



NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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September 9, 2010

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Via Electronic Submission

RE: Comments on Notice of Filing of Proposed Rule change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook
Release No. 34-62718; File No. SR-FINRA-2010-039

Dear Secretary Murphy:

The North American Securities Administrators Association, Inc. (“NASAA”)¹ appreciates the opportunity to comment on Release No. 34-62718; File No. SR-FINRA-2010-039, “Comments on Notice of Filing of Proposed Rule change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook” (the “Release”).

Background

In May 2009, the Financial Industry Regulatory Authority (“FINRA”) sought comment on a proposed rule consolidation for NASD Rule 2310 and NYSE 405 (the “Notice”).² As a result of FINRA’s request for comment, NASAA filed a comment letter, dated July 13, 2009 (the “Comment Letter”).³ On July 30, 2010, FINRA filed the proposed rule change with the Securities and Exchange Commission (the “Commission”), and the Commission published the Release on August 13, 2010.⁴

¹ NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.

² FINRA Regulatory Notice 2009-25, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p118709.pdf>.

³ Available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p119415.pdf>.

⁴ The August 13, 2010, Release was republished in whole, in the Federal Register, on August 26, 2010, to correct footnote errors.

Comments

- Not Applicable to Every Order

NASAA disagrees with FINRA's proposal not to adopt the NYSE requirement to learn the essential facts relative to every order. NASAA believes the "know your customer" rule should require due diligence as to every order, just as it currently exists in NYSE Rule 405(1). The "every order" due diligence requirement is stronger and clearer language and is preferable to the proposed language in Rule 2090, which only applies to every account.

- Scope of the Suitability Rule / Non-Securities Products

In the Notice, FINRA sought comment as to whether the "suitability obligations [should expand] to all recommendations of investment products, services and strategies made in connection with a firm's business, regardless of whether the recommendations involve securities." As NASAA stated in its Comment Letter, in order to make suitable investment recommendations, a registered securities professional needs to be generally apprised of the financial marketplace as a whole. FINRA, however, disagreed with this approach and decided against references to non-securities products in the rule. NASAA reaffirms its assertion that the "general knowledge of, and general comparison to, non-securities products is implicit for a registered person to make suitable investment recommendations."

- Elimination of Interpretative Material Following NASD Rule 2310

NASAA disagrees with the deletion of the related NASD Interpretative Materials ("IMs") and Incorporated NYSE Rule Interpretations in the proposed rule change. In the Release, FINRA claims the modifications "strengthen and clarify" the Know Your Customer and Suitability rules. Apparently, "strengthening and clarification" takes the form of deleting a considerable body of interpretative material for each rule. As NASAA noted in its Comment Letter, the IMs help both registered securities professionals and the investing public understand how the suitability rule applies to specific transactions. The Commission should note that elimination of these interpretative materials by FINRA serves no useful purpose, fosters a lack of clarity, and does not support the goal of investor protection. As such, NASAA recommends against eliminating the IMs and instead encourages the codification of existing IMs.

- Institutional Investor / Eliminating Detailed Discussion From IM-2310-3

NASAA applauds FINRA's proposal to increase the monetary threshold for the definition of an institutional investor from \$10 million invested in securities and/or under management to \$50 million in assets. Institutional investors, just as retail investors, have been hard hit during these trying economic times, arguing for strong investor protection

standards.⁵ NASAA is still concerned, however, that proposed Rule 2111(b) modifies the limited exemption in IM-2310-3 and eliminates the significant guidance currently available in IM-2310-3. For example, proposed Rule 2111(b) provides that a member's suitability obligation is fulfilled when the member has a reasonable basis to believe that the institutional investor is capable of evaluating the risks independently and the institutional investor affirmatively indicates that they are exercising independent judgment. Proposed Rule 2111(b), however, does not contain the relevant considerations that can be used to determine whether an institutional investor is capable of evaluating the risk independently. These considerations are currently present in IM-2310-3.⁶ NASAA recommends that the requirement for institutional investors to affirmatively indicate that they are exercising independent judgment in Rule 2111 be eliminated, and instead, the current considerations and factors in IM-2310-3 should be maintained.

Conclusion

Thank you again for the opportunity to comment on these proposed rules. NASAA appreciates the opportunity to express its views on this matter of vital importance to investors and encourages the Commission not to diminish any investor protections that currently exist. Please do not hesitate to contact the undersigned with any questions regarding this matter.

Sincerely,

A handwritten signature in black ink, appearing to read 'Tina G. Stavrou', is written over a horizontal line. The signature is stylized and somewhat cursive.

Tina G. Stavrou
Assistant General Counsel
NASAA

⁵ In the Release, FINRA states, "the suitability obligations set forth in proposed Rule 2111 would not be inconsistent with the addition of a fiduciary duty." NASAA notes that the sole purpose of proposed Rule 2111(b) is to exempt members from suitability requirements to institutional investors. An inconsistency arises, however, when one considers that fiduciary duty standard, under both state and federal law governing investment advisers, does not differentiate between retail and institutional investors – an investment adviser owes a fiduciary duty to both.

⁶ These considerations include the institutional investor's use of consultants, their general level of experience, their ability to understand the economic features of the security involved, etc.