Suitability 101: Assessing Client Suitability (B2BC)
Tuesday, May 16
1:45 p.m. – 2:45 p.m.

This Back to Basics Compliance session provides a review of important suitability obligations for new compliance and legal professionals. Join FINRA staff, along with industry participants, as they share relevant information on the key components of the suitability rule, including the three-main suitability obligations: customer-specific, reasonable-basis and quantitative suitability.

Moderator: Scott Maestri
Associate District Director
FINRA Dallas District Office

Panelists:
Bill Clark
Founder and Chief Executive Officer
MicroVentures Marketplace

Donald Runkle
Regulatory Compliance Director
Coordinated Capital Securities, Inc.

William (Will) Schmitt
General Counsel
Prospera Financial Services, Inc.
Suitability 101: Assessing Client Suitability (B2BC) Panelist Bios:

Moderator:

Scott H. Maestri is Associate District Director in FINRA's Dallas Office. He began his career with NASD in 1999 as an examiner in the New Orleans District Office. Mr. Maestri was promoted to management in September of 2003 and became responsible for a team of examiners who monitored member firms through cycle and cause investigations, as well as, the Membership Application Process and Financial Surveillance. Mr. Maestri was promoted to the Associate District Director position in May of 2010 where his primary responsibility is the review and approval of the District Office’s major program areas. Prior to NASD, Mr. Maestri worked in a variety of sales, operational, and compliance roles with both Morgan Stanley and Legg Mason in the Jackson, Mississippi branch office locations. During the course of his career, Mr. Maestri has been selected for Advanced Management training, and successfully obtained the Certified Regulatory and Compliance Professional™ (CRCP™) designation both issued through The Wharton School at the University of Pennsylvania. Mr. Maestri received his B.B.A. in Finance from The Elze School of Management at Millsaps College.

Panelists:

Bill Clark is the founder and CEO of MicroVentures, Inc. which operates a registered broker dealer and a funding portal. Since founding the company in 2009 they have raised over $100 million for private companies in various stages of the lifecycle. He holds a BS in Finance from Michigan State University as well as Series 7, 24, 63 and 79 securities licenses.

Don Runkle is the Director of Consulting Services with Freeman Mathis & Gary, LLP, and the Regulatory Compliance Director for Coordinated Capital Securities, Inc. Mr. Runkle works with broker-dealers, investment advisers, and registered representatives to develop, implement, and execute strategies to mitigate or eliminate their litigation and regulatory risks. In his role with Coordinated Capital Securities, Mr. Runkle helps to ensure that the firm has appropriate processes and procedures to exceed all regulatory requirements and manage risks in an efficient and effective fashion. He also assists with the execution of all procedures as necessary, including support functions in examinations, regulatory inquiries, customer complaints, options activities, municipal bond activities, new and ongoing product reviews, suitability analyses, and general operational and compliance functions. Mr. Runkle was previously the Chief Compliance Officer for Raymond James Financial Services, Inc., in St. Petersburg, Florida. He has more than 25 years of experience in the financial services industry, having worked as a financial advisor and in several compliance-related roles. Mr. Runkle has been an active leader in numerous industry associations and regulatory committees. He currently serves on the FINRA Membership Committee, and he was previously elected to two terms on the FINRA District 7 Committee. He has also served on the FINRA Regulatory Advisory Committee, the SIFMA Compliance and Regulatory Policy Committee, the FSI Compliance Council, and the SIFMA Compliance and Legal Society’s Regional Firms Committee. Previous industry involvement also includes the FINRA Compliance Resources and Education Committee, the FINRA Books and Records Task Force, the NASD Licensing and Registrations Council, the SIFMA Self-Regulations and Supervisory Practices Committee, the SIFMA State Regulation and Legislation Committee, and the IAFP Compliance Advisory Council. He holds numerous industry licenses, including the Series 7, 24, 53, 4, 63, 65, and previously obtained the Florida Life and Health insurance license. He also completed the Securities Industry Institute at the University of Pennsylvania Wharton School in 2004, and he has been a FINRA arbitrator since 1998.

William M. Schmitt currently serves as General Counsel for Prospera Financial Services, Inc., a dually registered Broker Dealer and Registered Investment Advisor. From June 2014 until February 2016, Mr. Schmitt was a Managing Director at Faulkner Partners, which participated in Private Equity transactions and consulted on commodity finance. From October 2008 until June 2014, Mr. Schmitt was First Vice President and Associate Corporate Counsel in the litigation departments of Morgan Keegan & Company, Inc. and later Raymond James Financial, Inc. Mr. Schmitt is a graduate with honors of the University of Mississippi School of Law.
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Panelists

Moderator

- Scott Maestri, Associate District Director, FINRA Dallas District Office

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- Bill Clark, Founder and Chief Executive Officer, MicroVentures Marketplace
- Donald Runkle, Regulatory Compliance Director, Coordinated Capital Securities, Inc.
- William (Will) Schmitt, General Counsel, Prospera Financial Services, Inc.
To Access Polling

- Under the “Schedule” icon on the home screen,
- Select the day,
- Choose the Suitability 101: Assessing Client Suitability session,
- Click on the polling icon:
1. What is your Firm Type:
   a. Introducing
   b. Non-Introducing
   c. Clearing / Self-Clearing
Polling Question 2

2. What is your Firm Size [# of People]:
   a. Small (0-50)
   b. Medium (50-150)
   c. Large (150+)
Polling Question 3

3. What is your Main Business Focus:
   a. Retail
   b. Institutional
   c. Both
Polling Question 4

4. Number of Years you’ve been in the Industry:
   a. 1 to 5 Years
   b. 5 to 10 Years
   c. 10 + Years
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Resources

FINRA Rules

- FINRA Rule 2111 (Suitability)
  

- FINRA Rule 2330 (Member Responsibilities for Deferred Variable Annuities)
  

FINRA Subject-Matter Webpages

- Suitability
  
  www.finra.org/Industry/Issues/Suitability

- Variable Annuities
  
  www.finra.org/Industry/Issues/Variable-Annuities

FINRA Frequently Asked Questions

- Combined Suitability FAQs
  
  www.finra.org/industry/faq-finra-rule-2111-suitability-faq

FINRA Notices

- FINRA Regulatory Notice 13-45, Reminding firms of their responsibilities concerning IRA rollovers (December 2013)
  
  www.finra.org/industry/notices/13-45

- FINRA Regulatory Notice 13-31, Highlighting FINRA examination approaches, common findings and effective practices for complying with the suitability rule (September. 2013)
  
  www.finra.org/industry/notices/13-31
• FINRA Regulatory Notice 12-55, Addressing the scope of the terms “customer” and “investment strategy” for purposes of the suitability rule (December 2012)
  www.finra.org/industry/notices/12-55

• FINRA Regulatory Notice 12-25, Providing guidance on the new suitability rule in Q&A format (May 2012)
  www.finra.org/industry/notices/12-25

• FINRA Regulatory Notice 12-03 Providing guidance regarding heightened supervision of and explaining suitability obligations for complex products (January 2012)
  www.finra.org/industry/notices/12-03

• FINRA Regulatory Notice 11-25, Providing guidance on and a new effective date for FINRA’s new “know your customer” and suitability rules (May 2011)
  www.finra.org/industry/notices/11-25

• FINRA Regulatory Notice 11-02 Announcing SEC approval of FINRA’s new “know your customer” and suitability rules (January 2011)
  www.finra.org/industry/notices/11-02

• FINRA Regulatory Notice 10-22, Discussing suitability obligations in context of private offerings (April 2010)
  www.finra.org/industry/notices/10-22

• FINRA Regulatory Notice 09-42, Reminding firms of their obligations with variable life settlement activities (July 2009)
  www.finra.org/industry/notices/09-42

• FINRA Regulatory Notice 09-32, Announcing SEC approval of amendments to the variable annuity rule that limited the rule’s application to recommended transactions, changed the triggering event that begins the principal review period, and clarified various other issues (June 2009)
  www.finra.org/industry/notices/09-32

• FINRA Regulatory Notice 09-31, Reminding firms of sales practice obligations relating to leveraged and inverse exchange-traded fund (June 2009)
  www.finra.org/industry/notices/09-31

• FINRA Regulatory Notice 09-25, Proposing consolidated FINRA rules governing suitability and know-your-customer obligations (May 2009)
  www.finra.org/industry/notices/09-25

• FINRA Regulatory Notice 07-53, Deferred Variable Annuities: Announcing SEC approval of and the effective date for Rule 2821 covering sales practices for deferred variable annuities, including a suitability obligation tailored specifically to such transactions (November 2007)
  www.finra.org/industry/notices/07-53
FINRA Regulatory Notice 07-43, Senior Investors: Reminding firms of the obligations, including suitability obligations, relating to senior investors and highlighting industry practices to serve such customers (September 2007)

www.finra.org/industry/notices/07-43

Notices to Members

• Notice to Members 07-06, Supervision of Recommendations after a Registered Representative Changes Firms explaining special considerations when supervising recommendations of newly associated registered representatives to replace funds and variable products (February 2007)

www.finra.org/industry/notices/07-06

• Notice to Members 03-71, NASD Reminds Members of Obligations When Selling Non-Conventional Investments (reminding members of their obligations, including suitability requirements, when selling non-conventional investments) (November 2003)

www.finra.org/industry/notices/03-71

• Notice to Members 99-35, NASD Reminds Members of Their Responsibilities Regarding the Sales of Variable Annuities (reminding members of their responsibilities, including suitability obligations, regarding the sales of variable annuities and providing guidelines) (May 1999)

www.finra.org/industry/notices/99-35

• Notice to Members 96-86, NASD Regulation Reminds Members and Associated Persons that Sales of Variable Contracts are Subject to NASD Suitability Requirements (emphasizing that sales of variable contracts are subject to suitability requirements) (December 1996)

www.finra.org/industry/notices/96-86

• Notice to Members 95-80, NASD Further Explains Members Obligations and Responsibilities Regarding Mutual Funds Sales Practices (reminding members that, when determining suitability of a mutual fund, they should consider fund’s expense ratio and sales charges as well as its investment objectives) (September 1995)


• Notice to Members 94-16, NASD Reminds Members Of Mutual Fund Sales Practice Obligations (providing guidance regarding mutual fund sales practices, including suitability) (March 1994)


FINRA Interpretive Letters

• FINRA Interpretive Letter to Brian Sweeney, Trustmont Financial Group, Inc., dated Aug. 26, 2013, from James S. Wrona, FINRA Vice President and Associate General Counsel (providing guidance on the applicability of FINRA Rule 2111 (Suitability) to FINRA members’ recommendations of securities transactions in connection with the EB-5 Immigrant Investor Program)

www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P332008
FINRA Regulatory & Compliance Alerts

- **Reminder—Suitability of Variable Annuity Sales**, Regulatory & Compliance Alert (2002) (emphasizing, in part, that an associated person must be knowledgeable about a variable annuity before he or she can determine whether a recommendation to purchase, sell or exchange the variable annuity is appropriate)
  
  www.finra.org/sites/default/files/RCA/p002370.pdf

- **Suitability Issues for Multi-Class Mutual Funds**, Regulatory & Compliance Alert (Summer 2000) (discussing various suitability issues related to mutual funds)
  
  www.finra.org/sites/default/files/RCA/p002377.pdf

FINRA Investor Materials

- Suitability: What Investors Need to Know
  
  www.finra.org/Investors/ProtectYourself/BeforeYouInvest/P197434

- FINRA Investor Alert: Duration – What an Interest Rate Hike Could Do to Your Bond Portfolio
  
  www.finra.org/Investors/ProtectYourself/InvestorAlerts/Bonds/P204318

Law Review Articles

  
  www.americanbar.org/publications/the_business_lawyer/volume_68/number_1.html

  
  https://cblr.columbia.edu/the-securities-industry-and-the-internet-a-suitable-match/

Other FINRA Publications Discussing Suitability-Type Issues

  
  www.finra.org/industry/notices/05-26

- **Notice to Members 03-68**, NASD Reminds Members That Fee-Based Compensation Programs Must Be Appropriate (November 2003) (discussing factors to consider when determining the appropriateness of fee-based compensation programs)
  
  www.finra.org/industry/notices/03-68

Significant Suitability Cases

- Costello v. Oppenheimer & Co., 711 F.2d 1361, 1369 (7th Cir. 1983) (discussing various factors that courts and regulators consider in determining whether the trading was excessive)
• Richard G. Cody, Exchange Act Rel. No. 64565, 2011 SEC LEXIS 1862, *30-32 (May 27, 2011) (explaining, among other things, that a broker can violate reasonable-basis suitability by failing to perform a reasonable investigation of a recommended product and to understand the risks of the recommendation notwithstanding that the recommendation could be suitable for some investors)

• Scott Epstein, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217, at *40 n.24 (Jan. 30, 2009) (“In interpreting the suitability rule, we have stated that a [broker’s] ‘recommendations must be consistent with his customer’s best interests.’”)

• Michael Frederick Siegel, Exchange Act Rel. No. 58737, 2008 SEC LEXIS 2459 (Oct. 6, 2008) (discussing various factors to consider in determining whether a communication is a recommendation and reviewing elements of reasonable-basis and customer-specific suitability), aff’d in relevant part, 592 F.3d 147 (D.C. Cir. Jan. 12, 2010), cert. denied, 2010 U.S. LEXIS 4340 (May 24, 2010)

• Raghavan Sathianathan, Exchange Act Rel. No. 54722, 2006 SEC LEXIS 2572, at *21-33 (Nov. 8, 2006) (discussing suitability obligations in the context of different mutual fund share classes, as well as the use of margin)

• Dane S. Faber, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *23-24 (Feb. 10, 2004) (stating that, under the suitability rule, a “broker’s recommendations must be consistent with his customer’s best interests” and are “not suitable merely because the customer acquiesces in [them]”); id. at *26 (“We have repeatedly found that high concentration of investments in one or a limited number of speculative securities is not suitable for investors seeking limited risk.”)

• Wendell D. Belden, Exchange Act Rel. No. 47859, 2003 SEC LEXIS 1154, at *14 (May 14, 2003) (finding unsuitable recommendations where motivation for recommending Class B shares over Class A shares was the significantly greater commissions that the broker received from the former shares)

• James B. Chase, Exchange Act Rel. No. 47476, 2003 SEC LEXIS 566, at *12-21 (March 10, 2003) (upholding suitability violation and noting that high concentration in a speculative security was inappropriate and that the customer’s college education does not mean that she was a sophisticated investor who fully understood the risky investment)

• Jack H. Stein, Exchange Act Rel. No. 47335, 2003 SEC LEXIS 338, at *8 (Feb. 10, 2003) (“Even in cases in which a customer affirmatively seeks to engage in highly speculative or otherwise aggressive trading, a representative is under a duty to refrain from making recommendations that are incompatible with the customer’s financial profile.”); id. at *11 (stating that it was improper for a broker to make recommendations “on the basis of guesswork” regarding a customer’s net worth where a customer refused to provide broker with any information regarding other assets not listed on her new account form)

• Rafael Pinchas, 54 S.E.C. 331, 341 n.22 & 342 (1999) (holding that “[t]ransactions that were not specifically authorized by a client but were executed on the client’s behalf are considered to have been implicitly recommended within the meaning of the NASD rules” and “excessive trading, by itself, can violate NASD suitability standards by representing an unsuitable frequency of trading”)

• Clinton Hugh Holland, Jr., 52 S.E.C. 562, 565-66 (1995) (emphasizing, in the suitability context, the inappropriateness of the shift in the customer’s portfolio from conservative to speculative securities), aff’d, 105 F.3d 665 (9th Cir. 1996)

• David Joseph Dambro, 51 S.E.C. 513, 517 & n.14 (1993) (“[The respondent] was obligated to make his recommendation only on the basis of concrete information about [his customer’s] financial situation . . . [and] [w]ithout knowing [the customer’s] other securities holdings and financial situation, [the respondent] could not make the requisite customer-specific evaluation necessary for a suitable recommendation.”)

• F.J. Kaufman and Co., 50 S.E.C. 164, 168 (1989) (explaining “reasonable basis” and “customer specific” suitability obligations)
• Dep’t of Enforcement v. Medeck, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7 (NAC July 30, 2009) (discussing various elements of churning and excessive trading)

• Dep’t of Enforcement v. Frankfort, No. C02040032 (NAC May 24, 2007) (finding a violation of the suitability rule and noting that a broker can, under certain circumstances, violate the suitability rule by failing to disclose material information)

• Dep’t of Enforcement v. Siegel, No. C05020055 (NAC May 11, 2007) (discussing the relevant factors for determining whether a broker has made a “recommendation” triggering application of the rule and finding that the broker violated the “reasonable basis” suitability obligation)

• Dep’t of Enforcement v. Bendetsen, No. C01020025, 2004 NASD Discip. LEXIS 13, at *12 (NAC Aug. 9, 2004) (“[A] broker’s recommendations must serve his client’s best interests and the test for whether a broker’s recommendation is suitable is not whether the client acquiesced in them, but whether the broker’s recommendations were consistent with the client’s financial situation and needs.”)


• Dist. Bus. Conduct Comm. v. Nickles, Complaint No. C8A910051, 1992 NASD Discip. LEXIS 28, *18 (NBCC Oct. 19, 1992) (holding that suitability rule "applies not only to transactions that registered persons effect for their clients, but also to any recommendations that a registered person makes to his or her client")

SEC Resources

• SEC Request for Data and Other Information Regarding the Duties of Investment Advisers and Broker-dealers, Release Nos. 34-69013; IA-3558 (requesting data and other information regarding possible rulemaking for investment advisers and broker-dealers to, inter alia, create a uniform fiduciary duty) (March 1, 2013)


SEC Studies

• SEC Study on Investment Advisers and Broker-Dealers (discussing the obligations of investment advisers and broker-dealers, including suitability obligations, as required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act) (January 2011)

