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Eight attorneys general sue SEC over Reg BI concerns

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Letitia James, the New York attorney general, is one of eight attorneys general filing a lawsuit against the SEC's new Reg Bi rule.

Eight attorneys general filed a **federal lawsuit** Monday challenging a recently passed Securities and Exchange Commission rule saying it does not sufficiently protect investors under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The SEC's rule package, commonly known as Reg BI for its centerpiece best-interest standard that compels brokers to put clients' financial interests ahead of their own and requires them to mitigate financial conflicts, was approved June 5.

Like many consumer advocacy groups, including AARP and the Consumer Federation of America, the attorneys general — all Democrats — said the regulation is ambiguous and does not sufficiently mitigate conflicts of interests, among other concerns.

The lawsuit, brought by attorneys general in seven states — California, Connecticut, Delaware, Maine, New Mexico, New York and Oregon — and the District of Columbia, was filed in the Southern District of New York.

"With this rule, the SEC is choosing Wall Street over Main Street," said New York Attorney General Letitia James, in a news release. "Instead of adopting the investor protections of Dodd-Frank, this watered-down rule puts brokers first. The SEC is now promulgating a rule that fails to address the confusion felt by consumers and fails to remedy the conflicting advice that motivated Congress to act in the first place."

The states and District of Columbia argue that the rule allows broker-dealers to consider their own interest when making a recommendation. Moreover, the rule could lead to investor confusion as to the duties applicable to broker-dealers and investment advisers, the lawsuit states.

Investment advisers "are fiduciaries who must act in their clients' best interests and are subject to duties of loyalty and care. Broker-dealers, by contrast, have generally been subject under federal law only to a duty of fair dealing, which requires merely that recommendations be 'suitable' for a customer," the lawsuit states.

An SEC spokesman could not immediately be reached for comment.

SEC Chairman Jay Clayton, who championed the rule package's passage, said in June that it's designed to enhance the quality and transparency of the financial professional-retail investor relationship. "Broadly speaking, these rules and interpretations address the obligations of broker-dealers and investment advisers when they provide investment advice and services to our Main Street investors," Mr. Clayton said.

David G. Tittsworth, a lawyer at Ropes & Gray, said the lawsuit's legal merits will involve a close look at the complicated provisions of Section 913 of the Dodd-Frank Act. "That section of Dodd-Frank authorized — but did not require — the SEC to promulgate rules governing standards of conduct for broker-dealers and investment advisers," Mr. Tittsworth said. "But the provisions are arguably ambiguous."

One provision states that the SEC can adopt rules for broker-dealers who provide personalized investment advice to retail customers and that the rules "shall be the same" as an investment adviser's standard of conduct, Mr. Tittsworth noted. But another provision states that the standard of conduct for broker-dealers and investment advisers —

when providing personalized investment advice to retail customers — "shall be to act in the best interest of the customer without regard" to the broker's or adviser's financial interest, he added.

"These may seem like minor deviations, but the merits of the lawsuit could turn on small details," Mr. Tittsworth said.