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September 9, 2010

Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SR-FINRA-2010-039 Rule Proposal Rules 2090 (Know Your Customer) and 2111 (Suitability)

Dear Ms. Harmon:

Thank you for the opportunity to comment on the Rule Proposals of the Financial Industry Regulatory Authority (“FINRA”) to adopt FINRA Rule 2111 (Suitability) and FINRA Rule 2090 (Know Your Customer) as part of the Consolidated FINRA Rulebook. I write on behalf of the Public Investors Arbitration Bar Association (“PIABA”)¹ in general support of the above-referenced rule proposals. The proposed rules would be a step in the right direction to codify suitability and know-your-customer standards for FINRA members. PIABA respectfully asks the SEC to accept the proposed rule for a number of reasons but hopes that additional changes are made to this proposal.

Proposed Rule 2111

PIABA supports proposed Rule 2111 regarding suitability. Current NASD Rule 2310 applies to recommendations of a “purchase, sale or exchange of any security.” The inclusion of both “recommended transaction[s]” and “investment strateg[ies]” under the proposed Rule 2111 is a welcome change. Today, brokers-dealers and their representatives make recommendations for not only individual purchases but also for particular strategies or plans. Brokers should have a reasonable basis for recommending an overall strategy in addition to recommending an individual investment.

PIABA also supports the inclusion of the listed factors to be considered when determining a reasonable basis for recommendations. Brokers and their

¹ PIABA is an international bar association, consisting of more than 460 members, dedicated to the protection of investors’ rights in securities arbitration proceedings.

firms will have clearer guidance from FINRA that they should consider these factors when making the recommendations. It is also encouraging that brokers should also ascertain “any other information the customer may disclose to the member or associated person in connection with such recommendation.”

The addition of the supplementary materials to proposed Rule 2111 should benefit investors and the member firms for the most part. These materials will help provide more guidance to the firms in making recommendations. Importantly, we support the inclusion of Supplementary Material .03, which identifies three suitability analyses that firms and brokers should consider when making a recommendation. Moreover, Supplementary Material .04 is helpful, as brokers should not make a recommendation that is inconsistent with the customer’s ability to meet such a financial commitment. It makes common sense that a broker should not make a recommendation knowing that the customer may not be able to afford the particular investment or strategy.

PIABA does not support the inclusion of Supplementary Material .02, which specifically excludes a number of communications from Rule 2111’s coverage. Brokers and firms often use asset allocation models when making recommendations to clients, particularly when the broker or firm are recommending a particular, overall portfolio strategy. Part C of Supplementary Material .02 would seem to not require a broker to include this information when discussing a strategy with a client. Securities customers should be informed of this information when their broker and firm recommend a strategy to them.

The most glaring omission from Rule 2111 is that there is no definition of “recommended” or “recommendation.” PIABA believes that omitting a definition for this key term would create a loophole for brokers and firms to attempt to get around the suitability rules. PIABA supports clarifying this important term from sources used in the past by the industry.

NYSE Rule 472.40(1) defines a recommendation as “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.” PIABA supports the inclusion of this definition into Rule 2111 or its supplementary materials. This would provide a framework for brokers and firms to understand what would constitute a recommendation.

Importantly, PIABA hopes that FINRA and the SEC would include this definition to clarify that recommendations to “hold” a security are covered by the new rule. In reality, brokers make just as many recommendations to hold a security or not to sell a security at a particular time, as they would for purchases or sales. Many customers rely on this advice from their broker in determining a course of action to take. A recommendation to hold is almost just as important (and sometimes more important) to a customer than the decision to buy. Changes in the market conditions or the client’s individual circumstances may prompt a decision to sell or hold a

security. The inclusion of recommendations to hold within this rule would provide a great benefit to investors, who should be afforded a reasonable opportunity to have such a claim considered by the arbitrators.

We therefore think it would be detrimental to exclude a part of the rule that creates suitability obligations for recommendations to hold. The mere absence of suitability obligations for recommendations to hold would send a signal to member firms and brokers that its absence is indicative that FINRA did not intend to include such in the rule. PIABA hopes that FINRA will consider this issue and propose language to include suitability obligations for recommendations to hold as well (or at least make the language clearer to indicate that recommendations to hold are covered under proposed Rule 2111).

Also, we believe that the proposed rule should be broader to include suitability obligations for all transactions, not just broker recommendations. In today's securities brokerage industry, most brokers are more than just mere order-takers. Many brokers provide advice to their customers about which securities to buy, sell, or hold, and many brokers hold themselves out as "financial planners."

A broker should have the same obligations to a customer who himself or herself decides which security to buy, sell, or hold. Brokers are often in a better position to evaluate the risks and characteristics of a given investment product than the client is. Brokers have better access to research reports, prospectuses, marketing materials, brochures, etc., than their clients, and many times are in a better position to understand the available information. This should prompt brokers to consider and discuss with the client the suitability of such investment. Today's brokers should consider the suitability factors when discussing all transactions, including customer-initiated transactions. This treatment would also be more consistent with goals to better harmonize the duties among brokers and other financial professional and decrease public confusion concerning multiple professional designations.

Proposed Rule 2090

PIABA also supports the inclusion of the NYSE's "Know Your Customer" rule as part of proposed Rule 2090. This proposed rule complements proposed Rule 2111 well. This will provide better protection to investors, as it requires the firms to use diligence to know and retain important and essential information about each customer and persons acting on behalf of the customer (such as trustees or powers of attorney).

However, PIABA is concerned that the proposed rule does not require the broker to do anything more than learn this information. The proposed rule should clarify that this rule requires the broker to use that knowledge not only for recommendations to buy and sell but for recommendations to hold as well. This is especially important in the context where securities are

transferred from one firm to another. The broker at the transferee firm should be required to not only know the customer at that point but also to make recommendations based on the customer's individual circumstances and what securities are held in that customer's portfolio. If that customer's portfolio does not match his or her investment objectives, risk tolerances, or financial resources, then the broker should be required to take an active approach and do more than just learn of the customer's "essential facts." Most public customers believe that brokers are undertaking these professional tasks as a matter of course, especially when fees or compensation of any kind are involved.

In addition, we believe that the proposed rule should clarify that the broker should be required not only to know the essential facts about his customer, but also to know the essential facts about the order or recommendation. This would require the broker to not only "know your customer" but also to "know your security."

Recently in FINRA Notice to Members 10-22, FINRA stated "The Securities and Exchange Commission (SEC) and federal courts have long held that a BD that recommends a security is under a duty to conduct a reasonable investigation concerning that security and the issuer's representations about it." A number of cases have stated that even in non-discretionary accounts, a broker has a duty to "recommend a stock only after studying it sufficiently to become informed as to its nature, price, and financial prognosis." *Leib vs. Merrill Lumch, Pierce, Fenner & Smith*, 461 F.Supp. 951, 953 (E.D. Mich. S.D. 1978); see also *Patsos v. First Albany Corp.*, 741 N.E.2d 841, 849-50 (Mass. 2001); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng*, 901 F.2d 1124, 1128 (D.C. Cir. 1990); *Burns v. Prudential Securities, Inc.*, 857 N.E.2d 621 (Ohio App. 2006). At a time when investments are becoming increasingly complex, and novel investments are created routinely, FINRA should enforce the notion that the brokers selling these products have an adequate understanding of the risks and characteristics of the investments they are selling in order to explain them to the customers.

Conclusion

In sum, PIABA supports these new rule proposals but hopes that FINRA and the SEC would make some additional changes in order to better protect the investing public. I would like to thank you once again for the opportunity to comment on this rule proposal.

Sincerely,

/s/

Scott R. Shewan
President

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