

Suitability and Know Your Customer Resources

SEC Studies

- SEC Study on Investment Advisers and Broker-Dealers (January 2011) (discussing the obligations of investment advisers and broker-dealers, as required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act)
- SEC Special Study of Securities Markets, H.R. Doc. No. 88-95, pt. 1 (1st Sess. 1963) (discussing, *inter alia*, various suitability issues regarding low-priced securities)

FINRA Regulatory Notices

- Regulatory Notice 12-03 (Jan. 2012) (providing guidance to broker-dealers regarding heightened supervision of and explaining suitability obligations for complex products)

<http://www.finra.org/Industry/Regulation/Notices/2012/P125398>
- Regulatory Notice 11-25 (May 2011) (providing additional guidance regarding FINRA's new "know your customer" and suitability rules in Q&A format)

<http://www.finra.org/Industry/Regulation/Notices/2011/P123702>
- Regulatory Notice 11-02 (January 2011) (announcing SEC approval of and the effective date for FINRA's new "know your customer" and suitability rules)

<http://www.finra.org/Industry/Regulation/Notices/2011/P122779>
- Regulatory Notice 10-22 (April 2010) (discussing suitability obligations in context of private offerings)

<http://www.finra.org/Industry/Regulation/Notices/2010/P121299>
- Regulatory Notice 09-42 (July 2009) (reminding firms of their obligations with variable life settlement activities)

<http://www.finra.org/Industry/Regulation/Notices/2009/P119547>
- *Regulatory Notice 09-32* (June 2009) (announcing SEC approval of amendments to Rule 2821 (Deferred Variable Annuities) that limit the rule's application to recommended transactions, change the triggering event that begins the principal review period, and clarify various issues through new supplementary material to the rule)

<http://www.finra.org/Industry/Regulation/Notices/2009/P118955>

- Regulatory Notice 09-31 (June 2009) (reminding firms of sales practice obligations relating to leveraged and inverse exchange-traded funds)

<http://www.finra.org/Industry/Regulation/Notices/2009/P118953>

- Regulatory Notice 09-25 (May 2009) (proposing consolidated FINRA rules governing suitability and know-your-customer obligations)

<http://www.finra.org/Industry/Regulation/Notices/2009/P118711>

- *Regulatory Notice 07-53, Deferred Variable Annuities* (November 2007) (announcing SEC approval of and the effective date for Rule 2821 covering sales practices for deferred variable annuities, including a suitability obligation tailored specifically to such transactions)

<http://www.finra.org/RulesRegulation/NoticestoMembers/2007NoticestoMembers/P037403>

- *Regulatory Notice 07-43, Senior Investors* (September 2007) (reminding firms of the obligations, including suitability obligations, relating to senior investors and highlighting industry practices to serve such customers)

http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p036816.pdf

FINRA Notices to Members

- *Notice to Members 07-06, Supervision of Recommendations after a Registered Representative Changes Firms* (February 2007) (explaining special considerations when supervising recommendations of newly associated registered representatives to replace funds and variable products)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_018630.pdf

- *Notice to Members 05-59, NASD Reminds Members of Obligations When Selling Structured Products* (September 2005) (reminding members of their obligations, including suitability requirements, when selling structured products)

<http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p014997.pdf>

- *Notice to Members 03-71, NASD Reminds Members of Obligations When Selling Non-Conventional Investments* (November 2003) (reminding members of their obligations, including suitability requirements, when selling non-conventional investments)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_003070.pdf

- *Notice to Members 01-23, Suitability Rule and Online Communications* (April 2001) (discussing various suitability issues in the online context and also providing guidelines for determining whether a particular communication—whether electronic or otherwise—constitutes a "recommendation" triggering application of the suitability rule)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_003887.pdf

- *Notice to Members 99-35, NASD Reminds Members of Their Responsibilities Regarding the Sales of Variable Annuities* (May 1999) (reminding members of their responsibilities, including suitability obligations, regarding the sales of variable annuities and providing guidelines)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_004395.pdf

- *Notice to Members 96-60, Clarification of Members' Suitability Responsibilities under NASD Rules with Special Emphasis on Member Activities in Speculative and Low-Priced Securities* (March 1997) (discussing members' suitability obligations when selling low-priced securities and clarifying the breadth of the suitability rule's coverage)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_016905.pdf

- *Notice to Members 96-86, NASD Regulation Reminds Members and Associated Persons that Sales of Variable Contracts are Subject to NASD Suitability Requirements* (December 1996) (emphasizing that sales of variable contracts are subject to suitability requirements)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_004697.pdf

- *Notice to Members 95-80, NASD Further Explains Members Obligations and Responsibilities Regarding Mutual Funds Sales Practices* (September 1995) (reminding members that, when determining suitability of a fund, they should consider fund's expense ratio and sales charges as well as its investment objectives)

http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1518

- *Notice to Members 94-16, NASD Reminds Members Of Mutual Fund Sales Practice Obligations* (March 1994) (providing guidance regarding mutual fund sales practices, including suitability determinations)

http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1518

FINRA Regulatory & Compliance Alerts

- *Reminder—Suitability of Variable Annuity Sales, Regulatory & Compliance Alert* (2002) (emphasizing, in part, that an associated person must be knowledgeable about a variable annuity before he or she can determine whether a recommendation to purchase, sell or exchange the variable annuity is appropriate)

http://www.nasd.com/RulesRegulation/PublicationsGuidance/MemberUpdates/RegulatoryandComplianceAlerts/NASDW_015299

- *Online Brokerage Services and the Suitability Rule, Regulatory & Compliance Alert* (Summer 2000) (providing guidance regarding electronic communications that could be considered "recommendations" triggering application of the suitability rule)

http://www.nasd.com/web/groups/rules_regs/documents/rca/nasdw_002377.pdf

- *Suitability Issues for Multi-Class Mutual Funds, Regulatory & Compliance Alert* (Summer 2000) (discussing various suitability issues related to mutual funds)

http://www.nasd.com/web/groups/rules_regs/documents/rca/nasdw_002377.pdf

FINRA Course

- *Suitability and Know Your Customer Obligations: FINRA Rules 2111 and 2090 (EL-ELC197)* This course demonstrates the key requirements of FINRA's suitability and know your customer rules, and specific obligations of firms and associate persons under those rules.

<http://www.finra.org/Industry/Education/OnlineLearning/E-learningCourses/P125907>

Law Review Articles

- Nancy C. Libin & James S. Wrona, *The Securities Industry and the Internet: A Suitable Match?* 2001 COLUM. BUS. L. REV. 601 (2001).

<http://www.cblr.org/archives.html>

Other FINRA Publications Discussing Suitability-Type Issues

- *Notice to Members 05-50, Member Responsibilities for Supervising Sales of Unregistered Equity-Indexed Annuities* (August 2005) (discussing members' responsibilities for supervising sales of equity-indexed annuities)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_014821.pdf

- *Notice to Members 05-48, Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers* (July 2005) (outlining members' responsibilities when outsourcing activities to third-party service providers)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_014735.pdf

- *Notice to Members 05-26, NASD Recommends Best Practices for Reviewing New Products* (April 2005) (recommending best practices for reviewing new products)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_013755.pdf

- *Notice to Members 04-89, NASD Alerts Members to Concerns When Recommending or Facilitating Investments of Liquefied Home Equity* (December 2004) (discussing concerns when recommending or facilitating investments of liquefied home equity)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_012714.pdf

- *Notice to Members 03-68, NASD Reminds Members That Fee-Based Compensation Programs Must Be Appropriate* (November 2003) (discussing factors to consider when determining the appropriateness of fee-based compensation programs)

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_003079.pdf

Significant Suitability Cases

- *Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1369 (7th Cir. 1983) (discussing various factors that courts and regulators consider in determining whether the trading was excessive)
- *Richard G. Cody*, Exchange Act Rel. No. 64565, 2011 SEC LEXIS 1862, *30-32 (May 27, 2011) (explaining, among other things, that a broker can violate reasonable-basis suitability by failing to perform a reasonable investigation of a recommended product and to understand the risks of the recommendation notwithstanding that the recommendation could be suitable for *some* investors)
- *Michael Frederick Siegel*, Exchange Act Rel. No.58737, 2008 SEC LEXIS 2459 (Oct. 6, 2008) (discussing various factors to consider in determining whether a communication is a recommendation and reviewing elements of reasonable-basis and customer-specific suitability), *aff'd in relevant part*, 592 F.3d 147 (D.C. Cir. Jan. 12, 2010), *cert. denied*, 2010 U.S. LEXIS 4340 (May 24, 2010)
- *Raghavan Sathianathan*, Exchange Act Rel. No. 54722, 2006 SEC LEXIS 2572, at *21-33 (Nov. 8, 2006) (discussing suitability obligations in the context of different mutual fund share classes, as well as the use of margin)
- *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *23-24 (Feb. 10, 2004) (stating that, under the suitability rule, a “broker’s recommendations must be consistent with his customer’s best interests” and are “not suitable merely because the customer acquiesces in [them]”); *id.* at *26 (“We have repeatedly found that high concentration of investments in one or a limited number of speculative securities is not suitable for investors seeking limited risk.”)
- *Wendell D. Belden*, Exchange Act Rel. No. 47859, 2003 SEC LEXIS 1154, at *14 (May 14, 2003) (finding unsuitable recommendations where motivation for recommending Class B shares over Class A shares was the significantly greater commissions that the broker received from the former shares)
- *James B. Chase*, Exchange Act Rel. No. 47476, 2003 SEC LEXIS 566, at *12-21 (March 10, 2003) (upholding suitability violation and noting that high concentration in a speculative security was inappropriate and that the customer’s college education does not mean that she was a sophisticated investor who fully understood the risky investment)
- *Jack H. Stein*, Exchange Act Rel. No. 47335, 2003 SEC LEXIS 338, at *8 (Feb. 10, 2003) (“Even in cases in which a customer affirmatively seeks to engage in highly speculative or otherwise aggressive trading, a representative is under a duty to refrain from making recommendations that are incompatible with the customer’s financial profile.”); *id.* at *11 (stating that it was improper for a broker to make recommendations “on the basis of guesswork” regarding a customer’s net worth)

where a customer refused to provide broker with any information regarding other assets not listed on her new account form)

- *Rafael Pinchas*, 54 S.E.C. 331, 341 n.22 & 342 (1999) (holding that "[t]ransactions that were not specifically authorized by a client but were executed on the client's behalf are considered to have been implicitly recommended within the meaning of the NASD rules" and "excessive trading, by itself, can violate NASD suitability standards by representing an unsuitable frequency of trading")
- *Clinton Hugh Holland, Jr.*, 52 S.E.C. 562, 565-66 (1995) (emphasizing, in the suitability context, the inappropriateness of the shift in the customer's portfolio from conservative to speculative securities), *aff'd*, 105 F.3d 665 (9th Cir. 1996)
- *David Joseph Dambro*, 51 S.E.C. 513, 517 & n.14 (1993) ("[The respondent] was obligated to make his recommendation only on the basis of concrete information about [his customer's] financial situation . . . [and] [w]ithout knowing [the customer's] other securities holdings and financial situation, [the respondent] could not make the requisite customer-specific evaluation necessary for a suitable recommendation.")
- *F.J. Kaufman and Co.*, 50 S.E.C. 164, 168 (1989) (explaining the "reasonable basis" suitability obligation)
- *Dep't of Enforcement v. Medeck*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7 (NAC July 30, 2009) (discussing various elements of churning and excessive trading)
- *Dep't of Enforcement v. Frankfort*, No. C02040032 (NAC May 24, 2007) (finding a violation of the suitability rule and noting that a broker can, under certain limited circumstances, violate the suitability rule by failing to disclose material information that, if not disclosed, also could amount to a violation of the anti-fraud provisions, especially where disclosure of such information would be necessary for the broker to properly assess the customer's risk tolerance and investment objectives)
- *Dep't of Enforcement v. Siegel*, No. C05020055 (NAC May 11, 2007) (discussing the relevant factors for determining whether a broker has made a "recommendation" triggering application of the rule and finding that the broker violated the "reasonable basis" suitability obligation)
- *Dep't of Enforcement v. Bendetsen*, No. C01020025, 2004 NASD Discip. LEXIS 13, at *12 (NAC Aug. 9, 2004) ("[A] broker's recommendations must serve his client's best interests and the test for whether a broker's recommendation is suitable is not whether the client acquiesced in them, but whether the broker's recommendations were consistent with the client's financial situation and needs.")
- *Dep't of Enforcement v. Howard*, No. C11970032, 2000 NASD Discip. LEXIS 16, at *19 (NAC Nov. 16, 2000) (holding that the broker's recommendations "also led to an undue concentration of these speculative securities, making the recommendations particularly unsuitable"), *aff'd*, Exchange Act Rel. No 46269, 2002 SEC LEXIS 1909 (July 26, 2002), *aff'd*, No. 02-1939, 2003 U.S. App. LEXIS 19454 (1st Cir. Sept. 19, 2003)

- *Dist. Bus. Conduct Comm. v. Kunz*, Complaint No. C3A960029, 1999 NASD Discip. LEXIS 20, *62-63 & n.29 (NAC July 7, 1999) (implicitly holding that respondent's distribution of an issuer's offering document in connection with a rescission offer, without more, did not constitute a recommendation of the subject security), *aff'd*, Exchange Act Rel. No. 45290, 2002 SEC LEXIS 104 (Jan. 16, 2002)
- *Dist. Bus. Conduct Comm. v. Nickles*, Complaint No. C8A910051, 1992 NASD Discip. LEXIS 28, *18 (NBCC Oct. 19, 1992) (holding that suitability rule "applies not only to transactions that registered persons effect for their clients, but also to any recommendations that a registered person makes to his or her client")