

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53333; File No. SR-NASD-2006-011)

February 17, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Principal Pre-Use Approval of Member Correspondence to 25 or More Existing Retail Customers Within a 30 Calendar-Day Period

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 27, 2006, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On February 13, 2006, NASD filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

NASD is proposing to amend NASD Rule 2211 to require principal pre-use approval of member correspondence to 25 or more existing retail customers within a 30 calendar-day period. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in [brackets].

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 to SR-NASD-2006-011 replaced and superseded the original rule filing filed on January 27, 2006 in its entirety.

2211. Institutional Sales Material and Correspondence

(a) No Change.

(b) Approval and Recordkeeping

(1) Registered Principal Approval

(A) Correspondence. Correspondence need not be approved by a registered principal prior to use, [but] unless such correspondence is distributed to 25 or more existing retail customers within any 30 calendar-day period and is not solely and exclusively clerical or ministerial in nature. All correspondence is subject to the supervision and review requirements of Rule 3010(d).

(B) No Change.

(2) No Change.

(c) through (e) No Change.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

### Definition of “Correspondence”

In 2003, the SEC approved as part of NASD’s modernization of its advertising rules the creation of new Rule 2211, which included an amended definition of “correspondence.” The amended definition of correspondence includes any written letter 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.<sup>4</sup> 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”).<sup>5</sup> 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 certain emails and form letters. However, NASD understands that many firms continue to require registered principal pre-use approval of some correspondence.

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<sup>4</sup> 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 may qualify as correspondence or sales literature, depending upon the facts and circumstances. See Notice to Members 03-33 (July 2003).

<sup>5</sup> NASD Rule 3010(d)(2) 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 or securities business. Where such procedures 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.

NASD has found that some member correspondence to multiple existing customers raises the same regulatory concerns as member advertisements and sales literature, despite the fact that it is not required to be filed with NASD or approved by a principal prior to use. 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. As a result, NASD believes it no longer should apply the principal pre-use approval requirement differently to non-clerical correspondence sent to prospective and existing retail customers.

#### Proposed Amendment

NASD is proposing to amend Rule 2211 to require registered principal pre-use approval of any non-clerical correspondence sent to 25 or more existing retail customers within any 30 calendar-day period. Non-clerical 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 before reaching current or prospective customers. 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 may not require the same level of investor protection as correspondence to prospective retail customers. Of course, a firm may choose to file this correspondence with the Department to better ensure that it complies with applicable standards, particularly when the correspondence promotes the firm's products or services.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 30 days following Commission approval. The effective date will be 90 days following publication of the Notice to Members announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>6</sup> which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that requiring that a principal approve prior to use any non-clerical correspondence that is sent to 25 or more existing retail customers will protect investors and the public interest. In particular, this proposed rule change will help prevent fraudulent or misleading communications from reaching a widespread retail audience by requiring principals to review non-clerical correspondence sent to a large number of investors prior to use.

B. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

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<sup>6</sup> 15 U.S.C. 78o-3(b)(6).

The proposed rule change was published for comment in NASD Notice to Members 05-27 (April 2005). NASD received eleven comments in response to the Notice.<sup>7</sup>

There were two primary comments on the proposal. First, several commenters inquired as to what type of principal registration would be required to approve correspondence prior to use. Second, a number of commenters argued that the proposal should not require principal pre-use approval for correspondence that is solely clerical or ministerial in nature.<sup>8</sup> There were also a number of other miscellaneous questions and comments regarding the proposal.

#### Principal Qualifications

The proposed rule would require a registered principal to approve prior to use any correspondence that is distributed to 25 or more existing retail customers within any 30 calendar-day period. Notice to Members 05-27 did not indicate, however, whether a particular principal registration would be required in order to fulfill this duty. ARM, Edward Jones and UBS inquired as to whether, among other principal exams, a Limited Principal – General Securities Sales Supervisor (formerly Series 8 and now Series 9/10) could perform this function under the proposed rule. In particular, ARM and UBS noted that NASD does not accept the General

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<sup>7</sup> Letter from Association of Registration Management (“ARM”) dated May 25, 2005; Letter from Cutter & Company, Inc. (“Cutter”), dated May 27, 2005; Letter from Frank Dealy dated April 21, 2005; Letter from Edward D. Jones & Co., LP (“Edward Jones”), dated May 27, 2005; Letter from the Financial Services Institute (“FSI”) dated May 27, 2005; Letter from Fintegra, LLC (“Fintegra”), dated April 14, 2005; Letter from Investment Company Institute (“ICI”) dated May 27, 2005; Letter from Jefferson Pilot Securities Corporation (“Jefferson Pilot”) dated May 27, 2005; Letter from Krieger-Campbell, Incorporated (“Krieger-Campbell”) dated May 20, 2005; Letter from UBS Financial Services Inc. (“UBS”) dated May 27, 2005; and Letter from Wulff, Hansen & Co. (“Wulff Hansen”) dated April 14, 2005.

<sup>8</sup> The version of the proposed rule change that was published for comment in Notice to Members 05-27 did not contain an exception from the principal pre-use approval requirement for correspondence that is solely and exclusively clerical or ministerial in nature.

Securities Sales Supervisor exam as satisfying the principal qualification requirement for approval of advertisements under Rule 2210.<sup>9</sup>

Commenters also noted that while branch managers often possess only the General Securities Sales Supervisors principal registration and are not registered as General Securities Principals (Series 24), they typically supervise correspondence as required by Rule 3010. Commenters argued that a branch manager is best qualified to supervise correspondence at the branch office level and that to require these branch managers to obtain a General Securities Principal registration would be enormously burdensome.

NASD agrees that the General Securities Sales Supervisor registration category is sufficient to meet the proposal's requirements for pre-use approval of correspondence sent to 25 or more existing retail customers within a 30 calendar-day period. NASD already interprets Rule 3010 to permit General Securities Sales Supervisors to supervise correspondence in accordance with that rule's provisions. Accordingly, NASD would interpret the proposed rule change to permit a General Securities Sales Supervisor (formerly Series 8 and now Series 9/10) to approve correspondence prior to use.

#### Administrative and Clerical Correspondence

Edward Jones and Wulff Hansen both commented that, if NASD intends to go forward with the proposal, the principal pre-use approval requirement should not apply to correspondence that is solely of an administrative, service or clerical nature. Similarly, the FSI and Jefferson Pilot argue that the principal pre-use approval requirements should not apply to correspondence unless it contains a recommendation to buy or sell a security or service. In support of this

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<sup>9</sup> See Rule 1022(g)(2)(C)(iii).

change, commenters argued that there is little need for heightened investor protection measures when correspondence concerns such matters as reorganization notices, stock dividend details, notices of office closings or extended hours, and the like. Edward Jones pointed out that the New York Stock Exchange employs a content-oriented definition of “sales literature.”<sup>10</sup> Wulff Hansen also noted that NASD Rule 1060 does not require registration for persons associated with a member whose functions are solely and exclusively clerical and ministerial.

NASD agrees that correspondence the content of which is solely clerical or ministerial does not raise the same investor protection issues as correspondence that is non-administrative in nature, such as correspondence that promotes a member product or service. Accordingly, NASD has modified the proposed rule language to exclude from the principal pre-use approval requirement correspondence that is solely and exclusively clerical or ministerial in nature.

#### Other Comments

The ICI supported the proposal on the ground that it strikes a reasonable regulatory balance by requiring principal approval for some correspondence without placing an undue burden on members by requiring the filing of correspondence with the Department. Fintegra noted that it supports the proposal as long as members are not required to file correspondence with NASD. NASD confirms that the proposal would not impose new filing requirements for correspondence.

Cutter noted that NASD has taken the position under Rule 2711 that a communication that is distributed to 15 or more persons and includes an analysis of equity securities of

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<sup>10</sup> See NYSE Rule 472.10(5) (defining sales literature as any written or electronic communication “discussing or promoting the products, services, and facilities offered by a member or member organization”).



individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision, is deemed to be a research report. Cutter argued that, if the proposed principal pre-use approval requirement is adopted, the numerical thresholds for determining when principal pre-use approval is required under Rule 2211 and when a communication is deemed a research report under Rule 2711 should be the same (i.e., 25 or more persons).

While NASD recognizes different numerical thresholds for different rules may present a compliance challenge, Rule 2211 serves a different purpose than Rule 2711. In addition, the 15-person threshold under Rule 2711 was derived from SEC Regulation Analyst Certification, which also deals with research reports. Moreover, NASD has not proposed to amend Rule 2711 as part of this rule filing.

Cutter, the FSI and Jefferson Pilot all commented that, if there is a problem with misleading correspondence to retail customers, a better approach would be to require heightened supervision for firms that have a history of correspondence compliance problems. The FSI argued that the burdens that the proposal would impose on members do not justify its adoption. Similarly, Krieger-Campbell commented that the proposal could have unintended consequences, such as holding up member communications regarding a Regulation D private placement offering. Additionally, Edward Jones and Jefferson Pilot argued that the current correspondence definition has not been in place long enough to justify requiring principal pre-use approval for correspondence sent to 25 or more existing retail customers.

While NASD recognizes that there are other possible approaches to address potentially misleading correspondence and that the proposal may impose additional compliance costs on some members, NASD believes that requiring principal pre-use approval of correspondence sent

to 25 or more existing retail customers is a more proactive and effective means of preventing the distribution of potentially misleading correspondence to large numbers of customers. In addition, the current rule and the heightened supervision approach do not address the investor protection dichotomy that exists between current and prospective retail customers.

The FSI and Jefferson Pilot argued that the proposal would inhibit the transmission of time-sensitive e-mails to existing retail customers, such as those alerting customers of significant market news. NASD believes that these types of communications, which often urge customers to buy or sell securities on a short-term basis, are precisely the types of communications that require principal review. Accordingly, NASD does not favor amending the proposal for this reason.

The FSI also states in its comment letter that “NASD staff has advised the Institute that they will not interpret the proposed rule as written” and instead will apply the rule only to form letters and other correspondence with identical content sent by one or more registered representatives in the same office. This comment is misguided. The rule proposal is intended to apply to any non-clerical correspondence, including emails, sent to 25 or more existing customers over a 30-calendar-day period, and NASD intends to enforce the rule accordingly if approved in its current form.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which NASD consents, the Commission will:

- (A) by order approve such proposed rule change, or

- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act.

Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2006-011 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-011. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All

comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2006-011 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

Nancy M. Morris  
Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).