

[Securities Regulation Daily Wrap Up, TOP STORY—S.D.N.Y.: Financial planners join battle over SEC's Regulation BI, \(Sept. 12, 2019\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

Two financial planning firms filed suit to challenge the validity of the SEC's Regulation BI on largely the same grounds as multiple state attorneys general did just days before, although some differences exist between the complaints.

XY Planning Network, LLC (XYPN) and Ford Financial Solutions, LLC have sued the SEC alleging that the recently effective Regulation Best Interest (Regulation BI) is legally infirm because it exceeded the SEC's statutory authority, its adoption failed to comply with the law, and that the resulting final rule is arbitrary or capricious. XYPN is a [financial planning firm](#) that focuses on advising Generation X and Y clients. Regulation BI was adopted in June 2019, became effective September 10, 2019, and firms will be required to begin complying with the rule by June 30, 2020 ([XY Planning Network, LLC v. SEC](#), September 10, 2019).

Same story as states. XYPN's complaint, filed in the federal court in the Southern District of New York, tells a remarkably similar story to the [complaint by eight state attorneys general](#) filed days earlier. Both complaints lament that the distinctions between investment advisers and broker-dealers have become increasingly blurred and that Regulation BI does little to clarify those differences. Both complaints note that a majority of the Commission, in adopting Regulation BI, disregarded the recommendation of SEC staff who conducted the Dodd-Frank Act-mandated study that the Commission impose a uniform fiduciary duty without regard to the financial interests of a broker-dealer. And both complaints find fault in the Commission majority's reliance on Dodd-Frank Act Section 913(f) (authority to "commence rulemaking") and other Exchange Act provisions to justify the adoption of Regulation BI rather than citing Dodd-Frank Act Section 913(g), which provides more specific rulemaking authority regarding the type of standard to be adopted.

Moreover, both XYPN's and the states' complaints recite that Dodd-Frank Act Section 913 was the result of compromise between the House and Senate versions of the legislation that was intended to give the SEC authority to increase the standard of conduct applicable to broker-dealers. XYPN said that historically broker-dealers were considered "intermediaries" rather than fiduciaries, while the states' complaint explained that broker-dealers make "arms-length sales recommendations." That means broker-dealers generally must provide "suitable" recommendations under the Financial Industry Regulatory Authority's Rule 2111. By contrast, XYPN said investment advisers historically have been fiduciaries, which the states' complaint elaborated upon by saying investment advisers adhere to fiduciary principles of "trust and confidence," which the states' complaint said embraces two components—a duty of care (including the suitability standard) plus a duty of loyalty (avoid or disclose conflicts).

Although XYPN's complaint did not mention the now-defunct Department of Labor (DOL) best interest contract standard, the states' complaint did note that the [Fifth Circuit](#) had credited Dodd-Frank Act Section 913(g)(2) as the basis for the SEC's authority to regulate in the investment adviser space, as opposed to the DOL's lack of such authority, in vacating and setting aside the DOL's fiduciary rule.

The Fifth Circuit opinion explained further that the blurring of the distinction between investment advisers and broker-dealers, as noted by a "major securities law treatise," had been observed as early as 2006 in a study conducted by LNR-Rand which provided some of the impetus for the Dodd-Frank Act provisions on broker-dealers, including Section 913(g). With respect to the [Section 913 study](#) mandated by the Dodd-Frank Act, the treatise further noted that two SEC commissioners raised concerns about the recommendation in a [public](#)

[statement](#) because, in part, the study lacked sufficient analysis. (See Loss, Seligman & Paredes, Securities Regulation, a Wolters Kluwer Legal & Regulatory U.S. publication, at [Chapter 8.A.1.](#))

"Solely incidental." The Commission, in the context of Regulation BI, also addressed via an interpretive release several potentially confusing issues regarding Regulation BI and the Investment Advisers Act's exclusion of certain broker-dealer activities. Advisers Act Section 202(a)(11) defines "investment adviser" to mean, among other things, any person who is compensated for engaging in the business of advising others about the value of securities. Advisers Act Section 202(a)(11)(C) excludes from this definition any broker-dealer who performs these services in a manner that is "solely incidental" to the conduct of the broker-dealer business and who does not receive "special compensation" for those services; this exclusion is known as the broker-dealer exclusion.

The Commission's new [interpretive release](#), issued the same day it adopted Regulation BI, states in relevant part: "We interpret the statutory language to mean that a broker-dealer's provision of advice as to the value and characteristics of securities or as to the advisability of transacting in securities is consistent with the solely incidental prong if the advice is provided in connection with and is reasonably related to the broker-dealer's primary business of effecting securities transactions."

XYPN's complaint, but not the states' complaint, further observed that the "harmful consequences" of Regulation BI could be "exacerbated" due to the interpretive release. Specifically, the complaint posits that the Commission's interpretive release seeks to revive an expansive view of the Advisers Act's catch-all provision allowing the Commission to exempt "such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order" (See Investment Advisers Act Section 202(a)(11)(H)). According to XYPN, the interpretive release, thus, runs afoul of a 2-1 [decision](#) by the D.C. Circuit in 2007 invalidating the Commission's attempt to create an exemption for another set of broker-dealers beyond those mentioned in Advisers Act Section 202(a)(11)(C). The majority in that case consisted of Judge Judith Rogers (author of the opinion) and now-Supreme Court Justice Brett Kavanaugh; Chief Judge Merrick Garland dissented because he believed that *Chevron* required deference to the Commission's interpretation.

XYPN's co-founder, Michael Kitces, had [commented](#) on proposed Regulation BI noting both that the proposed standard for broker-dealers would perpetuate the confusion that already existed among retail investors about what standards apply to investment advisers and to broker-dealers. The comment also posited that the SEC had elided the fact that, absent a narrow exception for "solely incidental" services, broker-dealers are required to register as investment advisers if they want to give investment advice to customers.

Standing. It is axiomatic that in order to bring suit in federal court a party must have standing to do so. XYPN asserted that its members could be harmed by the anti-competitive effects of Regulation BI. Put another way, XYPN claims its members, who take a "fiduciary oath" and are registered investment advisers, could, among other things, lose business if broker-dealers are able to market themselves as pursuing their customer's best interest all the while adhering to a lower legal standard than is applicable to investment advisers.

The states' complaint, by contrast, asserts that they could lose tax revenue from the taxable portions of their residents' retirement accounts if broker-dealers are able to give conflicted investment advice under Regulation BI. The states also assert that they may incur "a greater financial burden" if they must assist retirees who have reduced financial means. Moreover, the states posit that they have a "quasi-sovereign" obligation to look out for their resident's economic well-being.

The case is [No. 19-cv-08415](#).

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Companies: XY Planning Network, LLC; Ford Financial Solutions, LLC

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