

Financial Services Professional Liability

The Financial Services Professional Liability Practice Group handles claims and disputes facing a number of professionals, including brokers, broker-dealers, disability agent/brokers, enrolled agents, financial planners, health agents/brokers, casualty/property insurance agents/brokers, investment advisors, investment banks, investment bankers, investment managers, investment advisory firms, life agent/brokers, pension consultants, receivers, registered representatives, stock brokers, Taft-Hartley consultants, tax preparers, third party administrators, trustees and turn around consultants.

In addition to the formation, dissolution and transactional needs of its clients, Reminger is uniquely positioned to handle the regulatory, litigation and arbitration disputes of its clients before state and federal courts, FINRA and other state regulatory agencies.

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FINRA Narrows the Scope of its New Suitability Rule

Financial Industry Regulatory Authority ("FINRA") Rule 2111 went into effect on July 9, 2012. Rule 2111 requires FINRA-member firms, registered representatives, and financial advisors to have a reasonable basis to recommend a securities transaction or investment strategy to a client. Under the Rule, one determines suitability by analyzing the customer's investment profile and objectives. Moreover, the suitability obligation extends to endorsed "investment strategies" in addition to recommended purchases, sales, or exchange transactions. In short, Rule 2111 significantly expands the obligations placed on broker-dealers and associated persons.

FINRA Regulatory Notice 12-55 ("RN 12-55"), published on December 10, 2012, clarifies the scope of this new suitability rule for FINRA-member firms, registered representatives, and financial advisors. Previously, FINRA stated that a broker-dealer's suitability obligations may extend to "an individual or entity with whom a broker dealer has even an informal business relationship ... [such as] when a broker recommends a security to a potential investor, even if that potential investor does not have an account at the firm." This language suggested that FINRA's suitability obligations extended to informal discussions made at social gatherings or investment presentations. In RN 12-55, however, FINRA clarified the applicability of the suitability rule to informal investment advice: "The suitability rule would not apply to the recommendation ... if the potential investor does not act on the recommendation or execute the recommended transaction [at another] broker-dealer[.]" However, if the potential investor establishes an account, acts on the recommendation, and becomes a customer, the suitability of the recommendation is properly evaluated based upon the circumstances that existed at the time the recommendation was made.

In RN 12-55, FINRA also clarified the meaning of "investment strategy" for purposes of suitability compliance. Specifically, FINRA determined that the term applies to recommendations that customers invest in specific types of securities, such as stocks, a market sector, or a trading strategy (e.g., bond ladder, day trading, margin strategy), as opposed to a general recommendation to invest in "equity" or "fixed income" securities. Additionally, the term imposes a suitability obligation to an "explicit recommendation to hold a security or to continue to use an investment strategy involving a security."

The effect of this new rule remains to be seen. It is expected, however, that the claimants' bar will use this new rule and recent notice to support new claims and expand upon their existing theories of liability.

If you would like a copy of FINRA Regulatory Notice 12-55, or would like specific guidance based on this or other issues, please feel free to contact Reminger's Financial Services Professional Liability Chair Andrew J. Dorman, Chetan S. Patil, or another member of our practice group.

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