NSCP

NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS INC.

June 29, 2009

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

RE: Regulatory Notice 09-25 Suitability and "Know Your Customer"

Dear Ms. Asquith,

This letter is submitted on behalf of the National Society of Compliance Professionals Inc. ("NSCP")[1] in response to the Financial Industry Regulatory Authority's ("FINRA") solicitation of comments with respect to proposed consolidated FINRA rules governing suitability and know-your-customer obligations.[2] The purpose of this letter is to inform FINRA of NSCP's concerns regarding the proposed consolidated rules as currently written.

1. Fiduciary or Universal Care Standard

Before turning to our specific comments, we would like to begin with a general observation. Considerable support has been voiced by the public, by members of Congress, and by senior regulatory and self-regulatory officials for the adoption of a "fiduciary" standard or "universal standard of care" that would apply consistent standards of conduct regardless of whether a securities professional functioned in a broker-dealer or investment adviser capacity. This initiative would appear to have the potential for overlapping with, and possibly supplanting, the current and proposed suitability and "know your customer" rule obligations for many broker/customer relationships. The adoption of such a "fiduciary" standard would not appear to require any changes in legislation to proceed and, given the broad support for it, could be the subject of rulemaking in the very near term. Changes in customer care standards impose operational, documentation, educational and compliance costs on member firms and, depending on the details of the rules and the method of implementation, can also give rise to significant systems and programming burdens. The adoption of changes to the current suitability and "know your customer rules," only to be followed by adoption of a new fiduciary standard, could double these burdens; indeed, the need to implement

two sets of changes could actually delay implementation of the eventual fiduciary standards. Under these circumstances, NSCP questions whether it might not be preferable to defer any action on integrating the NASD suitability and NYSE "know your customer" rules in the consolidated FINRA rulebook until a determination is made on how a fiduciary or universal care standard is implemented, so that a single, integrated change to customer care standards can be adopted at one time.

That said, we applaud FINRA's continued efforts to make its rules more workable for all member firms, and as part of this effort, we would like to suggest certain ways in which the proposed rule amendments pursuant to Regulatory Notice 09-25 could be improved.

1. Definitional Issues and New Legal Standards

a. Investment Strategy

FINRA proposes to expand member firms' suitability obligations to cover both recommended transactions and investment strategies involving a security or securities. We believe that including investment strategies under proposed Rule 2111 raises several issues for both FINRA member firms and FINRA examiners.

Applying Rule 2111 to an "investment strategy" risks inconsistent application of the expanded rule among member firms. The proposed rule does not define the word "strategy" and, in the absence of a definition that all member firms understand, it is highly unlikely that every firm will define the word in the same way. For compliance purposes, all member firms that make recommendations or permit their associated persons to make recommendations will have to engage in protracted analyses to establish which series of transactions qualify as an "investment strategy." This kind of analysis will have to be constantly "re-done" as the markets go through different economic cycles and customer needs, and investment ideas change in response thereto. With each member firm engaging in its own self-analysis, investors are likely to have different experiences from firm to firm. For example, Firm "A" may decide that all asset allocation programs are "strategies." Firm "B," however, may determine that plain vanilla types of asset allocation are investment goals, not strategies. Firm B may further decide that asset allocation is only a "strategy" when the customer commits to periodic re-balancing. Dollar cost averaging and "buy and hold" are further examples of investment techniques that, although common in the industry, may or may not be determined by a particular firm to be a "strategy" under the proposed rule. In addition to varying interpretations among member firms of what constitutes a "strategy," the label is subject to being used retroactively by a customer who is displeased with the results of his or her own non-recommended "strategy." A further complication is that the rule does not purport to link the suitability obligation to a *transaction* in securities.

We believe it is likely that the absence of a definition for the word "strategy" will also pose problems for FINRA examiners, and will lead to inconsistent exam results. If Firm A does not define "strategy" in the same manner as Firm B, how will FINRA examiners make decisions

regarding which firm correctly defined the term? How will disciplinary decisions be made? Most importantly, what benefit will investors realize from the expanded scope of the rule in the absence of any industry wide agreement regarding how the rule is to be applied?

We believe that if Rule 2111 is to be expanded in the manner proposed, FINRA should revise the proposal to define the operative term or provide member firms with clear guidance regarding how member firms should define the term "strategy." FINRA should also categorically state that "investment strategy" is not a label that can be applied after-the-fact by any of the parties, but rather must be defined and agreed to by the customer and the member firm before the first securities transaction in the strategy is undertaken. We believe these changes would result in a workable rule and would accomplish several key objectives: namely, consistent examinations and enforcement of the rule; clear compliance and supervisory policies and procedures; and consistent investor experiences across all member firms.

Finally, we also believe that FINRA should recognize that where strategies are used, many member firms will be dependent upon manual forms of surveillance and recordkeeping in order to identify the separate components of the strategy. In other words, firms can and should be expected to document the customer's consent to the strategy and to the transaction that must be present in order for the suitability obligation to attach, but all firms are unlikely to have the electronic capability to "tag" every component of a "strategy" for surveillance and other purposes. FINRA must recognize that compliance with proposed Rule 2111 will require in many cases a significant reliance on manual documentation.

b. Institutional Customer Exemption – a New Legal Standard

NSCP appreciates FINRA's simplification of the factors considered when exempting customer-specific suitability obligations for institutional customers.[3] We are concerned, however, that the first factor fundamentally changes the way the exemption has operated since its inception. The first factor requires "the institutional customer [to] affirmatively indicate[] that it is willing to forego the protection of the customer-specific obligation of the suitability rule."[4] To our knowledge, this affirmative representation would be a brand new requirement, and we believe it would likely prove unworkable in application because institutional investors (at least many of them) lack the statutory or contractual authority to give an open-ended "pass" to liability on the part of the member firm. Thus, this particular requirement of the rule is likely to decrease the ability of institutional investors to deal on an arms-length basis with member firms, as they do today. We question whether that result is beneficial for institutional investors.

c. Institutional Account

FINRA proposes to tie together the definition of an "institutional customer" with "institutional account" as defined in NASD Rule 3110(c)(4).[5] Rule 3110 defines an "institutional account" as one having at least $50 million in assets. Institutional customer interpretative material ("IM") to current Rule 2310 defines an "institutional account" as one

having $10 million in assets. NSCP respectfully requests a unified definition of "institutional customer" across the FINRA rules. Where an entity is labeled an institutional customer for one purpose, it should be so defined for all. NSCP supports a threshold amount of $10 million in assets as this is consistent with the current institutional suitability rule and we are unaware of any problems with the current rule. If a compromise is called for, NSCP would support a threshold amount of $25 million in assets, which would mirror the minimum amount of assets under management for SEC-registered investment advisers.

d. Information Gathering Requirements

Proposed FINRA Rule 2111 heightens the amount of information firms must gather to meet their suitability obligations. In determining whether a recommendation is suitable for a particular client, firms are currently required to analyze customer-disclosed information. Under the new rule, firms would have to take into consideration information about the customer "known by the member [firm] or associated person."[6] There is tremendous vagueness around the word "known" in this context. For example, if a registered representative learns of his client's illness from a third party at a neighborhood block party, what is the representative's obligation? Is it a breach of privacy for the representative to call the client and ask about the illness? We suggest that the "known" concept is unworkable and should be stricken from the rule.

e. Know Your Customer

FINRA proposes a know-your-customer obligation under proposed FINRA Rule 2090 that would encapsulate the due diligence standard promulgated by existing NYSE Rule 405(1).[7] While NSCP supports such a standard, we believe that it must be a very clear standard in order for compliance officers and staff to determine exactly what information must be collected from a customer in circumstances where no recommendation will be made. As proposed, the rule would require firms to use reasonable efforts to collect the customer's "financial profile" and "investment objectives or policy." "Financial profile" is not defined. Moreover, it is unclear why these particular items are needed to open an account for a customer that will direct his or her own trading. If a member firm collects this information, what is its required use? These questions are particularly pertinent because a broadening of the information collection obligation will necessitate that all forms of data collection currently in use by member firms be re-done. As these efforts are not without cost, we believe that a good case must be made regarding why these items need to be collected.

As an alternative, we would suggest that firms be permitted to form a reasonable judgment in determining what information to collect from prospective customers, in light of each firm's business model, services provided, and existing regulatory and legal requirements, *e.g.*, the anti-money laundering rules. This would be in keeping with SEC rules, principally Rule 17a-3, which as you know imposes different recordkeeping requirements on accounts for which a suitability determination has been made.

Finally, we would like to suggest that the due diligence standard be added to proposed Rule 2111, rather than adopted as a separate rule (proposed Rule 2090). FINRA rightly points out that the due diligence "obligation arises at the beginning of the customer/broker relationship and does not depend on whether a recommendation has been made."[8] FINRA also notes that similar due diligence requirements are housed under current FINRA Rule 2010.[9] Including the due diligence standard within Rule 2111 is an appropriate and simplified alternative to adding a separate rule. In the interest of brevity and clarity, efforts should be made to combine in a single rule firms' information collection responsibilities.

2. Expansion of FINRA Jurisdiction

FINRA requests comment on whether suitability obligations should extend to all recommendations of investment products, services and strategies, regardless of whether they involve securities. NSCP respectfully rejects this regulatory extension inasmuch as non-security based products are outside FINRA's jurisdiction. We also note that apart from jurisdictional issues, regulators of non-securities products and services have developed significant expertise and infrastructure with respect to these products and services. Having multiple regulators expend their resources in furtherance of the same goal, investor protection, would create material redundancies. In the current environment, where all resources must be marshaled in the most efficient and efficacious manner, this kind of redundancy should be avoided.

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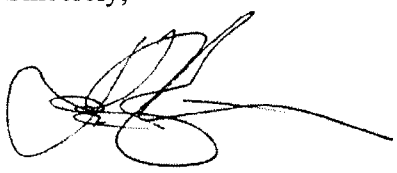
NSCP appreciates the opportunity to provide comments on FINRA's proposed consolidated rules governing suitability and know-your-customer obligations and hopes you find the comments useful. NSCP would be pleased to assist FINRA in any way that it can going forward. Please feel free to contact the undersigned if you have any questions or require further information regarding our comments.

Sincerely,



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[1]NSCP is a non-profit membership organization made up of over 1700 securities industry professionals committed to developing education initiatives and practical solutions to compliance-related issues.

[2]New FINRA Rule 2111 would replace current NASD Rule 2310. Existing NYSE Rule 405 would be adopted as FINRA Rule 2090.

[3] Where all the factors are present, FINRA provides an exemption from customer-specific suitability requirements for institutional customers. The privilege is already afforded under the current rules and NSCP does not raise issue with the exemption generally. NSCP's concern rests with the proposed language of the first factor.

[4] FINRA Notice 09-25, at 3. The new requirement apparently would eliminate a critical sentence currently found in IM-2310-3. "Where the broker-dealer has reasonable grounds for concluding that the institutional customer is making independent investment decisions and is capable of independently evaluating investment risk, then a member's obligation to determine that a recommendation is suitable for a particular customer is fulfilled."

[5] This connection will effectively adopt NASD Rule 3110(c)(4) as FINRA Rule 4512(c). *See* FINRA Notice 09-25 n.8, at 5.

[6] FINRA Notice 09-25, at 3.

[7] NYSE Rule 405(1) requires firms to "[u]se due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization."

[8] FINRA Notice 09-25, at 4.

[9] FINRA Rule 2010 states: "A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."