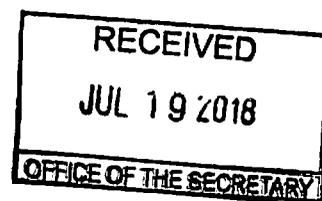


Richard L. Stone, Esquire
[REDACTED]
[REDACTED]
[REDACTED]



July 12, 2018

Brent J. Fields
Secretary
U.S. Securities & Exchange Commission
100 F Street, N.E.,
Washington D.C 20549-1090

Ref File Number: S7-07-18/Proposed Best Interest Rule

Dear Mr. Fields and Honorable Commissioners,

I write to briefly offer several comments upon the proposed Regulation Best Interest. I do so in my own capacity as an attorney, and not in my capacity as a representative of any clients. I am a member of the New York Bar and a graduate of Columbia Law School. I have taught as an adjunct professor at the Florida State University School of Law and the Shepard Broad School of Law. I am currently an adjunct professor at Florida Atlantic University.

1. PREEMPTION ISSUES

The proposed rule does not make clear whether it is the intention of the Commission to preempt state law with respect to broker-dealer obligations currently existing under state law. The proposal discusses the fact that in many states broker conduct is regulated and that also, in many states brokers are not treated as fiduciaries. However, the regulation does not comprehensively address state law regulation of broker dealers and whether or not Regulation Best Interest is intended to preempt this large and varied body of state law. This issue should be of great significance as it is obvious that defense counsel and brokerage firms will argue based upon language contained in the rule proposal that Regulation Best

Interest does in fact preempt state law and intends to establish a comprehensive and uniform federal standard for broker-dealer conduct.

I believe that the Commission should make clear that Regulation Best Interest is **not** intended to preempt or otherwise, override state law regulation of brokers or registered representatives and that such state law will survive intact if the regulation is adopted.¹

The proposed rule is being adopted against the background of varying state regulations and common law which exist with respect to the conduct of broker-dealers and registered representatives. Much of which existed prior to the passage of the Exchange Act and the creation of the NASD/FINRA. I have not conducted an exhaustive study of these various state statutes and common law interpretations however, I point out by way of example that under Florida Common Law, broker-dealers are generally treated as fiduciaries See, Rush v Wells Fargo 752 F.Supp.2d 1254 (M.D.Fla.2010). See, First Union v Milo 717 F. Supp. 1519 (S.D. Fla 1989); In re Dupree, 336 B.R.520 (M.D. Fla 2005). This fiduciary standard is much broader and more comprehensive than the proposed Regulation Best Interest. The proposing release offers no reason why this Fiduciary Standard, under long-standing Florida law should be superseded or preempted by Regulation Best Interest nor does the release offer any analysis with respect to the effect of such preemption. I suggest that the proposed rule be amended to make clear that it is not the intention of the Commission to preempt any state common law or statutory law and that Regulation Best Interest does not in fact preempt state law.

In the proposing release, the staff discusses the fact that under many state common law standards, brokers are treated as fiduciaries when they have discretion in respect to an account or otherwise maintain “control” of the account based upon the factual circumstances of the underlying transactions. Regulation Best Interest does not make clear whether or not this “discretionary account” fiduciary standard is preempted by Regulation Best Interest. Again, the Commission should make clear that Regulation Best Interest does not preempt

¹ Of course, section 28 of the Securities Exchange Act makes clear that preemption of state law is not mandatory or typical with respect to rules and regulations adopted under the Securities Exchange Act. However, various courts have found that SEC regulations can preempt state law and some of the language contained in the proposing release can be argued to indicate an intent to preempt. The Commission should make clear that the regulation does not intend to preempt existing state law.

state common law or statutory law establishing a fiduciary relationship between brokers and customers where brokers have discretion or otherwise “control” a brokerage account.

2. STANDARD OF LIABILITY

If Regulation Best Interest is adopted, it will likely be used as the new industry standard with respect to brokerage conduct and treated as the basis for customer claims in FINRA arbitrations and in other forums. It is therefore important that the Commission set forth clearly whether Regulation Best Interest imposes a negligence based or strict liability-based standard. Stated differently, the Commission should make clear whether or not a violation of Regulation Best Interest requires at least negligent conduct.

3. CONFLICT AND CONFUSION WITH RESPECT TO EXISTING FINRA RULES

As pointed out in the proposing release, FINRA interpretations of the “suitability standard” under FINRA rules have addressed, discussed and established a best interest standard as part of the suitability standard, under FINRA Rule 2111. The proposing release attempts to distinguish this FINRA interpretive language contending that FINRA has not specifically adopted a best interest standard. This is irrelevant. At issue is whether or not the Commission’s Regulation Best Interest is to be interpreted consistently with FINRA’s defacto best interest standard. Indeed, in the Q&A published by FINRA with respect to FINRA Rule 2111 FINRA states clearly that best interests are part of the suitability responsibilities of brokers, and then goes on to state certain types of conduct which would violate this standard in the opinion of FINRA. Does the Commission agree that the types of conduct described by FINRA as violative of the best interest standard do in fact violate the best interest standard? Is the FINRA elaboration of conduct in violation of the best interest standard comprehensive? The interaction of the proposed SEC standard and the defacto existing FINRA standard should be addressed in the regulation so there is no conflict or confusion in the interpretation of the rule once adopted.

4. COMPLEX PRODUCTS

In FINRA Regulatory Notice 12-03, FINRA establishes higher suitability standards and supervisory standards for the sale of so called, complex products - asset back securities and derivative products. These standards establish a higher

requirement for establishing suitability and for “vetting products” prior to sale to customers. Is it the intention of the Commission through Regulation Best Interest to supersede the standard set forth in FINRA regulatory notice 12-03. Stated differently, with satisfying Regulation Best Interest in fact satisfy the higher Suitability Standards set forth in FINRA regulatory notice 12-03?

5. MATERIAL CONFLICTS OF INTEREST

The proposed regulation would require disclosure to retail customers of all “material conflicts of interests that are associated with the recommendation”. The proposed regulation, however, does not clearly define what material conflicts of interest are and should do more to do so. As previously stated, FINRA in its Q&A issued pursuant to its suitability rule addresses, some conduct which would present a material conflict of interest and therefore be required to be disclosed. The staff has not done an equivalent analysis in the proposal. By way of example would material conflicts of interest relate only to compensation paid to brokers or registered representatives in connection with the recommendation or would it be broader. Would it be a material conflict of interest for a firm to fail to disclose that it had a large proprietary short position in a security which it recommended for purchase? Would it violate the regulation to recommend to some customers the purchase of a security and to other customers the sale of the same security without full out complete disclosure of each recommendation? My comment is focused on the breath of the term, “material conflict of interest” which if not additionally defined in the proposal will lead to years of litigation and arbitration over its intended meaning. The analysis with respect to what would constitute a material conflict of interest must necessarily address the existence of “firm-wide” information which may not otherwise be available to brokers or their supervisors in a multi service brokerage firm because of the existence of Chinese walls or other internal informational barriers. This fundamental issue must be addressed i.e. whether all information existing at a multi service brokerage firm,(whether or not such information is cordoned-off pursuant to Chinese wall or other internal policy) can be considered as information which may result in the material conflict, or is the rule only intended to address specific material conflicts with respect to the individual broker’s activity in the sale and recommendation process i.e. compensation to brokers and incentives to brokers which might cause them to sell improper product to clients.

I offer my comments with the expectation, that clarifying these important issues will reduce post-adoption litigation disputes with respect to the intended meaning of this regulation. The Commission is proposing the adoption of a

regulation against the background of decades of pre-existing rules and regulations at SRO's and on the state level pursuant to agency and fiduciary duty law in 50 jurisdictions. It should, in connection with the adoption of the rule, address the impact of the regulation upon the existing regulatory scheme in a more nuanced fashion.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read 'R. L. Stone', with a stylized flourish at the end.

Richard L. Stone