

Regulatory Notice

08-30

Illiquid Investments

Guidance Relating to Illiquid Investments

Executive Summary

FINRA is providing guidance to member firms on obligations that may arise in connection with customer requests to sell generally illiquid securities and informing customers of buy interest in such securities.

Questions concerning this *Notice* should be directed to the Office of General Counsel at (202) 728-8071.

Discussion

Recently, questions have been raised regarding a firm's obligations when it receives a customer's unsolicited instruction to liquidate a position in an illiquid security when the customer is aware of specific buying interest in that security.¹ There is no FINRA rule that would require a firm to refuse to follow the customer's instruction under these circumstances, even if the firm believes the market or price for the security is not favorable at that time. In those instances, the firm should fully disclose the pricing risks to the customer and receive a written acknowledgment that the customer understands those risks.

FINRA also recognizes that there may be valid reasons for a firm to delay, or obtain more information, before following a customer's instructions (*e.g.*, if the firm has reason to doubt the identity of the person giving the instruction). However, a firm's refusal to follow the customer's unsolicited instruction to sell to a specific buyer may violate NASD Rule 2110.² When the following conditions are present, firms should not delay or decline executing such a transaction in an illiquid security:

- (1) the customers on both sides of the transaction have indicated their understanding that the firm is not recommending the transaction or making a suitability determination;

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Notice Type

- Guidance

Suggested Routing

- Compliance
- Legal
- Registered Representatives
- Senior Management

Key Topic(s)

- Illiquid Investments

Referenced Rules & Notices

- NASD Rule 2110
- NASD Rule 2310
- NTM 01-23

- (2) the customers understand that the firm cannot reach a view as to the sufficiency or competitiveness of pricing; and
- (3) there are no legitimate concerns as to the ability of both sides to settle the proposed transaction.

Customers may also learn of buy interest from their firm. In informing customers of buy interest, firms should also consider appropriate disclosure, including, as applicable, information regarding the firm's inability to make a representation as to the nature, fairness or sufficiency of the pricing; and any pecuniary interest the firm may have in the transaction. If the firm recommends the transaction to a customer, the firm has additional obligations and must ensure that the transaction is suitable pursuant to NASD Rule 2310.³

Endnotes

- 1 The guidance in this *Notice* is limited to unsolicited instructions. Whether a customer order is solicited is dependent upon the specific facts and circumstances.
- 2 NASD Rule 2110 requires firms to observe high standards of commercial honor and just and equitable principles of trade when conducting business with their customers.
- 3 Whether a transaction is "recommended" depends upon the facts and circumstances. Firms may wish to review the guidance in *NASD Notice to Members 01-23* (April 2001) regarding the content, context and manner of presentation of customer communications and when those communications are recommendations for purposes of the suitability rule.