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Marcia E. Asquith
Senior Vice President and Corporate Secretary
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Re: Proposed Consolidated FINRA Rules Governing Suitability and Know-Your-Customer Obligations

I represent customers in forced industry arbitration and my comments reflect the point of view of customers with suitability claims in Finra arbitration.

The proposed rule retains many of the opaque features that allow selective and minimal enforcement and places customers at a distinct disadvantage when filing a complaint for "unsuitable" transactions in forced arbitration. Like many Finra rules, the proposed Rule 2111 provides the appearance of regulation without the substance that would allow investors to understand and enforce its provisions. Its more noticeable shortcomings are as follows.

DEFINITIONS

There is no definition of "recommendation." While one can turn to several NASD Notice To Members (NTM) concerning the meaning, the proposed rule would be an ideal time to codify a definition. NTM 96-60 states that "a broad range of circumstances may cause a transaction to be considered recommended, and this determination does not depend on the classification of the transaction by a particular member as 'solicited' or 'unsolicited.'" If "recommended" has nothing to do with "solicited" and "unsolicited" what do those two terms mean when they appear on the confirmation a customer receives? In an arbitration hearing, they are often the determinative issue and customers are often held to a high standard of registering a complaint if the confirmation is incorrect. While customers are presumed to understand what the terms mean, Finra doesn't have a definition.

The confirmation is normally the only document received by a customer that indicates if the broker is attempting to blame really bad investments on the customer or taking responsibility for the "recommendation" himself. Even then, brokers often deny that "solicited" means that they recommended the security. That disingenuous defense is supported by NTM 96-60. The term may be characterized as a technical designation indicating that the broker sent the client a prospectus, report, or other information at the customer's request without any "recommendation" involved in the glowing description provided. A far better definition was that of the NYSE:

> Recommendations [See Rule 472.40(1)]
> For purposes of these standards, the term "recommendation" includes any advice, suggestion or other statement, written or oral, that is intended, or can reasonably be expected, to influence a customer to purchase, sell or hold a security.

That would be simple and definitive. In a current wave of arbitration complaints against Charles Schwab concerning its YieldPlus Ultra-Short Bond funds, orders were marked "unsolicited" even though the customers had never heard of the fund prior to Schwab brokers sending them glowing sales literature concerning (and misrepresenting) the funds. Under the proposed Finra rule, that may or may not be covered and the rule should codify to the extent possible what constitutes a "recommendation" and that if an order is marked "unsolicited" then the customer can not have been provided any written or oral statement that would influence a purchase to buy, sell, or hold.

That means the terms "solicited" and "unsolicited" need definition. Why are they on order confirmations if no one knows what they mean? I have had arbitration claims where the customer was churned with all orders marked "unsolicited." The customer agreed that the broker had never called to solicit a purchase or sale. He had made all the transactions on a discretionary basis, which she did not understand either and which the broker denied claiming she should have complained if the trades were incorrectly marked "unsolicited." The terms need to be spelled out and provided public customers so that everyone can understand the common meaning.

De Facto Control

Another issue of definition is in Supplementary Material 02 concerning quantitative suitability which only applies when a member or associated person has "actual or de facto control." The control issue is completely ridiculous when a broker is making any "recommendation," the consequence of which is to generate excessive commissions. If a customer is trading too much, (s)he should be notified of that fact and told the cost of that trading and the rate of return the customer would need in order to break even after costs. The broker should not be allowed to add fuel to the fire, if truly acting solely as an order taker, with additional recommendations to compound the problem.

In most cases, customers who churn themselves do it at discount brokerage firms that act as order takers only. The "control" issue developed when commissions were fixed and the costs were the same wherever an investor traded. With deregulation of commissions and the advent of discount brokers the concept lost any meaning. Allowing "full service" brokers to churn customers beyond any possibility of profit while claiming that they do not "control" the account is an anachronism retained only to protect churning, the lifeblood of the industry. If a customer is trading excessively to her detriment, the broker and firm should be required to notify her of that and cease making recommendations to further aggravate the situation.

SPEAK NO EVIL

Rule 2090 requires a firm to use due diligence in the opening and maintenance of every account to know the essential facts, but it doesn't require them to do anything with that knowledge. It does not benefit the investing public that a firm uses due diligence if there is no affirmative duty to disclose that the investments are highly unsuitable based on the information acquired. If the firm notes that the securities are qualitatively unsuitable or the customer is trading way too much to show a positive return the customer should be notified.

In the case where a rogue broker changes firms and the securities transferred are entirely unsuitable, the firm appears to have no further duty, and simply determining that they are unsuitable without further action is meaningless. There should be a requirement that the firm notify the customer that her holdings do not meet her financial profile. Instead, firms are allowed to quietly replace all the unsuitable investments, at full commission, without ever "ratting out" the crooked broker who is abusing the customer and will probably do it again. That is not a suitability requirement. It's a suitability joke. If a firm is required to "know its customers" it should be required to inform its customers.

INPUT OR OUTPUT

What is "risk tolerance" and how does a customer know if they have it? How do they know how much money they can comfortably lose until they have lost it? During the 1990's tech bubble, everyone thought that they were "aggressive" because nothing bad ever happened . . . until it did. Most people whose lives and retirements were ruined found that they weren't as "aggressive" as their broker led them to believe. Any "risk tolerance" should be defined by what percent of their liquid net worth they are willing to lose, not how much they believe they stand to gain in a bull market. This is a term with no definition and fuzzy parameters. The customers doesn't know their risk tolerance and the broker decides it for them. It is the result of a suitability determination, not an input. Brokers should not be allowed to designate a "moderate" or "aggressive" risk tolerance without showing the customer how much that means the firm believes they are comfortable losing. As the rule is currently written, the term is an excuse for bad conduct, not a deterrent.

Most customers do not have a clue about their investment objectives either. They just want to make money and not lose very much if any. The broker should have a duty to define the investment objective based on the client needs and how much they can afford to lose without undue suffering. Some firms provide definitions, but many do not. Instead, most customer investment objectives are based on what the broker wants to sell to that customer. Brokerage firms routinely claim at the arbitration hearing that "growth" means risk if not when the account is opened. This is compounded when research reports have no risk parameters so that a recommendation to buy IBM is not distinguished from a buy of a new tech start-up without earnings or history. If the customer has an investment objective and a risk tolerance, then research recommendations should be made according to those parameters, i.e. this is a buy recommendation for high risk accounts only. The customer should not be required to figure it out on their own while the broker maintains that he didn't recommend it.

Another vague term is "investment time horizon" which brokers define in different ways. If a person is approaching retirement, is her "time horizon" until retirement or life expectancy. Brokers commonly defend over concentration in stocks based on the fact that the customer has a 20-year time horizon at age 65. So what is a time horizon? It's a vague term which allows the broker to tell a customer one thing and an arbitration panel another.

I don't expect all of this to be codified in the Finra suitability rule, but the rule uses a lot of terms that are moving targets with no way to ascertain how they relate. Most customers are told that if they want to make money, they have to be aggressive in the

pursuit of growth. Yet according to Ibbotson[1], value stocks, characterized partly by dividend yield, outperform growth stocks over the long term. John Bogle[2] has demonstrated that from 1900 through 2006, reinvested dividends provided almost half of the nominal total return of stocks. Adjusted for inflation, dividends provide 75% of the real total return of stocks. So why is growth so popular an investment? It's partly due to brokers being allowed to claim that growth is the same as speculation and one certainty is that speculative investments pay brokers higher commissions than conservative investments.

ANY WHAT?

Brokers do not seem to be required to document "any other information" upon which they relied in making a suitability determination. Instead, they are allowed to wait until someone files an arbitration complaint against them and then do a post claim suitability determination going back nine years to see if the customer ever did anything similar. A prior speculative investment of any kind has become an absolute defense to a suitability claim before most arbitrators trained by Finra. As it stands now, an investment objective can only be changed after the six year eligibility period for forced arbitration plus the additional three years provided by the Discovery Guide is reached, a total of nine years. Prior to that, its open season on any customer who has engaged in prior speculative investment strategies. No matter what they say, the post claim suitability determination may be made using Finra's Discovery Guide. A change of broker to become more conservative is useless. As long as there is forced arbitration and post claim suitability determinations mandated by Finra in arbitration, the customer doesn't have a right to change her investment objectives to more conservative parameters.

The minimal requirement of checking a few boxes instead of documenting the "other information" used at the time feeds this anti-customer arbitration practice. If a broker doesn't have to document the "other information" he is free to make it up later. Suitability determinations should be based on information known at the time, not discovered later. This could be accomplished by amending 2111 (a) to read . . . "based on the facts known by the member or associated person . . . prior to making the recommendation." If a customer has engaged in speculative activity prior to the recommendation it should be documented prior to the recommendation. It should be "know your customer" not "know your arbitration claimant." Post claim suitability inquiries in arbitration should be banned, which is admittedly another, if related, subject.

A RECOMMENDATION TO HOLD

The proposed rule applies to "transactions" which presumably include purchases, sales and exchanges of securities, but not "staying the course" or "hold" recommendations. A broker may ignore a customer's changed financial situation or the changed suitability of a security or strategy because the recommendation to "hold" is not covered by the suitability rule even though it has the exact same economic effect on the customer as a buy or sell.

A broker should have the same responsibility to take into consideration a customers (changed) financial situation, investment objectives and other information to

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[1] Ibbotson, SBBI 2009 Classic Yearbook, pg. 119, Morningstar, Inc.
[2] Remarks by John C. Bogle at the FINRA first joint Enforcement Meeting, October 15, 2007.

"recommend" that a customer do nothing as to recommend a purchase or sale. Often the recommendation to hold is based on fraudulent information concerning proprietary products or advice. The major example of this was during the tech wreck when customers were repeatedly encouraged to "hold" and "stay the course" based on phony analyst opinions when those same analysts were telling favored institutional customers that the securities had little or no value. Because a recommendation to "hold" is not subject to the suitability rule, it didn't violate a Finra rule. That is really self serving on the part of the industry and should not be allowed to continue. A recommendation to hold has the same economic effect as a recommendation to buy or sell. It should be treated the same.

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