19-2886(L)

19-2893(CON)

In the United States Court of Appeals for the Second Circuit

XY PLANNING NETWORK, LLC; FORD FINANCIAL SOLUTIONS, LLC, et al.,
Petitioners,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, et al.,
Respondents.

On Petition for Review of a Final Rule of the
Securities and Exchange Commission (File No. S7-07-18)

BRIEF OF PETITIONERS XY PLANNING NETWORK AND FORD FINANCIAL SOLUTIONS

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CORPORATE DISCLOSURE STATEMENT

XY Planning Network and Ford Financial Solutions have no parent corporations. No publicly held company owns 10% or more of their stock.

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INTRODUCTION

The market for personal financial advice is a risky place. Consumers are often presented with complex financial instruments and terms that are difficult to understand, and there is significant potential for conflicts of interest. For decades, these risks have been mitigated by holding registered investment advisers to the high standard of fiduciary duties when giving financial advice. Under the Investment Advisers Act of 1940, these fiduciary duties apply specifically to those in the business of providing personalized financial advice for compensation, while lower standards applied to those whose business model is focused on brokerage services and executing financial transactions. This regulatory regime served a dual purpose: "to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts," and "to safeguard the honest investment adviser against the stigma of the activities of these individuals," thereby preserving the integrity of the retail investment market. H.R. Rep. No. 76-2639, at 28 (1940).

But in recent years, personalized financial advice has been increasingly marketed to consumers by brokers and dealers, who are not held to the fiduciary standard of registered financial advisers. Recognizing the potential for consumer confusion and abuse where similar or identical services are governed by different legal protections, Congress sought to close this broker-dealer loophole in the Dodd-Frank Act of 2010. It required the SEC to examine the "legal or regulatory gaps" in the standard of care between broker-dealers and investment advisers, and report back to Congress with its findings. It then authorized the SEC to "commence a rulemaking," and directed it to decide whether to issue a specific rule: a rule providing that the standard of conduct for brokers and dealers when providing personalized investment advice "shall be the same" as that for investment advisers under the Investment Advisers Act. The SEC's staff conducted the study, and issued a report recommending that the agency exercise its power under the Dodd-Frank Act to promulgate a rule that equalized the standard of conduct between broker-dealers and investment advisers.

But then, after waiting seven years, the agency promulgated a different rule. The agency's rule, Regulation Best Interest, does not subject broker-dealers to fiduciary duties, but instead creates a new set of obligations that the agency collectively refers to as a "best interest" standard. The SEC justified this regulation by the need to preserve consumer choice, citing the ability of consumers to navigate between broker-dealers and investment advisers and select the combination of price and legal protection that they most want.

This regulation is both contrary to law and arbitrary and capricious. The Dodd-Frank Act empowered the SEC to promulgate a very specific rule: one that makes the standard of care for broker-dealers and investment advisers "the same." The Act does not empower the SEC to create a new, different standard for broker-dealers providing personalized investment advice. The SEC's argument to the contrary renders superfluous multiple detailed subsections of the Dodd-Frank Act that clearly specify the kind of regulation that Congress had in mind. Regulation Best Interest is therefore contrary to law and in excess of statutory authority.

Regulation Best Interest is also arbitrary and capricious. During the rulemaking, the SEC received substantial, persuasive evidence—much of which it had commissioned itself—demonstrating that consumers are unable to distinguish between the standards of conduct owed by broker-dealers and investment advisers even after disclosure and explanation. The SEC responded to this specific evidence with broad generalizations about the usefulness of disclosure to consumers. This failure to respond adequately to strong evidence on a cornerstone of the agency's decision cannot survive the requisite hard-look review.

JURISDICTIONAL STATEMENT

Regulation Best Interest was promulgated on July 12, 2019. The petition for review in this case was filed on September 10, 2019. Venue is also proper in this circuit because Ford Financial Solutions "resides" and "has [its] principal place of business" in this circuit. 15 U.S.C. § 78y(b); *see* Decl. of Julie Ford at ¶ 1. The petitioners have established Article III standing under the competitor-standing doctrine.

STATEMENT OF THE ISSUES

1. Was the SEC's promulgation of Regulation Best Interest in excess of statutory authority and contrary to the Dodd-Frank Act?

2. Was the SEC's promulgation of Regulation Best Interest arbitrary and capricious?

STATEMENT OF THE CASE

I. Historical and regulatory background

A. The Investment Advisers Act of 1940 creates a federal fiduciary duty standard for investment advisers.

In the wake of the stock market crash of 1929 and the ensuing Great Depression, Congress passed a series of laws to protect retail investors and safeguard the integrity of securities markets. These laws were designed "to achieve a high standard of business ethics in the securities industry," thereby ending "the philosophy of caveat emptor" that lay behind the abuses that led to the economic collapse of the 1930s. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963).

The first of these laws, the Securities Act of 1933 and the Securities Exchange Act of 1934, regulated the purchase and sale of securities on formal exchanges. *See* Philip A. Loomis, Jr., *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 Geo. Wash. L. Rev. 214 (1959). But shortly after its creation, the Securities Exchange Commission issued a congressionally commissioned report discussing "abuses and defects" in the context of over-the-counter sales of securities and investment advice to everyday retail investors. *See Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services* (1939) ("SEC Investment Adviser Report"), at 28. The SEC noted significant concerns where investment advice was provided by individuals or firms with a conflict of interest, such as where an investment adviser "was closely affiliated with investment bankers or brokerage firms." *Id.* at 28-29. The "exhaustive study and report . . . stressed that affiliations by investment advisers with investment bankers or corporations might be 'an impediment to a disinterested, objective, or critical attitude toward an investment by clients,'" whether or not the adviser was consciously aware of his or her clouded judgment. *Capital Gains Research Bureau*, 375 U.S. at 187-88 (quoting SEC Investment Adviser Report at 29).

Congress responded with the Investment Adviser Act of 1940. The Investment Adviser Act was introduced in Congress with a declaration that "the national public interest and the interest of investors are adversely affected" when "the business of investment advisers is so conducted as to . . . relieve themselves of their fiduciary obligations to their clients." *Id.* at 189 (quoting S. 3580, 76th Cong., 3d Sess., § 202). The Act therefore created a federal regulatory regime requiring investment advisers to act as fiduciaries for their clients. *See* 15 U.S.C. § 80b-6; *see also Transamerica Mortg. Advisors, Inc. (TAMA) v. Lewis*, 444 U.S. 11, 17 (1979). The Investment Advisers Act applied these fiduciary-duty requirements broadly. It defined "investment adviser" to mean "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, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." 15 U.S.C. § 80b-2(a)(11).

The Act also created a series of exceptions from this definition, such as an exemption for the publishers of newspapers and magazines. *Id.* A key exception was the broker-dealer exception: the Investment Adviser Act's requirements would not apply to "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." *Id.*

B. Changes in technology and market structure affect the activity governed by the Investment Advisers Act.

The Investment Advisers Act's distinction between broker-dealers and investment advisers reflected the realities of the market structure for retail investors in the 1930s and 1940s. At the time, executing an order to buy or sell securities was a complex task requiring "skill, care, and probity." Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 Wash. L. Rev. 707, 729

(2012) (quoting Rudolph L. Weissman, *The New Wall Street* 6 (1939)). A normal trade might involve an investor placing an order with a salesman operating on behalf of a broker; the broker would then bring the order to a more specialized broker who "made a market" by having established operations that were dedicated toward buying or selling that particular security; depending on who else was looking to purchase or sell via the specialized broker, the first broker might then have to decide whether to make a trade with a different broker, to trade directly with the specialist broker out of the specialist's own accounts, or to enter an order in the specialist's book to be executed by the specialist if and when the security reached a particular price. *Id.; see also* Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 Bus. Law. 395, 421-22 (2010) (detailing the many steps necessary "to accomplish a garden variety stock transaction in the 1930s"). In contrast to the skill and expertise required to execute these orders, broker-dealers generally did not specialize in providing advisory services. Laby, *Selling Advice and Creating Expectations*, at 729-30. Instead, they would employ salesmen who "functioned much like order clerks, accepting orders from customers, transmitting them for execution, and reporting back to the customer once the execution was complete." *Id.* at 730.

But as time passed, the de facto distinction between broker-dealers and investment advisers that was embodied in the Investment Advisers Act began to break down. The execution of securities transactions became increasingly electronic and automated, making many of the services offered by broker-dealers either ministerial or obsolete. *See*, *e.g.*, Michael J. Simon & Robert L. D. Colby, *The National Market System for Over-the-Counter Stocks*, 55 Geo. Wash. L. Rev. 17, 34-44 (1986) (describing the effects that automation and electronic execution in NASDAQ had on brokers and dealers); Jerry W. Markham & Daniel J. Harty, *For Whom the Bell Tolls: the Demise of Exchange Trading Floors and the Growth of ECNS*, 33 J. Corp. L. 865, 866, 897-910 (2008) (describing the "radical changes" that occur "as the trading of stocks and derivative instruments moves to electronic communications networks . . . that simply match trades by computers through algorithms"). These technological shifts "tilted the balance of brokers' activity away from execution and toward advice." Laby, *Selling Advice and Creating Expectations*, at 730.

In 1994, concerned about conflicts of interest in the brokerage industry, the SEC convened a committee chaired by five luminaries in the financial services industry, including CEO of Merrill Lynch Daniel P. Tully and CEO of Berkshire Hathaway Warren Buffett. *See* Report of the Committee on Compensation Practices 1 (April 10, 1995). The "Tully Report" that the committee issued confirmed the shifts that had occurred since the Investment Advisers Act of 1940. The Report noted that the "most important role" of retail brokerages' representatives had become "to provide investment counsel to individual clients, not to generate transaction revenues." *Id.* at 3. And the Report warned that the prevailing compensation structure for broker-dealers "inevitably leads to conflicts of interest," a finding that was particularly troubling given that the number of retail investors with only "the most rudimentary understandings of markets, financial instruments, and risks," had "markedly increased." *Id.* at 3-4.

Recognizing that broker-dealers were increasingly serving as financial advisers, the SEC attempted to clarify when and how the Investment Advisers Act would apply. The SEC's initial approach was to narrow the Act's application, expanding the amount of activity that broker-dealers could engage in without being covered by the Act. The SEC proposed a rule in 1999 that effectively abrogated the Act's provision that broker-dealers would not be considered investment advisers so long as they do not receive "special compensation" for investment advice. *See Certain Broker-Dealers Deemed Not To Be Investment Advisers*, 64 Fed. Reg. 61,226, 61,227 (Nov. 4, 1999) (proposed rule); 15 U.S.C. § 80b-2(a)(11) (broker-dealer exception). The proposed rule stated that a broker-dealer could receive "special compensation" without being "deemed to be an investment adviser" provided that certain limited conditions were met, such as providing a disclosure on the forms governing the broker-dealer's accounts. 64 Fed. Reg. at 61,232. In a somewhat unusual arrangement, the SEC's proposal declared that while the proposed rule was being considered, the SEC "would act as if it had already issued the rule" and not take any action against a broker-dealer whose actions were protected under the terms of the proposed rule. *Fin. Planning Ass'n v. SEC*, 482 F.3d 481, 485 (D.C. Cir. 2007) (discussing 64 Fed. Reg. at 61,227).

Six years later (in 2005), the SEC ultimately promulgated a final version of the rule that was largely similar to the proposed rule. *Id.*; *see also Certain Broker-Dealers Deemed Not To Be Investment Advisers*, 70 Fed. Reg. 20,424 (Apr. 19, 2005). But the D.C. Circuit vacated the rule, holding that the SEC had "exceeded its authority in promulgating the rule" because Congress had "addressed the precise issue at hand" by providing that broker-dealers could not receive special compensation for financial advice without being deemed investment advisers. *Financial Planning Ass'n*, 482 F.3d at 487. Although the SEC invoked its authority under the Investment Advisers Act to create additional exceptions to the definition of "investment adviser" "by rules and regulations or order," the D.C. Circuit held that the SEC could not "use general clauses" to justify a rulemaking "where the statutory text is clear" as to Congress's desired treatment of broker-dealers. *Id.* at 488-89. The Court noted that the legislative history of the Investment Advisers Act reflected Congress's "intention to protect investors and bona fide investment advisers," which would be "inconsistent with a construction of the SEC's authority

. . . that would enable persons Congress determined should be subject to the [Act] to escape its restrictions." *Id.* at 490.

C. The Dodd-Frank Act targets "regulatory arbitrage" by broker-dealers.

Not long after the SEC's rule was vacated, the 2008 financial crisis disrupted the world economy and led to demands for further regulation and oversight of financial transactions. Congress's primary response to the crisis was the Dodd-Frank Act of 2010, a sweeping set of reforms that aimed to protect consumers and safeguard the integrity of financial markets. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

In Dodd-Frank, Congress directly confronted the changed reality of the retail market for investment advice, in which broker-dealers now regularly provide personalized financial advice alongside investment advisers without registering themselves under the Investment Advisers Act. The hearings leading up to the passage of Dodd-Frank identified "the inconsistent regulatory regimes that exist today for investment advisors and broker-dealers" as one of the key areas in which Congress could "clos[e] regulatory gaps and respond[] to changes in the marketplace." *Enhancing Investor Protection and the Regulation of Securities Markets: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 12 (March 10, 2009) (prepared statement of T. Timothy Ryan, Jr.).

One of the main motivations behind Dodd-Frank was to end legal arrangements that permitted "systemic regulatory arbitrage," a practice blamed for contributing to the financial crisis in which regulated entities could take advantage of gaps in regulation to engage in nearly identical conduct but face a lighter regulatory burden. 156 Cong. Rec. S5882 (daily ed. July 15, 2010) (statement of Sen. Warner). Dodd-Frank's supporters, including Chairman Schapiro of the SEC, emphasized the need to close such gaps to prevent bad actors from "just reorganiz[ing] to fit into an exemption." *Oversight of the U.S. Securities and Exchange Commission: Evaluating Present Reforms and Future Challenges: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Services*, 111th Cong. (July 20, 2010) (Statement of Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission); *see also* 156 Cong. Rec. S5888 (daily ed. July 15, 2010) (statement of Sen. Johnson) (identifying "gaps in regulation" as a cause of the 2008 financial crisis, because "rules that applied to some financial companies but not all opened loopholes that bad actors could exploit").

The supporters of the Dodd-Frank Act saw that "too many investors do not know the difference between a broker and an investment advisor," despite the fact that only investment advisors were required to act as fiduciaries. 156 Cong. Rec. S5870 (daily ed. July 15, 2010) (statement of Sen. Akaka). They sought to "ensure that all investment professionals that offer personalized investment advice have a fiduciary duty imposed on them." *Id.* Both the House and Senate therefore included provisions in their proposed drafts of the Dodd-Frank bill that were designed to unify the standards governing broker-dealers and investment advisers in light of the increasingly similar services they provided. *See* Michael V. Seitzinger, Cong. Research Serv., R41381, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Standards of Conduct of Brokers, Dealers, and Investment Advisers* 5 (Aug. 19, 2010). In the House bill, the same standard of care would apply to both broker-dealers and investment advisers when providing personalized investment advice. *Id.* (citing Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, § 7103, 111th Cong. (2010)). In the Senate bill, the SEC was ordered to study the effectiveness of the existing standards for broker-dealers and advisers and then make rules "concerning any gaps or overlaps found by the study." *Id.*

Section 913 of the Dodd-Frank Act ultimately combined elements of both of these bills. *See* 124 Stat. 1824-30. It mapped out a course of conduct in which the SEC would conduct a study and then consider whether a specific kind of regulation was warranted. First, the SEC was directed to conduct a study to evaluate "the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers," and persons associated with them. *Id.* at 1824. In particular, the agency was told to evaluate "whether there are legal or regulatory gaps, shortcomings, or overlaps in [the] legal or regulatory standards of care" governing broker-dealers and investment advisers. *Id.* at 1824-25. Dodd-Frank listed a series of considerations that the SEC was required to bear in mind while conducting the study, required the SEC to seek "public input, comments, and data," and ultimately directed the SEC to publish a report describing its conclusions and making recommendations. *Id.* at 1824-27.

Dodd-Frank then authorized the SEC to "commence a rulemaking" based on the study. *Id.* at 1827-28. The Act specified that the SEC "may promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer . . . the standard of conduct for such broker or dealer with respect to such customer shall be the same as the standard of conduct applicable to an investment adviser" under the Investment Advisers Act of 1940. *Id.* at 1828. In particular, the Act authorized the SEC to harmonize the standard of conduct between broker-dealers and investment advisers so that each was required "to act in the best interest of the customer" when providing personalized investment advice, "without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice." *Id.* If the SEC used this authority to issue new rules, Dodd-Frank mandated that "[s]uch rules shall provide that such standard of conduct shall be no less stringent than" the fiduciary duty standard required of investment advisers under the Investment Advisers Act. *Id.* at 1829.

D. The SEC's report under Section 913 recommends that the agency create a uniform standard of conduct to govern broker-dealers and investment advisers.

The Dodd-Frank Act was passed in 2010, and shortly thereafter the SEC began conducting the study required by Section 913. *See* PA320-527. The Commission conducted a thorough review, meeting with a wide range of interested parties, soliciting data and comments, receiving over 3,500 submissions from the public, and ultimately issuing a report of more than 200 pages. PA322. Among other things, the report examined studies that the SEC had commissioned to evaluate "whether investors understood the duties and obligations owed by investment advisers and broker-dealers to their clients and customers." PA429.

One of these studies, commissioned by the SEC from RAND and published in 2008, found that "current laws and regulations are based on distinctions between the two types of financial professionals that date back to the early 20th century and . . . appear to be eroding today." Angela A. Hung et al., RAND Institute for Civil Justice, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* 115 (2008), https://perma.cc/YA4H-YFBQ ("2008 RAND Study"). To evaluate consumers' understanding of the distinction between broker-dealers and investment advisers, RAND administered a nationwide survey with more than

650 respondents and conducted six "intensive focus groups" with 67 participants in different locations. *Id.* at 116. The research found that "the roles of broker-dealers and investment advisers are confusing to most survey respondents and focus-group participants," and, in particular, that "participants struggled to understand the differences between the standards of care" owed by broker-dealers and investment advisers. *Id*. at 118. The research also suggested that this confusion would be difficult to cure through disclosures, noting that "[e]ven though we made attempts to explain [the standards of care] in plain language, focus-group participants struggled to understand the differences." *Id.* at 113.

The Section 913 report considered the 2008 RAND study as well as several other studies that resulted in similar findings. *See* PA426-434. The report concluded that there was "robust recent evidence that many retail investors do not understand or are confused by the different standards of care applicable to investment advisers and broker-dealers." PA427. The report noted that "interchangeable titles and 'we do it all' advertisements made it difficult to discern broker-dealers from investment advisers" in the market for financial advice. PA431. The report ultimately concluded that, "[d]espite the extensive regulation of both investment advisers and broker-dealers," retail customers "do not understand" the difference between them and are confused regarding what standards of care apply when consumers are receiving "personalized investment advice and recommendations about securities."

PA498. The report therefore recommended that the SEC "exercise its rulemaking authority to implement [a] uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers." PA326. The report found that a uniform standard of conduct would offer "[h]eightened investor protection" while still "preserv[ing] investor choice," and "should not decrease investors' access to existing products or services or service providers." PA328.

II. Regulation Best Interest

Seven years later (in 2018), the SEC proposed a rule entitled "Regulation Best Interest" that rejected the approach recommended by the Section 913 report and instead preserved the regulatory gap between broker-dealers and investment advisers in the market for personalized investment advice. *See* Notice of Proposed Rulemaking, *Regulation Best Interest*, 83 Fed. Reg. 21,574 (May 9, 2018). The proposed rule did not adopt a uniform fiduciary standard for broker-dealers and investment advisers. *Id*. at 21,575. Nor did it follow the Dodd-Frank Act's directive that the new standards promulgated for broker-dealers require that they "act in the best interest of the customer without regard to the financial or other interest of the broker." 124 Stat. 1828. Instead, the proposed rule required only that broker dealers not place their interests "ahead of the interest of the retail customer" when providing a recommendation. 83 Fed. Reg. at 21,575.

At the same time, the SEC issued another proposed regulation creating a disclosure form called a "customer or client relationship summary," and requiring broker-dealers and investment advisers to use the form to disclose the services they provide, the standard of conduct applicable to those services, conflicts of interests the broker-dealer or investment adviser may have, and other information. *See* 83 Fed. Reg. at 21,419 (May 9, 2018). On the relationship summary form, broker-dealers and investment advisers would be required to make a number of disclosures, including disclosures regarding the standard of conduct that governed their advice and recommendations. Broker-dealers, for instance, would be required to state "[w]e must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy." 83 Fed. Reg. at 21,555. Investment advisers, in contrast, would be required to state "[w]e are held to a fiduciary standard that covers our entire investment advisory relationship with you." *Id.* at 21,556. The SEC believed that these requirements "should assist the investor in making an informed choice for the services that best suit her particular needs and circumstances." *Id.* at 21,419.

During the public comment period, many individuals and organizations submitted comments identifying concerns with this proposed rule. Michael Kitces, co-founder of the membership network of registered investment advisers XY Planning Network, explained that the SEC's proposed rule would mislead consumers who do not understand the difference between broker-dealers and investment advisers or the different standards governing their conduct. PA969-981. Kitces' comment also noted that the rule was premised on a misunderstanding of the Investment Advisers Act: Except for the narrow category of advice "solely incidental" to the provision of brokerage services that is made without receiving "special compensation," broker-dealers are supposed to register as investment advisers before they give advice to retail investors, thereby obligating themselves to act under a fiduciary duty standard. *Id.*; 15 U.S.C. § 80b-2(a)(11). Many additional commenters submitted a wide variety of similar objections, including detailed studies and surveys of academic literature demonstrating rampant consumer confusion in the market for financial advice. *See, e.g.*, PA3085-3177; PA1369-1539.

After the proposed rule was announced, the SEC commissioned RAND to conduct a new study to evaluate the proposed relationship summary disclosure form. *See* PA704-825. The study found that focus group participants "seemed to misunderstand the differences between account types and financial professionals from the beginning," and some "never fully grasp[ed]" the distinction even after going through a sample relationship summary form. PA755. The study noted that "[m]any participants expressed confusion over how to reconcile" the sections of the disclosure form in which broker-dealers and investment advisers described the standards of conduct they were held to with the sections in which they disclosed the conflicts of interest they may have. PA753. Others did not understand the distinct legal obligations owed by investment advisers and broker-dealers; as one participant noted, "it's basically the same language . . . but they just kind of word it differently." PA750.

In July 2019, the SEC issued a final version of Regulation Best Interest that adhered significantly to the proposed rule. *See Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 84 Fed. Reg. 33,318 (July 12, 2019). Like the proposed rule, the final rule did not equalize the standard of conduct between broker-dealers and investment advisers; nor did it require broker-dealers to give advice "without regard to" their own financial interests. *Id.* at 33,331. The rule stated that the phrase "without regard to" was subject to "a range of different meanings," and so the SEC opted instead for a regulation that required broker-dealers to make recommendations "without placing [their] financial or other interest . . . *ahead of* the interest of the retail customer." *Id.* at 33,332 (emphasis added).

At the same time, the SEC also issued a final version of the rule governing the relationship summary disclosures for broker-dealers and investment advisers. *See Form CRS Relationship Summary; Amendments to Form ADV*, 84 Fed. Reg. 33,492 (July 12, 2019). The final rule contained a number of modifications to the form. *See id*. at 33,498. The SEC noted that it was "substantially revising [its] approach to disclosing standard of conduct and conflicts of interest," "eliminating the word 'fiduciary'" from the required disclosure in the proposed rule and instead "requiring firms—whether broker-dealers, investment advisers, or dual registrants—to use the term 'best interest' to describe their applicable standard of conduct." *Id*. at 33,499. The SEC said that this standardized language "will clarify for retail investors their firm's legal obligation . . . regardless of whether that obligation arises from Regulation Best Interest or an investment adviser's fiduciary duty under the Investment Advisers Act." *Id.* at 33,532. Overall, the final rule stated that the revised relationship summary form helps consumers by "facilitating more robust substantive comparisons across firms." *Id*. at 33,502.

As it promulgated Regulation Best Interest and the final relationship summary rule, the SEC also issued an interpretive rule. The interpretive rule was intended to provide guidance as to what activity fits into the Investment Advisers Act's broker-dealer exception. *See Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser*, 84 Fed. Reg. 33,681 (July 12, 2019) ("Solely Incidental Interpretation"); 15 U.S.C. § 80b-2(a)(11).

The interpretive rule stated that it "complements each of the rules and forms" the SEC was concurrently adopting, which the SEC had designed "individually and collectively" with the goal of "enhanc[ing] investor understanding of the relationships and services offered by investment advisers and broker-dealers." 84 Fed. Reg. at 33,683. The rule provided that a broker-dealer would be deemed to be providing financial advice "solely incidental" to its business "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. The rule elaborated on this interpretation, stating that the "quantum or importance of investment advice . . . is not determinative," and that "[a]dvice need not be trivial, inconsequential, or infrequent to be consistent with the solely incidental prong." *Id.*

III. Procedural background

Regulation Best Interest was promulgated on July 12, 2019. *See* SA1-175. This petition was filed on September 10, 2019. Dkt. No. 1. Petitioners simultaneously filed a complaint in the Southern District of New York challenging Regulation Best Interest. *See XY Planning Network v. SEC*, No. 19-cv-08365-VM (S.D.N.Y. filed Sept. 10, 2019). On September 27, 2019, Judge Marrero of the SDNY dismissed the case for lack of subject matter jurisdiction on the court's own motion, holding that jurisdiction in the Second Circuit, rather than the district court, was proper. *Id.* Dkt. No. 27.

STANDARD OF REVIEW

On a petition for review of agency action, this Court must "hold unlawful and set aside" agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," as well as action that is "in excess of statutory jurisdiction, authority, or limitations." 5 U.S.C. § 706(2). This Court's "inquiry must be searching and careful" to determine whether the agency "examined the relevant data and articulated a satisfactory explanation for its action." *NRDC v. EPA*, 658 F.3d 200, 215 (2d Cir. 2011) (internal punctuation and citation omitted). This Court "may not supply a reasoned basis for the agency's action that the agency itself has not given." *Id.*

SUMMARY OF ARGUMENT

Regulation Best Interest is both contrary to law and arbitrary and capricious. To begin with, Regulation Best Interest exceeds the authority given to the SEC by the Dodd-Frank Act. Dodd-Frank provided the SEC with the authority to "promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice . . . the standard of conduct for such broker or dealer with respect to such customer *shall be the same as* the standard of conduct applicable to an investment adviser" under the Investment Advisers Act. 15 U.S.C. § 78*o*(k) (emphasis added). The SEC had authority under Dodd-Frank *not* to issue such a regulation; but Dodd-Frank did not grant the SEC additional authority to create a new, *different* standard of conduct governing broker-dealers providing personalized investment advice.

Dodd-Frank also authorizes the SEC to promulgate a rule providing that broker-dealers and investment advisers must act "in the best interest of the customer" when providing personalized investment advice, but states that that rule shall require broker-dealers and investment advisers to act "without regard to the financial or other interest of the broker, dealer, or investment adviser." 124 Stat. 1828. Regulation Best Interest, in contrast, explicitly permits broker-dealers to consider their own financial interests when they provide personalized financial recommendations so long as a broker-dealer does not "place its own interests ahead of the customer's interests." 84 Fed. Reg. at 33,320.

The SEC's attempt to justify these contraventions of Dodd-Frank renders large sections of the Act superfluous. According to the SEC, the provision in Section 913(f) of the Dodd-Frank Act that allows it to "commence a rulemaking" also provides a general substantive grant of authority for the SEC to regulate the standard of conduct for broker-dealers providing personalized investment advice. *See* 84 Fed. Reg. at 33,330 n.122. But if that were true, there would be no reason for Section 913(g) of the Act to exist. That section provides a detailed, specific grant of rulemaking authority that gives the SEC a clear directive: after studying the market and the laws, decide whether to harmonize the standard of care for those giving personalized financial advice. If Section 913(f) gave the SEC general authority to regulate the standard of care more broadly, there would be no need for the specific powers granted in Section 913(g). The SEC's interpretation of its authority for Regulation Best Interest thus runs afoul of the fundamental rule of statutory interpretation that courts "must give effect to every word of a statute wherever possible." *United States v. Halloran*, 821 F.3d 321, 333 (2d Cir. 2016) (quoting *Leocal v. Ashcroft*, 543 U.S. 1, 12 (2004)).

Regulation Best Interest is also invalid because it is an arbitrary and capricious exercise of the SEC's rulemaking authority. First, the regulation is premised on an unreasonable interpretation of the Investment Advisers Act's broker-dealer exception. The SEC says that a broker-dealer provides advice that is "solely incidental" to its business so long as that advice "is provided in connection with and is reasonably related to the broker-dealer's primary business of effecting securities transactions." 84 Fed. Reg. at 33,685. The SEC rejects the idea that whether advice is "solely incidental" is determined by "the quantum or importance of investment advice," or whether it is frequent or consequential. *Id.* It even goes so far as to say a broker-dealer can "'h[o]ld itself out' as an investment adviser" to the general public and still qualify for the "solely incidental" exception. *Id*. at 33,351.

This reading of the Investment Advisers Act is unreasonable. Dictionaries have long defined "incidental" to mean "being likely to ensue as a chance or minor consequence," or "[o]f a minor, casual, or subordinate nature." *Incidental*, Merriam-Webster.com (last accessed Dec. 20, 2019); *Incidental*, The American

Heritage Dictionary of the English Language (5th Ed. 2020). And the SEC's reading is contrary to the purposes of the Investment Advisers Act, a protective statute whose terms should be read "not technically and restrictively, but flexibly to effectuate its remedial purposes." *Capital Gains Research Bureau*, 375 U.S. at 195.

Regulation Best Interest also repeatedly ignores Investment Advisers Act's provision that the broker-dealer exception does not apply if broker-dealers receive "special compensation" for their advice. The regulation details a variety of scenarios in which broker-dealers receive compensation specifically for advice they are providing. The rules around conflicts of interest center in large part on "compensation associated with recommendations to retail customers." 84 Fed. Reg. at 33,363. And the regulation is clear that it applies to situations in which a "broker-dealer receives compensation" for "recommendations." *Id.* at 33,344. The rule's disclosure provisions contemplate the possibility that broker-dealers should disclose when their compensation structures give them "an incentive to recommend certain products over other products for which the broker-dealer receives less compensation." *Id.* at 33,363. These actions are all ones that broker-dealers would not be permitted to take under any reasonable reading of the Investment Advisers Act.

Regulation Best Interest must therefore be struck down. "If a regulation is based on an incorrect view of applicable law, the regulation cannot stand as promulgated, unless the mistake of the administrative body is one that clearly had no bearing on the procedure used or the substance of the decision reached." *Prill v. NLRB*, 755 F.2d 941, 948 (D.C. Cir. 1985). Here, the SEC's interpretations of the broker-dealer exception are foundational to Regulation Best Interest, defining the breadth of its application and underlying its reasoning and the SEC's responses to comments. *See, e.g.*, 84 Fed. Reg. at 33,320-21, 33,323, 33,336, 33,340-41, 33,351-53, 33,358, 33,383 n.654, 33,406 n.895, 33,408 n.910, 33,419 n.972, 33,439, 33,464 & n.1345, 33,484. It would be impossible for the SEC to demonstrate that its interpretation of this provision—which defines who will fall under the regulation's terms—"clearly had no bearing on . . . the substance of the decision." *Prill*, 755 F.2d at 948.

Finally, Regulation Best Interest is also arbitrary and capricious because the SEC failed to adequately address abundant evidence regarding the ineffectiveness of the rule's disclosure provisions. The SEC was presented with thorough evidence, much of which it had commissioned itself, that consumers in this particular context fail to understand the different standards of care owed by broker-dealers and investment advisers. But the SEC presented no reasonable response to this evidence, instead pointing only to general studies about the value of disclosures to consumers. In the face of "specific evidence" regarding a particular policy measure, it is not enough to "cite[] generally to an industry-wide study" or "a nonspecific nationwide trend" to say that disclosure rules will enable consumers to differentiate between broker-dealers and investment advisers and balance for themselves which standard of care is worth what price for goods and services. *Ergon-W. Virginia, Inc. v. EPA*, 896 F.3d 600, 613 (4th Cir. 2018). The SEC's failure to adequately confront the specific evidence undermining its decision-making means that the agency has not "articulate[d] a satisfactory explanation for its action," and Regulation Best Interest must be overturned. *NRDC v. FAA*, 564 F.3d 549 (2d Cir. 2009) (quoting *Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.* ("*State Farm*"), 463 U.S. 29, 43 (1983)).

ARGUMENT

I. The plaintiffs have standing to bring this petition for review.

XY Planning Network and Ford Financial Solutions have standing under Article III of the U.S. Constitution to petition this Court for review of Regulation Best Interest. The test for Article III standing has three familiar components: (1) an injury in fact that (2) is caused by the conduct challenged in the lawsuit and (3) is likely to be redressed by a favorable decision. *See CREW v. Trump*, 939 F.3d 131, 142 (2d Cir. 2019).

XY Planning Network and Ford Financial Solutions easily satisfy this test because they directly compete with the broker-dealers affected by Regulation Best Interest. There is a "well-established Article III threshold for economic competitors who allege that, because of unlawful conduct, their rivals enjoy a competitive advantage in the marketplace." *Id.* at 143 (collecting cases). This basis for Article III standing, which is common in the area of financial regulation, has long permitted businesses and business associations to challenge federal agency actions on the ground that those actions impermissibly benefit the businesses' competitors. *See, e.g.*, *Sec. Indus. Ass'n v. Clarke*, 885 F.2d 1034, 1039-41 (2d Cir. 1989) (citing *Inv. Co. Inst. v. Camp*, 401 U.S. 617, 620-21 (1971) and *Ass'n of Data Processing Serv. Orgs., Inc. v. Camp*, 397 U.S. 150 (1970)). It applies where, as here, a network of financial planners petitions to set aside an unlawful SEC rule that would benefit their competitors. *See, e.g.*, *Fin. Planning Ass'n*, 482 F.3d at 486-87 (holding that a network of financial planners had standing to challenge an SEC rule that resulted in a lower regulatory burden for broker-dealers, thereby increasing competition).

In this case, XY Planning Network and Ford Financial Solutions are injured because the SEC has unlawfully promulgated a rule that allows their competitors to offer identical or nearly identical goods and services without being subject to the same standard of conduct. *See* Decl. of Michael Kitces at ¶¶ 5-6; Decl. of Julie Ford at ¶¶ 4-5. XY Planning Network is an organization of more than 1,100 financial planners who work under registered investment advisers; its membership comprises more than 5% of all state-registered RIAs doing financial planning nationwide. Decl. of Michael Kitces at ¶ 1. XY Planning Network's members, including Ford

Financial Solutions, are all bound by fiduciary obligations to act in the best interests of their clients. Decl. of Michael Kitces at ¶ 3; Decl. of Julie Ford at ¶ 2.

Ford Financial Solutions and XY Planning Network's members are injured by Regulation Best Interest in at least two ways. First, the regulation allows the competitors of registered investment advisers to pursue their own financial interests when providing the same financial-planning services. These competitors can therefore increase their revenue and decrease their legal exposure all while providing similar or identical products and services, resulting in a competitive disadvantage to XY Planning Network's membership. Decl. of Michael Kitces at ¶¶ 5-6. Second, by using the label "best interests" to describe the lower standard of care applicable to broker-dealers, Regulation Best Interest makes it more difficult for consumers to differentiate between financial planners who are bound by fiduciary obligations and broker-dealers who may consider their own financial interests when making recommendations. Decl. of Michael Kitces at ¶¶ 5-6; Decl. of Julie Ford at ¶ 4.

This harms Ford Financial Solutions and XY Planning Network's other members by hindering their ability to compete with broker-dealers on the basis of the higher standard of care that registered investment advisers offer. Decl. of Michael Kitces at ¶ 6; Decl. of Julie Ford at ¶¶ 4-5. Additionally, XY Planning Network is directly harmed because it receives revenue from its members, and its business model depends in substantial part on financial planners having an incentive to register as registered investment advisers. Decl. of Michael Kitces at ¶ 5. Because Regulation Best Interest unlawfully fails to impose the same standard of conduct for broker-dealers as for investment advisers, the rule reduces the likelihood that broker-dealers will register as investment advisers, resulting in a loss of business for XY Planning Network. *Id*.

These injuries satisfy the injury-in-fact prong of the Article III standing inquiry. The SEC has bestowed "some competitive advantage" on broker-dealers, who "compete in the same arena" as Ford Financial Solutions and XY Planning Network's members. *CREW*, 939 F.3d at 143 (collecting cases). Causation and redressability are also satisfied, because the petitioners' injuries are caused directly by the rule and an order to vacate the rule "will be likely to at least diminish further instance of the injury," whether by increasing the likelihood that the SEC issues a new rule that creates equal standards or by removing the confusing "best interests" terminology that will make it harder for registered investment advisers to distinguish themselves to customers. *Id.* at 147.[1]

[1] XY Planning Network also has organizational standing, because its mission includes promoting the interests of its members; its members have standing to sue in their own right; and the claims asserted and relief requested in this petition do not require the participation of individual members. *See NRDC v. Nat'l Highway Traffic Safety Admin.*, 894 F.3d 95, 104 (2d Cir. 2018).

II. Regulation Best Interest is contrary to the Dodd-Frank Act's limited grant of rulemaking authority.

Regulation Best Interest violates the plain text of the Dodd-Frank Act. First, Regulation Best Interest exceeds the authority granted to the SEC by the Dodd-Frank Act. The Dodd-Frank Act does not permit the SEC to choose whatever standard of care it wishes to apply to broker-dealers. Section 913(f) provides that the SEC "may commence a rulemaking," and Section 913(g) specifies the substantive content of that rulemaking: the SEC "may promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice . . . the standard of conduct for such broker or dealer with respect to such customer shall be the same as the standard of conduct applicable to an investment adviser under section 211 of the Investment Advisers Act of 1940." 124 Stat. 1827-28; 15 U.S.C. § 78*o*(k).

That's it. There is no language providing that if the SEC chooses *not* to apply "the same" standard of conduct to broker-dealers, it can elect to create some new, *different* standard of conduct. Section 913 gives the SEC the choice whether to apply an equal standard of conduct to broker-dealers. But Regulation Best Interest does something else, creating a complicated new regulatory scheme for broker-dealers with a variety of unique obligations, completely separate from the standards governing investment advisers. Regulation Best Interest is therefore "not in accordance with law" and "in excess of statutory . . . authority." 5 U.S.C. § 706(2).

Second, the new regulatory scheme created by Regulation Best Interest violates the Dodd-Frank Act by implementing a "best interest" standard that is contrary to the one specified in Section 913(g)(2). *See* 124 Stat. 1827-28; 15 U.S.C. § 80b-11(g). That provision of Dodd-Frank grants the SEC the authority to promulgate rules requiring that "all brokers, dealers, and investment advisers . . . act in the best interest of the customer," but specifies that such rules shall require broker-dealers and investment advisers to act "without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice." *Id.* Regulation Best Interest directly contradicts this command by permitting a broker-dealer to consider its own financial interests when providing a financial recommendation so long as it does not "place its own interests ahead of the customer's interests." 84 Fed. Reg. at 33,320.

The SEC does not even attempt to square its regulation with the text of Section 913(g) of the Dodd-Frank Act. Instead, the SEC says that the rule is promulgated pursuant to Section 913(f). *See* 84 Fed. Reg. at 33,330. According to the SEC, "[t]he plain text of Section 913(f) authorizes the Commission to promulgate this rule addressing the legal and regulatory standards of care for broker-dealers, and their associated persons." *Id.*

This reading of Section 913(f) is contrary to the "'plain terms' and 'core purposes'" of the Dodd-Frank Act. *NRDC v. Nat'l Highway Traffic Safety Admin.*, 894

F.3d at 108 (quoting *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760, 773 (2016)). Section 913(f) provides for the SEC to "commence a rulemaking, as necessary or appropriate in the public interest . . . to address the legal or regulatory standards of care for" broker-dealers, investment advisers, and associated persons when providing personalized financial advice. 124 Stat. at 1827. But this authorization is purely procedural; it allows the SEC to "commence a rulemaking," but does not provide any substantive standards governing the content of whatever rule the SEC issues. *Cf. City of Willcox v. Fed. Power Comm'n*, 567 F.2d 394, 402 (D.C. Cir. 1977) (distinguishing between substantive and procedural authority for rulemaking under the Natural Gas Act). Such a procedural authorization may "provid[e] for implementation of" a congressional directive, but "does not itself grant independent powers" to determine the substance of rules or agency decisions. *Am. Smelting & Ref. Co. v. Fed. Power Comm'n*, 494 F.2d 925, 933 (D.C. Cir. 1974). Here, the substantive grant of power comes from Section 913(g), which expressly provides for the content of the SEC's rulemaking authority—not Section 913(f), which does not.

This reading of Section 913(f) is reinforced by the structure of Section 913 as a whole. Section 913 is written as a sequence of steps that the SEC was required to take after the Dodd-Frank Act was passed. *See* 124 Stat. 1824-30. In addition to a definition section (a) and an enforcement section (h), it contains six pairs of subsections; the first subsection of each pair contains a grant of authority, and the second of each pair specifies some substantive aspect of how that authority should be used. *See id.* Subsection (b) directs the SEC to "conduct a study to evaluate" the "existing legal or regulatory standards of care for brokers, dealers, [and] investment advisers"; subsection (c) then lists the items that the SEC must consider in that study—specifying the study's content. 124 Stat. at 1824-27. Next, subsection (d) requires the SEC to submit a report on the study to Congress describing its findings and recommendations, and subsection (e) provides more specific conditions for such a report, requiring the SEC to "seek and consider public input, comments, and data in order to prepare the report." *Id.* at 1827. Then, subsection (f) authorizes the SEC to "commence a rulemaking" in light of the study and report, and subsection (g) describes the permissible content of that rulemaking—a rule that makes the standard of conduct for broker-dealers "the same as" the standard of conduct for investment advisers. *Id.* at 1827-28.

When construing statutory language, courts "must read the words in their context and with a view to their place in the overall statutory scheme." *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015). The structure of Section 913 of the Dodd-Frank Act clearly envisions a particular course of action for the SEC: that the SEC will conduct a study regarding broker-dealers, consider a variety of specific factors, solicit input from the public, write a report, and then make a specific rulemaking decision. That specific decision is whether or not to make the standard of conduct for broker-dealers "the same as" the standard of conduct for investment advisers when providing personalized investment advice, which "shall be no less stringent than" the fiduciary standard imposed by the Investment Advisers Act. 124 Stat. 1828-29. No provision grants the SEC general rulemaking authority to determine whatever standard of conduct it chooses to apply to broker-dealers, including one that is both less stringent than and different from the fiduciary standard that applies to investment advisers.

The SEC's reading of Section 913(f), in contrast, conflicts with the text and structure of the Act. According to the SEC, Section 913(f) is an "express and broad grant of rulemaking authority" that permits the SEC generally to promulgate a rule "addressing the legal and regulatory standards of care for broker-dealers, and their associated persons." 84 Fed. Reg. at 33,330. But if this were true, it would render Section 913(g) superfluous. Section 913(g) grants the SEC authority to promulgate a very specific rule "addressing the legal and regulatory standards of care for broker-dealers"; if the SEC is right about Section 913(f), and that Section provides general authority to regulate that standard of care in whatever way the SEC deems fit, all of the authority granted in Section 913(g) would be subsumed by the authority granted in Section 913(f). There would be no reason for the detailed provisions in Section 913(g), in which the Dodd-Frank Act amends two decades-old statutes to provide precise and specific authorization regarding the standard of care for broker-dealers.

This Court should reject such a reading. It is a fundamental principle of statutory interpretation that courts "must give effect to every word of a statute wherever possible." *Halloran*, 821 F.3d at 333 (quoting *Leocal*, 543 U.S. at 12). But the SEC's reading effaces more than a word—it makes redundant an entire detailed subsection of the Dodd-Frank Act. The SEC reads Section 913(f) as a "general" grant of power "that would include [the powers] specifically enumerated" in Section 913(g), an "interpretation of a congressional enactment which renders superfluous another portion of that same law." *United States v. Jicarilla Apache Nation*, 564 U.S. 162, 185 (2011) (quoting *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825, 837 (1988)). Such a reading, which "would vitiate Congress' specification" of the particular policy decision that it wanted the SEC to make, runs contrary to the longstanding command for courts to follow congressional intent and give effect to every provision of a statute's text. *Id.* at 186.

In addition to making the text of Section 913(g) a nullity, the SEC's reading of the Dodd-Frank Act runs contrary to its legislative history and "core purposes." *Electric Power Supply Ass'n*, 136 S. Ct. at 773. Dodd-Frank was specifically concerned with the problem of "regulatory arbitrage," in which financial-services companies could exploit the differences in regulatory standards for similar products to skirt their obligations. *See, e.g.*, 156 Cong. Rec. S5882 (daily ed. July 15, 2010) (statement of Sen. Warner) (emphasizing that Dodd-Frank was intended to "make sure the huge gaps that existed that allowed systemic regulatory arbitrage could no longer take place"). The supporters of Dodd-Frank were keenly aware that where rules "applied to some financial companies but not all," this "opened loopholes that bad actors could exploit," contributing to the "gaps in regulation" that had been one of the underlying causes of the 2008 financial crisis. *Id.* at S5888 (statement of Sen. Johnson). In other words, the Dodd-Frank Act was intended not only to modify or improve regulations as a general matter, but to *equalize* the regulatory burdens on similarly situated actors, to prevent financial-services companies from "just reorganiz[ing] to fit into an exemption." *Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises*, 111th Cong. (July 20, 2010) (Statement of Mary L. Schapiro, SEC Chairman).

The ability of broker-dealers to offer similar services to investment advisers with less of a regulatory burden was one of the regulatory gaps that the Dodd-Frank Act sought to close. In the hearings leading up to the Act's passage, Congress heard testimony regarding "the inconsistent regulatory regimes that exist today for investment advisors and broker-dealers" and the need to "clos[e] regulatory gaps and respond[] to changes in the marketplace." *Enhancing Investor Protection and the Regulation of Securities Markets: Hearing Before the S. Comm. on Banking, Housing, and Urban*

Affairs, 111th Cong. 12 (March 10, 2009) (prepared statement of T. Timothy Ryan, Jr.). Supporters of the Act observed that "too many investors do not know the difference between a broker and an investment advisor," and wanted the Act to "ensure that all investment professionals that offer personalized investment advice have a fiduciary duty imposed on them." 156 Cong. Rec. S5870 (daily ed. July 15, 2010) (July 15, 2010) (statement of Sen. Akaka). The SEC was specifically directed to consider this concern when conducting its study and report on broker-dealers and investment advisers; Section 913(c) directs the SEC to consider the "legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, [and] investment advisers . . . that should be addressed by rule or statute." 124 Stat. at 1825. The differing regulatory obligations of broker-dealers and investment advisers was thus one of the specific regulatory gaps that the Dodd-Frank Act sought to close by equalizing the regulatory burdens on similarly situated actors.

The SEC ignores this. According to the SEC, Section 913(f) authorizes the agency to promulgate a rule for broker-dealers that adopts whatever standard of conduct it deems fit—even if that standard of conduct is different from and less stringent than the standard that applies to investment advisers. In addition to reading Section 913(g) out of the Dodd-Frank Act, this understanding of Section 913(f) disregards Congress's specific concern with equalizing standards for similar conduct. Section 913(g) makes that concern clear—in Section 913(g), Congress authorized the SEC to make the decision of whether to equalize the standards for broker-dealers and investment advisers when they provide personalized investment advice, and took pains to ensure that any new, equal standard could not be less stringent than the fiduciary standards of the Investment Advisers Act of 1940. *See* 124 Stat. at 1824-28. But the SEC reads Section 913 atextually and ahistorically, as granting it the authority to simply "promulgate [a] rule addressing the legal and regulatory standards of care for broker-dealers, and their associated persons," whatever that standard may be. 84 Fed. Reg. at 33,330.[2]

"It is well settled that an agency may only act within the authority granted to it by statute." *NRDC v. Nat'l Highway Traffic Safety Admin.,* 894 F.3d at 108. The SEC is "a creature of statute," and has "*only* those authorities conferred upon it by Congress." *Id.* (quoting *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 8 (D.C. Cir. 2002)). The Dodd-Frank Act did not confer general rulemaking authority on the SEC to set any standard of conduct for broker dealers and investment advisers that

[2] The SEC also appears to indicate that it may perceive a distinction between a broker-dealer giving "advice" and providing a "recommendation." *See, e.g.*, 84 Fed. Reg. at 33,318. Whatever the merits of this distinction, it demonstrates another problem with the SEC's interpretation of Dodd-Frank. Dodd-Frank grants the SEC authority only to regulate the standard of conduct for broker-dealers and investment advisers when "providing personalized investment advice." To the extent the SEC's position is that the recommendations regulated by Regulation Best Interest are distinct from "advice," that further undermines its claim that Section 913(f) provides authority to issue the regulation.

it deemed fit. Because the agency "has gone beyond what Congress has permitted it to do," this Court must hold Regulation Best Interest unlawful and set it aside. *NRDC v. Nat'l Highway Traffic Safety Admin.*, 894 F.3d at 108 (quoting *City of Arlington v. FCC*, 569 U.S. 290, 297-98 (2013)); 5 U.S.C. § 706(2).

III. Regulation Best Interest is arbitrary and capricious.

In addition to striking down regulations that are contrary to law, this Court must set aside regulations that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). In a notice-and-comment rulemaking like the one at issue in this case, the agency must show that it "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action." *NRDC v. FAA*, 564 F.3d at 555 (quoting *State Farm*, 463 U.S. at 43). When it comes to evaluating the agency's justifications, this Court's "inquiry must be searching and careful." *NRDC v. EPA*, 658 F.3d at 215. Ultimately, the agency's determinations "must be reasonable and reasonably explained." *North Baja Pipeline, LLC v. FERC*, 483 F.3d 819, 821 (D.C. Cir. 2007).

A. Regulation Best Interest is premised on an incorrect interpretation of the Investment Advisers Act.

Regulation Best Interest is arbitrary and capricious because it relies on a misinterpretation of the Investment Advisers Act. "If a regulation is based on an incorrect view of applicable law, the regulation cannot stand as promulgated, unless the 'mistake of the administrative body is one that clearly had no bearing on the procedure used or the substance of decision reached.'" *Prill*, 755 F.2d at 948 (quoting *Mass. Trustees v. United States*, 377 U.S. 235, 248 (1964)). As a result, where an agency has relied on a "legally erroneous . . . premise" in reaching a decision, that decision is rendered "arbitrary, capricious, or otherwise not in accordance with law" and must be remanded to the agency for reconsideration. *See, e.g.*, *Safe Air for Everyone v. EPA*, 488 F.3d 1088, 1101 (9th Cir. 2007).

Here, Regulation Best Interest relies heavily on the SEC's misinterpretation of the broker-dealer exclusion in the Investment Advisers Act. *See* 15 U.S.C. § 80b-2(a)(11)(C). The Investment Advisers Act provides that an "investment adviser" is "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . ." *Id.* § 80b-2(a)(11). This broad definition is followed by a few limited exceptions, including the broker-dealer exception. The broker-dealer exception applies to "any broker or dealer" that meets two requirements: (1) their "performance of such services is solely incidental to the conduct of [their] business as a broker or dealer," and (2) they "receive[] no special compensation" for their performance of such services. *Id.* These two requirements are referred to respectively as the "solely incidental" prong and the "special compensation" prong. Regulation Best Interest is premised on an erroneous interpretation of each prong.

1. The "solely incidental" prong. Regulation Best Interest is predicated on an interpretation of the phrase "solely incidental" that is contrary to the plain text of the Investment Advisers Act. This interpretation is contained in an interpretive rule that the agency refers to as the "Solely Incidental Interpretation," which was issued concurrently with Regulation Best Interest. *See* Solely Incidental Interpretation, 84 Fed. Reg. 33,681-89. The Solely Incidental Interpretation is invoked and relied on throughout Regulation Best Interest. *See* 84 Fed. Reg. at 33,320-21, 33,323, 33,336, 33,340-41, 33,351-53, 33,358, 33,383 n.654, 33,406 n.895, 33,408 n.910, 33,419 n.972, 33,439, 33,464 & n.1345, 33,484.

The Solely Incidental Interpretation essentially reads the phrase "solely incidental" out of the Investment Advisers Act altogether. According to the SEC, a broker-dealer may provide investment advice that is considered "solely incidental to the conduct of [their] business as a broker or dealer," 84 Fed. Reg. at 33,682, as long as "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. In other words, as long as the broker-dealer's "primary business" is "effecting securities transactions," the broker-dealer may provide any amount of advice, at any time, in any manner, if it is "in connection with and is reasonably related to" that business. *Id.*

The Solely Incidental Interpretation is explicit about this. It specifically rejects the view that "the quantum or importance of investment advice" should determine "whether or not the provision of advice is consistent with the solely incidental prong." *Id.* As the SEC sees it, "[a]dvice need not be trivial, inconsequential, or infrequent to be consistent with the solely incidental prong." *Id.* As a result, according to Regulation Best Interest the solely incidental prong can be satisfied even where a broker-dealer has "'held itself out' as an investment adviser" to the general public. 84 Fed. Reg. at 33,351 & n.335 (citing the Solely Incidental Interpretation). Regulation Best Interest is thus based on an understanding in which a broker-dealer can hold itself out to the public as an investment adviser, provide frequent and significant investment advice to its clients, and generate substantial revenue from this advice as a routine part of its business model.

This is an unreasonable reading of the Investment Advisers Act. The word "incidental," both in 1940 and today, indicates an event that is of low importance or concern, usually in connection with its chance or infrequent nature. *See, e.g.*, Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, at 420 (surveying dictionary definitions from the time of the Investment Advisers Act). As Professor Laby describes it, "contemporaneous dictionaries define the term 'incidental' as an event happening by chance and, therefore, of secondary importance to another." *Id.* Webster's Dictionary from 1938, for instance, defined an "incidental" event as "not of prime concern" and "subordinate"; a thesaurus from 1938 lists "accidental, casual, fortuitous, subordinate, contingent, occasional, adventitious, extraneous, and non-essential" as synonyms for "incidental." *Id.* (citing *Webster's New International Dictionary of the English Language* 1257 (2d ed. 1938); Richard Soule, *A Dictionary of English Synonyms and Synonymous Expressions* 280 (1938)).

Today, similarly, "incidental" has only two definitions in Merriam-Webster's dictionary: "being likely to ensue as a chance or minor consequence," and "occurring merely by chance or without intention or calculation." *Incidental*, Merriam-Webster.com. The American Heritage Dictionary also has only two definitions: "Occurring or likely to occur as an unpredictable or minor consequence," and "[o]f a minor, casual, or subordinate nature." *Incidental*, The American Heritage Dictionary of the English Language (5th ed. 2020).

The SEC's interpretation—that "solely incidental" does not create a standard that emphasizes the "importance or frequency" of the investment advice given, 84 Fed. Reg. at 33,684—is therefore directly opposed to the plain meaning of the word "incidental." And even if there were any doubt about that, the Investment Advisers Act does not only use the word "incidental"—it uses the term "*solely* incidental." 15 U.S.C. § 80b-2(a)(11)(C) (emphasis added). The word "solely" means "entirely; exclusively." *Solely*, The American Heritage Dictionary of the English Language (5th ed. 2020); *see also Solely*, Merriam-Webster.com (last accessed

Dec. 20, 2019) (defining "solely" as "to the exclusion of all else"). By modifying "incidental" with "solely," the Investment Advisers Act makes clear that for the broker-dealer exception to apply, *all* of the financial advice that a broker-dealer gives must be "likely to ensue as a chance or minor consequence" of its business as a broker-dealer. *Incidental*, Merriam-Webster.com. This is irreconcilable with the SEC's interpretation, under which a broker-dealer may "h[o]ld itself out as an investment adviser" and give "[]frequent" and "[]consequential" financial advice without running afoul of the "solely incidental" prong. 84 Fed. Reg. at 33,351 & n.335; 84 Fed. Reg. at 33,685.

Further evidence that the SEC's interpretation is erroneous comes from the SEC's own prior decisions. In 2005, the SEC issued a final rule stating that a broker-dealer "would not be providing advice solely incidental to brokerage" if it "holds itself out generally to the public as a financial planner or as providing financial planning services." 70 Fed. Reg. 20,438 (April 19, 2005), *vacated on other grounds by Fin. Planning Ass'n*, 482 F.3d at 483. The SEC's reasoning depended on the frequency, scope, and significance of the advice—it wrote that financial planners address "long-term" needs, and that they involve "a comprehensive financial program" that may "address a wide spectrum" of client needs. *Id.* On this basis, the SEC concluded that financial planning is a "distinct" service and not "solely incidental" to brokerage services. *Id.* Yet Regulation Best Interest eschews this reasoning and reaches a directly contrary conclusion, holding that it is acceptable for broker-dealers to hold themselves out as "investment adviser[s]," literally the title for which the Investment Advisers Act seeks to require registration.

The SEC's interpretation of "solely incidental" is also contrary to the structure, purpose, and context of the Investment Advisers Act. *See King*, 135 S. Ct. at 2492 ("[W]e must read the words in their context and with a view to their place in the overall statutory scheme."). The Investment Advisers Act was a response to the concern that consumers and the public at large are harmed when "the business of investment advisers is so conducted as to . . . relieve themselves of their fiduciary obligations to their clients." *Capital Gains Research Bureau*, 375 U.S. at 189 (quoting S. 3580, 76th Cong., 3d Sess., § 202). The Act thus created a fiduciary standard that applied broadly, to "any person who, for compensation, engages in the business of advising others" regarding their financial investments. 15 U.S.C. § 80b-2(a)(11).

The Supreme Court has held that the Act's provisions should be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes." *Capital Gains Research Bureau*, 375 U.S. at 195. Yet the flexibility that the SEC deploys in Regulation Best Interest is not to read the Act's remedial provisions broadly, but instead to read the *exception* to the Act's provisions broadly. The SEC has tried to do this previously in this context, when it nearly read the "special compensation" prong out of existence. *See Fin. Planning Assoc. v. SEC*, 482 F.3d at 483 (noting that the rule "exempt[ed] broker-dealers from the IAA when they receive 'special compensation'" for giving advice). This interpretation, like that one, is an unreasonable narrowing of a remedial statute.

2. The "special compensation" prong. For broker-dealers to be able to provide financial advice without being considered investment advisers under the Act, they not only must comply with the solely incidental prong but also must not receive "special compensation" for the advice that they provide. *See* 15 U.S.C. § 80b-2(a)(11)(C). Regulation Best Interest is also fundamentally premised on an erroneous interpretation of this prong of the broker-dealer exception to the Investment Advisers Act.

Unlike its issuance of the Solely Incidental Interpretation, the SEC has not released an interpretive document concurrently with Regulation Best Interest explaining its interpretation of the special compensation prong.[3] But regardless of

[3] Instead, a footnote in the Solely Incidental Interpretation states that the SEC "do[es] not believe our views on this prong require additional clarification." 84 Fed. Reg. 33,683 n.17. The footnote then cites two documents. First, it cites a 2007 proposed interpretive rule in which the SEC states that "broker-dealers receive 'special compensation' where there is a clearly definable charge for investment advice." *See id.* (citing *Interpretive Rule Under the Advisers Act Affecting Broker-Dealers*, Investment Advisers Act Release No. 2652 (Sept. 24, 2007)). Next, it cites the 2005 final rule vacated by the D.C. Circuit in *Financial Planning Association v. SEC*, in which the SEC attempted to allow broker-dealers to take advantage of the Investment Advisers Act's exception even if they *had* received "special

how the SEC would characterize its views, it is clear that Regulation Best Interest relies on an interpretation of the special compensation prong that cannot be reconciled with the statutory text. Regulation Best Interest specifically contemplates a variety of scenarios in which broker-dealers will receive compensation specifically for giving advice. The rule is clear that it applies to situations in which a "broker-dealer receives compensation" for "recommendations." 84 Fed. Reg. 33,344. It discusses scenarios in which broker-dealers receive compensation "directly or indirectly as a result of [their] recommendation," and whether or not "the retail customer" has an account with the broker-dealer's firm. *Id.*

The regulation is replete with discussions of broker-dealers receiving compensation specifically for advice—indeed, it is one of the focuses of the rule. The discussion of conflicts of interest, for instance, centers in large part on "compensation associated with recommendations to retail customers." 84 Fed. Reg. at 33,363. The rule's discussion of its disclosure requirements specifically contemplates the possibility that broker-dealers should disclose when their

compensation." *See id.* (citing *Certain Broker-Dealers Deemed Not to Be Investment Advisers*, Investment Advisers Act Release No. 2376 (Apr. 12, 2005)); *Fin. Planning Ass'n*, 482 F.3d at 483 (vacating the 2005 rule). Despite the SEC's assertion that its views do not "require additional clarification," it is unclear whether it believes its views are represented by the 2007 proposed interpretive rule (which contains only a limited interpretation of the special compensation prong) or by the 2005 final rule (which has been vacated).

compensation structures give them "an incentive to recommend certain products over other products for which the broker-dealer receives less compensation." *Id.*; *see also id.* at 33,364 (discussing "[t]he receipt of higher compensation for recommending some products rather than others"). Such compensation—literally, money paid to a broker-dealer for making a specific recommendation—must fall under any reasonable interpretation of what the Investment Advisers Act means by "special compensation" given for "the business of advising others." 15 U.S.C. § 80b-2(a)(11).

The rule's inconsistency with the statutory text is reinforced by the SEC's past interpretation of the special compensation prong. Shortly after the Investment Advisers Act was passed, the General Counsel of the SEC issued an opinion discussing the prong. *See Opinion of Chester T. Lane,* Investment Advisors Act of 1940, Release No. 2 (1940). That opinion states that the special compensation prong "amounts to [a] . . . clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the Act merely because he is also engaged in effecting market transactions in securities." *Id.* In discussing a variety of possible factual scenarios, the opinion states that a broker or dealer "may safely consider himself excluded from the definition of the term 'investment adviser'" only if the broker-dealer is confident that the compensation at issue "bear[s] *no relation* *whatsoever* to the rendition of investment advice to his customers." *Id.* (emphasis added). It is a far cry from that interpretation to Regulation Best Interest, whose principles regarding the standard of care for broker-dealers are based around the assumption that broker-dealers will receive extra compensation not only for the act of providing advice to their clients, but for the specific content of their recommendations. 84 Fed. Reg. at 33,363.

* * *

These unreasonable interpretations of the two prongs of the broker-dealer exception render Regulation Best Interest arbitrary and capricious. Even if the ultimate prescriptions of Regulation Best Interest would be "permissible as an exercise of discretion," the rule "cannot be sustained where it is based . . . on an erroneous view of the law." *Sea-Land Serv., Inc. v. Dep't of Transp.*, 137 F.3d 646 (D.C. Cir. 1998) (quoting *Prill*, 755 F.2d at 948). Consistent with the *Chenery* doctrine, "[i]f a regulation is based on an incorrect view of applicable law, the regulation cannot stand as promulgated, unless the mistake of the administrative body is one that clearly had no bearing on the procedure used or the substance of decision reached." *Prill*, 755 F.2d at 948; *see also SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943) (judicial review must be confined "to a judgment upon the validity of the grounds upon which the [agency] itself based its action").

In this case, the SEC's unreasonable interpretations of the two prongs of the broker-dealer exception clearly had a bearing on "the substance of the decision reached." *Prill*, 755 F.2d at 948. Regulation Best Interest frequently invokes the Solely Incidental Interpretation as a basis for the agency's reasoning, an elaboration of the agency's position, and a response to specific comments. *See* 84 Fed. Reg. at 33,320-21, 33,323, 33,336, 33,340-41, 33,351-53, 33,358, 33,383 n.654, 33,406 n.895, 33,408 n.910, 33,419 n.972, 33,439, 33,464 & n.1345, 33,484.

In addition, the size and scope of the entire market the rule covers—the market of broker-dealers who provide investment advice—is defined by the boundaries set by the broker-dealer exception. *See* 15 U.S.C. § 80b-2. Regulation Best Interest regularly justifies its decision-making by invoking consumer choice and the incentives broker-dealers may have to become dual registrants. *See, e.g.*, *id.* at 33,329-30; 33,442; 33,451; 33,454; 33,461-68. How the SEC interprets the exception determines what conduct broker-dealers can engage in without triggering the regulatory burdens that fall on investment advisers, which influences what services broker-dealers offer and what proportion of broker-dealers may choose to become dual registrants. As a result, the SEC's interpretation of the scope of the broker-dealer exception is core to its decision-making throughout Regulation Best Interest. Because the rule is based on the "legally erroneous . . .

premise" of the SEC's interpretation of the Investment Advisers Act, it must be remanded to the agency for reconsideration. *Safe Air for Everyone*, 488 F.3d at 1101.

B. Regulation Best Interest does not reasonably address the problem of consumer confusion.

In addition to being premised on legally erroneous interpretations, Regulation Best Interest is an unreasonable response to the evidence that was presented to the SEC. To satisfy the Administrative Procedure Act's requirement of reasoned decision-making, an agency must "examine[] the relevant data and articulate[] a satisfactory explanation for its action." *NRDC v. FAA*, 564 F.3d at 555 (quoting *State Farm*, 463 U.S. at 43). The agency's response to the evidence "must be reasonable and reasonably explained." *NRDC v. EPA*, 571 F.3d 1245, 1267 (D.C. Cir. 2009). Here, the SEC failed to reasonably account for the significant evidence that consumers are not meaningfully able to differentiate between the standards of conduct owed by broker-dealers and investment advisers even with the assistance of disclosure forms.

1. The evidence presented to the SEC. To begin with, the SEC was presented with evidence firmly establishing that consumers are confused by the difference between broker-dealers and investment advisers and do not understand the significance of the different legal standards that apply to them. *See, e.g.*, PA320-527; PA539-695; PA704-825; PA1369-1538. Much of this evidence comes from the SEC's own reports and from studies that the SEC has commissioned.

In 2005, for instance, the SEC commissioned a study that found that consumers generally "did not understand that the roles and legal obligations of investment advisers and broker-dealers were different." PA429. That study, in turn, was confirmed by a much larger study that the SEC commissioned from RAND the following year, which found that consumers nationwide "did not understand the differences between investment advisers and broker-dealers." PA431. As the SEC noted, the 2008 RAND study "shed further light on this confusion" by finding that "the interchangeable titles and 'we do it all' advertisements" of financial firms "made it difficult to discern broker-dealers from investment advisers." *Id.* Examining these and other studies, the SEC's report issued under Dodd-Frank Act Section 913 concluded that "there is robust recent evidence that many retail investors do not understand or are confused by the different standards of care applicable to investment advisers and broker-dealers and their respective associated persons." PA427.

The SEC was also presented with thorough and persuasive evidence that disclosures made by broker-dealers and investment advisers are ineffective at dispelling this confusion. The RAND survey found that after focus group participants were presented with fact sheets, they were still confused by the distinctions between investment advisers and broker dealers. 2008 RAND Study at 111. Even after RAND focus-group participants had different standards of care explained to them, the "participants struggled to understand the differences." *Id.* at 118.

Subsequent RAND studies, commissioned by the SEC more recently, bolster these results. A 2018 RAND study found that confusion about the differences between broker-dealers and investments advisers persisted even after presenting focus-group participants with a fact sheet. PA539-695. Another study by RAND was commissioned by the SEC specifically to evaluate the SEC's "relationship summary" disclosure form. *See* JA704-825. The study found that there were consumers who "seemed to misunderstand the differences between account types and financial professionals from the beginning, never fully grasping it" even after being presented with a sample relationship summary. PA755. Many who encountered the word "fiduciary" "had never heard of the word," and "others had heard it but did not know what it meant in this context." PA750.

Still others did not understand how an obligation to act in a customer's best interest could coexist with a disclosure stating that the consumer's interest and the adviser or broker's interest could conflict. *Id.* The study noted that "[m]any participants expressed confusion over how to reconcile" the sections of the relationship summary describing broker-dealers and investment advisers' legal duties with the sections disclosing conflict of interest. PA753. And others did not understand the distinct legal obligations owed by investment advisers and broker-dealers under Regulation Best Interest. *Id.* One participant stated that "it's basically the same language . . . but they just kind of word it differently," hypothesizing that "they try to" make one set of legal duties "sound a little fancier." *Id.* at 750.

The findings from these SEC-commissioned studies are reinforced by additional evidence submitted to the SEC via public comment. The AARP, noting the "central" role of disclosure in the SEC's proposed approach, commissioned an independent study to evaluate "whether typical investors would be able to make an informed choice between a brokerage account and an advisory account" based on the disclosures in the Relationship Summary. PA3508, 3511. The study, which involved ninety-minute one-on-one interviews with investors around the country, found that "[m]ost participants did not understand disclosures regarding legal obligations," and that "most participants assumed the standards [of conduct] would be the same despite the different language used to describe them." PA3509. Some believed that the term "best interest" cast "a more favorable light" on brokerage accounts than "fiduciary duty" did for investment advisers. *Id.*

Examining the statements made by participants indicated that their attempt to understand the disclosures "[t]oo often . . . leads, not just to a lack of understanding, but to a misunderstanding of the information presented." PA3511. The AARP observed that "investors like the idea of a brief disclosure document," but noted that the study demonstrated "serious problems" and indicated that the disclosures provided for by the SEC "do not achieve the intended result" of increasing consumer understanding. *Id.*

2. The SEC's response. Even though the SEC was presented with this broad base of evidence that disclosures are not effective at helping consumers differentiate between broker-dealers and investment advisers, Regulation Best Interest relies heavily on the effectiveness of disclosures. As the SEC describes it, Regulation Best Interest and the interpretations released concurrently with it "are designed to help retail customers better understand and compare the services offered by broker-dealers and investment advisers and make an informed choice of the relationship best suited to their needs and circumstances." 84 Fed. Reg. at 33,484. Regulation Best Interest's way of facilitating that "informed choice," meanwhile, is the disclosure obligation and Relationship Summary form—the same form that the RAND study casts doubt on—which provide "key information" to "[r]educe the information asymmetry that may exist between a retail customer and their broker-dealer" and "facilitate customer comparisons." *Id.* at 33,347.

But the SEC never adequately addresses the evidence demonstrating that disclosure is an extremely limited tool in this specific context. The closest it comes is in a brief section in Regulation Best Interest entitled "Evidence on the Effectiveness and Limitations of Disclosure," 84 Fed. Reg. 33,433, and a similarly short untitled passage of several paragraphs in the Form CRS Final Rule, 84 Fed. Reg. 33,580-81. These two passages suffer from a common fundamental flaw: they make cursory statements regarding the benefits of disclosure to consumers in general while ignoring the specific evidence that disclosure will not meaningfully help consumers understand the difference between broker-dealers and investment advisers.

The SEC notes, for instance, that "[c]haracteristics of effective disclosures include saliency of information, clear and concise information delivered in a transparent manner, and increased use of visual and interactive design, among others." 84 Fed. Reg. at 33,433. It then cites several studies discussing better or worse ways of designing disclosure documents, along with a single study suggesting that consumers may get value from disclosures regarding conflicts of interest. *Id.* & nn.1144-48. The SEC also acknowledges many studies casting doubt on the value to consumers of these disclosures. *Id.* But the SEC cites no evidence demonstrating specifically that disclosure will enable consumers to differentiate between the standards of care owed by broker-dealers and investment advisers. *See* 84 Fed. Reg. 33,433; 84 Fed. Reg. 33,580-81.

The inadequacies of the SEC's evidentiary analysis are highlighted in particular by the second study conducted by the AARP. *See* PA3085-3177. The AARP's second study was designed specifically "to develop and test alternate language and design" for a Relationship Summary disclosure form. PA3086. The AARP engaged in "extensive revisions" to conform the disclosure form to best practices, including "shortening the document . . . simplifying and clarifying the language, and adopting a question-and-answer format." *Id.* But "the inescapable conclusion of this second round of testing, like the previous round, was that many, if not most, investors failed to understand many of the key points" in the disclosure. *Id.* The AARP found that despite these improvements, "[m]ost participants did not understand disclosures regarding legal obligations," and "[t]he overall level of comprehension was poor." PA3087.

In the face of such "specific evidence," including evidence commissioned directly by the SEC regarding this exact rulemaking, it is not enough to "cite[] generally to an industry-wide study" or "a nonspecific nationwide trend" to say that disclosure rules will enable consumers to differentiate between broker-dealers and investment advisers and balance for themselves which standard of care is worth what price for goods and services. *Ergon-W. Virginia, Inc.*, 896 F.3d at 613. The basic premise of Regulation Best Interest is that the SEC did not need to harmonize the standard of conduct between broker-dealers and investment advisers because consumers can choose between different standards of conduct based on their preferences. *See, e.g.*, 84 Fed. Reg. at 33,460. But specific evidence casts doubt on consumers' ability to understand the differences between the standards of conduct, both before and after the disclosures required by rule. The SEC's failure to respond to this specific evidence means that the agency has not "articulate[d] a satisfactory explanation for its action," which must be overturned. *NRDC v. FAA*, 564 F.3d at 555 (quoting *State Farm*, 463 U.S. at 43).

CONCLUSION

This Court should hold Regulation Best Interest to be unlawful and set it aside under 5 U.S.C. § 706.

December 27, 2019

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Local Rule 32.1(a)(4) because this brief contains 13,991 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(f). This brief complies with the typeface requirements of Rule 32(a)(5) and the type-style requirements of Rule 32(a)(6) because this brief has been prepared in proportionally spaced typeface using Microsoft Word in 14-point Baskerville font.

December 27, 2019

/s/ Deepak Gupta
Deepak Gupta
Counsel for Investment Adviser Petitioners

CERTIFICATE OF SERVICE

I hereby certify that on December 27, 2019, I electronically filed the foregoing brief with the Clerk of the Court for the U.S. Court of Appeals for the Second Circuit by using the CM/ECF system. All participants are registered CM/ECF users and will be served by the CM/ECF system.

/s/ Deepak Gupta
Deepak Gupta

ADDENDUM

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UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

XY PLANNING NETWORK, LLC; FORD FINANCIAL SOLUTIONS, LLC, et al., *Plaintiffs*, v. UNITED STATES SECURITIES AND EXCHANGE COMMISSION; and WALTER "JAY" CLAYTON III, in his official capacity as Chairman of the United States Securities and Exchange Commission, *Defendants*.	No. 19-2886

DECLARATION OF MICHAEL KITCES

I, Michael Kitces, declare as follows:

1. I am one of the co-founders of XY Planning Network (XYPN), an organization of over 1,100 financial planners. The financial planners who constitute the membership of XY Planning Network work under registered investment advisers (or RIAs) that provide financial-planning services on a fee-for-service basis, primarily to Gen X and Gen Y consumers. After five years of rapid growth, XYPN now comprises more than 5% of all state-registered RIAs doing financial planning nationwide, and has about as many advisers as a top-30 broker-dealer by advisor headcount.

2. A core part of XYPN's mission is to facilitate the growth of financial planning firms that focus on working with Gen X and Gen Y clients. XYPN provides an array of services to help its members start, grow, and maintain their RIA financial-planning businesses in a competitive marketplace, from registration and compliance services to technological, business, and consulting services. XYPN derives revenue from the advisors it serves, who pay an annual fee of approximately $5,000.

3. All of XYPN's members are bound by fiduciary obligations to their clients. In addition to their duties that arise under federal and state law by operating as an RIA, XYPN requires all members who join to sign a separate and additional fiduciary oath to adhere to a fiduciary standard of acting in the best interests of their clients.

4. XYPN's members join XYPN in large part because they are legally required to register as an investment adviser to provide and be compensated for financial-planning services, which include investment advice. Registering as an investment adviser entails a number of obligations. An adviser who wishes to charge fees for investment advice typically seeks out compliance services to register their RIA businesses, and will often need technology, coaching, and consulting services to succeed as RIAs. XYPN provides these services and more.

5. The SEC's "best interest" rule presents a significant threat to XYPN's business. XYPN's business model depends in substantial part on financial planners having an incentive to register as RIAs to be compensated for financial planning advice. By failing to impose a standard of conduct for broker-dealers that is the same as the standard for investment advisers, as required by Dodd-Frank section 913(g), the SEC's rule permits brokers to be compensated for financial planning advice through the sale and distribution (i.e., implementation) of brokerage products without registering as an investment adviser. It also permits brokers to implement such products as recommended in their financial plans pursuant to a lower Regulation Best Interest standard with less legal exposure than would apply as an RIA. By permitting these actions, the rule reduces the likelihood that registered representatives of broker-dealers will register as investment advisers to be compensated for their financial planning advice, resulting in a loss of business for XYPN.

6. The SEC's rule also poses a significant threat to the businesses of XYPN's

members. In subjecting broker-dealers to a lower standard of conduct than RIAs, the rule allows broker-dealers to participate economically in the conflicted manufacture, sale, and distribution of financial products alongside providing the same financial-planning services as RIAs, while also reducing their legal exposure despite the introduction of such conflicts. And the rule does so while using the label "best interests" to refer to the lower standard of care applicable to broker-dealers. This makes it more difficult for XYPN member RIAs to differentiate the fiduciary duty they owe—and their own actual "best interests" standard of conduct—from the lesser duty owed by broker-dealers operating a more conflicted model under the SEC's new rule, and allowing competing dually-registered broker-dealer/RIAs to voluntarily choose to cease their own RIA fiduciary obligation to a client by implementing recommendations via the sale of a brokerage product. This results in a competitive disadvantage to XYPN's purely-RIA members, who sign a fiduciary oath to act in their clients' best interests, and must maintain their fiduciary duty throughout the entire client relationship as an RIA, throughout both the advice, recommendation, *and* implementation stages. This competitive harm also injures XYPN by increasing members' risk of failure in a competitive marketplace for financial planning advice, which would reduce XYPN's membership fees.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

DocuSigned by:
Michael Kitces
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Dated: December 20, 2019 Michael Kitces

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

XY PLANNING NETWORK, LLC; FORD FINANCIAL SOLUTIONS, LLC, et al., *Plaintiffs*, v. UNITED STATES SECURITIES AND EXCHANGE COMMISSION; and WALTER "JAY" CLAYTON III, in his official capacity as Chairman of the United States Securities and Exchange Commission, *Defendants*.	No. 19-2886

DECLARATION OF JULIE FORD

I, Julie Ford, declare as follows:

1. I am the owner and principal of Ford Financial Solutions, LLC, a registered investment adviser that provides financial-planning services to individuals and families on a fee-for-service basis. Ford Financial Solutions has operated as a registered investment adviser for over three years. Ford Financial Solutions is located at 33 West 60th Street, New York, NY 10023.

2. I am a member of the XY Planning Network, and have been for over three years. As part of this membership, I have signed a fiduciary-duty oath to act in my clients' best interests. I pay an annual membership fee to XY Planning Network of approximately $5,000.

3. As a registered investment adviser, one of my firm's hallmarks is its obligation to act as an advocate for and in the best interests of my clients at all times

— to serve as their trusted fiduciary. I currently attract and retain clients by, in part, highlighting my firm's fiduciary duty to clients.

4. I believe that the SEC's "best interest" rule will provide an unfair competitive advantage to broker-dealers when it comes to attracting new clients that I might otherwise serve. Under this new rule, there is a significant risk that clients will not be able to effectively differentiate the fiduciary duty that I owe them from the lower duty that broker-dealers owe their clients. This would harm my ability to attract customers through my highlighting the increased standard of loyalty and care that I owe to my clients.

5. I am also concerned that under the new rule broker-dealers will be able to provide the same or similar advice and services as I offer, but without acting as an advocate and trusted fiduciary for clients at all times. For my broker-dealer competitors this will mean comparatively fewer regulatory obligations, lower compliance costs, and less legal exposure, giving them a competitive advantage. Were the playing field level, broker-dealers would likewise be held to a fiduciary standard when clients engage them for financial planning or investment advice.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Dated: December 20, 2019

Julie Ford