SYRACUSE UNIVERSITY
COLLEGE OF LAW
OFFICE OF CLINICAL LEGAL EDUCATION

June 29, 2009

Ms. Marcia E. Asquith
Office of Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

RE: 09-25 Proposed Consolidated FINRA Rules Governing Suitability (Rule 2111) and Know -Your -Customer Obligations (Rule 2090)

Dear Ms. Asquith:

The Securities Arbitration and Consumer Clinic (SACC), of the Syracuse University College of Law, welcomes the opportunity to comment on FINRA's Proposed Rules 'Governing Suitability and Know-Your-Customer Obligations', Rules 2111 and 2090 respectively.

The SACC generally supports these rule proposals. They reflect a more principled approach in dealing with suitability obligations that do the existing rules. In addition, the SACC offers a few suggestions to specific provisions, as discussed below. Finally, per the request in 09-25, we are pleased to briefly comment upon whether FINRA should propose a rule regarding suitability obligations for investment s recommendations made in connection with a member's business, regardless if the recommendations involve securities.

The SACC is a Syracuse University Law School curricular offering in which law students provide representation to public investors, most of whom would be unable to hire private counsel. We have helped several investors who lost lump sum retirement packages to investments in variable annuities, senior investors who were targeted by promoters of unregistered viatical investments, and numerous others investors with a range of problems. The majority of our clients are seniors residing in Central/ Upstate New York. The SACC is very proud of its education programs, wherein we provide the public with basic investment information and awareness of resources. FINRA's proposed Rules are of extreme importance to our clients and community.

Proposed Rule 2111(a) Clarifies Some Important Suitability Obligations

The SACC supports proposed Rule 2111(a). It clearly directs member firms/associated persons to conduct suitability assessments when recommending investment *strategies*, as well as when recommending isolated trades or a series of trades. Currently, the NASD Suitability Rule 2310 is limited to recommendations concerning the "purchase, sale or exchange of any security", and is silent on the duties surrounding strategy recommendations. Yet, investment strategies are often recommended in today's markets. Moreover, member firms advertise their abilities to deliver custom made portfolios (presumably based upon a strategy) for any circumstance the investor might face. The days of ad hoc trades are long gone for many if not most retail investors. As such, the existing suitability rule is quite outdated and should be replaced in accordance with FINRA's proposal. We offer suggestions on other points of 2111(a) below.

Furthermore, proposed Rule 2111(a) more accurately tracks existing decisions from the SEC, and from FINRA itself, concerning recommendations of investment strategies. *See, e.g. F.J. Kaufman & Co.,* Securities Exchange Act Release No. 34-37535, 45 S.E.C. Docket 97 (Dec. 13, 1989) (broker's recommended "strategy was less than the value of one of its parts, and Kaufman should have known that fact and should have understood that his strategy was therefore unsuitable for these customers"); NASD IM- 2310-3 (institutional customer IM explains that firms have suitability duties when recommending a security or strategy),

The SACC also supports FINRA's delineation in Rule 2111(a) of nine key factors to be considered by the member firm/ associated person when making recommendations. This list of from existing factors listed in NASD Rule 2310(b) should help industry personnel to better grasp the range and nature of investigations that accompany a meaningful suitability assessment. We further support the proposed Supplementary Materials, with one caveat concerning a portion of the Quantitative Suitability component in 2111.02.

SACC Proposals

I. Rule 2111(a) - Factors Not Exhaustive

We believe the Rule would be further improved by a brief addition explaining that the rule's list of nine factors is not intended to be exhaustive.

We suggest another minor improvement to the final clause of 2111(a). Specifically, the final clause would better serve its purpose if the 'other information' to be considered is pegged to what a diligent, or 'reasonable member firm', 'reasonable associated person' would consider when making a recommendation. The 'reasonable member' standard would provide more guidance than the currently proposed subjective standard of "the [any] member". The subjective language currently in place could create confusion. In its present form, the clause could allow reckless or careless members/brokers, to ignore, pertinent "other information" that a reasonable member would not ignore. This gap can easily be closed.

II. The SACC Submits That 'Hold' Recommendations Belong Within Rule 2111(a)

Neither the current rule nor the proposed rule addresses unsuitable "hold" recommendations. We urge FINRA to include 'hold' recommendations within the scope of proposed Rule 2111(a).

At the SACC, and in private practice, we have seen many cases where a broker affirmatively advises a client to 'hold' a position, or an entire portfolio, thereby presenting the client with a definite investment decision. Average investors regard members/associated persons as having superior skill and knowledge. Not surprisingly, these retail investors consider all member/broker recommendations, whether to buy, sell or hold, as investment advice from the professionals. Yet, the members/brokers sometimes pay scant attention to the gravity and obligations surrounding hold recommendations. As a practical matter, 'hold' recommendations are not going to appear as a trade on records the member may use for supervisory purposes. Nor has FINRA included recommendations to hold within its primary suitability rule 2310. By putting explicit language regarding 'hold' recommendations in what will likely be FINRA's cornerstone for guidance on suitability questions, FINRA can provide clarity within the industry and further protect the retail investor.

Perhaps the member/associated person's obligations regarding 'hold' recommendations is contemplated as a 'strategy' within the proposed rule. Certainly the obligations would be subsumed within concepts of 'fair dealing', which we are very pleased to see incorporated within the proposed Supplementary Materials. Nevertheless, the SACC submits that 'holding' recommendations are common, sometimes signaling a shift in goals or strategies, and warrant express treatment.

We note that a recommendation to 'hold' should not be confused or equated with legal theories of a duty to monitor. The former reflects a definitive act by a member/ associated person. In contrast, the latter theory – not at issue here- generally arises under contract.

One does not have to look far for examples of public harm caused by unsuitable 'hold' recommendations. Classic 'pump and dump' schemes sometimes utilize 'hold' recommendations, as well as 'buy' recommendations, to drive up, and hold up, the price of stock for the benefit of the seller in waiting . Deceptive hold recommendations in these cases would necessarily be unsuitable. Similarly, the Research Analysts scandals which were resolved through the 2003 Global Settlement, although prosecuted as conflicts of interest cases, did in part involve deceptive recommendations to 'hold', or to remain 'neutral', thereby wreaking havoc throughout the retail markets. While these schemes may be extreme, and hopefully will remain few in number, they seem to highlight the need for a bright line rule regarding hold recommendations.

In the context of arbitration practice, we sometimes see dire consequences when an investor relies on a broker's careless hold recommendations. Over the decades, the undersigned has seen more than a few instances where a broker persuades a customer to hold, despite countervailing wishes of the customer. For example, there have been instances when a broker urges a client to

'hold', when the client otherwise was planning to sell and spend invested funds, so that the broker can retain an impressive ' book' of business while marketing himself to a potential employer. These situations and other examples will undoubtedly continue to occur.

. We recognize that over the years, industry lawyers and associated persons have adopted as [mistaken] dogma the incorrect idea that suitability considerations do not apply when recommending that a 'hold'.. This may be due in part to a flawed reading of *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), wherein the Court limited standing under SEC Rule 10b-5 to actual purchasers or sellers of the security. Not only did the Court limit its holding to 10b cases, it expressly noted that claims for inaction are sometimes available under state law.[1] If FINRA were to be guided by case law on this question, we submit it weighs in favor of common law principles cited herein. However, and more importantly, we submit that FINRA's role is distinct from, and independent of, the lawyers in the trenches. FINRA's primary role is of course the protection of investors, through various mechanisms. We submit that investor protection can only benefit by including 'holding' recommendations clearly within the proposed rules/materials. Omission of such recommendations, on the other hand, will create more confusion and lack of diligence within the industry.

Another way to include hold recommendations within FINRA's current proposal would be simple to incorporate the define the term 'recommendation', in accordance with Incorporated NYSE Rule 472.10/09, which states in part :

> "Communications with the Public-Definitions" ...a recommendation is "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."

III. Quantitative Suitability

The Supplemental Material as concerns Quantitative Suitability is too restrictive in our view. By requiring that a broker have actual or de facto control over an account before he can be obligated to assess quantitative suitability imposes, we believe, a new restriction that in effect unravels much of what is accomplished by Proposed Rule 2111(a). Moreover, this restrictive language runs counter to existing guidelines from the SEC. *See James B. Chase*, Exchange Act Rel. No. 47476 (Mar. 10 2003); *see also John M. Reynolds,* 50 S.E.C. 805, 809 (1992) (regardless of whether customer wanted to engage in aggressive and speculative trading, representative was obligated to abstain from making recommendations that were inconsistent

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[1] The majority of state courts that have considered the issue have recognized a cause of action for the wrongful inducement to "hold" a stock. *See E.g. Small v. Fritz Companies, Inc.*, 30 Cal. 4th 167, 132 Cal. Rptr. 2d 490, 65 P.3d 1255 (Cal. 2003) (the California Supreme Court recognized a cause of action in favor of holders of securities and found that the tort of fraudulent misrepresentation applied in connection with a decision not to sell securities based on a defendant's misrepresentations); **New York:** *Continental Insurance Co. v. Mercandante*, 222 A.D 181, 183, 225 N.Y.S. 488, 493-494 (N.Y. App. Div 1927) (seminal case recognizing "Holder" claim from fraudulent inducement of retaining a security); Marbury Mgmt., Inc. v. Kohn, 629 F.2d 705, 708-710 (2d Cir. 1980) (discussing favorably long history of decisions recognizing liability for fraudulently induced retention of securities).

with customer's financial situation), *amended on other grounds*, Exchange Act R. No. 300036A(Feb. 25 1992), 50 SEC Docket 1839.

Whether a member/associated person has control over an account should not relieve him of his obligations. Otherwise, he more resembles an order taker. The language concerning control or de facto control should simply be eliminated from this section.

Retention of the ' Know Your Customer' Rule is Essential

The SACC generally supports Proposed Rule 2090, formerly NYSE Rule 405, and submits a few remarks for consideration.

The proposed Rule 2090 s applies to "every customer, every account", and is not limited to "recommendations" as is the Proposed NASD Rule 2111(a). Subject to a comment below, inclusion of this Rule in the Consolidated FINRA Rulebook reflects significant commitment to recognize fundamental obligations of FINRA members and associated persons. We agree that the Know Your Customer obligation arises at the beginning of customer/broker relationship *before* a recommendation, if any, has been made. Currently, no FINRA rule protects customers who allege unsuitable transactions/investments in the absence of a recommendation. We note with approval FINRA's statement in 09-25 to the effect that diligence obligations arise from the inception of the broker/customer relationship.

SACC also notes with approval that, under Rule 2090, the member or associated person is required to know and retain the essential facts about a customer concerning the opening and maintenance of every account. The language "maintenance" (of every account) imposes an on-going obligation on the broker-dealers. Now, broker-dealers must take steps (use due diligence) to learn/know about material changes, if any, in the investment objectives or financial circumstances of their customers throughout.

Furthermore, proposed Rule 2090 will properly extend to all member/associated persons, and not just to NYSE members who are subject to NYSE Rule 405. This is a very positive step.

Proposed Rule 2090 Should Retain More of NYSE 405

The SACC would urge FINRA to retain that potion of NYSE 405 which requires firms to know essential facts concerning every 'order'. This omitted language is necessary to clarify that members/associated persons must use due diligence when assessing or recommending securities to the customer. By eliminating that language in Rule 2090, FINRA may be inadvertently narrowing obligations that exist in 405, and in other materials within existing FINRA materials. To avoid ambiguity, we propose that the original language of NYSE 405 – "every order, every cash or margin account' – be retained.

Potential Rule Proposal Regarding All Investment Recommendations

The SACC encourages FINRA to propose a rule to extend the suitability obligations of firms/ associated persons when they recommend any investment products, including non-securities, when recommended in connection with the firm's business. As FINRA notes, the business of members is today often seamless in nature with other investment related entities. One area ripe for such a rule might be the member's recommendation of insurance products through an affiliate or parent company. When making recommendations for such a vital piece of a customer's financial picture, a member/broker certainly should be required to a diligent suitability assessment. This approach is consistent the 'shingle theory' which essentially requires one who holds himself out as able to provide the financial service, be also accountable for the service. The SACC would welcome more direction from FINRA on the details of its potential rule proposal. We encourage FINRA to explore this very timely issue.

Conclusion

The SACC is greatly in favor of most of FINRA's Proposed Rules 2111(a) and 2090. As indicated, we believe that there is room for improvement. We urge FINRA to consider and incorporate herein our recommendations, and to file the revised rule proposals with the SEC. Please do not hesitate to contact us if you have questions regarding these comments.

Thank your for your consideration and attention.

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