

# Client Alert

Chapman and Cutler LLP  
Attorneys at Law • Focused on Finance®

CURRENT ISSUES RELEVANT TO OUR CLIENTS

MAY 19, 2011

## FINRA Announces New Know-Your-Customer and Suitability Compliance Date and Interpretive Guidance

The Financial Industry Regulatory Authority, Inc. (“FINRA”) has formally announced that is delaying the implementation date of the new FINRA rules governing know-your-customer and suitability obligations to July 9, 2012. New FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) had already been approved by the SEC but FINRA had proposed to move the implementation date from October 7, 2011 to July 9, 2012 to allow broker-dealers to better supervise and educate associated persons regarding the new and modified requirements. FINRA has also issued additional guidance in response to recent industry questions and concerns.

The related FINRA regulatory notice is available at <http://www.finra.org/Industry/Regulation/Notices/2011/P123701>. Our prior Client Alert regarding the delayed implementation of the new rules is available at <http://www.chapman.com/media/news/media.1001.pdf> and our original summary of the new rules is available at <http://www.chapman.com/media/news/media.916.pdf>.

The FINRA guidance includes one item regarding the know-your-customer obligation that focuses on the obligation to understand the authority of each person acting on behalf of a customer. FINRA clarified that the obligation generally requires a firm to not only know the name of authorized persons but also know any limits on the authority of those persons that the customer establishes and communicates to the firm. FINRA noted, however, that a firm could decide to accept only customers that do not limit the scope of authority of authorized persons.

The FINRA guidance also includes ten items on specific aspects of the suitability rule. Several of these items address detailed questions regarding a firm's obligations to obtain information related to a customer's investment profile. Among other suitability rule issues discussed, FINRA makes clear that the inclusion of “strategy” recommendations within the suitability rule captures an *explicit* recommendation to *hold* a security but would not capture an *implicit* recommendation to hold a security (such as where a representative remains silent regarding a

security in an account or refrains from recommending a sale). In addition, FINRA clarified that absent an agreement, course of conduct or unusual situation that would change the normal broker-dealer relationship with a customer, a hold recommendation would not create an ongoing duty to monitor and make subsequent recommendations. FINRA also noted that due diligence review and approval of a product by a firm's “product committee” does not necessarily mean that the firm's associated persons have complied with the “reasonable-basis” suitability obligation. As a result, an individual broker representative's lack of understanding of a product or strategy could result in a violation of the obligation even if the firm's product committee has reviewed and approved the product or strategy.

For additional details on the guidance, please refer to the FINRA notice linked above.

Attorney Advertising Material

If you would like to discuss any of the issues discussed in this Client Alert, please contact any attorney in our Investment Management Group or visit us online at [chapman.com](http://chapman.com).

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

© Chapman and Cutler LLP, 2011. All Rights Reserved.