
NASD Amends Rule 2211, Imposing New Pre-approval Requirements on Communications with Non-institutional Customers

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Overview

On July 26, 2006, the Securities and Exchange Commission approved amendments to NASD Rule 2211,¹ with an effective date of **December 1, 2006**. The amendments will impose new pre-approval requirements on correspondence sent to 25 or more non-institutional customers within any 30 calendar-day period, if such correspondence makes any financial or investment recommendation, or otherwise promotes the member's products or services.

Current Rule 2211

NASD Rule 2211 establishes approval requirements and content standards for institutional sales material and non-institutional customer correspondence distributed by member firms. Under this rule, member firms currently are **not** required to pre-approve any such communications prior to their distribution. While "institutional sales material" is defined as communications that are distributed or made available only to institutional investors, "correspondence" is "any written letter or electronic mail message distributed by a member to one or more of its existing retail customers; and fewer than 25 prospective retail customers within any 30 calendar-day period."² As a result of this broad definition of correspondence, member firms currently are not required to pre-approve materials that may be sent to an unlimited number of non-institutional, existing customers.

Amended Rule 2211

As amended, NASD Rule 2211 will impose pre-approval requirements on **a significant portion of** correspondence sent to 25 or more retail customers within a 30 calendar-day period—whether or not they are existing or prospective customers. Specifically, a registered principal must approve any correspondence, prior to use, that is sent to 25 or more existing retail customers within any 30 calendar-day period if the correspondence makes any financial or investment recommendation, or otherwise promotes the member's products or services.³ The principal designated to be responsible for this pre-approval must be registered in accordance with the registration requirements for principals supervising correspondence under Rule 3010(d)(2).⁴

According to the Approval Order, the NASD adopted the amendments because it determined that member correspondence sent to multiple existing customers may raise the same regulatory concerns as member advertisements and non-institutional sales literature, which must be pre-approved.⁵ The NASD clarified that the new pre-approval requirements do not apply to correspondence concerning clerical or ministerial matters, such as dividend notices or changes in office hours, or to correspondence that does not promote a member's products or services, such as emails including only market commentary.⁶

The following chart outlines the NASD supervision requirements for correspondence, sales literature and advertisements once amended Rule 2211 goes into effect:

Category of Customer Communication	NASD Supervision Requirement
Correspondence with fewer than 25 retail customers (whether existing or prospective)	Post-use review and approval (Rule 2211)
Correspondence with 25 or more existing retail customers that does not make any financial or investment recommendation, or otherwise promote a member's products or services	Post-use review and approval (Rule 2211)
Correspondence with 25 or more retail customers (whether existing or prospective) that makes a financial or investment recommendation, or otherwise promotes a member's products or services	Pre-approval (Rule 2211)
Sales literature for retail customers (i.e., communications that do not qualify as "institutional sales material" or "correspondence," as defined in Rule 2211). (For example, communications may not qualify as "correspondence" under NASD rules if they are sent to 25 or more prospective retail customers.)	Pre-approval (Rule 2210)
Sales literature for institutional customers (i.e., "institutional sales material," as defined in Rule 2211)	Post-use review and approval (Rule 2211) ⁷
Advertisements (as defined in Rule 2210)	Pre-approval (Rule 2210)

Conclusion

As a result of these amendments, NASD member firms will need to reexamine their policies and procedures for approving communications with non-institutional customers. Firms should take particular note that correspondence with high-net-worth individual customers (who do not fall within the definition of an institutional investor) may be subject to the heightened pre-approval requirements.

For more information on this or other securities matters, please contact the authors listed above.

¹ Exchange Act Rel. No. 54217 (July 26, 2006); 71 Fed. Reg. 43831 (Aug. 2, 2006) (Approval Order).

² NASD Rule 2211(a)(1) and (2). The term "institutional investor" is defined in NASD Rule 2211(a)(3), and excludes individual customers (even if those persons are high-net-worth individuals).

³ The Rule amendments do not require the correspondence to be filed with the NASD, nor is the correspondence subject to all of the content requirements of the non-institutional sales literature and advertising rules. See NASD Notice to Members 06-45 (Aug. 2006) (NtM 06-45).

4 A General Securities Sales Principal (Series 9/10, formerly Series 8) or a General Securities Principal (Series 24) may perform this function. See NtM 06-45.

5 Approval Order at 43831.

6 Approval Order at 43832.

7 We note that the New York Stock Exchange (NYSE) has proposed a new rule that would exempt certain communications to institutional customers from the NYSE's pre-use review and approval requirements. See Exchange Act Rel. No. 52685 (Oct. 26, 2005), 70 Fed. Reg. (Nov. 3, 2005). This NYSE proposal, however, is not identical to the NASD's rules for institutional sales material. Also, unlike the NASD rules, the NYSE rules do not define the term "correspondence."

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