

# Public Investors Arbitration Bar Association

Via email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

December 14, 2010

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: SR-FINRA-2010-039 Amendment 1 to Proposed Rule Change to Adopt Rules 2090 (Know Your Customer) and 2111 (Suitability)**

Dear Ms. Murphy:

Thank you for the opportunity to comment on Amendment 1 to the Proposed Rule Change filed by the Financial Industry Regulatory Authority (“FINRA”) to adopt FINRA Rule 2090 (Know Your Customer) and FINRA Rule 2111 (Suitability). I write on behalf of the Public Investors Arbitration Bar Association (“PIABA”). The rule proposal was initially filed with the Commission on July 30, 2010, and at that time, PIABA submitted a comment letter in general support of the rule proposal with the request that further attention be given to certain aspects of the proposal.

PIABA is a national, not-for-profit bar association comprised of attorneys, including law school professors and regulators, both former and current, who devote a significant portion of their practice to the representation of public investors in securities arbitrations. As stated previously, we believe the proposed rules are a step in the right direction to codify the suitability and know-your-customer standards for FINRA members. Additionally, we are pleased that the amendment which FINRA has filed now explicitly includes recommendations to hold within the purview of the suitability rule. However, we do believe that there remain concerns which were previously raised in our comment letter which remain unaddressed.

## Proposed Rule 2090

PIABA supports the inclusion of the NYSE’s “Know Your Customer” rule as part of proposed Rule 2090. This inclusion will provide better protection to investors, as it requires the firms to use diligence to know and to retain essential facts concerning every customer. However, PIABA remains concerned that the proposed rule does not require the firms or the brokers to do anything more than learn this information. This lack of necessary proactive action is especially troubling if a customer transfers an account from one firm to another, but there are no recommendations ever made at the new firm. A customer may believe, rightly

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so, that if a firm is gathering all of this information when the customer is opening the account, that the firm is using the information for some purpose, such as reviewing the appropriateness of the portfolio that was transferred into the firm. 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 to 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. However, as the proposed rules are currently written, a broker may not have a duty absent an explicit recommendation.

### Proposed Rule 2111

PIABA continues to support proposed Rule 2111 regarding suitability. Current NASD Rule 2310 applies to recommendations of a "purchase, sale or exchange of any security." As we have previously stated, 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 factors that are considered to be part of a customer's investment profile and the specification that a broker should consider these factors when making a recommendation.

We are also pleased with inclusion of the supplementary materials to proposed Rule 2111 for the most part, as they clarify the purpose of the rule. We welcome the inclusion, through the amendment, of Supplementary Material .02, which prevents a member or associated person from disclaiming responsibility under the rule. Additionally, Supplementary Material .03 has been amended so that the phrase "investment strategy" includes "an explicit recommendation to hold a security or securities." Recommendations to hold are important components of investment strategies and are properly included within the definition of the term. We are puzzled as to why the term "explicit" is used before recommendation in this context when it is not used in other parts of the rule. We believe this phrasing may lead to confusion in the application of the rule and to attempts to make unintended distinctions.

Supplementary Material .04 has also been added with the amendment, requiring that an associated person have sufficient information about a customer before making a recommendation. This section makes it clear that there is an obligation on part of the broker to obtain and analyze the customer's investment profile as specifically delineated in the rule when a recommendation is being made.

As discussed in our previous comment letter, we support the inclusion of Supplementary Material .05, which identifies three suitability analyses that firms and brokers should consider when making a recommendation. Supplementary Material .06 seems that it should be intuitive, as brokers should not make a

recommendation that is inconsistent with the customer's ability to meet such a financial commitment.

PIABA does not support the inclusion of the part of Supplementary Material .03, which specifically excludes a number of communications from Rule 2111's coverage if the communication does not include the recommendation of a particular security or securities. Brokers and firms often use asset allocation models, particularly when recommending a particular, overall portfolio strategy. The mere fact that the asset allocation model is not accompanied by a specific recommendation should not relieve a broker of his obligations under the rule. The broker should have an obligation to believe that the asset allocation model he is presenting to a customer is suitable for that customer. Moreover, general financial and investment information which includes an assessment of a customer's investment profile is specifically excluded. It seems counterintuitive to exclude from the coverage of the rule communications which are specifically tailored to customers and which those customers are clearly meant to rely upon.

The most glaring omission from Rule 2111 continues to be the omission of a 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 inclusion would provide a framework for brokers and firms to understand what would constitute a recommendation.

Also, we continue to believe that the proposed rule should be broadened 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" or "financial advisers." 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 to discuss with the client the suitability of such investments. 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 harmonize the duties among brokers and other financial professionals and to decrease public confusion concerning multiple professional designations.

Conclusion

PIABA supports the proposal to adopt the two new rules but requests that the Commission further examine the Supplementary Materials and consider other ways in which the rules can further provide for investor protection. Thank you for your consideration in this matter.

Respectfully submitted,

PUBLIC INVESTORS ARBITRATION  
BAR ASSOCIATION

/s/

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President

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