections for investors. (Reg BI went into effect on September 10, 2019 and has a compliance date of June 30, 2020.) The Massachusetts Fiduciary Rule, which went into effect on March 6, 2020 and has a delayed enforcement period beginning September 1, 2020, applies to all broker-dealers and their agents conducting business into and/or from Massachusetts, and covers recommendations concerning securities (but does not explicitly apply to advice on commodities or insurance products).

The Rule imposes more onerous standards than the SEC’s Reg BI in several important respects. First, unlike Reg BI, the Rule explicitly applies a “fiduciary” obligation to brokers, requiring that they act without regard to their own financial interests when advising customers. Second, the Rule includes a broad prohibition on sales contests, while Reg BI only requires brokers to create and implement policies and procedures to eliminate such contests and is limited to specific securities or categories of securities and to sales contests during a finite period of time. Third, the Rule includes more stringent obligations for conflicts of interest. Under Reg BI, brokers are, at a minimum, required to identify and disclose conflicts. But under the Rule, disclosure alone is not sufficient. Instead, brokers and their agents are required to avoid, eliminate, or mitigate conflicts. Fourth, the Rule defines “customer” more broadly, extending to both individuals and entities, whereas Reg BI covers recommendations to individuals only.

The Rule comes against the backdrop of intense controversy surrounding the SEC’s adoption of Reg BI last year. A former SEC commissioner, investor advocates and several states have heavily criticized Reg BI as inadequate to protect retail investors against conflicted investment advice from their brokers, and the attorneys general of several states sued the SEC last year to invalidate Reg BI on the theory that it fails to satisfy the SEC’s obligation under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to do so.

The Massachusetts Fiduciary Rule is intended to substitute for the fiduciary rule proposed by the U.S. Department of Labor in 2016, which would have imposed a fiduciary standard on all financial professionals, including broker-dealers, who make recommendations with respect to retirement plans, but was struck down by the U.S. Court of Appeals for the Fifth Circuit in 2018.

Other states, including Nevada, New Jersey, and Maryland, are also considering adopting their own, more rigorous standards for broker-dealers, raising concerns that broker-dealers will be subject to a discordant patchwork of regulations. It is likely that the financial industry will challenge these rules in court, further ensuring that the legal landscape with respect to broker-dealer standards of conduct will remain active. We will continue to provide updates on developments in this area.

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