Notice to Members

APRIL 2005

SUGGESTED ROUTING

Advertising
Investment Companies
Legal & Compliance
Registered Representatives
Senior Management
Variable Contracts

KEY TOPICS

Advertising
Communications with the Public
NASD Rules 2211 and 3010

REQUEST FOR COMMENT

Principal Pre-Use Approval of Member Correspondence

NASD Requests Comment on Proposal to Require Principal Pre-Use Approval of Member Correspondence to 25 or More Existing Retail Customers within a 30-Calendar-Day Period; **Comment Period Expires May 27, 2005**

Executive Summary

NASD currently defines correspondence to include any written letter or electronic mail message distributed by a member to (a) one or more of its existing retail customers, and (b) fewer than 25 prospective retail customers within any 30 calendar-day period. The definition of correspondence is significant because firms generally are not required to have a registered principal approve correspondence prior to use, and because some of the specific content standards applicable to other types of communications with the public do not apply to correspondence. NASD is proposing to amend Rule 2211 to require that a registered principal approve, prior to use, any correspondence that is sent to 25 or more existing retail customers within a 30-calendar-day period.

Questions/Further Information

Questions concerning this *Notice* may be directed to Thomas M. Selman, Senior Vice President, Investment Companies/Corporate Financing, at (240) 386-4533; Joseph P. Savage, Associate Vice President, Investment Companies Regulation, at (240) 386-4534; or Philip A. Shaikun, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8451.

Action Requested

NASD encourages all interested parties to comment on the proposed rule change. Comments must be received by May 27, 2005. Members and other interested parties can submit their comments using the following methods:

Mail comments in hard copy to the address below; **or**

E-mail comments to *pubcom@nasd.com*.

To help NASD process and review comments more efficiently, persons commenting on this proposal should use only one method. Comments sent by hard copy should be mailed to:

Barbara Z. Sweeney
Office of Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1506

Important Notes: The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the NASD Web site. Generally, comments will be posted on the NASD Web site one week after the end of the comment period.[1]

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the NASD Board, and then must be approved by the SEC, following publication in the Federal Register.[2]

Background and Discussion

Definition of "Correspondence"

In 2003, the SEC approved as part of NASD's modernization of its advertising rules a change to the definition of "correspondence" in Rule 2211. The new definition of correspondence includes any written or electronic mail message distributed by a firm to one or more of its existing retail customers and to fewer than 25 prospective retail customers within a 30-calendar-day period.[3] Previously, "correspondence" included any written or electronic communication prepared for delivery to a single current or prospective customer, and not for dissemination to multiple customers or the general public.

The definition of correspondence is significant in several respects. Firms generally are not required to have a registered principal approve correspondence prior to use, nor are they required to file correspondence with the NASD Advertising Regulation Department (Department).[4] In addition, correspondence is subject to fewer content restrictions than advertisements and sales literature.

NASD amended the definition in order to provide firms with more flexibility regarding the supervision of e-mail and form letters. However, we understand that many firms voluntarily continue to require registered principal pre-use approval of some correspondence.

NASD has found that some member correspondence to multiple existing customers raises the same sorts of issues that member advertisements and sales literature do. For example, NASD has reviewed form letters that encourage *existing* customers to invest in mutual funds, variable annuities, or other securities and, as such, did not meet the applicable advertising standards of the SEC and NASD rules. As "correspondence" under the existing definition, these communications do not require principal pre-use approval. As a result, in some cases, this correspondence that had already been sent to customers required substantial revisions; in other cases, NASD took informal disciplinary action against the member that distributed the correspondence.

In contrast, had these types of form letters been sent to at least 25 *prospective* retail customers, such correspondence would have required both registered principal pre-use approval and filing with the Department. NASD now questions whether it should apply the principal pre-use approval requirement differently to correspondence sent to prospective and existing retail customers.

Proposed Amendment

NASD is proposing to amend NASD Rule 2211 to require registered principal pre-use approval of any correspondence sent to 25 or more existing retail customers within any 30-calendar-day period (see Attachment A). In so doing, the proposal would impose the same standard for principal pre-use approval on written letters and electronic mail messages distributed by a member to either existing or prospective retail customers. Correspondence with such a wide distribution often will constitute a solicitation to purchase or sell a security or to use a brokerage service. Registered principal pre-use approval would better ensure that this material complies with applicable standards of the advertising rules. Since many firms already require registered principal pre-use approval of such correspondence, NASD believes the benefits of the proposed requirement outweigh any additional burden on members.

NASD does not propose to require that this correspondence be filed with the Department or that it be subject to all of the content standards of the advertising rules. NASD recognizes that correspondence with existing retail customers sometimes involves matters other than the promotion of a member's products or services and, therefore, may not require the same level of investor protection as correspondence to prospective retail customers. Of course, a firm may voluntarily file this correspondence with the Department in order to better ensure that it complies with applicable standards, particularly when the correspondence promotes the firm's products or services.

Endnotes

1 *See Notice to Members 03-73* (Nov. 2003) (NASD Announces Online Availability of Comments). Personal identifying information, such as names or e-mail addresses, will not be edited from submissions. Persons commenting on this proposal should submit only information that they wish to make publicly available.

2 Section 19 of the Securities Exchange Act of 1934 (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. *See* Exchange Act Section 19 and rules thereunder.

3 NASD has clarified that, for purposes of its rules governing member communications with the public, NASD views instant messaging in the same manner in which it views traditional electronic mail messages. Accordingly, instant messaging by a member or its associated person may qualify as correspondence or sales literature, depending upon the facts and circumstances. *See Notice to Members 03-33* (July 2003) (Clarification for Members Regarding Supervisory Obligations and Recordkeeping Requirements for Instant Messaging).

4 NASD Rule 3010(d)(2) governs members' supervision and review of correspondence. The rule requires each member to develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing correspondence with the public relating to its investment banking and securities business. Where such procedures for the review of correspondence do not require review of all correspondence prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing correspondence, documentation of such education and training, and surveillance and follow-up to ensure that such procedures are implemented and adhered to.

ATTACHMENT A

Text of proposed rule change. New language is underlined.

2211. Institutional Sales Material and Correspondence

(a) Definitions

No change.

(b) Approval and Record Keeping

(1) Registered Principal Approval

(A) Correspondence. Correspondence need not be approved by a registered principal prior to use, <u>unless it is distributed by a member to 25 or more existing retail customers within any 30 calendar-day period. </u>[but]<u>All correspondence</u> is subject to the supervision and review requirements of Rule 3010(d).

(B) No change.

(2) Recordkeeping

No change.

(C) through (e). No change.