

Required fields are shown with yellow backgrounds and asterisks.

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4File No.* SR - 2010 - * 039
Amendment No. (req. for Amendments *) 1Proposed Rule Change by Financial Industry Regulatory Authority
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
☐	☒	☐	☒	☐	☐
Pilot	Extension of Time Period for Commission Action *	Date Expires *	Rule		
☐	☐		☐ 19b-4(f)(1) ☐ 19b-4(f)(4) ☐ 19b-4(f)(2) ☐ 19b-4(f)(5) ☐ 19b-4(f)(3) ☐ 19b-4(f)(6)		

Exhibit 2 Sent As Paper Document



Exhibit 3 Sent As Paper Document

**Description**

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name * James Last Name * Wrona

Title * Associate Vice President and Associate General Counsel

E-mail * jim.wrona@finra.org

Telephone * (202) 728-8270 Fax (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 10/21/2010

By Patrice Gliniecki
(Name *)

Senior Vice President and Deputy General Counsel

(Title *)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Patrice Gliniecki,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information (required)

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change (required)

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “SEA”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) Amendment No. 1 to SR-FINRA-2010-039, which proposed a rule change to adopt FINRA Rule 2090 (Know Your Customer) and FINRA Rule 2111 (Suitability) as part of the consolidated FINRA rulebook. As described herein, Amendment No. 1 to SR-FINRA-2010-039 proposes modifications to the rule change in response to comments. The text of the proposed rule change is attached as Exhibit 5.

(b) As noted in the original rule filing, upon Commission approval and implementation by FINRA of the proposed rule change, the corresponding NASD and NYSE rules and interpretations will be eliminated from the current FINRA rulebook.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on February 11, 2009, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change. FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be 270 days following publication of the Regulatory Notice announcing Commission approval.

¹ 15 U.S.C. 78s(b)(1).

3. **Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

(a) Purpose

On July 30, 2010, as part of the process of developing a new consolidated FINRA rulebook, FINRA proposed adopting FINRA Rule 2090 (Know Your Customer) and FINRA Rule 2111 (Suitability). The proposed rules are based in large part on NYSE Rule 405(1) (Diligence as to Accounts), NASD Rule 2310 (Recommendations to Customers (Suitability)) and its related Interpretative Materials ("IMs"), and case law interpretations of those rules.² On August 19, 2010, the SEC published FINRA's proposed rule change in the Federal Register and sought public comment.³ On August 26, 2010, the SEC published a corrected notice in the Federal Register seeking public comment.⁴ The public comment period closed on September 9, 2010. Twenty-two comment letters were submitted. By separate letter, FINRA filed today with the SEC its

² FINRA further explained that the proposed rule change would delete NYSE Rule 405(1) through (3) (including NYSE Supplementary Material 405.10 through .30), NYSE Rule Interpretations 405/01 through /04, NASD Rule 2310, IM-2310-1 (Possible Application of SEC Rules 15c-1 through 15c-9), IM-2310-2 (Fair Dealing with Customers), and IM-2310-3 (Suitability Obligations to Institutional Customers). FINRA also noted that NYSE Rule 405(4) was eliminated on June 14, 2010 pursuant to another rule filing. See Securities Exchange Act Release No. 61808 (March 31, 2010), 75 FR 17456 (April 6, 2010) (Order Approving File No. SR-FINRA-2010-005); see also Regulatory Notice 10-21 (April 2010).

³ See Securities Exchange Act Release No. 62718 (August 13, 2010), 75 FR 51310 (August 19, 2010) (Notice of Filing of Proposed Rule Change; SR-FINRA-2010-039). FINRA noted that it essentially was updating the suitability rule by codifying various well-settled interpretations of the rule. FINRA did not narrow any existing suitability obligations via this rule filing.

⁴ See Securities Exchange Act Release No. 62718A (August 20, 2010), 75 FR 52562 (August 26, 2010) (Corrected Notice of Filing of Proposed Rule Change; SR-FINRA-2010-039). The SEC published the correction to rectify various footnoting errors, in large part inadvertent clerical mistakes. Id. The corrected notice did not contain substantive changes. Id.

response to those comments made in relation to the publication of the proposed rule change in the Federal Register. This amendment proposes modifications to the rule change in response to those comments. The relevant comments and proposed amendments that emanate from them are summarized below.⁵

One commenter stated that FINRA should maintain a standard approach to the terminology used in the proposed rules.⁶ The commenter gave as an example the suitability rule's use of "reasonable basis" in one discussion and "reasonable grounds" in another. The commenter also noted that the rule uses both "reasonable diligence" and "adequate due diligence" at different places. Another commenter asked FINRA to provide greater clarity in Supplementary Material to the suitability rule regarding the terms "investment profile" and "reasonable diligence."⁷ A few commenters raised concerns with the proposed suitability rule's expanded list of explicit information that members and associated persons would have to attempt to gather and analyze when making recommendations. These commenters stated that obtaining each specified category of information is not warranted on every occasion.⁸ They asked that FINRA

⁵ FINRA notes that the proposed rule change originally was published for comment in Regulatory Notice 09-25 (May 2009). FINRA received 2,083 comment letters in response to that Notice. In its original rule filing with the Commission, FINRA provided a detailed discussion of those comments and FINRA's responses thereto. See 75 FR 52562, 52565-52574.

⁶ See James T. McHale, Managing Director and Associate General Counsel, SIFMA (September 14, 2010) ("SIFMA Letter").

⁷ See Sutherland Asbill & Brennan LLP, on behalf of the Committee of Annuity Insurers (September 9, 2010) ("Committee of Annuity Insurers Letter").

⁸ See Committee of Annuity Insurers Letter, supra note 7; Bari Havlik, SVP and Chief Compliance Officer, Charles Schwab & Co., Inc. (September 9, 2010) ("Charles Schwab Letter"); John S. Markle, Deputy General Counsel, TD Ameritrade (September 15, 2010) ("TD Ameritrade Letter"); Pamela Lewis

build flexibility into the rule so that a firm would not have to collect information if it was not relevant based on the particular facts and circumstances.⁹ Numerous other commenters requested that FINRA state in the rule language that the suitability rule covers recommendations to hold a security or securities.¹⁰

In response to these comments, FINRA is proposing a few modifications to the rule change. For instance, FINRA agrees with those comments requesting that the rule use more consistent terminology, where possible. The amended rules now consistently use the term “reasonable basis” rather than also using “reasonable grounds” and

Marlborough, Associate General Counsel, TIAA-CREF (September 9, 2010) (“TIAA-CREF Letter”); SIFMA Letter, supra note 6. At present, the suitability rule generally requires that broker-dealers and associated persons attempt to gather information about and analyze the customer’s other security holdings, financial situation and needs, financial status, tax status, investment objectives, and such other information used or considered to be reasonable by such member or associated person in making recommendations to the customer. FINRA expanded that list to include the customer's age, investment experience, investment time horizon, liquidity needs, and risk tolerance.

⁹ See, e.g., Committee of Annuity Insurers Letter, supra note 7; TD Ameritrade Letter, supra note 8; TIAA-CREF Letter, supra note 8.

¹⁰ See, e.g., G. Mark Brewer, Esq., Investment Recovery Counsel (Sept. 9, 2010); Lisa Catalano, Director, St. John’s University School of Law Securities Arbitration Clinic (Sept. 9, 2010); Barry D. Estell, Esq. (Sept. 9, 2010); Scott C. Ilgenfritz, Esq., Johnson, Pope, Bokor, Ruppel & Burns, LLP (Sept. 24, 2010); William A. Jacobson, Director, Cornell Law School Securities Law Clinic (Sept. 9, 2010); Stephen Krosschell, Goodman Nekvasil, P.A. (Sept. 9, 2010); Richard M. Layne (Sept. 9, 2010); Peter J. Mougey, Levin, Papatonio, Thomas, Mitchell, Echsner, Rafferty, Proctor, P.A. (Sept. 9, 2010); David P. Neuman, Stoltmann Law Offices, PC (Sept. 9, 2010); Scott R. Shewan, President, Public Investors Arbitration Bar Association (Sept. 9, 2010); Al Van Kampen, Esq. (Sept. 10, 2010).

“reasonable expectations” and the term “reasonable diligence” instead of also using “due diligence” and “adequate due diligence.”¹¹

FINRA also agrees that it would be helpful to provide more detailed explanations of the terms “reasonable diligence” and “customer’s investment profile” in relation to the proposed suitability rule. For instance, the amendment provides an expanded discussion of the term “reasonable diligence” in the context of reasonable-basis suitability, which requires that a firm have a reasonable basis, based on reasonable diligence, to believe that the recommendation could be suitable for at least some investors. The amendment adds that a “member’s or associated person’s reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule.”¹² In addition, the amendment provides more detailed explanations of both terms in relation to a customer’s investment profile. A new Supplementary Material provides as follows:

.04 Customer’s Investment Profile. A member or associated person shall make a recommendation covered by this Rule only if, among other things, the member or associated person has sufficient information about the customer to have a reasonable basis to believe that the

¹¹ See, e.g., Proposed Rule 2090 (replacing the term “due diligence” with “reasonable diligence”); Supplementary Material .04 (Customer’s Investment Profile) to Proposed Rule 2111 (using the terms “reasonable basis” and “reasonable diligence”); Supplementary Material .05 (Components of Suitability Obligations) to Proposed Rule 2111 (replacing the term “adequate due diligence” with the term “reasonable diligence” and replacing the term “reasonable grounds” with the term “reasonable basis”); Supplementary Material .06 (Customer’s Financial Ability) to Proposed Rule 2111 (replacing the term “reasonable expectation” with the term “reasonable basis”).

¹² Supplementary Material .05 (Components of Suitability Obligations) to Proposed Rule 2111.

recommendation is suitable for that customer. The factors delineated in Rule 2111(a) regarding a customer's investment profile generally are relevant to a determination regarding whether a recommendation is suitable for a particular customer, although the level of importance of each factor may vary depending on the facts and circumstances of the particular case. A member or associated person shall use reasonable diligence to obtain and analyze all of the factors delineated in Rule 2111(a) unless the member or associated person has a reasonable basis to believe, documented with specificity, that one or more of the factors are not relevant components of a customer's investment profile in light of the facts and circumstances of the particular case.¹³

Moreover, as reflected in the new Supplementary Material .04 (Customer's Investment Profile) above, FINRA is proposing changes in response to comments on the proposed suitability rule's information-gathering requirement. FINRA understands that not every factor regarding a "customer's investment profile" will be relevant to every recommendation. As a number of commenters requested, the amendment provides flexibility regarding the type of information that firms must seek to obtain and analyze in connection with a recommendation under the proposed suitability rule. However, because the factors discussed in Rule 2111(a) generally are relevant (and often crucial) to a suitability analysis, the rule would require firms to document with specificity their reasonable basis for believing that a factor is not relevant in order to be relieved of the obligation to seek to obtain information about that factor.

¹³ Supplementary Material .04 (Customer's Investment Profile) to Proposed Rule 2111. FINRA also created another Supplementary Material to Rule 2111 that reiterates FINRA's longstanding position that firms and associated persons cannot disclaim any obligations under the suitability rule. See Supplementary Material .02 (Disclaimers) to Proposed Rule 2111. Among other things, that Supplementary Material would make clear that firms and associated persons cannot disclaim their obligations to seek to obtain and analyze relevant customer information.

Finally, although FINRA stated in its original rule filing that the proposed suitability rule would cover explicit “hold” recommendations, FINRA is proposing to amend the Supplementary Material to address such recommendations in light of continued concerns raised by commenters.¹⁴ The amended Supplementary Material to the suitability rule now states that the rule would cover an explicit recommendation to hold a security or securities.¹⁵ As FINRA explained in its original rule filing, the rule recognizes that customers may rely on members’ and associated persons’ investment expertise and knowledge, and it is thus appropriate to hold members and associated persons responsible for the recommendations that they make to customers, regardless of whether those recommendations result in transactions or generate transaction-based compensation.¹⁶

As noted in Item 2 of this filing, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be 270 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

The proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁷ which requires, among other things, that FINRA’s rules must be designed to

¹⁴ As discussed in the original rule filing, the rule would not cover implicit recommendations to hold a security or securities. See 75 FR 52562, 52568.

¹⁵ See Supplementary Material .03 (Recommended Strategies) to Proposed Rule 2111 (stating that the term strategy would include “an explicit recommendation to hold a security or securities”).

¹⁶ See 75 FR 52562, 52568.

¹⁷ 15 U.S.C. 78o-3(b)(6).

prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change furthers these purposes because it requires firms and associated persons to know, deal fairly with, and make only suitable recommendations to customers.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

FINRA, by separate letter, filed with the Commission today its response to comments regarding the original rule filing for SR-FINRA-2010-039.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 4. Text of proposed rule change marking changes from the originally filed proposed rule change.

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2010-039)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) and amended on , the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing Amendment No. 1 to SR-FINRA-2010-039, which proposed a rule change to adopt FINRA Rule 2090 (Know Your Customer) and FINRA Rule 2111 (Suitability) as part of the consolidated FINRA rulebook. As described herein, Amendment No. 1 to SR-FINRA-2010-039 proposes modifications to the rule change in response to comments.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

On July 30, 2010, as part of the process of developing a new consolidated FINRA rulebook, FINRA proposed adopting FINRA Rule 2090 (Know Your Customer) and FINRA Rule 2111 (Suitability). The proposed rules are based in large part on NYSE Rule 405(1) (Diligence as to Accounts), NASD Rule 2310 (Recommendations to Customers (Suitability)) and its related Interpretative Materials ("IMs"), and case law interpretations of those rules.³ On August 19, 2010, the SEC published FINRA's

³ FINRA further explained that the proposed rule change would delete NYSE Rule 405(1) through (3) (including NYSE Supplementary Material 405.10 through .30), NYSE Rule Interpretations 405/01 through /04, NASD Rule 2310, IM-2310-1 (Possible Application of SEC Rules 15g-1 through 15g-9), IM-2310-2 (Fair Dealing with Customers), and IM-2310-3 (Suitability Obligations to Institutional Customers). FINRA also noted that NYSE Rule 405(4) was eliminated on June 14, 2010 pursuant to another rule filing. See Securities Exchange Act Release No. 61808 (March 31, 2010), 75 FR 17456 (April 6, 2010) (Order Approving File No. SR-FINRA-2010-005); see also Regulatory Notice 10-21 (April 2010).

proposed rule change in the Federal Register and sought public comment.⁴ On August 26, 2010, the SEC published a corrected notice in the Federal Register seeking public comment.⁵ The public comment period closed on September 9, 2010. Twenty-two comment letters were submitted. By separate letter, FINRA filed with the SEC its response to those comments made in relation to the publication of the proposed rule change in the Federal Register. This amendment proposes modifications to the rule change in response to those comments. The relevant comments and proposed amendments that emanate from them are summarized below.⁶

One commenter stated that FINRA should maintain a standard approach to the terminology used in the proposed rules.⁷ The commenter gave as an example the suitability rule's use of "reasonable basis" in one discussion and "reasonable grounds" in another. The commenter also noted that the rule uses both "reasonable diligence" and "adequate due diligence" at different places. Another commenter asked FINRA to

⁴ See Securities Exchange Act Release No. 62718 (August 13, 2010), 75 FR 51310 (August 19, 2010) (Notice of Filing of Proposed Rule Change; SR-FINRA-2010-039). FINRA noted that it essentially was updating the suitability rule by codifying various well-settled interpretations of the rule. FINRA did not narrow any existing suitability obligations via this rule filing.

⁵ See Securities Exchange Act Release No. 62718A (August 20, 2010), 75 FR 52562 (August 26, 2010) (Corrected Notice of Filing of Proposed Rule Change; SR-FINRA-2010-039). The SEC published the correction to rectify various footnoting errors, in large part inadvertent clerical mistakes. Id. The corrected notice did not contain substantive changes. Id.

⁶ FINRA notes that the proposed rule change originally was published for comment in Regulatory Notice 09-25 (May 2009). FINRA received 2,083 comment letters in response to that Notice. In its original rule filing with the Commission, FINRA provided a detailed discussion of those comments and FINRA's responses thereto. See 75 FR 52562, 52565-52574.

⁷ See James T. McHale, Managing Director and Associate General Counsel, SIFMA (September 14, 2010) ("SIFMA Letter").

provide greater clarity in Supplementary Material to the suitability rule regarding the terms “investment profile” and “reasonable diligence.”⁸ A few commenters raised concerns with the proposed suitability rule’s expanded list of explicit information that members and associated persons would have to attempt to gather and analyze when making recommendations. These commenters stated that obtaining each specified category of information is not warranted on every occasion.⁹ They asked that FINRA build flexibility into the rule so that a firm would not have to collect information if it was not relevant based on the particular facts and circumstances.¹⁰ Numerous other commenters requested that FINRA state in the rule language that the suitability rule covers recommendations to hold a security or securities.¹¹

⁸ See Sutherland Asbill & Brennan LLP, on behalf of the Committee of Annuity Insurers (September 9, 2010) (“Committee of Annuity Insurers Letter”).

⁹ See Committee of Annuity Insurers Letter, supra note 8; Bari Havlik, SVP and Chief Compliance Officer, Charles Schwab & Co., Inc. (September 9, 2010) (“Charles Schwab Letter”); John S. Markle, Deputy General Counsel, TD Ameritrade (September 15, 2010) (“TD Ameritrade Letter”); Pamela Lewis Marlborough, Associate General Counsel, TIAA-CREF (September 9, 2010) (“TIAA-CREF Letter”); SIFMA Letter, supra note 7. At present, the suitability rule generally requires that broker-dealers and associated persons attempt to gather information about and analyze the customer’s other security holdings, financial situation and needs, financial status, tax status, investment objectives, and such other information used or considered to be reasonable by such member or associated person in making recommendations to the customer. FINRA expanded that list to include the customer’s age, investment experience, investment time horizon, liquidity needs, and risk tolerance.

¹⁰ See, e.g., Committee of Annuity Insurers Letter, supra note 8; TD Ameritrade Letter, supra note 9; TIAA-CREF Letter, supra note 9.

¹¹ See, e.g., G. Mark Brewer, Esq., Investment Recovery Counsel (Sept. 9, 2010); Lisa Catalano, Director, St. John’s University School of Law Securities Arbitration Clinic (Sept. 9, 2010); Barry D. Estell, Esq. (Sept. 9, 2010); Scott C. Ilgenfritz, Esq., Johnson, Pope, Bokor, Ruppel & Burns, LLP (Sept. 24, 2010); William A. Jacobson, Director, Cornell Law School Securities Law Clinic (Sept. 9, 2010); Stephen Krosschell, Goodman Nekvasil, P.A. (Sept. 9, 2010); Richard

In response to these comments, FINRA is proposing a few modifications to the rule change. For instance, FINRA agrees with those comments requesting that the rule use more consistent terminology, where possible. The amended rules now consistently use the term “reasonable basis” rather than also using “reasonable grounds” and “reasonable expectations” and the term “reasonable diligence” instead of also using “due diligence” and “adequate due diligence.”¹²

FINRA also agrees that it would be helpful to provide more detailed explanations of the terms “reasonable diligence” and “customer’s investment profile” in relation to the proposed suitability rule. For instance, the amendment provides an expanded discussion of the term “reasonable diligence” in the context of reasonable-basis suitability, which requires that a firm have a reasonable basis, based on reasonable diligence, to believe that the recommendation could be suitable for at least some investors. The amendment adds that a “member’s or associated person’s reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when

M. Layne (Sept. 9, 2010); Peter J. Mougey, Levin, Papatonio, Thomas, Mitchell, Echsner, Rafferty, Proctor, P.A. (Sept. 9, 2010); David P. Neuman, Stoltmann Law Offices, PC (Sept. 9, 2010); Scott R. Shewan, President, Public Investors Arbitration Bar Association (Sept. 9, 2010); Al Van Kampen, Esq. (Sept. 10, 2010).

¹² See, e.g., Proposed Rule 2090 (replacing the term “due diligence” with “reasonable diligence”); Supplementary Material .04 (Customer’s Investment Profile) to Proposed Rule 2111 (using the terms “reasonable basis” and “reasonable diligence”); Supplementary Material .05 (Components of Suitability Obligations) to Proposed Rule 2111 (replacing the term “adequate due diligence” with the term “reasonable diligence” and replacing the term “reasonable grounds” with the term “reasonable basis”); Supplementary Material .06 (Customer’s Financial Ability) to Proposed Rule 2111 (replacing the term “reasonable expectation” with the term “reasonable basis”).

recommending a security or strategy violates the suitability rule.”¹³ In addition, the amendment provides more detailed explanations of both terms in relation to a customer’s investment profile. A new Supplementary Material provides as follows:

.04 Customer’s Investment Profile. A member or associated person shall make a recommendation covered by this Rule only if, among other things, the member or associated person has sufficient information about the customer to have a reasonable basis to believe that the recommendation is suitable for that customer. The factors delineated in Rule 2111(a) regarding a customer’s investment profile generally are relevant to a determination regarding whether a recommendation is suitable for a particular customer, although the level of importance of each factor may vary depending on the facts and circumstances of the particular case. A member or associated person shall use reasonable diligence to obtain and analyze all of the factors delineated in Rule 2111(a) unless the member or associated person has a reasonable basis to believe, documented with specificity, that one or more of the factors are not relevant components of a customer’s investment profile in light of the facts and circumstances of the particular case.¹⁴

Moreover, as reflected in the new Supplementary Material .04 (Customer’s Investment Profile) above, FINRA is proposing changes in response to comments on the proposed suitability rule’s information-gathering requirement. FINRA understands that not every factor regarding a “customer’s investment profile” will be relevant to every

¹³ Supplementary Material .05 (Components of Suitability Obligations) to Proposed Rule 2111.

¹⁴ Supplementary Material .04 (Customer’s Investment Profile) to Proposed Rule 2111. FINRA also created another Supplementary Material to Rule 2111 that reiterates FINRA’s longstanding position that firms and associated persons cannot disclaim any obligations under the suitability rule. See Supplementary Material .02 (Disclaimers) to Proposed Rule 2111. Among other things, that Supplementary Material would make clear that firms and associated persons cannot disclaim their obligations to seek to obtain and analyze relevant customer information.

recommendation. As a number of commenters requested, the amendment provides flexibility regarding the type of information that firms must seek to obtain and analyze in connection with a recommendation under the proposed suitability rule. However, because the factors discussed in Rule 2111(a) generally are relevant (and often crucial) to a suitability analysis, the rule would require firms to document with specificity their reasonable basis for believing that a factor is not relevant in order to be relieved of the obligation to seek to obtain information about that factor.

Finally, although FINRA stated in its original rule filing that the proposed suitability rule would cover explicit “hold” recommendations, FINRA is proposing to amend the Supplementary Material to address such recommendations in light of continued concerns raised by commenters.¹⁵ The amended Supplementary Material to the suitability rule now states that the rule would cover an explicit recommendation to hold a security or securities.¹⁶ As FINRA explained in its original rule filing, the rule recognizes that customers may rely on members’ and associated persons’ investment expertise and knowledge, and it is thus appropriate to hold members and associated persons responsible for the recommendations that they make to customers, regardless of whether those recommendations result in transactions or generate transaction-based compensation.¹⁷

¹⁵ As discussed in the original rule filing, the rule would not cover implicit recommendations to hold a security or securities. See 75 FR 52562, 52568.

¹⁶ See Supplementary Material .03 (Recommended Strategies) to Proposed Rule 2111 (stating that the term strategy would include “an explicit recommendation to hold a security or securities”).

¹⁷ See 75 FR 52562, 52568.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be 270 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

The proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁸ which requires, among other things, that FINRA's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change furthers these purposes because it requires firms and associated persons to know, deal fairly with, and make only suitable recommendations to customers.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

FINRA, by separate letter, filed with the Commission today its response to comments regarding the original rule filing for SR-FINRA-2010-039.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date

¹⁸ 15 U.S.C. 78o-3(b)(6).

if it finds such longer period to be appropriate and publishes its reasons for so finding or
(ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2010-039 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2010-039. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent

amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2010-039 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Florence E. Harmon

Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Exhibit 4 shows the changes proposed in this Amendment No. 1, with the proposed changes in the original filing shown as if adopted. New language proposed in this Amendment No. 1 is underlined; deletions proposed in this Amendment No. 1 are in brackets.

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Text of Proposed New FINRA Rules

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2000. DUTIES AND CONFLICTS

* * * * *

2090. Know Your Customer

Every member shall use [due] reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer.

• • • **Supplementary Material:** -----

.01 No Change.

2100. TRANSACTIONS WITH CUSTOMERS

2110. Recommendations

2111. Suitability

(a) 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, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile[.]. A customer's investment profile includes[ing], but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment

objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

(b) No Change.

• • • **Supplementary Material:** -----

.01 No Change.

.02 Disclaimers. A member or associated person cannot disclaim any responsibilities under the suitability rule.

.03 Recommended Strategies. The phrase “investment strategy involving a security or securities” used in this Rule is to be interpreted broadly and would include, among other things, an explicit recommendation to hold a security or securities. However, the following communications are excluded from the coverage of Rule 2111 as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities:

(a) General financial and investment information, including (i) basic investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment, (ii) historic differences in the return of asset classes (e.g., equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimate[ing]s of future retirement income needs, and (v) assessment of a customer’s investment profile;

(b) through (d) No Change.

.04 Customer’s Investment Profile. A member or associated person shall make a recommendation covered by this Rule only if, among other things, the member or

associated person has sufficient information about the customer to have a reasonable basis to believe that the recommendation is suitable for that customer. The factors delineated in Rule 2111(a) regarding a customer's investment profile generally are relevant to a determination regarding whether a recommendation is suitable for a particular customer, although the level of importance of each factor may vary depending on the facts and circumstances of the particular case. A member or associated person shall use reasonable diligence to obtain and analyze all of the factors delineated in Rule 2111(a) unless the member or associated person has a reasonable basis to believe, documented with specificity, that one or more of the factors are not relevant components of a customer's investment profile in light of the facts and circumstances of the particular case.

[.03].05 Components of Suitability Obligations. Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

(a) The reasonable-basis obligation requires a member or associated person to have a reasonable basis to believe, based on [adequate due] reasonable diligence, that the recommendation is suitable for at least *some* investors. In general, what constitutes [adequate due] reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and the member's or associated person's familiarity with the security or investment strategy. A member's or associated person's reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated

with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule.

(b) The customer-specific obligation requires that a member or associated person have a reasonable [grounds] basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule 2111(a).

(c) No Change.

[.04].06 Customer's Financial Ability. Rule 2111 prohibits a member or associated person from recommending a transaction or investment strategy involving a security or securities or the continuing purchase of a security or securities or use of an investment strategy involving a security or securities [if such recommendation is inconsistent with the] unless the member or associated person has a reasonable [expectation] basis to believe that the customer has the financial ability to meet such a commitment.

[.05].07 Institutional Investor Exemption. Rule 2111(b) provides an exemption to customer-specific suitability regarding institutional investors if the conditions delineated in that paragraph are satisfied. With respect to having to indicate affirmatively that it is exercising independent judgment in evaluating the member's or associated person's recommendations, an institutional customer may indicate that it is exercising independent judgment on a trade-by-trade basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions for its account.

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EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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Text of Proposed New FINRA Rules

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2000. DUTIES AND CONFLICTS

* * * * *

2090. Know Your Customer

Every member shall use reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer.

• • • Supplementary Material: -----

.01 Essential Facts. For purposes of this Rule, facts “essential” to “knowing the customer” are those required to (a) effectively service the customer’s account, (b) act in accordance with any special handling instructions for the account, (c) understand the authority of each person acting on behalf of the customer, and (d) comply with applicable laws, regulations, and rules.

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2100. TRANSACTIONS WITH CUSTOMERS

2110. Recommendations

2111. Suitability

(a) 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, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

(b) A member or associated person fulfills the customer-specific suitability obligation for an institutional account, as defined in NASD Rule 3110(c)(4), if (1) the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decisionmaking authority to an agent, such as an investment adviser or a bank trust department, these factors shall be applied to the agent.

• • • Supplementary Material: -----

.01 General Principles. Implicit in all member and associated person relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of FINRA's rules, with particular emphasis on the requirement to deal fairly

with the public. The suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct.

.02 Disclaimers. A member or associated person cannot disclaim any responsibilities under the suitability rule.

.03 Recommended Strategies. The phrase “investment strategy involving a security or securities” used in this Rule is to be interpreted broadly and would include, among other things, an explicit recommendation to hold a security or securities. However, the following communications are excluded from the coverage of Rule 2111 as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities:

(a) General financial and investment information, including (i) basic investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment, (ii) historic differences in the return of asset classes (e.g., equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimates of future retirement income needs, and (v) assessment of a customer’s investment profile;

(b) Descriptive information about an employer-sponsored retirement or benefit plan, participation in the plan, the benefits of plan participation, and the investment options available under the plan;

(c) Asset allocation models that are (i) based on generally accepted investment theory, (ii) accompanied by disclosures of all material facts and assumptions that may affect a reasonable investor’s assessment of the asset allocation model or any report generated by such model, and (iii) in compliance with NASD IM-2210-6 (Requirements

for the Use of Investment Analysis Tools) if the asset allocation model is an “investment analysis tool” covered by NASD IM-2210-6; and

(d) Interactive investment materials that incorporate the above.

.04 Customer’s Investment Profile. A member or associated person shall make a recommendation covered by this Rule only if, among other things, the member or associated person has sufficient information about the customer to have a reasonable basis to believe that the recommendation is suitable for that customer. The factors delineated in Rule 2111(a) regarding a customer’s investment profile generally are relevant to a determination regarding whether a recommendation is suitable for a particular customer, although the level of importance of each factor may vary depending on the facts and circumstances of the particular case. A member or associated person shall use reasonable diligence to obtain and analyze all of the factors delineated in Rule 2111(a) unless the member or associated person has a reasonable basis to believe, documented with specificity, that one or more of the factors are not relevant components of a customer’s investment profile in light of the facts and circumstances of the particular case.

.05 Components of Suitability Obligations. Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

(a) The reasonable-basis obligation requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and

risks associated with the security or investment strategy and the member's or associated person's familiarity with the security or investment strategy. A member's or associated person's reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule.

(b) The customer-specific obligation requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule 2111(a).

(c) Quantitative suitability requires a member or associated person who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a). No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation.

.06 Customer's Financial Ability. Rule 2111 prohibits a member or associated person from recommending a transaction or investment strategy involving a security or securities or the continuing purchase of a security or securities or use of an investment strategy involving a security or securities unless the member or associated person has a reasonable basis to believe that the customer has the financial ability to meet such a commitment.

.07 Institutional Investor Exemption. Rule 2111(b) provides an exemption to customer-specific suitability regarding institutional investors if the conditions delineated in that paragraph are satisfied. With respect to having to indicate affirmatively that it is exercising independent judgment in evaluating the member's or associated person's recommendations, an institutional customer may indicate that it is exercising independent judgment on a trade-by-trade basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions for its account.

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**Text of NASD, Incorporated NYSE Rules and NYSE Rule Interpretations to
be Deleted In Their Entirety from the Transitional Rulebook**

NASD Rules

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[2310. Recommendations to Customers (Suitability)]

Entire text deleted.

[IM-2310-1. Possible Application of SEC Rules 15g-1 through 15g-9]

Entire text deleted.

[IM-2310-2. Fair Dealing with Customers]

Entire text deleted.

[IM-2310-3. Suitability Obligations to Institutional Customers]

Entire text deleted.

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Incorporated NYSE Rules

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[Rule 405. Diligence as to Accounts]

Entire text deleted.

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NYSE RULE INTERPRETATION

[Rule 405 Diligence as to Accounts]

Entire text deleted.

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