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June 25, 2009

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, D.C. 20006-1500

Re: Proposed Consolidated FINRA Rules 2090 and 2111 – Know Your Customer and Suitability

Dear Ms. Asquith:

The Securities Arbitration Clinic at St. John's University School of Law is very pleased to accept this opportunity to comment on the proposed FINRA rule consolidation concerning suitability and know-your-customer obligations, proposed consolidated rules 2090 and 2111, set forth in Regulatory Notice 09-25. The Clinic strongly supports the rule consolidation because we believe that the proposed rules properly place the responsibility of obtaining the information necessary for making an appropriate recommendation on the broker. However, we believe that some ambiguities remain in the language of the rules and that the rules could go further in order to ensure investors are sufficiently protected.

The Securities Arbitration Clinic represents investors, most of whom are of modest means, in the arbitration process against brokers and brokerage firms. In addition to representing aggrieved investors, the Clinic is committed to investor education and protection. Accordingly, the Clinic has a strong interest in the rules governing brokers' obligations to gather information about their customers prior to making investment recommendations, and ensuring that investors are sufficiently protected by the process. It is important that the suitability rules reflect that the recommendation process is not a caveat emptor system.

The current NASD Rule 2310 is inadequate for ensuring that a broker has obtained a sufficient amount of customer information in order to make a suitable investment recommendation. Under this rule, a broker must have reasonable grounds to believe that his recommendation is suitable based on any information disclosed to him by the customer. The rule also requires that a broker make reasonable efforts to obtain the customer's financial status, tax status, and investment objective, however, this

information need only be obtained prior to execution of the trade, not prior to the recommendation. It is implied that the broker need only consider the information disclosed by the customer when making a recommendation. Consequently, under this rule, if a customer has not made any disclosures about his financial situation or needs, the broker's recommendation could potentially be based on no information whatsoever, essentially disregarding client-specific suitability. The proposed consolidated rules help to alleviate this inadequacy. The proposed consolidated rules adopt a standard that incorporates NYSE Rule 405 which requires that firms use due diligence to learn the essential facts about each customer. We believe that the proposed consolidated rules properly place the onus on the broker to obtain customer information prior to making a recommendation, rather than allowing the broker to solely rely on information provided by the customer, without any affirmative duty on the broker until the trade is placed. The rules also delineate a comprehensive list of facts that a broker should make a reasonable effort to obtain, which has been absent from previous versions. We believe that this addition will help to ensure that a greater number of consistent criteria are considered by brokers by clarifying what specifically a broker should consider when determining if a recommendation is suitable. This should ultimately result in greater uniformity and less ambiguity about the intent of the rule. The proposed consolidated rule also goes further in that it requires the broker to consider information known by the firm or the broker, regardless of how the firm learned the information. We support these changes to the proposed consolidated rules.

While the Clinic supports the proposed consolidated rules generally, we believe that the proposed language still contains ambiguities that should be clarified in order to provide increased protection to investors. Proposed rule 2111 states "[a] member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer," but the rule never explicitly states what is actually considered a "transaction" or "investment strategy." Presumably, these terms would encompass recommendations regarding the purchase, sale, or exchange of any security, as stated in NASD Rule 2310. However, the terms presumably also include some set of recommendations beyond those stated in Rule 2310 given that alternative language was used, but it is unclear what types of recommendations are actually covered. In order to avoid the possibility that these terms are not interpreted narrowly to merely include recommendations that involve a purchase, sale, or exchange, they should be defined specifically in the supplementary material.

The lack of specific definitions for "transaction" and "investment strategy" is problematic because it opens up a possible loophole whereby a broker could avoid liability under the suitability rule entirely. Under proposed rule 2111, in the absence of explicit definitions, a broker could simply argue that certain recommendations constitute neither a transaction, nor an investment strategy. If this were the case, the broker would never be responsible for unsuitable recommendations because his actions would fall outside the black-letter provisions of the rule. We suggest that the proposed rule state that the term "investment strategy" should be viewed broadly and should include, but not be limited to, recommendations involving the retention of any investment, even if the investment was transferred into the firm. Moreover, there should be an affirmative duty

to review portfolios that are transferred into a firm, as the lack of a recommendation to make any changes to the portfolio effectively constitutes an implicit recommendation to retain what was in the account.

The language in the section on quantitative suitability in the supplementary material is also problematic. A member or associated person is only subject to the suitability obligations pertaining to quantitative suitability when he or she has "actual or de facto control" over the customer's account. We believe that requiring actual or de facto control is extraneous and this language should be removed. If the number of trades being recommended by a broker is unsuitable, it should not matter whether the broker has control over the account. The suitability obligation should lie with the broker simply by virtue of the fact it is the broker making a recommendation. A broker's unqualified obligations to a customer should not be viewed in the vacuum of each individual transaction; the suitability obligation should take into consideration the totality of circumstances. The number of trades a broker recommends should be as suitable as the individual recommendations. This language can be eliminated from the proposed rule without sacrificing any substantive impact the quantitative suitability section may have.

Furthermore, while the Clinic supports the inclusion of a section that requires evaluating quantitative suitability, we feel that there should be additional sections. The proposed quantitative suitability section requires that the combination of recommended investments be viewed as a whole to determine if they are collectively, and not just individually, suitable in number given a customer's profile. Likewise, the concentration that will result from any recommendation should also be evaluated for suitability. By not requiring evaluation of the concentration, it is possible that while a series of recommended investments appear suitable, they may not actually be suitable in their recommended proportions. An account may be over-weighted in a specific investment, a particular type of investment, or in an investment sector. While it may be possible to argue that an evaluation of the concentration of each investment is implicit in the language proposed, we suggest that the requirement be explicitly stated for additional protection and to prevent ambiguity.

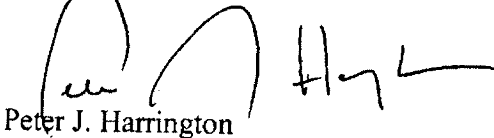
The Clinic does not support limiting the scope of the proposed suitability rule to only recommendations involving securities. We believe the suitability rule should be applicable in all instances where an investment professional is making a recommendation of any product, service, or investment strategy. Customers confer with investment professionals for their financial expertise. The advice a customer receives from a broker is generally relied on, and often acted upon, because most customers lack the financial savvy to make these choices on their own, or they believe the broker has greater financial expertise. Due to the high frequency of reliance, it is necessary to provide customers with greater protection when they seek financial advice, regardless of whether securities are involved in the recommendation.

By limiting the suitability obligation to recommendations that involve securities, the rule would be inviting brokers to neglect suitability obligations in the event that the recommendation made did not involve securities, regardless of what advice was sought

by the customer. In today's world, brokers often deal with different types of investments, services and strategies. Adopting a uniform obligation would eliminate the need to evaluate the character of a recommendation, and would permit the focus to be on the substance of the recommendation. Additionally, by extending the suitability obligation to recommendations of any product, service, or investment strategy, brokers would be aware of their obligation at all times, rather than having a different standard depending on the nature of their recommendation. Customers often do not understand that their broker may be subject to different rules depending on the service they are rendering at that particular moment. Customers should be protected in every instance, and the protection offered should be based on who they are dealing with, not what hat that person happens to be wearing when the customer speaks to them. Moreover, by restricting the suitability obligations to only recommendations involving securities, FINRA is essentially providing an endorsement to make unsuitable recommendations in other contexts. Due to the discrepancy of knowledge between the broker and customer, and the level of reliance on the broker due to the broker's presumed superior knowledge or experience, it is necessary to ensure that all recommendations are subject to the same suitability obligations, and not just those involving securities.

As discussed above, we support the proposed consolidated rules as they should help to decrease the number of unsuitable recommendations by clarifying the broker's obligation to obtain information about their customers, and to consider that information when making a recommendation. However, we believe that it would be possible to expand these obligations even further while still remaining consistent with the spirit of the rules, thus ensuring that all recommendations made, regardless of their nature, are appropriate for each individual customer. We ask that FINRA continue to consider additional improvements that could be made to the suitability obligations to increase the protection of public investors. Thank you for your consideration of this important matter.

Respectfully,



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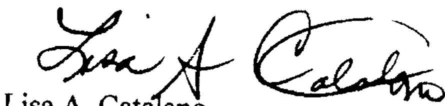

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