REGULATION BEST INTEREST AND THE STATE–AGENCY CONFLICT

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Once it became apparent that the SEC would not impose a broker-dealer fiduciary duty to retail customers, a number of states proposed regulations that would rectify the perceived shortcomings of Regulation Best Interest (Reg BI). The new SEC rule brought into question the validity of these state fiduciary rules, as well as the common law broker-dealer fiduciary rules in other states. This Note is the first attempt to frame and resolve Reg BI's preemption problem. This Note begins by documenting the three sources of authority in the broker-dealer regulatory framework before and after the issuance of Reg BI. It then frames the preemption problem, identifying obstacle preemption as the appropriate theory, and ultimately relies on congressional intent in the Dodd–Frank Act to argue that Reg BI likely sets only a regulatory floor. But even those state laws that impose more rigorous duties than Reg BI may still be vulnerable to preemption challenges. States would then do well, this Note concludes, to justify their fiduciary rules using arguments grounded in empirical evidence and federalism.

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INTRODUCTION

"Our Nation is facing a savings crisis."[1] And in the midst of this savings crisis, commentators have speculated whether federal securities regulators are taking a step back from their usual level of oversight.[2] States, on the other hand, have been willing to fill the apparent enforcement vacuum.[3] In certain areas of securities law, the division between federal and state jurisdiction is clear; but in others, the blurred lines of federalism give rise to concurrent jurisdiction, allowing one enforcer to pick up the slack when the other's enthusiasm recedes.[4]

In recent years, no division between federal agencies, state regulators, and other organizations within securities law has been more debated—and

1. Robert J. Jackson Jr., Comm'r, SEC, Statement on Final Rules Governing Investment Advice (June 5, 2019), https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd [https://perma.cc/8Z2H-YYVX] ("Many young workers are unable to save at all; half of America's retirees have saved less than $65,000 and face the terrifying prospect of running out of money in retirement." (citing Vanguard, How America Saves 2018, at 34, 51 (2018), https://pressroom.vanguard.com/nonindexed/HAS18_062018.pdf [https://perma.cc/92ZP-NT5D])).

2. While SEC Chairman Jay Clayton has reaffirmed his commitment to SEC enforcement, his tenure as Chairman has prioritized promoting initial public offerings and reducing regulatory burdens on capital formation. See Kurt Wolfe, Where Have the SEC Enforcement Actions Gone?, Law360 (Sept. 19, 2018), https://www.law360.com/articles/1084059 (on file with the *Columbia Law Review*). But see Oversight of the U.S. Securities and Exchange Commission: Hearing Before the H. Comm. on Fin. Servs., 115th Cong. 65 (2018) (statement of Jay Clayton, Chairman, SEC) ("I can assure you that our Enforcement Division will continue its vigorous enforcement of the federal securities laws and hold bad actors accountable.").

3. In the consumer finance context, the trend is clear. See, e.g., Matthew Levine, DFS Enforcement to Increase Focus on Consumer Protection: 'Where CFPB Steps Down, DFS Has to Step Up', N.Y.L.J. (Sept. 3, 2019), https://www.law.com/newyorklawjournal/2019/09/03/dfs-enforcement-to-increase-focus-on-consumer-protection-where-cfpb-steps-down-dfs-has-to-step-up (on file with the *Columbia Law Review*). In the securities context, the trend is less clear. But see infra section III.B (arguing that states took on a corrective, agency-policing role following the SEC's promulgation of Regulation Best Interest).

4. See infra sections I.A.1–.2.

more politically heated—than the law surrounding broker-dealers.[5] Broker-dealers execute trades for clients and occasionally offer advice, serving a crucial role in American financial markets for main street investors.[6] In 2017 alone, the Financial Industry Regulatory Authority (FINRA), an important regulator of broker-dealers nationwide, oversaw an average of $168 billion in value of trade executions each day,[7] conducted more than 7,800 regulatory exams, and returned "$66.8 million in restitution to harmed investors."[8] Specifically, the current controversy surrounds the nature of a broker-dealer's duty to clients: whether it is a fiduciary relationship, similar to investment advisers under the Investment Advisers Act of 1940; a nonheightened duty typical of arm's-length transactions, as some state courts have found; a standard mandating that the suggested investment merely be "suitable," as required by FINRA; or somewhere in between.[9]

In June 2019, the SEC used the authority that Congress had delegated in Section 913 of the Dodd–Frank Wall Street Reform and Protection Act to issue Regulation Best Interest (Reg BI).[10] Broadly, Reg BI defined the duty of broker-dealers to retail customers as one of "best interest" but provided little guidance regarding what that duty entails.[11] What is clear is that the SEC implemented an obligation less demanding than fiduciary duty,[12] in turn confusing the broker-dealer industry[13] and threatening the

5. For an overview of broker-dealer duties in different jurisdictions, see infra Part I.

6. See infra notes 16–18 and accompanying text.

7. See FINRA, 2018 FINRA Industry Snapshot 1, 5, 28 (2018), https://www.finra.org/sites/default/files/2018_finra_industry_snapshot.pdf [https://perma.cc/XC6E-JNAS].

8. FINRA, 2017 FINRA Annual Financial Report 3 (2017), https://www.finra.org/sites/default/files/2017_AFR.pdf [https://perma.cc/N44N-3VGB] [hereinafter FINRA, 2017 Annual Report].

9. See infra section I.A.

10. Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019) (codified at 17 C.F.R. § 240.15*l*-1 (2020)).

11. Reg BI institutes a "General Obligation," which is satisfied by four component obligations: disclosure, care, conflict of interest, and compliance. See infra notes 71–74 and accompanying text.

12. The SEC expressly stated that Reg BI is not a fiduciary standard but confusingly incorporated other elements of traditional fiduciary duty into the best interest obligation. For a longer discussion of how Reg BI derogates from the fiduciary standard, see infra section I.B.1.

13. See, e.g., Bradley Kellum, Tammi Ling, Allen Meyer, Michael Moloney & Farooq Sheikh, Oliver Wyman, Time to Start Again: Preliminary Views on Regulation Best Interest 5 (2019), https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2019/jun/Oliver_Wyman_Regulation_Best_Interest.pdf [https://perma.cc/JH85-VHVC] ("Despite industry requests, the SEC did not provide prescriptive guidance around many aspects of the final Rule . . . . [B]roker-dealers will need to . . . develop their own firm-specific interpretations.").

validity of state laws or proposed regulations that require fiduciary duty.[14] The SEC also failed to clarify Reg BI's intended preemptive effect and left the question to the courts.[15]

This Note addresses the preemption question that the SEC left open, arguing that Reg BI likely preempts only those state laws that implement a duty lower than that of "best interest." But even state laws that clear the preemption floor—those that require fiduciary duty—must cohere with the objectives and methods of execution that undergirded Congress's enactment of Section 913 of the Dodd–Frank Act. Accordingly, Part I introduces the broker-dealer regulatory framework and the origins of Reg BI. Part II then provides an overview of preemption doctrine, argues that Reg BI sets a regulatory floor, and identifies an area of potential conflict between congressional intent and state fiduciary rules. Part III suggests two arguments—one based in empirical evidence, another in federalism—to reconcile the conflict, strengthening the states' defense against a federal regulation that seeks to diminish investor protection.

I. THE BROKER-DEALER REGULATORY ENVIRONMENT

Broker-dealers serve important and diverse functions in American financial markets. Brokers act as agents, offering services such as discount brokerage,[16] custody and trade execution for independent financial advisors or investment advisers, generalized or specific educational and research materials, asset allocation services within criteria determined by the consumer, limited trading discretion over customer accounts, and some wealth management and financial planning services.[17] Dealers, who act as principals, similarly provide a wide range of services: selling securities out of inventory and buying from customers, selling investment products affiliated with the broker-dealer, selling public and other underwritten offerings, exercising authority as the principal of customers' Individual Retirement Accounts, and market making.[18] Broker-dealers

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14. See, e.g., id. at 9 (noting that Reg BI made "it difficult to determine what will happen in states that have already, or are planning to propose their own fiduciary standards" and that Reg BI "will add an incremental layer of complexity").

15. See Regulation Best Interest, 84 Fed. Reg. at 33,435 n.1163.

16. Discount brokers offer no advice to investors and execute trades only upon the investor's request. See John Downes & Jordan Elliot Goodman, Full-Service Broker, Dictionary of Finance and Investment Terms 295 (9th ed. 2014).

17. SEC, Study on Investment Advisers and Broker-Dealers 9–10 (2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf [https://perma.cc/HQ8Y-KSCA] [hereinafter SEC, Section 913 Study] (listing an even wider range of offered brokerage services than mentioned here).

18. Id. at 10. A market maker is "a firm that stands ready to buy and sell a particular stock on a regular and continuous basis at a publicly quoted price." Market Maker, SEC, https://www.sec.gov/fast-answers/answersmktmakerhtm.html [https://perma.cc/63Z3-GEM7] (last updated Mar. 17, 2000). Market making is thus essential to ensuring liquidity in securities markets. See id.

help millions of Americans who would otherwise lack access to financial expertise tap into the public markets to save for retirement or college tuition.[19]

But because broker-dealers are typically compensated through commission structures, the business model creates an inherent misalignment of interests since income is tied to the occurrence of the transaction itself, not the underlying long-term success of an investment.[20] In turn, securities regulators have long sought to regulate the relationship between broker-dealers and their retail customers,[21] but their solutions have never been straightforward. Part I provides a broad overview of this complex regulatory scheme. Section I.A outlines the regulatory structure at a high level with particular focus on regulation of broker-dealer conduct. Section I.B then introduces the Dodd–Frank Act and Reg BI, notes some of the key provisions that give rise to ambiguity, and summarizes the state legislative and regulatory dissent that ensued.

A. *The Pre–Reg BI Regulatory Environment*

Three major sources of authority are at play in the broker-dealer regulatory environment: federal law and regulation, state law and regulation, and the FINRA rules. Section I.A.1 summarizes key provisions of the Securities Exchange Act and Investment Advisers Act and describes the market conditions that have rendered the federal statutory framework dated and inadequate. Sections I.A.2 and I.A.3 discuss the latter two categories, documenting the morass of broker-dealer obligations in the interstices of the federal statutory framework before Reg BI's passage.

1. *The Federal Framework.* — The Securities Exchange Act of 1934 defines a broker as "any person engaged in the business of effecting transactions in securities for the account of others."[22] A dealer is "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise."[23] Broker-dealers, who take on both roles, are intermediaries who "connect investors to investments, which range from common stock and mutual funds to complex financial products, and in doing so, enhance the overall liquidity and

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19. See Jay Clayton, Chairman, SEC, Statement at the Open Meeting on Commission Actions to Enhance and Clarify the Obligations Financial Professionals Owe to Our Main Street Investors (June 5, 2019), https://www.sec.gov/news/public-statement/statement-clayton-060519-iabd [https://perma.cc/2384-KCNW] [hereinafter Clayton, Reg BI Statement]; Jackson, supra note 1.

20. See, e.g., A Framework for Addressing Broker-Dealer and Investment Adviser Conflicts of Interest When Providing Retail Investment Advice, Consumer Fed'n of Am., https://consumerfed.org/wp-content/uploads/2019/04/CFA-Conflict-of-Interest-Framework.pdf [https://perma.cc/5UZ6-L8MP] (last visited Jan. 19, 2020).

21. This conflict of interest is at the core of the SEC's purported reason for adopting Reg BI instead of uniformly applying the fiduciary duty under the Investment Advisers Act to broker-dealers. See infra notes 75, 77 and accompanying text.

22. Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(4)(A) (2018).

23. Id. § 78c(a)(5)(A).

efficiency of the financial markets."[24] Alternatively, under the Investment Advisers Act of 1940, investment advisers are a broader category that includes "any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who . . . issues or promulgates analyses or reports concerning securities."[25] Broker-dealers are included under this broad definition but qualify for a crucial exception if they meet two elements related to the nature of the investment advice they provide.[26]

This exemption is crucial because federal law subjects investment advisers, but not broker-dealers, to fiduciary duty.[27] The Investment Advisers Act never made fiduciary duty explicit,[28] but the Supreme Court, after having reviewed legislative records, found "a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."[29] To do so, the Court affirmed the "congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship'" in the Investment Advisers Act.[30] This difference

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24. SEC, Section 913 Study, supra note 17, at 8.

25. 15 U.S.C. § 80b-2(a)(11).

26. See id. § 80b-2(a)(11)(C) ("'Investment adviser' . . . does not include . . . any broker or dealer [1] whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and [2] who receives no special compensation therefor."). This categorization is important because determining whether an entity is a broker-dealer or investment adviser can directly determine the duty it owes to its clients. For the full discussion of investment adviser duty, see infra notes 28–30 and accompanying text.

On the first element: The SEC, concurrently with Reg BI, issued an interpretation of the solely incidental prong. Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, 84 Fed. Reg. 33,681, 33,682 n.6 (July 12, 2019). The SEC "interpret[s] the statutory language to mean that a broker-dealer's provision of advice . . . is consistent with the solely incidental prong if the advice is provided in connection with and is reasonably related to the broker-dealer's primary business of effecting securities transactions." Id. at 33,685.

On the second element: "'[S]pecial compensation' refers to economic benefit that is received specifically for investment advice, in a form other than a commission for the sale of the underlying product." Thomas v. Metro. Life Ins., 631 F.3d 1153, 1165 (10th Cir. 2011). The Tenth Circuit's standard reflects the general differences between broker-dealer and investment adviser compensation schemes. For broker-dealers, compensation typically "is transaction-based and is earned through commissions, mark-ups, mark-downs, sales loads or similar fees on *specific transactions*." SEC, Section 913 Study, supra note 17, at 11 (emphasis added). In contrast, over ninety-five percent of surveyed investment advisers in 2011 charged clients fees "based on the percentage of assets under management"; others charged hourly, fixed, or commission-based fees. Id. at 7.

27. See Arthur B. Laby, Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries, 87 Wash. L. Rev. 707, 710 (2012).

28. See 15 U.S.C. § 80b-6.

29. Sec. Exch. Comm'n v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 191–92 (1963).

30. Id. at 191 (quoting 2 Louis Loss, Fundamentals of Securities Regulation 1412 (2d ed. 1961)).

between broker-dealers and investment advisers presented an opportunity for regulatory arbitrage: Investment advisers who qualify for the Investment Advisers Act exception could avoid an onerous fiduciary duty and subject themselves to lower broker-dealer standards.[31] To avert this behavior, federal courts have acknowledged several methods of elevating the duty of broker-dealers to fiduciary level, but this case-by-case determination is "particularly fact-based" and depends "on the relationship between the broker and the investor."[32] Apart from this case law in the federal courts, regulation of broker-dealer conduct was largely left to the states and self-regulating organizations.[33]

But questions about the adequacy of the federal regulatory scheme have intensified as broker-dealer industry practices have encroached on what had traditionally been the realm of investment advisers.[34] Broker-dealers first began offering financial planning services in the 1980s; by the 1990s, they used titles that included the word "adviser" and encouraged customers to consider them advisers rather than trade executors.[35] Broker-dealers' shift from exclusively charging commission on trades to implementing fee-based pricing, which is a form of pricing independent of the

31. See supra note 26 (describing the test used to distinguish between the two).

32. Romano v. Merrill Lynch, Pierce, Fenner & Smith, 834 F.2d 523, 530 (5th Cir. 1987). In the 1949 case that established this doctrine, the D.C. Circuit held that because the broker-dealer "acted simultaneously in the dual capacity of investment adviser and of broker and dealer," she "acted as a fiduciary," and "the law has consistently stepped in to provide safeguards in the form of prescribed and stringent standards of conduct on the part of the fiduciary." Hughes v. Sec. Exch. Comm'n, 174 F.2d 969, 975 (D.C. Cir. 1949).

Federal courts have also required that broker-dealers establish "a relationship of trust and confidence" when extending fiduciary duty, even when the broker-dealer is not registered as an investment adviser. See, e.g., Avern Tr. v. Clarke, 415 F.2d 1238, 1239–40 (7th Cir. 1969) (dismissing that a fiduciary relationship existed as a matter of law when a jury did not find "a relationship of trust and confidence"). Furthermore, the Second Circuit specified that "the elements of 'reliance and de facto control and dominance' . . . are required to establish a fiduciary relationship." United States v. Skelly, 442 F.3d 94, 99 (2d Cir. 2006) (quoting United States v. Szur, 289 F.3d 200, 210 (2d Cir. 2002)). Finding broker-dealer fiduciary duty is a fact-based inquiry that may also involve consideration of solicitation, lack of inventory, or other business practices. See 2 Louis Loss, Joel Seligman & Troy Paredes, Fundamentals of Securities Regulation 1615–16 (7th ed. 2018).

33. But it is important to note that federal law expressly preempts state law on matters related to broker-dealer capital, margin, and reporting requirements. See National Securities Markets Improvement Act (NSMIA) of 1996, 15 U.S.C. § 78o(i)(1) ("No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements for brokers[] [or] dealers . . . ."). Nonetheless, Congress required the SEC to periodically consult state securities regulators "concerning the adequacy of such requirements." Id.

34. See Arthur B. Laby, Reforming the Regulation of Broker-Dealers and Investment Advisers, 65 Bus. Law. 395, 404 (2010) [hereinafter Laby, Regulation of Broker-Dealers].

35. Id.

number of transactions executed, further blurred the lines.[36] As a result, retail customers became increasingly confused about the distinctions between broker-dealers, investment advisers, and so-called "financial advisors"; a study in 2008 reported that many investors thought all three owed them the same duty.[37] The investor protection concerns that arose from applying a twentieth-century regulatory scheme to a twenty-first-century industry would ultimately motivate the need for Section 913 of the Dodd–Frank Act and Reg BI itself.[38]

2. *The State Law Patchwork.* — The doctrine on broker-dealer fiduciary duty across states is as inconsistent as it is unclear. Professors Michael Finke and Thomas P. Langdon divide state common law into three categories: (1) states that mandate an affirmative fiduciary duty, (2) states that require a limited or heightened duty similar to fiduciary duty, and (3) states that do not impose fiduciary duty.[39] But even such neat categorizations are difficult to maintain and document.

California, Missouri, South Carolina, and South Dakota courts have been clear about uniformly imposing fiduciary duty under common law.[40] The Delaware Supreme Court has also held that "[t]he relationship between a customer and stock broker is that of principal and agent . . . .

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36. Id. at 406 (noting that the transition was motivated by the SEC's aim of reducing churning). Churning is a kind of broker-dealer fraud that "denotes a course of excessive trading through which a broker advances his own interests (*e.g.*, commissions based on volume) over those of his customer." Costello v. Oppenheimer & Co., 711 F.2d 1361, 1367–68 (7th Cir. 1983).

37. See Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi & Farrukh Suvankulov, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers 112 (2008), https://www.rand.org/etc/rand/support/pdfjs/viewer.html?file=/content/dam/rand/pubs/technical_reports/2008/RAND_TR556.pdf [https://perma.cc/58PQ-XVRT] ("Overall, we found that many survey respondents and focus-group participants do not understand key distinctions between investment advisers and broker-dealers—their duties, the titles they use, the firms for which they work, or the services they offer."). The report also notes that survey respondents approach broker-dealers for investment advice due to the more attractive account minimums, industry certifications, and costs—in addition to the general confusion surrounding the use of the title "financial advisor." Id. at 113.

In an early attempt to remedy this issue, the SEC issued a now-invalidated rule in order to clarify that broker-dealers charging fees would not necessarily be subject to the Investment Advisers Act. Certain Broker-Dealers Deemed Not to Be Investment Advisers, 70 Fed. Reg. 20,424, 20,453–54 (Apr. 19, 2005), invalidated by Fin. Plan. Ass'n v. Sec. Exch. Comm'n, 482 F.3d 481 (D.C. Cir. 2007). The D.C. Circuit struck down the rule in 2007 because it found the Investment Advisers Act exemption, which the SEC regulation was interpreting, to be unambiguous. See *Fin. Plan. Ass'n*, 482 F.3d at 493.

38. See infra section I.B.

39. Michael Finke & Thomas P. Langdon, The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice, J. Fin. Plan., Dec. 2019, at 98, 102.

40. See Hobbs v. Bateman Eichler, Hill Richards, Inc., 210 Cal. Rptr. 387, 403 (Ct. App. 1985); State ex rel. PaineWebber, Inc. v. Voorhees, 891 S.W.2d 126, 130 (Mo. 1995); Cowburn v. Leventis, 619 S.E.2d 437, 447 (S.C. 2005); Dinsmore v. Piper Jaffray, Inc., 593 N.W.2d 41, 46 (S.D. 1999).

These obligations at times are described as fiduciary duties of good faith, fair dealing, and loyalty . . . and are limited only by the scope of the agency."[41] The Massachusetts Securities Division filed an administrative complaint under a similar theory, alleging that the respondent failed to meet its fiduciary duty and thus violated a state securities fraud statute.[42] On the other hand, some states, such as New York, presume an arm's-length relationship and subject broker-dealers to fiduciary duty only when contracted for.[43]

Other states have diverged from the rigidity of the Investment Advisers Act exemption and have applied investment adviser fiduciary duty to broker-dealers instead of finding broker-dealer fiduciary duty. Montana and Colorado, for example, have held that a fiduciary relationship arises only if the broker-dealer "has discretion to buy, sell, or otherwise control a client's account."[44] But because discretionary control over investment accounts is within the typical ambit of the investment adviser's role,[45] these decisions can be interpreted as applications of state-level investment adviser

41. O'Malley v. Boris, 742 A.2d 845, 849 (Del. 1999) (footnotes omitted) (citing Sci. Accessories Corp. v. Summagraphics Corp., 425 A.2d 957 (Del. 1980); N.Y. Stock Exch. v. Pickard & Co., 274 A.2d 148 (Del. Ch. 1971)) (comparing these obligations "to the fiduciary duties of corporate directors").

42. See Administrative Complaint at 4–5, 17–18, In re Scottrade, Inc., No. E-2017-0045 (Mass. Sec. Div. filed Feb. 15, 2018), 2018 Mass. Sec. LEXIS 1, at *6–7, *23–25 (sourcing the fiduciary duty in the DOL rule); see also infra notes 64–65 and accompanying text (explaining that the DOL fiduciary rule has since been invalidated).

43. See, e.g., Jordan v. UBS AG, 782 N.Y.S.2d 722, 723 (App. Div. 2004) ("Absent agreement to the contrary, not present here, a broker does not owe fiduciary duties to a purchaser of securities . . . excepting executing trades in accordance with the customer's instructions." (citing Perl v. Smith Barney, 646 N.Y.S.2d 678, 680 (App. Div. 1996); Saboundjian v. Bank Audi (USA), 556 N.Y.S.2d 258, 260–61 (App. Div. 1990))). But see Solomon Cap., LLC v. Lion Biotechnologies, Inc., 98 N.Y.S.3d 26, 29 (App. Div. 2019) (noting that more informal inquiries into the parties' relationship can establish fiduciary duty in underwriting or placement arrangements).

44. Willems v. U.S. Bancorp Piper Jaffray, Inc., 107 P.3d 465, 468 (Mont. 2005); see also Paine, Webber, Jackson & Curtis, Inc. v. Adams, 718 P.2d 508, 517–18 (Colo. 1986) ("[W]e decline to adopt a rule that a stockbroker/customer relationship is, *per se*, fiduciary in nature . . . . [P]roof of practical control of a customer's account by a broker will establish that the broker owes fiduciary duties to the customer with regard to the broker's handling of the customer's account.").

45. SEC, Section 913 Study, supra note 17, at 7 (noting that 91.2% of assets managed by SEC-registered investment advisers were in discretionary accounts). But see id. at 10 (acknowledging that broker-dealers may exercise "limited trading discretion over customer accounts").

fiduciary duty[46] to broker-dealers.[47] One Maine securities administrative decision, for instance, found a heightened duty as a result of the respondent's association with an investment adviser committing similar fraud: "In considering conduct that may be viewed as antithetical to the interests of investors and potentially dishonest, regulators take a broad view."[48] Another decision from Washington, focusing on a state securities registration exemption, held that the broker-dealer respondent "clearly acts in a fiduciary capacity" by also being registered as an investment adviser.[49] But such variation in state law can have mixed effects. While it creates a treacherous and costly regulatory environment for nationwide broker-dealer firms,[50] it allows states to act outside the outdated constraints of federal law and regulate more flexibly than their SEC counterparts.

3. *The FINRA Rules.* — The FINRA rules are the final component of the legal framework regulating broker-dealer conduct. FINRA is a "not-for-profit, self-regulatory organization" tasked by law with overseeing the nation's broker-dealers.[51] Congress passed the Maloney Act four years after the Exchange Act, allowing for the creation of self-regulatory organizations to supplement the SEC's regulatory efforts.[52] FINRA is the only

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46. For example, state administrative decisions in Alabama, California, Colorado, Illinois, Kansas, Kentucky, Maine, Maryland, Missouri, Nevada, New Hampshire, Ohio, Vermont, and West Virginia have all held state-registered investment advisers subject to broad fiduciary obligations under state law. See N. Am. Sec. Adm'rs Ass'n, Supplemental Comment Letter to NASAA's 2018 Consolidated Comments to SEC Proposed Rulemaking: Regulation Best Interest 22 n.40 (Feb. 19, 2019), https://www.sec.gov/comments/s7-07-18/s70718-4947456-178566.pdf [https://perma.cc/N3EP-ME8F].

47. See id. at 22–23; see also Burns v. Prudential Sec., Inc., 857 N.E.2d 621, 635 (Ohio Ct. App. 2006) (outlining the various methods under Ohio law in which broker-dealers can become fiduciaries, guided by "an expansive view of the relationship between a broker and client").

48. See In re N. Atl. Sec., LLC, No. 11-7214-2, 2011 Maine Sec. LEXIS 14, at *29 (Me. Off. of Sec. Feb. 2, 2011) ("Broker-dealers and their agents, while not held to the same fiduciary standard as investment advisers, are held to a high standard of conduct.").

49. In re Templeton Franklin Inv. Servs., Inc., No. O-01695, 1996 Wa. Sec. LEXIS 18, at *5–6 (Wash. Sec. Div. June 25, 1996) (evaluating whether a dually registered investment adviser and broker-dealer falls within a statutory provision exempting a broker-dealer from registration when the purchaser acts in a fiduciary capacity).

50. See, e.g., Sec. Indus. & Fin. Mkts. Ass'n, Comment Letter on Proposed Rules on Regulation Best Interest and Form CRS Customer Relationship Summary 2 (Mar. 29, 2019), https://www.sifma.org/wp-content/uploads/2019/04/s70718-5263945-183727.pdf [https://perma.cc/T57J-T4LH] [hereinafter SIFMA, March 2019 Comment Letter to SEC] (explaining that a state-by-state regulatory approach risks increasing broker-dealer service costs and reducing accessibility).

51. FINRA, 2017 Annual Report, supra note 8, at 1; see also Securities Exchange Act of 1934, 15 U.S.C. § 78o(b)(8) (2018) ("It shall be unlawful for any registered broker or dealer to effect any transaction . . . unless such broker or dealer is a member of a securities association . . . or effects transactions in securities solely on a national securities exchange of which it is a member.").

52. See Maloney Act, 15 U.S.C. § 78o-3(a); see also Laby, Regulation of Broker-Dealers, supra note 34, at 402.

such national securities association registered with the SEC,[53] and it enjoys rulemaking authority that binds registered broker-dealers.[54]

The rule most pertinent to broker-dealers is FINRA Rule 2111 on suitability, requiring that "[a] member . . . must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security . . . is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile."[55] Underpinning the rule is a "fundamental responsibility of fair dealing," but that duty is too narrow to address situations where broker-dealers offer conflicted advice that otherwise suits the client's investment needs.[56] Furthermore, whereas FINRA has its own adjudication and arbitration process,[57] state regulators that do not expressly impose fiduciary duty on broker-dealers can and do enforce standards that exceed the FINRA suitability rule.[58]

B. *The Current Regulatory Environment*

In 2010, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act with the intention of overhauling the securities industry to contain the financial turmoil of 2008.[59] In Section 913,

53. SEC, Section 913 Study, supra note 17, at 47 n.198.

54. See, e.g., 15 U.S.C. §§ 78c(a)(28), 78o-3(a).

55. FINRA Rules Section 2111: Suitability, FINRA, https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111 [https://perma.cc/ELR3-36Z7] (last updated June 30, 2020). Three core obligations comprise the so-called suitability rule: (1) the reasonable basis obligation, "requir[ing] a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least *some* investors"; (2) the customer-specific obligation, "requir[ing] that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile"; and (3) the quantitative stability obligation, "requir[ing] a [FINRA] member . . . to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile." Id.

56. Id. FINRA has suggested that the suitability rule encompasses violations of best interest: "[T]he suitability rule and the concept that a broker's recommendation must be consistent with the customer's best interests are inextricably intertwined." FINRA, Regulatory Notice 12-25, at 3–4 (2012), https://www.finra.org/sites/default/files/NoticeDocument/p126431.pdf [https://perma.cc/YHA7-9NDR] (noting that while "[a] broker whose motivation for recommending one product over another was to receive larger commissions" is a violation of Rule 2111, suitability "does not obligate a broker to recommend the 'least expensive' security or investment strategy").

57. See Adjudications & Decisions, FINRA, https://www.finra.org/rules-guidance/adjudication-decisions [https://perma.cc/J66K-RPR6] (last visited Jan. 19, 2020).

58. See Finke & Langdon, supra note 39, at 102.

59. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered titles of the U.S.C.); Baird Webel, Cong. Rsch. Serv., R41350, The Dodd–Frank Wall Street Reform and Consumer Protection Act: Issues and Summary 1 (2010).

Congress addressed broker-dealer standards of conduct in two steps: first, by requiring the SEC to conduct a study (the "Section 913 Study"),[60] and second, by delegating to the Commission the rulemaking authority to define a new standard of conduct.[61] The SEC addressed the first step quickly. The Section 913 Study, released in 2011, offered two main recommendations: (1) a uniform fiduciary standard no less stringent than the investment adviser fiduciary duty to apply to both investment advisers and broker-dealers when providing personalized investment advice to retail customers, and (2) further harmonization of the regulation of broker-dealers and investment advisers.[62] The study emphasized that "many retail investors do not understand . . . the different standards of care applicable to investment advisers and broker-dealers," referencing the industry trend towards blurring investment adviser and broker-dealer distinctions.[63]

It took much longer for the SEC to implement the second step through Reg BI. In the meantime, the Department of Labor issued a "fiduciary rule" in 2016 that subjected brokers to fiduciary duty when providing recommendations to participants in retirement plans.[64] The Fifth Circuit struck down the DOL rule on the reasoning that it violated the Employee Retirement Income Security Act (ERISA) definition of fiduciary, which uses the trust and confidence test under common law.[65] Nonetheless, the brief policy experiment that was the DOL rule prompted studies to analyze its effects on broker-dealers, which the SEC later referenced to justify forgoing a fiduciary duty.[66] Once the SEC implemented Reg BI in 2019, it concluded a decade-long debate between roughly two camps: those who had advocated the imposition of fiduciary duty in order

60. See § 913(b)–(c), 124 Stat. at 1824–27.

61. See id. § 913(f)–(g). But see infra note 107 and accompanying text (explaining why the scope of rulemaking authority granted to the SEC has been controversial).

62. SEC, Section 913 Study, supra note 17, at v–x. The latter harmonization recommendation refers to more ancillary protections, such as regulations on advertising, use of finders and solicitors, regulatory supervision, licensing, and books and records. Id. at viii–ix.

63. Id. at 94; see also supra notes 34–38 and accompanying text.

64. John J. Topoleski & Gary Shorter, Cong. Rsch. Serv., R44884, Department of Labor's 2016 Fiduciary Rule: Background and Issues 9 (2017); see also Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,997 (Apr. 8, 2016) (codified at 17 C.F.R. parts 2509–2510, 2550 (2018)), invalidated by Chamber of Com. v. U.S. Dep't of Lab., 885 F.3d 360, 368–69 (5th Cir. 2018).

65. *Chamber of Com.*, 885 F.3d at 368–69. The court found it unambiguous that the term "fiduciary" in the ERISA statute referred to the common law definition of "trust and confidence"; the DOL's interpretation of the scope of fiduciary duty included broker-dealers and insurance agents, whose relationship did not reach the level of fiduciary under common law. See id. at 369–71. The DOL rule failed to overcome the common law presumption, conflicted with the plain meaning of the statutory text, and was inconsistent with other prongs of the ERISA fiduciary definition. See id. at 372, 376.

66. See infra notes 176–181 and accompanying text; see also Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,322 nn.33–34 (July 12, 2019) (codified at 17 C.F.R. § 240.15*l*-1 (2020)).

to maximize consumer protection[67] and those who had feared that imposing such a duty would undermine the ends it sought to achieve by severely limiting consumer access to investment services.[68] Section I.B.1 summarizes the main provisions of Reg BI and documents industry and congressional responses. Section I.B.2 then focuses on the pattern of state dissent following Reg BI's initial proposal.

1. *The Best Interest Obligation.* — Reg BI did not implement a uniform fiduciary standard as the Section 913 Study had recommended. But the SEC still sought to meet Congress's mandate of clarifying broker-dealer standards of conduct, defining its "Best Interest Obligation" as:

> A broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, shall act in the *best interest* of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.[69]

Meeting this best interest duty requires satisfaction of four component obligations:[70] disclosure,[71] care,[72] conflict of interest,[73] and compliance.[74] Importantly, the best interest obligation does not "require a broker-dealer to provide conflict-free recommendations," allowing broker-dealers to recommend a more self-remunerative investment product if other factors counsel that the product is indeed in the best interest of the retail customer.[75]

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67. See, e.g., Jackson, supra note 1.

68. See, e.g., Clayton, Reg BI Statement, supra note 19. As section III.B.3 of this Note discusses, the conclusion of this debate was premature.

69. Regulation Best Interest, 17 C.F.R. § 240.15*l*-1(a)(1) (emphasis added).

70. Regulation Best Interest, 84 Fed. Reg. at 33,320.

71. 17 C.F.R. § 240.15*l*-1(a)(2)(i) (requiring the written disclosure of all material facts "relating to the scope and terms of the relationship" and "relating to conflicts of interest that are associated with the recommendation").

72. Id. § 240.15*l*-1(a)(2)(ii) (requiring the exercise of "reasonable diligence, care, and skill" when recommending a particular investment product to a customer).

73. Id. § 240.15*l*-1(a)(2)(iii) (requiring the establishment, maintenance, and enforcement of written policies regarding conflicts of interest).

74. Id. § 240.15*l*-1(a)(2)(iv) (requiring general compliance with Reg BI).

75. Regulation Best Interest, 84 Fed. Reg. at 33,331. The uniform fiduciary duty under the Section 913 Study would have required broker-dealers "to act in the best interest of the customer *without regard to* the financial or other interest of the broker, dealer, or investment adviser providing the advice." SEC, Section 913 Study, supra note 17, at 110 (emphasis added). The SEC refused to use this language in Reg BI because it was concerned that it would be construed to mean that all broker-dealer advice would have to be conflict-free; as the SEC itself notes, this change does not diverge from the investment adviser duty of loyalty, which is a component of fiduciary duty. See Regulation Best Interest, 84 Fed. Reg. at 33,332.

The SEC also expressly states that Reg BI is not a fiduciary standard, even though the "standard draws from key fiduciary principles," because the term "fiduciary" does not sufficiently describe the Reg BI standard and may introduce additional legal and compliance ambiguity.[76] The commentary also reasons that a uniform standard would fail to accommodate the inherent business model of broker-dealers and existing FINRA rules.[77] But Reg BI still suggests a lesser degree of uniformity: "[R]egardless of whether a retail investor chooses a broker-dealer or investment adviser . . . , the retail investor will be entitled to a recommendation . . . or advice . . . in the best interest of the retail investor . . . ."[78]

When compared to the DOL fiduciary rule, what Reg BI lacks in weight it gains in breadth; but it fails to mitigate investor confusion and simplify the broker-dealer regulatory regime. Reg BI expands beyond retirement accounts, regulates all broker-dealers, and mandates rigorous disclosure requirements.[79] Nonetheless, the true nature of this standard is unclear from the regulation's text: Beyond knowing that "best interest" is conduct that, at the very least, prevents a broker-dealer from placing another entity's interest ahead of the retail investor, the term "best interest" is never actually defined.[80] Public reaction to Reg BI, while

76. Regulation Best Interest, 84 Fed. Reg. at 33,333. While the SEC notes that such a heightened duty towards customers brings the broker-dealer duty of care closer to the fiduciary standard of investment advisers, the Commission makes explicit that "each rule and interpretation stands on its own and enhances the effectiveness of existing rules." Id. at 33,321 & n.22.

77. See id. at 33,322 ("Adopting a 'one size fits all' approach would risk reducing investor choice and access to existing products, services, service providers, and payment options, and would increase costs for firms and for retail investors in both broker-dealer and investment adviser relationships.").

78. Id. at 33,321.

79. Compare Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,997 (Apr. 8, 2016) (codified at 17 C.F.R. parts 2509–2510, 2550) (limiting the definition of a fiduciary to "a person . . . rendering investment advice with respect to moneys or other property of a plan or IRA"), invalidated by Chamber of Com. v. U.S. Dep't of Lab., 885 F.3d 360, 368–69 (5th Cir. 2018), with 17 C.F.R. § 240.15*l*-1(a)(1) (broadening the scope to "a broker, dealer, or [associate] . . . making a recommendation of *any* securities transaction or investment strategy involving securities . . . to a retail customer" (emphasis added)).

80. Regulation Best Interest, 84 Fed. Reg. at 33,491–92. But Reg BI does go beyond the FINRA Suitability Rule because, unlike the latter, Reg BI prohibits broker-dealers from recommending investment products that are not in the client's best interest yet still meet the client's general investment profile. See Dalia Blass, Dir., Div. of Inv. Mgmt., SEC, Remarks at the PLI Investment Management Institute 2018 (Apr. 30, 2018), https://www.sec.gov/news/speech/blass-remarks-pli-investment-management-institute-2018 [https://perma.cc/9A93-WXJ7] ("Reg. BI incorporates, but goes beyond suitability, in that it covers disclosure, care, and conflict obligations . . . . These obligations are key enhancements that cannot be satisfied by disclosure alone, that place greater emphasis on the importance of costs and financial incentives, and that could be directly enforced by the Commission.").

mixed, reflected widespread confusion with the expectations of Reg BI.[81] Some of the early literature on Reg BI even argued that the four component subobligations essentially give rise to a fiduciary duty to retail investors.[82] In Congress, the reception of Reg BI was split along partisan lines, focusing on disagreement as to whether the rule went far enough to protect retail investors nationwide.[83] While industry experts expect forthcoming information from the SEC about compliance with Reg BI and industry best practices,[84] the rule has raised a number of questions about its scope and effects that so far remain difficult to define, let alone answer.

2. *State Dissent and Legislation.* — One question in particular asks whether Reg BI's passage preempts state common law, statutes, and regulations on broker-dealer conduct. Notably, several states have proposed or issued new measures to contain the effects of what they perceived as agency failure to protect investors from shifting industry trends. Arguing that "imposing a fiduciary duty . . . protects investors against the abuses that can result when financial professionals place their own interests above those of their customers, will help to reduce investor

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81. See, e.g., Jamie Hopkins, SEC Brings Increased Confusion for Investors with New 'Best Interest' Rule, Forbes (June 5, 2019), https://www.forbes.com/sites/jamiehopkins/2019/06/05/sec-brings-increased-confusion-for-investors-with-new-best-interest-rule/#5d923ec4270b [https://perma.cc/MP4G-SQRT] ("Not only does this rule fail to expand consumer protections and add clarity to the broker vs. advisor roles, it allows brokers to continue business as usual by adding confusion to the market."); Venetia Woo, SEC Passes Regulation Best Interest, Accenture (July 30, 2019), https://financeandriskblog.accenture.com/regulatory-insights/regulatory-alert/sec-passes-regulation-best-interest [https://perma.cc/4ZYL-APX4] (noting that the SEC's new rules are expected to "generally expand the higher standard of care to everyone providing investment advice," but that investor advocates have criticized the rule for being "still too vague in its definition of 'best interest'").

82. See, e.g., D. Bruce Johnsen, A Transaction Cost Assessment of SEC Regulation Best Interest, 2018 Colum. Bus. L. Rev. 695, 698; Daniel P. Guernsey, Jr., Note, Requiring Broker-Dealers to Disclose Conflicts of Interest: A Solution Protecting and Empowering Investors, 73 U. Miami L. Rev. 1029, 1044 (2019).

83. Representative Maxine Waters, a top Democrat and chairman of the House Financial Services Committee, said Reg BI failed to implement "a strong, uniform, fiduciary standard of care when providing investors with investment advice." Katanga Johnson, U.S. SEC Adopts Rules to Prevent Broker Conflicts, Boost Disclosure, Reuters (June 5, 2019), https://www.reuters.com/article/us-usa-sec-bestinterest/u-s-sec-adopts-rules-to-prevent-broker-conflicts-boost-disclosure-idUSKCN1T617O [https://perma.cc/D8MC-HXTW] (internal quotation marks omitted); see also Patrick Temple-West, Warren, Waters Blast SEC Financial Advice Rule as Wall Street Cheers, Politico (June 5, 2019), https://www.politico.com/story/2019/06/05/warren-waters-blast-sec-financial-advice-rule-as-wall-street-cheers-1507335 [https://perma.cc/GGA2-29XW] (reporting that Democratic Senator Elizabeth Warren believed the new rule would "make it easier for Wall Street to cheat families out of their hard-earned life savings," while Republican Senator Mike Crapo concluded that the SEC "diligently crafted the appropriate balance" between investor protection and access to services (internal quotation marks omitted)).

84. See, e.g., Kellum et al., supra note 13, at 5 (advising broker-dealers to develop and adjust their own firm-specific interpretations of the rule as the SEC incrementally releases guidance and industry best practices).

confusion, and will work to foster public confidence in the financial profession," New Jersey regulators proposed a regulation implementing fiduciary duty on April 15, 2019.[85] The state's Bureau of Securities also made the determination that New Jersey's interest in investor protection outweighs increased costs from the heightened duty.[86] On June 14, 2019, the Massachusetts Securities Division of the Office of the Secretary, citing the SEC's failure "to define the key term 'best interest' . . . [and] to indicate whether some of the most problematic practices in the securities industry would be prohibited" under Reg BI, proposed a similar state regulation imposing fiduciary duty on broker-dealers.[87]

In addition to Massachusetts and New Jersey, Connecticut,[88] Nevada,[89] and New York[90] have either legislated or issued proposed regulations that could exceed, to varying degrees, the SEC's best interest obligation.[91]

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85. Rule Proposal: 51 N.J.R. 493(a), N.J. Div. of Consumer Affs. (Apr. 15, 2019), https://www.njconsumeraffairs.gov/Proposals/Pages/bos-04152019-proposal.aspx [https://perma.cc/ZT8P-RQZ4] [hereinafter N.J. Proposed Fiduciary Rule]. New Jersey Attorney General Gurbir Grewal has also stated, "We try to pre-empt the pre-emption arguments." Gabriel T. Rubin, States Pursue Their Own Broker-Conduct Rules, Wall St. J. (Apr. 19, 2019), https://www.wsj.com/articles/states-pursue-their-own-broker-conduct-rules-11555666200 (on file with the *Columbia Law Review*) (internal quotation marks omitted).

86. N.J. Proposed Fiduciary Rule, supra note 85.

87. Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, William Francis Galvin, Sec'y of the Commonwealth of Mass. (June 14, 2019), https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/fiduciaryconductstandardidx.htm [https://perma.cc/H6JK-58JG] [hereinafter Mass. Proposed Fiduciary Rule].

88. See Conn. Gen. Stat. § 7-464c (2019) (requiring heightened disclosures for companies administering a non-ERISA "retirement plan offered by a political subdivision of the state to the employees of such political subdivision").

89. See Nev. Rev. Stat. §§ 90-575, 628A-020 (2019) ("A broker-dealer . . . shall not violate the fiduciary duty toward a client . . . ."); see also Erin Houston & Diana J. Foley, State of Nev. Off. of the Sec'y of State, Notice of Draft Regulations and Request for Comment 1–8 (Jan. 18, 2019), https://www.nvsos.gov/sos/home/showdocument?id=6156 [https://perma.cc/EN8R-V48B] (proposing regulations to clarify the circumstances that constitute a breach of fiduciary duty).

90. See N.Y. Comp. Codes R. & Regs. tit. 11, § 224.4 (2020) ("Only the interests of the consumer shall be considered in making the recommendation. The producer's receipt of compensation or other incentives . . . is permitted . . . provided that the amount of the compensation or the receipt of an incentive does not influence the recommendation . . . ."); Press Release, Dep't of Fin. Servs., DFS Issues Final Life Insurance and Annuity Suitability Regulation Protecting Consumers from Conflicts of Interest (July 18, 2018), https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1807181 [https://perma.cc/MK3X-8JMU] (focusing the New York best-interest rule on only those broker-dealers "licensed to sell life insurance and annuity products"). A group of insurance agents and brokers challenged the regulation as arbitrary and capricious, but the trial court found for the state. See Indep. Ins. Agents & Brokers of N.Y. v. N.Y. State Dep't of Fin. Servs., 109 N.Y.S.3d 574, 584–85 (Sup. Ct. 2019).

91. Illinois and Maryland have also considered similar legislation, but bills in those states have either failed or been postponed indefinitely. See H.B. 4753, 100th Gen. Assemb.

These states now join California, Missouri, South Carolina, and South Dakota, where common law already imposes a fiduciary duty on all broker-dealers,[92] and other states in which courts have upheld a limited fiduciary standard.[93] In addition to this legislative dissent, eight state attorneys general filed suit in federal court in September 2019, arguing that Reg BI was contrary to the SEC's statutory authority.[94] Nonetheless, the Second Circuit recently rejected the claim, holding that the SEC was well within its authority to promulgate Reg BI.[95]

Unlike private interest groups or industry giants, states are unique and important dissenters in the federal system because they are held politically accountable.[96] Their usage of traditional police powers and the federal judiciary disrupts the status quo of the broker-dealer regulatory framework and challenges the complicated quasi-fiduciary standard of Reg BI. Most importantly, their dissent paves the way for a dispute in the federal courts about the nature and boundaries of the state–agency relationship in this new era of broker-dealer regulation.

II. THE STATE–AGENCY CONFLICT

Two sources of authority are in conflict: the SEC's authority, delegated by Congress through Section 913 of the Dodd–Frank Act, and states' authority, acknowledged by Congress in the National Securities Markets Improvement Act (NSMIA).[97] To determine which one prevails, section II.A introduces the federal common law doctrine of preemption, identifies conflict preemption as the theory most applicable to Reg BI, and concludes that Reg BI is unlikely to sweepingly preempt all state laws on broker-dealer conduct. Section II.B then argues that interpreting Reg BI as setting a regulatory ceiling conflicts with the congressional objectives behind Section 913. But when determining the scope of conflict with state law, courts look to not only the objective of the federal law but also the

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(Ill. 2018); Brian Croce, Maryland Fiduciary Standard Proposal Rejected in Committee, Pensions & Invs. (Apr. 4, 2019), https://www.pionline.com/article/20190404/ONLINE/190409900/maryland-fiduciary-standard-proposal-rejected-in-committee [https://perma.cc/Q6M9-N3D4]. In Maryland, industry stakeholders argued to lawmakers that the bill would increase costs for advisers, limit services to investors, and interfere with Reg BI. Croce, supra.

92. See supra note 40 and accompanying text.

93. See supra notes 41–42 and accompanying text.

94. Complaint at 31–32, New York v. Sec. Exch. Comm'n, No. 1:19-cv-08365 (S.D.N.Y. filed Sept. 9, 2019). In the alternative, the state attorneys general alleged that Reg BI conflicted with other provisions of the Dodd–Frank Act and was an arbitrary and capricious exercise of rulemaking authority. Id. at 32–33.

95. See XY Plan. Network, LLC v. Sec. Exch. Comm'n, 963 F.3d 244, 253–55 (2d Cir. 2020); see also infra note 107 (summarizing the court's reasoning for rejecting all claims).

96. See Gillian E. Metzger, Federalism and Federal Agency Reform, 111 Colum. L. Rev. 1, 71–72 (2011) [hereinafter Metzger, Federal Agency Reform].

97. See supra note 33 and accompanying text.

method of executing that law.[98] And states that clear the preemption floor may still be preempted unless they cohere with Congress's prescribed method. This Part concludes by noting the difficulty in determining whether state laws and congressional methods are aligned and leaves the solutions to this problem for Part III.

A. *Framing the Preemption Problem*

"A fundamental principle of the Constitution is that Congress has the power to preempt state law."[99] Because this power belongs to Congress, a federal regulation may preempt state law only if the relevant agency acts "within the scope of its congressionally delegated authority."[100] Whereas express delegation of preemptive authority to an agency is sufficient to invalidate state laws, the lack of such express delegation does not foreclose preemption,[101] and it is up to the courts to make independent determinations of preemptive effect.[102] In conducting this independent determination, the Supreme Court has identified two cornerstones of preemption jurisprudence.[103] "First, 'the purpose of Congress is the ultimate

98. See Hines v. Davidowitz, 312 U.S. 52, 67 n.20 (1941).

99. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 372 (2000) (citations omitted); see also U.S. Const. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . .").

100. La. Pub. Serv. Comm'n v. Fed. Commc'ns Comm'n, 476 U.S. 355, 373–75 (1986) (holding that the FCC did not preempt a state law partly because the agency was acting outside the scope of power that Congress had delegated and stressing that "[a]n agency may not confer power to itself"); see also Geier v. Am. Honda Motor Co., 529 U.S. 861, 867 (2000) (looking at the authorizing statute to determine preemption); Hillsborough County v. Automated Med. Lab'ys, 471 U.S. 707, 715–16 (1985) (explaining that field preemption principles apply to federal regulations since the FDA acted "pursuant to congressional delegation"). But a subsequent Supreme Court decision, Wyeth v. Levine, 555 U.S. 555 (2009), slightly complicated things: While the majority in *Wyeth* was largely silent on the "extent to which federal administrative regulations with the force of law . . . can preempt state law," at least four justices in that case reaffirmed the principle in *Geier* that substantive federal regulations can preempt state law. See Metzger, Federal Agency Reform, supra note 96, at 13–14 nn.52–53.

101. See *Wyeth*, 555 U.S. at 609 (Alito, J., dissenting); *Geier*, 529 U.S. at 869 (narrowing the scope of an express preemption clause but holding that the narrowed scope "does not bar the ordinary working of conflict preemption principles"). Some scholars have argued for requiring express delegation in order to find a regulation to be preemptive, see, e.g., Nina A. Mendelson, A Presumption Against Agency Preemption, 102 Nw. U. L. Rev. 695, 699 (2008), but Professor Gillian Metzger has noted the "extraordinary obstacles to federal administrative governance" that such a requirement would impose, see Gillian Metzger, Administrative Law as the New Federalism, 57 Duke L.J. 2023, 2071–72 (2008).

102. See *Wyeth*, 555 U.S. at 576. A court may grant some weight to an agency's explanation of the effect of state laws on federal objectives, but that weight depends on the "thoroughness, consistency, and persuasiveness" of the agency's underlying reasoning. Id. at 576–77.

103. Id. at 565.

touchstone in every pre-emption case.'"[104] Second, if Congress legislated in an area that "the States have traditionally occupied," courts assume that "the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."[105]

Of course, success on an administrative legal challenge to Reg BI—that the SEC acted outside its statutory authority, as the petitioners in *XY Planning Network, LLC v. SEC* tried to show—would have invalidated the rule and precluded any possibility of preemption.[106] But given that the rule still stands, and for good reason,[107] the first question in evaluating the preemptive effect of Reg BI is whether Congress expressly delegated preemptive authority to the SEC.[108] While Section 913 of the Dodd–Frank

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104. Id. (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996)).

105. Id. (internal quotation marks omitted) (quoting *Medtronic, Inc.*, 518 U.S. at 485).

106. See XY Plan. Network, LLC v. Sec. Exch. Comm'n, 963 F.3d 244, 253–55 (2d Cir. 2020).

107. The controversy arises from comparing subsection 913(f), which states the SEC "may commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers" without specifying the nature of the underlying standard of care, with subsection 913(g), which amends the Exchange Act and Investment Advisers Act to authorize an SEC rule that establishes fiduciary duty for broker-dealers identical to that of investment advisers. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(f)–(g), 124 Stat. 1376, 1827–29 (2010) (codified as amended in scattered titles of the U.S.C.). The SEC argues that the subsections provide "overlapping, yet distinct, rulemaking power"; the Commission expressly grounds Reg BI in subsection 913(f) as well as a host of provisions in the Exchange Act, such as subsection 15(c)(6). See Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,329–30, 33,491 (July 12, 2019) (codified at 17 C.F.R. § 240.15*l*-1 (2020)); see also Securities Exchange Act of 1934, 15 U.S.C. § 78o(c)(6) (2018) (authorizing SEC rule-making for investor protection from broker-dealer misconduct in inducing or effectuating securities transactions).

The Second Circuit relied on text and legislative history in agreeing that the SEC had the authority to promulgate Reg BI. First, the court noted that the use of "may" in subsection 913(f) indicated that Congress had "delegated to the SEC broad, discretionary authority, which the SEC lawfully exercised by promulgating Regulation Best Interest." *XY Plan.*, 963 F.3d at 253. Second, subsection 913(g) "is not superfluous because it clarifies that the SEC could have promulgated a uniform fiduciary standard." Id. at 253–54 (citing Skilling v. United States, 561 U.S. 358, 413 n.45 (2010)). Finally, the Second Circuit reaffirmed this textual reading using legislative history, noting that subsections 913(f) and (g) were a result of merging the independent House and Senate bills. See id. at 254 & n.8 ("The independent origins of Sections 913(f) and (g) thus support the interpretation that they are freestanding grants of rulemaking authority, not interdependent provisions that limit one another."); see also infra note 161 and accompanying text.

The court also rejected petitioners' final claim that Reg BI was arbitrary and capricious, concluding that the SEC gave "'adequate reasons for its decision[]' to prioritize consumer choice and affordability over the possibility of reducing consumer confusion, and it supported its findings with 'substantial evidence.'" *XY Plan.*, 963 F.3d at 257 (alteration in original) (first quoting Nat'l Res. Def. Council, Inc. v. Env't Prot. Agency, 961 F.3d 160, 170 (2d Cir. 2020); then quoting Fund for Animals v. Kempthorne, 538 F.3d 124, 132 (2d Cir. 2008)).

108. This Note analyzes Reg BI's preemptive threat to state statutes. The only other federal law that may potentially preempt state laws is NSMIA. In a comment letter to Nevada

Act acknowledges the presence of state laws on broker-dealer standards of conduct, it does not include an express provision authorizing preemption.[109] The lack of express authority, however, does not entirely rule out implied preemption; the party seeking preemption "must thus present a showing of implicit pre-emption . . . that is strong enough to overcome the presumption that state and local regulation . . . can constitutionally coexist with federal regulation."[110]

This leads to the second question, which is whether the presumption against preemption applies at all. Because the federal courts and Congress agree that "federal law does not enjoy complete preemptive force in the field of securities" and "Congress has expressly preserved the role of the states in securities regulation," the presumption against preemption remains in place.[111] Therefore, any of the following constituent theories of implied preemption will have to overcome the weight afforded to the states' historic and long-exercised powers in broker-dealer regulation.[112] Section II.A.1 narrows down the routes to preemption, arguing that conflict preemption is most relevant to Reg BI. And under this conflict preemption theory, section II.A.2 evaluates and dismisses the outcome where Reg BI sweepingly preempts all state laws on broker-dealer conduct.

1. *Determining the Appropriate Preemption Theory.* — A court may find implied preemption in at least two circumstances:[113] field preemption, "[w]hen Congress intends federal law to 'occupy the [sic] field'" of legislation of a particular subject matter,[114] and conflict preemption, when "state law is naturally preempted to the extent of any conflict with a federal statute."[115] The latter doctrine arises in one of two ways: impossibility

securities regulators in response to the promulgation of a draft fiduciary rule, the Securities Industry and Financial Markets Association (SIFMA) argued that NSMIA already preempted state laws on broker-dealer standards of conduct, but this claim relies on an overly broad interpretation of the NSMIA. See Benjamin P. Edwards, The Fate of State Investor Protection, 21 Transactions: Tenn. J. Bus. L. 213, 222–26 (2020) ("If Congress had wanted to prohibit states from regulating broker-dealer sales practices, a books and records provision would be an odd way to do it.").

109. Dodd–Frank Act § 913 (authorizing the Section 913 Study and SEC's rulemaking on obligations of brokers, dealers, and investment advisers).

110. Hillsborough County v. Automated Med. Lab'ys, 471 U.S. 707, 716 (1985).

111. Baker, Watts & Co. v. Miles & Stockbridge, 876 F.2d 1101, 1107 (4th Cir. 1989); see also Chanoff v. U.S. Surgical Corp., 857 F. Supp 1011, 1015 (D. Conn. 1994), aff'd, 31 F.3d 66 (2d Cir. 1994); supra note 33 and accompanying text.

112. See supra sections I.A.2, I.B.2.

113. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 372 (2000).

114. Id. (quoting California v. ARC Am. Corp., 490 U.S. 93, 100 (1989)) (misquotation); see also Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n, 461 U.S. 190, 216 (1983) (holding that congressional occupation of the field of nuclear energy regulation did not preempt a California law regulating nuclear waste disposal because the state law was motivated by economic concerns).

115. *Crosby*, 530 U.S. at 372.

preemption, "[w]hen compliance with both state and federal law is impossible,"[116] or obstacle preemption, "when the state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"[117]

Field preemption, "a rarely invoked doctrine,"[118] and impossibility preemption are likely unsuitable to the Reg BI analysis. While Congress has legislated extensively in the field of securities law, both section 28(a)(1) of the Exchange Act[119] and section 222(a) of the Investment Advisers Act[120] preserve state jurisdiction in the interstices of federal law. Regarding the narrower field of broker-dealer regulation, the enumerated limitations on state broker-dealer laws in the Exchange Act and the NSMIA indicate that Congress has similarly maintained some state authority.[121] Federal courts have also largely rejected the application of field preemption doctrine to securities law.[122] Because field preemption does not apply, conflict preemption remains as the alternative implied preemption theory. Conflict preemption's impossibility route, however, seems foreclosed here because it is possible for broker-dealers to comply with two duties at once by meeting the more demanding duty.

Reg BI preemption, therefore, must be evaluated under the theory of obstacle preemption. But because a multitude of state laws, both common law and statutory, determine the broker-dealer standard of care at varying degrees, not all state laws present a possible obstacle to the federal regulatory scheme in the same way. Some state laws are more stringent than Reg BI; others are less demanding. This variety in state law prompted Commissioner Robert Jackson to pose the question of whether Reg BI sets a floor or ceiling for broker-dealer regulatory enforcement.[123] The SEC's suggested approach is to evaluate challenges to individual state laws on a

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116. *ARC Am. Corp.*, 490 U.S. at 100 (citing Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142–43 (1963)).

117. Id. at 101 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

118. Movsesian v. Victoria Versicherung AG, 670 F.3d 1067, 1075 (9th Cir. 2012) (citing Von Saher v. Norton Simon Museum of Art at Pasadena, 592 F.3d 954, 963 (9th Cir. 2010)).

119. 15 U.S.C. § 78bb(a)(1) (2018).

120. Id. § 80b-18a.

121. See id. § 78o(i). Furthermore, Section 913 of the Dodd–Frank Act, the most recent expression of congressional intent on broker-dealer obligations, acknowledges the existence of both "Federal and State legal or regulatory standards" of care. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(b)(1), 124 Stat. 1376, 1824 (2010) (codified as amended in scattered titles of the U.S.C.).

122. See, e.g., Whistler Invs., Inc. v. Depository Tr. & Clearing Corp., 539 F.3d 1159, 1165 (9th Cir. 2008) (citing the Exchange Act as evidence of continuing state authority); Baker, Watts & Co. v. Miles & Stockbridge, 876 F.2d 1101, 1107 (4th Cir. 1989) (same); French v. First Union Sec., Inc., 209 F. Supp. 2d 818, 829 (M.D. Tenn. 2002) (finding that "states continue to have control over brokers and securities agents" even after the creation of a centralized registration depository).

123. See Jackson, supra note 1 (arguing that Reg BI set "a federal floor, not a ceiling, for investor protection").

case-by-case basis.[124] But given the similarity of state laws, three potential preemption outcomes[125] neatly categorize instances of state and federal overlap and simplify the conflict preemption analysis.[126]

2. *Dismissing a Sweeping Outcome*. — The first potential outcome of conflict preemption is *full standardization*. Implementing a uniform, nationwide duty would bring all states to the Reg BI median. But such a sweeping conclusion would require a court to find, as the Fourth Circuit put it in a different securities context, "concrete evidence of congressional intent" to take such a "portentous step."[127] While the complexity of the commercial setting and special tailoring of the federal regulation could potentially be factors for finding preemption,[128] the Supreme Court has rejected "the contention that pre-emption is to be inferred merely from the comprehensive character of the federal [law]."[129]

A sweeping outcome is hard to justify here. The Supreme Court has stated that "[t]he 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."[130] Not only has Congress left regulation of broker-dealer standards of care to the states since the inception of the Exchange Act,[131] but also the text of the Dodd–Frank Act reflects an express acknowledgement of a dual, federal–state regulatory system in this area. In fact, Congress directed the SEC to consider "the existing legal or regulatory standards of State securities regulators and other regulators intended to protect retail customers" in the

124. Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,435 n.1163 (July 12, 2019) (codified at 17 C.F.R. § 240.15*l*-1 (2020)).

125. The first preemption outcome, full standardization, is discussed and rejected in section II.A.2. Section II.B introduces the second and third preemption outcomes: the regulatory floor and ceiling theories.

126. This analysis assumes that states can reasonably be grouped together on the basis of sufficiently similar common law doctrines or statutes. Given the substantial similarities among common law doctrines, this method is feasible. See supra section I.A.2. Grouping states together is likely an even easier exercise when evaluating the shared intentions behind state statutes and proposed rules. See supra notes 85–90 and accompanying text.

127. *Baker, Watts & Co.*, 876 F.2d at 1107–08.

128. See Donmar Enters. v. S. Nat'l Bank of N.C., 828 F. Supp. 1230, 1236 (W.D.N.C. 1993) ("[C]ommon law remedies are sometimes inadequately refined to provide a suitable legal framework effectively allocating duties, rights, and ultimately liability for highly specialized commercial settings. This problem is precisely why Regulation J was promulgated."), aff'd, 64 F.3d 944 (4th Cir. 1995).

129. N.Y. State Dep't of Soc. Servs. v. Dublino, 413 U.S. 405, 415 (1973) (citing 42 U.S.C. §§ 602(a)(19), 630 et seq. (1970 & Supp. I 1971)).

130. Wyeth v. Levine, 555 U.S. 555, 575 (2009) (internal quotation marks omitted) (quoting Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 166–67 (1989)).

131. See supra section I.A.

Section 913 Study;[132] it further directed the Commission to study "the impact on Commission and State resources" if the broker-dealer exception to the Investment Advisers Act were removed.[133] The statutory text does not substantiate an intention to sweepingly preempt state authority.

The legislative history on the preemption point—notably, the lack thereof—similarly counsels against the full standardization outcome. The initial House version of Section 913 lacks the word "state" altogether;[134] the Senate version of Section 913 discusses state law insofar as it is relevant to the SEC's study on the efficacy of the broker-dealer regulatory framework.[135] After the two bills were combined into the final version, neither the House nor the Senate discussed Section 913's potential preemption of state law in the ensuing debate over the legislation.[136]

The limited evidence of congressional intent is thus likely insufficient to overcome the presumption against preemption. But more limited preemption outcomes that preserve the dual regulatory regime may still be justifiable. Nothing in the text of Section 913 precludes the SEC from modifying state standards.[137] The fact that Congress directed the SEC to consider the findings of the Section 913 Study—which included the effects of state regulation—in the rulemaking process may further suggest that Congress impliedly allowed the SEC to limit the scope of state law in the broker-dealer regulatory field.[138] The two preemption outcomes section II.B presents better comport with the dual regulatory regime while recognizing the significance of Congress's grant of rulemaking power to the SEC.

B. *Evaluating the Conflict*

Having established that evidence of congressional intent to sweepingly preempt state authority is scant, the central question becomes whether Reg BI sets a regulatory floor or ceiling—or does not preempt at all. This section ultimately argues that Reg BI most plausibly sets a *regulatory floor*, the second preemption outcome.

In this outcome, Reg BI would preempt state laws that require a lower duty to retail investors than that of best interest. These would potentially

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132. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(c)(8), 124 Stat. 1376, 1826 (2010) (codified as amended in scattered titles of the U.S.C.).

133. Id. § 913(c)(10)(C).

134. See H.R. 4173, 111th Cong. § 7103 (as passed by House, Dec. 11, 2009).

135. See id. § 913 (as amended by Senate, May 20, 2010).

136. See 156 Cong. Rec. 13,133–266 (2010) (Senate discussion); see also id. at 12,428–62 (House discussion).

137. See Dodd–Frank Act § 913.

138. See id. § 913(f) ("The Commission shall consider the findings conclusions, and recommendations of the study required under subsection (b).").

include state laws that merely implement the FINRA suitability standard[139] or standard duties of good faith in arm's-length relationships.[140] The Supreme Court has acknowledged such an outcome of conflict preemption.[141] One district court has even found the floor outcome in the broker-dealer registration context: In *French v. First Union Securities, Inc.*, the court held that the Central Registration Depository, a securities registration mechanism created by FINRA's predecessor under the auspices of the SEC, "represents the minimum duties that the federal government requires—a floor, rather than a ceiling."[142] The decision allowed state and local governments to implement heightened registration requirements of their own. Commissioner Jackson, concerned with Reg BI's potential obstruction of state experimentation, similarly advocated interpreting Reg BI as a floor, not ceiling, of state regulation.[143]

The third and final preemption outcome is setting a *regulatory ceiling*. Under this regime, Reg BI would preempt only those laws that set a standard more onerous than that of best interest—specifically, those that require a fiduciary standard by common law or statute.[144] To be clear, state common law that provides remedy for a breach of less-demanding broker-dealer duty would remain to supplement, but not abrogate, the federal Reg BI requirement. The Supreme Court has affirmed the outcome of setting preemption ceilings,[145] and the Securities Industry and Financial Markets Association (SIFMA), the leading trade association for broker-dealers, has adopted a position on Reg BI consistent with this preemption doctrine.[146] Ultimately, section II.B.1 concludes that the regulatory ceiling

139. See supra note 58 and accompanying text.

140. See supra note 43 and accompanying text.

141. See, e.g., Geier v. Am. Honda Motor Co., 529 U.S. 861, 868 (2000) (interpreting the National Traffic and Motor Vehicle Safety Act of 1966 as a floor in order to leave "adequate room for state tort law to operate").

142. 209 F. Supp. 2d 818, 829 (M.D. Tenn. 2002).

143. See Jackson, supra note 1.

144. See supra notes 86–92 and accompanying text.

145. See, e.g., Ark. Dep't of Health & Hum. Servs. v. Ahlborn, 547 U.S. 268, 282–84 (2006) (holding that the federal Medicaid statute set both lower and upper limits on each state's share of the tort recovery of a beneficiary); Exxon Corp. v. Eagerton, 462 U.S. 176, 186 (1983) (holding states could set price ceilings for intrastate gas producers lower than the federal price ceiling imposed by the Natural Gas Policy Act of 1978).

146. SIFMA has consistently testified before state legislatures and has sent letters to state regulatory agencies, arguing that states should not adopt fiduciary rules more onerous than Reg BI. See, e.g., Press Release, SIFMA, SIFMA Comments on Massachusetts Fiduciary Rule Proposal (July 26, 2019), https://www.sifma.org/resources/news/sifma-comments-on-massachusetts-fiduciary-rule-proposal [https://perma.cc/9G3C-ZHUM]; Press Release, SIFMA, SIFMA Testimony on New Jersey Fiduciary Rule Proposal (July 17, 2019), https://www.sifma.org/resources/news/sifma-testimony-on-new-jersey-fiduciary-rule-proposal [https://perma.cc/PXQ3-C4KL]. While SIFMA has generally disapproved of a "state-by-state" approach, it has not explicitly addressed the variety in state common law standards below the Reg BI threshold. See, e.g., SIFMA, March 2019 Comment Letter to SEC, supra note 50, at 2.

outcome contravenes Congress's objectives underpinning Section 913 of the Dodd–Frank Act. Section II.B.2, however, argues that even if state fiduciary rules clear the preemption floor, they must cohere with Congress's intended methods of execution in Section 913 in order to survive preemption.[147]

1. *Considering Congressional Objectives.* — In determining whether Reg BI sets a preemptive floor or ceiling, one question is central to the obstacle preemption analysis: Do certain kinds of state laws on broker-dealer conduct pose an "obstacle to the accomplishment and execution of the full purposes and objectives of Congress"?[148] Answering this question requires defining not only the full purposes of Congress but also each category of state standards on broker-dealer conduct. Those more stringent than Reg BI, as well as those less demanding, must pass muster as consistent with congressional objectives.

One of Congress's overarching aims when passing the Dodd–Frank Act was, as Senator Chris Dodd put it, "to fix [the] regulatory system to

147. In addition to an independent analysis, federal courts sometimes look to an agency's explanation of state laws' effects on the federal regulatory scheme for guidance. See supra note 102. But in the case of Reg BI, a court is likely to assign little to no weight to the SEC's explanation for two reasons. First, it is unclear whether the SEC evinced preemptive intent in the first place. Reg BI lacks an express preemption provision in the rule or the commentary. Whatever language that is in the commentary equivocates on the agency's view: "[T]he preemptive effect of Regulation Best Interest on any state law governing the relationship between regulated entities and their customers would be determined in future judicial proceedings based on the specific language and effect of that state law." Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,327 (July 12, 2019) (codified at 17 C.F.R. § 240.15*l*-1 (2020)). On the other hand, the SEC identifies its aims as "establishing greater consistency in the level of retail customer protections provided, and easing compliance across the regulatory landscape and the spectrum of investment professionals and products"; but the suggested case-by-case approach to preemption is arguably inconsistent with an aim of promoting uniformity. Id. at 33,327, 33,435 n.1163 (acknowledging that "the language and operation of the particular state law at issue" would vary in future preemption litigation).

Second, even if a court were to deduce the SEC's explanation of state laws' effects on Reg BI, the Commission likely fails to meet the procedural requirements imposed by *Wyeth*. In that case, the Supreme Court found the FDA's pronouncement on a regulation's preemptive effect to be "inherently suspect" because the FDA incorporated its position into the final rule without "notice or opportunity for comment" or "reasoned explanation, including any discussion of how state law has interfered with the FDA's regulation of drug labeling during decades of coexistence." Wyeth v. Levine, 555 U.S. 555, 577 (2009). Due to this "procedural failure," and because the regulation also contravened the existing evidence of congressional intent and prior agency actions, the Court assigned no weight to the FDA's express provision. Id. at 577–78. The SEC's actions present an even simpler fact pattern that falls far below the *Wyeth* standard because the first proposal of Reg BI did not even include an express provision on state preemption. See Regulation Best Interest, 83 Fed. Reg. 21,574, 21,681–82 (May 9, 2018) (codified at 17 C.F.R. § 240.15*l*-1 (2020)). But see id. at 21,598 (requesting comments on whether Reg BI "adequately account[s] for the[] additional protections" offered by state laws).

148. *Wyeth*, 555 U.S. at 577 (internal quotation marks omitted) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

make sure the huge gaps that existed that allowed systemic regulatory arbitrage could no longer take place."[149] When two substantially similar entities are each subject to different regulations, regulatory arbitrage refers to the practice of undergoing relatively minimal changes to be subject to the less onerous regulation.[150] In order for an entity to undergo regulatory arbitrage, the benefits from conforming to the more favorable regulation must outweigh the costs associated with making that transition.[151] In the era leading up to the Dodd–Frank Act, the differential in duty between investment advisers and broker-dealers largely remained the same since the *SEC v. Capital Gains Research Bureau, Inc.* decision in 1963, which had imposed a fiduciary duty on investment advisers.[152] But industry trends from the 1980s onwards lowered the costs associated with investment advisers becoming broker-dealers or vice versa,[153] yielding favorable conditions for regulatory arbitrage.[154]

The objective of Section 913 was to reduce this behavior in the broker-dealer regulatory context.[155] Congressman Paul Kanjorski acknowledged,

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149. 156 Cong. Rec. 13,146 (2010) (statement of Sen. Dodd). Concerns relating to regulatory arbitrage consistently resurfaced during congressional debates on the Dodd–Frank final bill. See, e.g., id. at 13,181–82 (statement of Sen. Reed) (highlighting the need for the SEC and the Commodity Futures Trading Commission to conduct joint rulemaking in order to reduce regulatory arbitrage risk).

150. See Frank Partnoy, Financial Derivatives and the Costs of Regulatory Arbitrage, 22 J. Corp. L. 211, 227 (1997) ("Regulatory arbitrage consists of those financial transactions designed specifically to reduce costs or capture profit opportunities created by differential regulations or laws."); see also Victor Fleischer, Regulatory Arbitrage, 89 Tex. L. Rev. 227, 229 (2010) ("Regulatory arbitrage exploits the gap between the economic substance of a transaction and its legal or regulatory treatment, taking advantage of the legal system's intrinsically limited ability to attach formal labels that track the economics of transactions with sufficient precision.").

151. See Fleischer, supra note 150, at 231 ("[D]eal lawyers face a tension between reducing regulatory costs on the one hand and increasing Coasean transaction costs on the other . . . . So long as the regulatory savings outweigh the increase in transaction costs, [regulatory arbitrage] is perfectly rational.").

152. 375 U.S. 180 (1963); see also supra notes 27–31 and accompanying text.

153. See supra notes 34–37 and accompanying text. Notably, the 2008 RAND report concluded that, as a result of the blurring of lines between broker-dealers and investment advisers, retail customers did not significantly discriminate between the two groups when deciding which financial advisor to hire. See Hung et al., supra note 37, at 113 (noting that survey respondents were "about equally likely to seek services or investment advice from a broker or from an investment adviser" and that even after differences in duties were explained, respondents "expressed doubt that the standards are different in practice").

154. The Section 913 Study similarly suggested the need to reduce regulatory arbitrage between broker-dealer and investment adviser duties "in order to improve the effectiveness of both regimes by providing more consistent protections to investors and reducing investor confusion." SEC, Section 913 Study, supra note 17, at 104.

155. See Chamber of Com. v. U.S. Dep't of Lab., 885 F.3d 360, 386 (5th Cir. 2018) ("[T]he genesis of this provision was an SEC initiative commencing in 2006 to address 'Trends Blurring the Distinction Between Broker-Dealers and Investment Advisers.' Congress was concerned to protect all retail investment clients . . . ." (quoting Loss et al., supra note 32, at 1090–94)). Referencing these concerns, Senator Daniel Akaka noted

"The issuance of new rules will fix this long-standing problem."[156] And when compared to congressional objectives, the regulatory ceiling outcome fails to accord with Congress's effort of "fix[ing] this long-standing problem."[157] State common laws that subject broker-dealers to lesser-than-Reg BI duties further widen the gap between broker-dealer and investment adviser duties to retail customers, in turn exacerbating conditions for regulatory arbitrage. Conversely, the regulatory floor outcome comports with congressional objectives: Heightening duty on the state level harmonizes broker-dealer and investment adviser obligations to their retail customers and diminishes the potential for regulatory arbitrage. This outcome remains the most likely option for interpreting Reg BI.

2. *Considering Congress's Method of Execution.* — But a state law's agreement with congressional objectives does not conclude the inquiry. Until this point, this Note has focused on preemption of a category of state laws that have shared characteristics. But when determining the scope of conflict with state law, obstacle preemption examines not only the objective of a federal law but also the method of executing that law.[158] And whereas considering the objective of Section 913 provides a compelling argument to categorically preempt lower-than-Reg BI duties,[159] higher-than-Reg BI state laws may still be subject to preemption on a specific, state-by-state basis if they contravene Congress's intended method of execution for reaching Section 913's objective. Thus, when examining state fiduciary rules, another question central to the preemption inquiry is whether the state duty in question coheres with the methods of execution that Congress set out in Section 913.[160]

The statutory text defines Congress's method clearly: first, to commission a study on regulatory efficiency, and second, to undergo a careful

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during the Senate debate on the final version of the bill that "too many investors do not know the difference between a broker and an investment [adviser]. Even fewer are likely to know that their broker has no obligation to act in their best interest." 156 Cong. Rec. 13,134 (2010) (statement of Sen. Akaka).

156. 156 Cong. Rec. H5237 (daily ed. June 30, 2010) (statement of Rep. Kanjorski) (noting the divergent duties of broker-dealers and investment advisers when "their services and marketing have become increasingly indistinguishable to retail investors").

157. Id.

158. See Hines v. Davidowitz, 312 U.S. 52, 67 n.20 (1941) ("[T]he entire scheme of the statute must . . . be considered . . . . If the purpose of the act cannot otherwise be accomplished—if its operation within its chosen field else must be frustrated and its provisions be refused their natural effect—the state law must yield to the regulation of Congress . . . ." (internal quotation marks omitted) (quoting Savage v. Jones, 225 U.S. 501, 533 (1912))).

159. See supra section II.B.1.

160. Of course, this question does not apply *only* to those states that have imposed fiduciary rules on broker-dealers. But because underenforcing states are likely to be preempted by Reg BI, the conflict with Section 913's methods of execution focuses on state laws that survive the initial categorical preemption.

and informed rulemaking process.[161] In short, Congress intended that changes in the law be justified—more precisely, substantiated by evidence of inefficiency in the regulatory system. Section 913's emphasis on the study as a response to inefficiency[162] calls to mind the underpinning conditions that lead to regulatory arbitrage: a law's failure to track economics.[163] The statute requires the study to evaluate "the effectiveness" of the existing regulatory framework and whether there are any "gaps, shortcomings, or overlaps . . . that should be addressed by rule or statute";[164] Section 913 also enumerates fourteen unique factors for consideration, many of which focus on estimating customer welfare and costs.[165] As Senator Dodd put it, "Even if there is an overlap or a gap, the

161. See supra notes 60–61 and accompanying text. Regarding the second step, the Second Circuit recently found that Congress intended that the SEC have broad discretion in determining the final form that the broker-dealer rule would take. See supra note 107. On the Senate floor, in the final days of the passage of the Dodd–Frank Act, Senators disagreed about the precise scope of rulemaking authority in Section 913 in the final days of the Dodd–Frank Act. For instance, Senator Akaka stated that Section 913 "will ensure that all financial professionals, whether they are an investment [adviser] or a broker, have the same duty to act in the best interests of their clients," implying that the SEC was certain to implement a fiduciary standard. 156 Cong. Rec. 13,134 (2010) (statement of Sen. Akaka). But Senators Tim Johnson, noting that "[S]ection 913 does not . . . mandate any particular duty or outcome, but . . . gives the SEC, subsequent to the conclusion of the study, the authority to conduct a rulemaking on the standard of care, including the authority to impose a fiduciary duty," id. at 13,153 (statement of Sen. Johnson), and Jack Reed, merely acknowledging the SEC's "authority to impose a fiduciary duty," id. at 13,183 (statement of Sen. Reed), did not share Senator Akaka's narrower view of SEC delegation. The Second Circuit's broad reading of the statute was most similar to that of Senators Johnson and Reed. See XY Plan. Network, LLC v. Sec. Exch. Comm'n, 963 F.3d 244, 254 (2d Cir. 2020).

162. Senator Dodd similarly emphasized that "the paramount issue is effectiveness." 156 Cong. Rec. 13,196 (statement of Sen. Dodd). Furthermore, the legislative history reveals that the inclusion of the study was a significant point of contention. Congress considered and declined to implement the House bill, which would have required the SEC to subject broker-dealers to investment adviser fiduciary duty without the preceding study. Compare Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(b), 124 Stat. 1376, 1824–25 (2010) (codified as amended in scattered titles of the U.S.C.) ("The Commission shall conduct a study to evaluate . . . whether there are legal or regulatory gaps . . . in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, [and] investment advisers . . . ."), with H.R. 4173, 111th Cong. § 7103(a)(1) (as passed by House, Dec. 11, 2009) ("[T]he Commission shall promulgate rules to provide that . . . the standard of conduct for such broker or dealer with respect to [a retail] customer shall be the same as the standard of conduct applicable to an investment adviser . . . ."). The Second Circuit read the legislative history similarly. See *XY Plan.*, 963 F.3d at 254 n.8 (noting that the Senate bill, unlike the House bill, had predicated rulemaking on the study's finding of "regulatory gaps or overlap" (internal quotation marks omitted) (quoting S. 3217, 111th Cong. § 913(f)(1) (as amended by Senate, Apr. 29, 2010))).

163. See Fleischer, supra note 150, at 229.

164. Dodd–Frank Act § 913(b).

165. These factors are: (1) the effectiveness of the existing regulatory regime; (2) whether there are any "gaps, shortcomings, or overlaps"; (3) whether retail customers understand the differing standards of care between broker-dealers and investment advisers;

Commission should not act *unless* eliminating the overlap or filling a gap would improve investor protection and is in the public interest."[166]

Therefore, the question narrows to whether state-imposed fiduciary duties resolve additional inefficiencies within the broker-dealer regulatory system. For instance, if a state regulation harmonizes broker-dealer and investment adviser duties but reduces investor welfare, that regulation likely contravenes the method of execution prescribed by the federal scheme, and it is at increased risk of preemption. In answering this question, special attention should be paid to the underlying justifications of the regulation. Not only is acting in furtherance of "investor protection and . . . the public interest"[167] likely required in order for a state regulation to avoid preemption, but also evidence showing the effectiveness of a fiduciary rule—analogous to Section 913's insistence on a study—likely strengthens the state's case.[168] But this question is difficult to answer, and Part III offers two potential frameworks for evaluating whether state-imposed fiduciary duties could increase efficiency in the broker-dealer regulatory system.

III. SQUARING FEDERAL AND STATE REGULATION

This Note takes up the question presented in section II.B.2—whether state-imposed fiduciary duties resolve inefficiencies within the broker-dealer regulatory system—and evaluates two potential answers. First, states can rely on empirical evidence to justify their fiduciary rules as in line with congressional methods of execution. But as section III.A discusses, the paucity of studies on the effects of state-level fiduciary duties makes reliance on empirical evidence ultimately unsatisfying. There is a serious need for more research on this issue: While this Note identifies an empirical narrative that could justify state laws, it remains unclear how to weigh the

(4) whether these differing standards are confusing to retail customers; (5) the regulatory, examination, and enforcement resources dedicated to enforcing these standards of care; (6) substantive differences in the regulation of brokers, dealers, and investment advisers; (7) specific instances of incongruity between broker-dealer and investment adviser duties; (8) existing state regulatory and legal standards; (9) the potential impact on retail customers of applying the Investment Advisers Act fiduciary duty to broker-dealers; (10) the potential impact of removing the broker-dealer exception to the Investment Advisers Act; (11) the varying level of services provided by broker-dealers and investment advisers; (12) other potential impacts that may result from changing broker-dealer duties; (13) potential additional costs borne by customers, broker-dealers, and investment advisers; and (14) any other consideration that the SEC deems necessary in order to "conduct a rulemaking under subsection (f)." Id. § 913(c).

166. 156 Cong. Rec. 13,196 (statement of Sen. Dodd) (emphasis added). The Senate amendments to Section 913 introduced the concept of compelling the SEC to conduct a study on broker-dealer duties, which would eventually become Sections 913(b)–(c) in the final legislative package. See H.R. 4173 § 913(b)–(c) (as amended by Senate, May 20, 2010).

167. 156 Cong. Rec. 13,196 (statement of Sen. Dodd).

168. See infra notes 198–201 and accompanying text.

evidence for and against state-imposed fiduciary duties. Section III.B then offers an alternative argument for states, one that considers the institutional design of the broker-dealer regulatory scheme. The preservation of state authority in a federal system resolves inefficiencies because it serves as a second line of defense against SEC failures when relief through administrative law fails, keeping both federal and state regulators accountable in enforcement and oversight.[169]

A. *Looking to Empirical Evidence*

One method to determine whether state-imposed fiduciary duties resolve inefficiencies is to find empirical justifications for their passage. In fact, two studies analyzing state law effects on fiduciary duty suggest that a regulatory floor would be consistent with promoting investor welfare. And in some cases, state-imposed fiduciary duties on broker-dealers may even increase returns for retail customers. The first study surveyed several hundred broker-dealers across four states with strict fiduciary standards and fourteen states with quasi-fiduciary standards;[170] the study concluded by discerning "no statistical differences between the two groups in the percentage of lower-income and high-wealth clients, the ability to provide a broad range of products including those that provide commission compensation, the ability to provide tailored advice, and the cost of compliance."[171] The same study also showed that "the number of registered [broker-dealer] representatives doing business within a state as a percentage of total households does not vary significantly for states with stricter fiduciary standards."[172] The second study, analyzing the impact of state fiduciary duty common law on annuity choice,[173] concluded that broker-dealers "with fiduciary duty are less likely to sell variable annuities; when selling a variable annuity, they are more likely to steer clients towards products with more and higher-quality investment options."[174] The study

169. The first line of defense refers to the *XY Planning* decision in the Second Circuit. See supra notes 106, 161 and accompanying text.

170. See Finke & Langdon, supra note 39, at 104–05.

171. Id. at 105.

172. Id. at 98, 105–07 & tbl.4 ("A multivariate analysis of broker saturation that controls for fiduciary and non-fiduciary regulation as well as state mean income yields no significant effect . . . ."). The study later concludes, "Empirical results provide no evidence that the broker-dealer industry is affected significantly by the imposition of a stricter fiduciary standard on the conduct of registered representatives." Id. at 106.

173. See Vivek Bhattacharya, Gaston Illanes & Manisha Padi, Fiduciary Duty and the Market for Financial Advice 1–2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 25861, 2019), https://www.nber.org/papers/w25861.pdf (on file with the *Columbia Law Review*). This study limited its data to broker-dealers who serve clients on the borders of their respective states, but only where the bordering state has a different duty. Id. at 6–7 & fig.1. This empirical design creates a control group of broker-dealers on the local level, thus accounting for extraneous variables that could affect broker-dealer conduct. See id. at 7.

174. Id. at 43. Variable annuities have generally been problematic for investors. See Variable Annuities, FINRA, https://www.finra.org/rules-guidance/key-topics/variable-

further found that subjecting broker-dealers that sell annuities to fiduciary duty "increases risk-adjusted returns" by 0.25 percent and leads to a sixteen percent reduction "in the number of [broker-dealer] firms without a change in the total sales of annuities."[175]

Countervailing evidence, however, suggests that subjecting broker-dealers to investment adviser fiduciary duty could lead to higher costs for investors and less access to broker-dealers for lower net-worth customers.[176] One study reported that financial institutions began restricting brokerage offerings or transitioning to a fee-based model, which diminished choice for retirement investors; the study attributed these changes to "a very uncertain operating and regulatory environment."[177] The study concluded that imposition of fiduciary duty through the DOL rule prompted fifty-three percent of brokerage advice services participating in the study to reduce or eliminate access to the public; ninety-five percent of participants changed the array of products available to clients.[178] Another study found that the DOL fiduciary rule similarly "resulted in a reduction in access to professional guidance" and "more limited investment options and higher costs, particularly for retirement investors with modest-sized accounts."[179] But Commissioner Jackson called this an "equally possible outcome"[180] when compared to the possibility that customers encounter a "different menu of choices that allows retail customers to access investment advice in a more cost-efficient manner

annuities [https://perma.cc/KD6Y-CJ7G] (last visited Jan. 19, 2020) ("Due to the complexity and confusion surrounding them, which can lead to questionable sales practices, variable annuities are a leading source of investor complaints to FINRA.").

175. Bhattacharya et al., supra note 173, at 43.

176. Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,322 n.33 (July 12, 2019) (codified at 17 C.F.R. § 240.15*l*-1 (2020)) ("[A] number of industry studies indicated that, as a result of the DOL fiduciary rule, industry participants had already or were planning to alter services and products available to retail customers.").

177. Deloitte, The DOL Fiduciary Rule: A Study on How Financial Institutions Have Responded and the Resulting Impacts on Retirement Investors 27 (2017), https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf [https://perma.cc/MG2G-9NRY]. SIFMA, see supra note 146 and accompanying text, engaged Deloitte to facilitate the study with twenty-one SIFMA member broker-dealers; these firms account for approximately forty-three percent of "financial advisors" in the United States and manage $4.6 trillion, or twenty-seven percent of the $16.9 trillion retirement savings marketplace. Deloitte, supra, at 3–4.

178. Deloitte, supra note 177, at 5.

179. Letter from Richard Foster, Senior Vice President & Senior Couns. for Reg. & Legal Affs., Fin. Servs. Roundtable, to Jay Clayton, Chairman, SEC 4, 6 & nn.20–21 (Oct. 17, 2017), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2641320-161289.pdf [https://perma.cc/38YU-EZ6M] (citing one report that found thirty-five percent of investment advisers and brokers surveyed would move away from accounts with less than $25,000 and approximately twenty-five percent of respondents would increase their client minimums, focusing instead on higher net-worth clients).

180. Jackson, supra note 1.

relative to the baseline."[181] Indeed, when looking at investment returns, a report by the Council of Economic Advisers surveyed the field of literature on conflicted investment advice and concluded that "the evidence suggests that conflicted advice reduces investment returns by roughly 1 percentage point for savers receiving that advice," costing customers $17 billion of lost savings each year.[182]

The question becomes how courts and regulators should evaluate this mixed evidence. One crucial note is that, unlike when these studies were completed, Reg BI is already in effect. The issue is not whether a uniform fiduciary standard is better than its alternatives but, as the SEC put it, "whether, if there was preemption, that preclusion of state law would have any positive or negative effects on investors when compared with the economic effects of Regulation Best Interest."[183] On this narrower question, the initial two studies showing an increase in returns may be the most dispositive. Furthermore, a state's determination to implement fiduciary duty may, in theory, be justified and consistent with the federal regulatory scheme; because each state's market for broker-dealer services and investment advice is inevitably different, each state's policy calculus in determining the tradeoff between increasing returns and reducing broker-dealer access can also vary.[184]

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181. Regulation Best Interest, 84 Fed. Reg. at 33,464. Commissioner Jackson criticizes the SEC for not affording proper weight to this empirical evidence. See Jackson, supra note 1 ("[W]e could and should have examined it rather than speculate about how it could confound evidence contrary to our policy priors.").

182. Council of Econ. Advisers, The Effects of Conflicted Investment Advice on Retirement Savings 26 (2015), https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf [https://perma.cc/Z7LS-MD6G]. The study notes the typical uncertainties involved but emphasizes that "this uncertainty should not mask the essential finding of this report: conflicted advice leads to large and economically meaningful costs for Americans' retirement savings." Id.

183. Regulation Best Interest, 84 Fed. Reg. at 33,435 n.1163. The SEC did argue that costs will be reduced "[t]o the extent that state-level law incorporates fiduciary principles similar to those reflected in Regulation Best Interest" and will remain the same to the extent the "obligations under Regulation Best Interest . . . differ from obligations under state law, such as the Conflict of Interest Obligation." Id. at 33,435. But the SEC did not offer data to support its conclusion. See id.

184. Smaller brokerage businesses and their more local customers may bear fewer costs than their multistate counterparts. For instance, the Deloitte–SIFMA study represented broker-dealer firms with seemingly only nationwide reach; it made no mention of the geographic characteristics of the studied firms, thus limiting the applicability of its findings in state- or local-level brokerage contexts. See Deloitte, supra note 177, at 3–5.

On the other hand, industry members have also noted a third tradeoff factor and argued that disparate state requirements would further confuse investors and reduce efficiency. See Letter from Richard Foster to Jay Clayton, supra note 179, at 8 ("Therefore, any standard of conduct should preempt state laws to ensure a uniform standard of conduct, and minimize the possibility of customer confusion over applicable standards."). But state implementation of uniform fiduciary standards between broker-dealers and investment advisers has arguably provided clarity, not confusion, to investors. In passing their fiduciary rules, clarifying investor confusion partly motivated state regulators and legislatures. See, Ultimately, any definitive conclusions about the efficiency of state fiduciary rules are unsatisfying because the literature on the interplay of state and federal fiduciary duties is too thin.[185] Federal and state regulators should commission more studies and meta-analyses on the effects of state law within the Reg BI regulatory framework.[186] Such data would not only resolve the preemption issue more clearly but also enrich the policymaking in this area of securities regulation. Most pertinently, states would have evidence to substantiate arguments that local fiduciary duties support, rather than contravene, the congressional methods of execution that underlie Section 913.

B. *Looking to Federalism*

Federalism offers a basis for another argument defending state-imposed fiduciary duties: State legislative and regulatory dissent from Reg BI promotes efficiency because it provides a second line of defense against SEC failure when relief through administrative law fails.[187] Professor Gillian Metzger argues that recent Supreme Court jurisprudence on preemption supports this point, understanding "the preservation of state authority less as a goal worth pursuing in its own right than instrumentally as an important mechanism for guarding against federal agency failure."[188] And unlike private groups or industry members who take part in federal

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e.g., N.J. Proposed Fiduciary Rule, supra note 85 ("[T]he proposed new rule will establish a uniform standard for financial professionals and rectify investor confusion that results from the lack of uniformity.").

185. See Jackson, supra note 1; cf. Regulation Best Interest, 84 Fed. Reg. at 33,435 n.1163 (failing to cite precise data on state broker-dealer standards of conduct). Perhaps the most relevant study that analyzes the federal–state interplay is the Bhattacharya et al. paper; the study, in addition to its focus on duty differentials among states, tries to measure the effects of a stringent federal fiduciary standard compared to those of state common law fiduciary standards. See Bhattacharya et al., supra note 173, at 43. The findings reveal that a stringent federal duty both enhances the quality of advice and increases fixed costs, and the former is "an especially dominant force underlying the observed effect" of the federally imposed duty, such as risk-adjusted return. See id. at 43–44 ("Even though fiduciary duty increases fixed costs and drives out high quality advisers from the market, . . . its effect on low-quality advice more than compensates.").

186. Relatedly, because retaining a preemption floor is the only way to guarantee that such studies on the interaction between federal and state securities take place, preserving state authority can promote efficiency in federal broker-dealer regulation. See infra section III.B.3.

187. See supra notes 106, 161, 169 and accompanying text.

188. Metzger, Federal Agency Reform, supra note 96, at 5; see also Cuomo v. Clearing House Ass'n, 557 U.S. 519, 529–34 (2009); Wyeth v. Levine, 555 U.S. 555, 574–81 (2009); Altria Grp., Inc. v. Good, 555 U.S. 70, 90–91 (2008). Professor Metzger argues that the Supreme Court, through its decision in Massachusetts v. EPA, 549 U.S. 497 (2007), confirmed the "special state role in monitoring and improving federal administration." Metzger, Federal Agency Reform, supra note 96, at 67–75. In that case, Massachusetts established standing by citing principles of preemption as an interest in litigation, "entitl[ing] [Massachusetts] to special solicitude in our standing analysis." *Massachusetts*, 549 U.S. at 519–20.

notice and comment rulemaking, states are uniquely positioned to take on a corrective role because they themselves are held politically accountable to state voters, in turn picking up the regulatory slack when federal agencies fail to act appropriately.[189] Section III.B.1 evaluates which theory of federalism best describes the post-Reg BI regulatory landscape. Section III.B.2 notes the inefficient costs of protecting a dual-enforcement regime and argues that federalism can mitigate these costs. Section III.B.3 explores potential benefits to retaining state authority that could promote efficiency and, in turn, cohere with the congressional methods of execution that underlie Section 913.

1. *Identifying an Appropriate Theory.* — Conventional models of federalism fall short in describing the recent developments between federal and state regulators in the broker-dealer context. State laws engage with federal regulatory schemes for a variety of reasons: The state law may be intended to effectuate the federal regulation, under a cooperative federalism theory,[190] or to protect state authority from federal intrusion, under a traditional federalism theory.[191] Before Reg BI, the broker-dealer regulatory framework largely conformed with the former, relying on cooperation between federal and state regulators in furthering FINRA standards of suitability and other federally mandated disclosure requirements.[192] But the flurry of state legislation and proposed regulations that followed Reg BI suggests a narrative of competitive, not cooperative, federalism. Between the traditional and cooperative federalism models lies a gray space that Professors Jessica Bulman-Pozen and Heather Gerken have termed "uncooperative federalism."[193] Characterized by the formation of productive dialogue on regulation and enforcement between state actors and federal agencies, this theory expands beyond the view that states are cooperative servants of agencies and describes a model of federalism in which allowing for state dissent cultivates better-informed federal policymaking.[194]

189. See Metzger, Federal Agency Reform, supra note 96, at 71–72 (explaining that state challenges to administrative action are often brought by state attorneys general who are accountable to their constituents).

190. In cooperative federalism, "[S]tates are not autonomous policymakers but instead carry out federal programs." Jessica Bulman-Pozen & Heather K. Gerken, Uncooperative Federalism, 118 Yale L.J. 1256, 1258 (2009).

191. In traditional federalism, states are autonomous policymakers within the bounds of their legislative authority. Id.

192. See Loss et al., supra note 32, at 2250.

193. See Bulman-Pozen & Gerken, supra note 190, at 1258–60.

194. See id. at 1260–72. But Professors Bulman-Pozen and Gerken make clear that their theory of uncooperative federalism is not meant to displace other theories of federalism, but rather "insist only that autonomy is not a necessary precondition for effective state contestation." Id. at 1260. The authors also argue that accepting the conclusion that state dissent is valuable could justify limiting the scope of preemption doctrine itself. Id. at 1302–04. In order to effectuate a preemption doctrine motivated by uncooperative federalism,

Uncooperative federalism is the most appropriate theory to describe the relationship between state and federal regulators in the broker-dealer standard of conduct context. The state legislation and regulatory proposals that followed Reg BI are less convincingly characterized as efforts to preserve state authority or carry out federal initiatives, and more convincingly characterized as attempts to correct agency failure—specifically, the SEC's failure to adhere to the Section 913 Study.[195] New Jersey's broker-dealer duty proposal states that "[t]he SEC's response to the [Section] 913 Study similarly compels the Bureau to take action to protect New Jersey investors" and claims that Reg BI "does not provide sufficient protections."[196] The New Jersey Attorney General similarly explained that "the SEC has not stepped up."[197] The Massachusetts proposed regulation faults the SEC for "fail[ing] to establish a strong and uniform fiduciary standard . . . , to define the key term 'best interest' . . . , [and] to indicate whether some of the most problematic practices in the securities industry would be prohibited" under Reg BI.[198] Attempting to cultivate better-informed policymaking, some states even cited empirical evidence to justify their corrective actions. The New Jersey proposal[199] cited the Finke and Langdon study[200] and the Council of Economic Advisers report,[201] and the New York Department of Financial Services cited empirical research in its agency action review litigation in state court.[202]

2. *Mitigating the Costs.* — Keeping the state–agency conflict alive and retaining overlapping oversight understandably inspire notions of inefficiency. Allowing multiple actors to regulate the same conduct could sacrifice efficiency for the sake of overenforcement, posing a number of risks: Institutions that compete for jurisdiction could shirk on their duties and rely on their counterparts, undermine quality of enforcement work by incentivizing a race to file charges first, and increase bureaucratic costs.[203]

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the revised doctrine would have to pay less attention to traditional state police powers and more attention to the extent of state and federal concurrent jurisdiction. Id. at 1304.

195. See Metzger, Federal Agency Reform, supra note 96, at 6–7, 9–13 (arguing that the treatment of preemption doctrine in a line of recent Supreme Court decisions assigns "the states a special role in policing and reforming federal administration").

196. N.J. Proposed Fiduciary Rule, supra note 85.

197. Rubin, supra note 85.

198. Mass. Proposed Fiduciary Rule, supra note 87. Similar to New Jersey regulators, Massachusetts regulators believed Reg BI should have followed the results of the Section 913 Study. Id.

199. N.J. Proposed Fiduciary Rule, supra note 85.

200. See supra notes 170–172 and accompanying text.

201. See supra note 182 and accompanying text.

202. See Indep. Ins. Agents & Brokers of N.Y. v. N.Y. State Dep't of Fin. Servs., 109 N.Y.S.3d 574, 581–82 (Sup. Ct. 2019) ("Petitioners are asking the Court to discount market studies, DFS experience, emerging research and recommendations by consumer advocates that a mere disclosure rule is not enough.").

203. See Anne Joseph O'Connell, The Architecture of Smart Intelligence: Structuring and Overseeing Agencies in the Post-9/11 World, 94 Calif. L. Rev. 1655, 1679–83 (2006).

But federalism mitigates these risks in two ways. First, unlike dual regulation between federal agencies, the federal–state hierarchy is well established.[204] The SEC is the primary securities regulator and enforcer in American financial markets,[205] while state regulators operate in the interstices of a complex, federally created regime on broker-dealers.[206] The SEC's unambiguous primacy reduces some of the aforementioned risks that would otherwise affect competing federal agencies.[207]

Second, states have shown that they are not duplicative in the securities regulatory framework—they can more adequately legislate and remedy small-scale investor harms that federal authorities would traditionally overlook.[208] While federal laws must balance the need for investor protection with "the broader goals of maintaining the integrity of the national capital markets and facilitating capital formation," the normative aims of state securities laws are more localized and typically prioritize investor protection.[209] Moreover, unlike politically insulated federal agencies, state enforcers answer to the people: Most state attorneys general, for instance, are elected.[210] In the securities space, state enforcers

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204. See U.S. Const. art. VI, cl. 2.

205. What We Do, SEC, https://www.sec.gov/Article/whatwedo.html [https://perma.cc/XR6J-TUL4] (last visited Jan. 19, 2020).

206. Congress expressly allowed states to "retain jurisdiction under the laws of such State to investigate and bring enforcement actions," establishing the coexistence of state laws with federally imposed obligations. Securities Exchange Act of 1934, 15 U.S.C. § 78bb(f)(4) (2018).

207. See Rachel E. Barkow, Insulating Agencies: Avoiding Capture Through Institutional Design, 89 Tex. L. Rev. 15, 56 (2010) ("It is all too easy for agencies to point fingers at each other with no one ultimately held accountable . . . . To remedy this risk . . . , the insulated agency should be designated as the primary enforcer to ensure greater accountability and to increase the incentives for the responsible agency to take action.").

208. See Carlos Berdejó, Small Investments, Big Losses: The States' Role in Protecting Local Investors from Securities Fraud, 92 Wash. L. Rev. 567, 573–75 (2017) (summarizing trends among state securities regulators that have allowed defrauded investors to request restitution from fraudulent actors and receive compensation from state-planned restitution funds, which can provide avenues for relief that would otherwise be unavailable under federal law).

209. Id. at 572–73 ("This under-regulation of small-scale securities transactions, which results from the confluence of federal preemption and existing civil remedies that are better suited to address large-scale fraud, is a symptom of a normative conflict between state and federal securities laws.").

210. About NAAG, Nat'l Ass'n of Att'ys Gen., https://www.naag.org/naag/about_naag.php [https://perma.cc/KST2-GKYC] (last visited Jan. 19, 2020) ("The attorney general is popularly elected in 43 states, as well as in Guam, the District of Columbia and the Northern Mariana Islands."). Political accountability is not limited to attorneys general, of course. For instance, the Secretary of the Commonwealth of Massachusetts, the office that promulgated the Massachusetts Fiduciary Rule, is also elected. See PD43+: Massachusetts Election Statistics, William Francis Galvin: Sec'y of the Commonwealth of Mass., https://electionstats.state.ma.us/elections/search/year_from:2018/year_to:2018/stage:General [https://perma.cc/6G3N-LNH8] (last visited Jan. 19, 2020); Mass. Proposed Fiduciary Rule, supra note 87 (circulating the rule from the Massachusetts Securities Division of the Office of the Secretary).

often appeal to broad consumer protections and bring enforcement actions to root out fraud.[211] Professor Rachel Barkow notes that attorneys general and state regulators, due to their democratic accountability, can serve "a valuable equalizing function" by reducing the SEC's risk of regulatory capture and resolving issues of securities fraud underenforcement.[212] In response to fears that states given such authority would resort to overenforcement, one empirical study in the consumer finance context even found that states largely avoid overenforcement and cooperate with federal enforcement in concurrent regimes.[213]

3. *Exploring the Benefits.* — The costs of a dual regulatory regime are not only mitigated by federalism but also outweighed by the benefits of increased accountability. As discussed above, a preemption floor offers states a second line of defense against SEC failure, preserving efficiency in the federal regulatory scheme in two important capacities. First, having state and federal regulators compete for enforcement increases efficiency by keeping Reg BI enforcement levels relatively constant. Allowing for state enforcement of a law in a dual system "checks against a particular federal failing: underenforcement, not overenforcement, of the law."[214] Setting a preemption floor allows the SEC, along with regulators from states without fiduciary rules, to concentrate enforcement efforts in jurisdictions where Reg BI is the highest standard. When either regulator's activity declines, its counterpart can fill the enforcement vacuum.[215] Alternatively, in those states with fiduciary duty, the same principle applies. Because state regulators will target broker-dealers who violate fiduciary duty under state law, and because conduct that violates Reg BI would also violate fiduciary duty,[216] the behavior the SEC seeks to regulate would still be subject to competitive regulatory forces, and enforcement levels would remain relatively consistent. In both categories of states, a dual system could thus provide a kind of regulatory insurance from enforcement

211. See Barkow, supra note 207, at 56–57 ("[State attorneys general] often win elections by appealing to broad consumer interests and bringing suits against fraudulent practices.").

212. See id. at 58. Regulatory capture broadly refers to situations in which a regulatory regime or agency is subject to a "persistent influence disproportionate to the balance of interests envisaged" during the regime or agency's creation. Lawrence G. Baxter, "Capture" in Financial Regulation: Can We Channel It Toward the Common Good?, 21 Cornell J.L. & Pub. Pol'y 175, 176 (2011).

213. Amy Widman & Prentiss Cox, State Attorneys General's Use of Concurrent Public Enforcement Authority in Federal Consumer Protection Laws, 33 Cardozo L. Rev. 53, 55, 81 (2011) (concluding that states "use concurrent enforcement authority with federal consumer protection laws in a sparing manner" and "have generated almost no conflict with federal agency enforcement").

214. Barkow, supra note 207, at 58.

215. See id. at 57–58.

216. See supra section I.B.1.

downturns. Ironically, preserving state dissent could in fact improve efficiency by ensuring full federal implementation of Reg BI.

Second, and perhaps more crucially, the continued need for data and state experimentation also furthers the efficiency aims of Congress. After the passage of Reg BI, Commissioner Jackson lamented the rule's preclusion of further study on broker-dealer conduct and underscored the states' ability to serve as laboratories of securities policy experimentation.[217] Specifically, he criticized the rule for undermining "nascent state regulation" of broker-dealer duties and inviting expensive litigation.[218] The federal government "has the power to prevent an experiment";[219] but given the lack of conclusive data on how state regulations on broker-dealer conduct would interact with Reg BI—as admitted by the SEC[220]—as well as the continued uncertainty over the magnitude of investor loss from conflicted investor advice,[221] preventing a regulatory floor would conclude an important policy debate at an inappropriately premature stage. Without state standards that can serve as a counterfactual in future empirical studies, it will be difficult to evaluate not only Reg BI's isolated effects on retail investors but also the increased protection that fiduciary duty may afford. State dissent is keeping this vital policy debate alive, and allowing for better-informed policymaking in the future undoubtedly coheres with Section 913's method of execution—a thorough empirical study. By appealing to the institutional design of broker-dealer regulation, grounded in uncooperative federalism theory, states can put forward a compelling case defending against preemption.

CONCLUSION

Americans deserve better, nonconflicted advice from their broker-dealers. But in implementing Reg BI, the SEC created an unclear standard and contradicted the Section 913 Study. Focusing on one particular area of ambiguity, this Note is an early attempt to determine the extent of the preemptive threat that Reg BI poses to conflicting state law. Because Congress did not expressly intend to remove broker-dealer standards of

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217. Jackson, supra note 1 (citing New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)).

218. Id.

219. *New State Ice Co.*, 285 U.S. at 311.

220. See Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,435 n.1163 (July 12, 2019) (codified at 17 C.F.R. § 240.15*l*-1 (2020)) ("We considered whether we could determine the economic impact of possible, future state-law preemption on retail customers, but concluded that we cannot analyze the economic effects of the possible preemption of state law at this point because the factors that will shape those judicial determinations are too speculative.").

221. See id. at 33,428–31 (critiquing evidence such as the Council of Economic Advisers study due to its reliance on selective and now-outdated data, but failing to offer affirmative evidence showing that conflicted advice has a negligible effect on investor returns).

conduct from the ambit of state power, this Note relies on the congressional objectives behind the Dodd–Frank Act to test the implied preemption theory. Stringent state fiduciary rules would narrow the broker-dealer–investment adviser duty differential and reduce regulatory arbitrage, supporting an interpretation of Reg BI as setting a regulatory floor. But questions still linger surrounding a state law's coherence with the method of execution underpinning Section 913: This Note concludes that states would do well to justify their regulations with empirical evidence, commission additional studies on the efficacy of their fiduciary rules, and defend themselves from federal preemption challenges by pointing to the collateral benefits that uncooperative federalism may yield in the wake of Reg BI. In the midst of a savings crisis, the possibility of federal preemption may be a risk that many main street investors cannot afford.