Regulatory Notice 09-10

Market Letters

SEC Approves Rule Relating to Supervision of Market Letters

Effective Date: February 5, 2009

Executive Summary

Effective February 5, 2009, firms may supervise "market letters" as correspondence rather than sales literature, unless the letters are distributed to 25 or more existing retail customers within any 30-calendar-day period and make a financial or investment recommendation or otherwise promote the firm's product or service.

The amendment to NASD Rules 2210 (Communications with the Public) and 2211 (Institutional Sales Material and Correspondence) and Incorporated NYSE Rule 472 (Communications with the Public)[1] also eliminates the requirement under Incorporated NYSE Rule 472 for market letters to be approved in advance by a supervisory analyst or qualified person. Market letter is defined as a communication that is excepted from the definition of "research report" under NASD Rule 2711(a)(9)(A) and Incorporated NYSE Rule 472.10(2)(a).

Questions concerning this *Notice* should be directed to:

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February 2009

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Operations
- Research
- Sales
- Senior Management
- Trading

Key Topic(s)

- Market Letters
- Correspondence
- Communications with the Public
- Sales Literature
- Supervision

Referenced Rules & Notices

- NASD Rule 2210
- NASD Rule 2211
- NASD Rule 2711
- NASD Rule 3010
- NYSE Rule 472

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Background & Discussion

NASD Rule 2210 requires a registered principal of a firm to approve prior to use any item of sales literature. The term "sales literature" excludes any item distributed or made available only to institutional investors.[2] Prior to this rule change, sales literature was defined to include market letters. Incorporated NYSE Rule 472 similarly required a registered principal or other qualified person to approve in advance of distribution any market letter, but contained no exception for market letters sent only to institutional investors. FINRA has been concerned that the pre-use approval requirements in some circumstances may have inhibited the flow of information to traders and other investors who base their investment decisions on timely market analysis.

To address this concern, FINRA has amended the definition of sales literature in NASD Rule 2210 to exclude market letters that qualify as "correspondence." FINRA also has correspondingly amended the definition of correspondence in NASD Rule 2211 to include market letters (as well as any written letter or electronic mail message) distributed by a firm to one or more of its existing retail customers and fewer than 25 prospective retail customers within any 30-calendar-day period. Pursuant to NASD Rule 2211(b)(1)(A), correspondence does not require approval by a registered principal prior to use, unless such correspondence is distributed to 25 or more existing retail customers within any 30-calendar-day period and makes a financial or investment recommendation or otherwise promotes a product or service of the member firm. The rule change also would amend Incorporated NYSE Rule 472 to eliminate the requirement that a qualified person approve market letters in advance of distribution.

Thus, all FINRA member firms may distribute market letters to institutional investors (as defined in NASD Rule 2211(a)(3)) without requiring prior approval by a registered principal or qualified person. In addition, a firm may distribute without prior approval by a registered principal a market letter that is sent only to existing retail customers and fewer than 25 prospective retail customers within a 30-calendar-day period. However, prior principal approval is required if the market letter both (1) is sent to 25 or more existing retail customers and (2) makes a financial or investment recommendation or otherwise promotes a product or service of the firm. In addition, similar to the manner in which other forms of correspondence (*i.e.*, written letters and electronic mail messages) are addressed by NASD Rules 2210 and 2211, if a market letter is sent to 25 or more prospective retail customers within a 30-calendar-day period, the market letter would fall within the definition of sales literature and have to be supervised as such, including approval by a registered principal prior to use.

As correspondence, market letters remain subject to the supervision and review requirements of NASD Rule 3010, which requires each firm to establish written procedures that are appropriate to its business, size, structure and customers for the review of outgoing correspondence. If these procedures do not require review of all correspondence prior to use or distribution, they must provide 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.

The rule change also creates a new definition of the term "market letter" in NASD Rule 2211—and modifies the existing definition in Incorporated NYSE Rule 472—to mean any communication specifically excepted from the definition of "research report" under NASD Rule 2711(a)(9)(A) and Incorporated NYSE Rule 472.10(2)(a), respectively. This exception consists of:

- discussions of broad-based indices;
- commentaries on economic, political or market conditions;
- technical analyses concerning the demand and supply for a sector, index or industry based on trading volume and price;
- statistical summaries of multiple companies' financial data, including listings of current ratings;
- recommendations regarding increasing or decreasing holdings in particular industries or sectors; and
- notices of ratings or price target changes (subject to certain disclosure requirements).

Firms may not supervise as correspondence communications that fall within the definition of "research report" under NASD Rule 2711 and Incorporated NYSE Rule 472.

Effective Date

The changes to NASD Rules 2210 and 2211 and Incorporated NYSE Rule 472 become effective on February 5, 2009.

Endnotes

1 *See* Securities Exchange Act Release No. 59096 (December 12, 2008), 73 FR 77085 (December 18, 2008)(SR-FINRA-2008-044).

2 Pursuant to NASD Rule 2211(a)(2), communications of any kind sent only to institutional investors (as defined in NASD Rule 2211(a)(3)) are considered to be "institutional sales material." NASD Rule 2210 does not require approval of institutional sales material by a registered principal prior to use. However, institutional sales material remains subject to the supervision and review requirements of NASD Rule 2211(b)(1)(B).