

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58648; File No. SR-FINRA-2008-044)

September 25, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to the Supervision of Market Letters

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 4, 2008, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA.³ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

FINRA is proposing to amend NASD Rules 2210 (Communications with the Public) and 2211 (Institutional Sales Material and Correspondence) and Incorporated New York Stock Exchange (“NYSE”) Rule 472 (Communications with the Public) to address the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Items include non-substantive edits discussed during a September 24, 2008 telephone call between Philip Shaikun, Associate Vice President and Associate General Counsel, FINRA; Haimera Workie, Branch Chief, Office of Chief Counsel, Division of Trading and Markets, SEC; and Timothy Cornell, Attorney, Office of Chief Counsel, Division of Trading and Markets, SEC.

supervision of market letters.⁴ Among other things, the proposed rule change would amend the definition of “sales literature” in NASD Rule 2210 to exclude market letters that qualify as “correspondence” and would define “correspondence” in NASD Rule 2211 to include market letters 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.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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NASD Rules

2200. COMMUNICATIONS WITH CUSTOMERS AND THE PUBLIC

2210. Communications with the Public

(a) Definitions. For purposes of this Rule and any interpretation thereof,

“communications with the public” consist of:

- (1) No Change.
- (2) “Sales Literature.” Any written or electronic communication, other than an advertisement, independently prepared reprint, institutional sales material and correspondence, that is generally distributed or made generally available to customers or the public, including circulars, research reports, [market letters,] performance reports or summaries, form letters, telemarketing scripts, seminar texts, reprints (that are not

⁴ The FINRA rulebook currently includes (1) NASD Rules and (2) rules incorporated from NYSE (“Incorporated NYSE Rules”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to members of both FINRA and the NYSE, referred to as Dual Members.

independently prepared reprints) or excerpts of any other advertisement, sales literature or published article, and press releases concerning a member's products or services.

(3) through (6) No Change.

(b) through (e) No Change.

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2211. Institutional Sales Material and Correspondence

(a) Definitions

For purposes of Rule 2210, this Rule, and any interpretation thereof:

(1) "Correspondence" consists of any written letter or electronic mail message and any market letter 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.

(2) through (4) No Change.

(5) "Market Letter" means any written communication excepted from the definition of "research report" pursuant to Rule 2711(a)(9)(A).

(b) through (e) No Change.

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Incorporated NYSE Rules

Rule 472. Communications with the Public

(a) Approval of Communications and Research Reports

(1) Each advertisement, [market letter,] sales literature or other similar type of communication which is generally distributed or made available by a member organization to customers or the public must be approved in advance by an allied member, supervisory analyst, or qualified person designated under the provisions of Rule 342(b)(1).

(2) No Change.

(b) through (m) No Change.

••• Supplementary Material: •••

.10 Definitions

(1) through (3) No Change.

(4) Market letter[s]. “Market letter[s]” [are]is defined as[, but are not limited to, any written comments on market conditions, individual securities, or other investment vehicles that are not defined as research reports. They may also include “follow-ups” to research reports and articles prepared by member organizations which appear in newspapers and periodicals.] any written communication excepted from the definition of “research report” pursuant to Rule 472.10(2)(a).

(5) No Change.

.20 through .140 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, FINRA 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. FINRA 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

NASD Rule 2210 (Communications with the Public) requires a registered principal of a member to approve prior to use any item of sales literature. The term "sales literature" does not include any item distributed or made available only to institutional investors.⁵

"Sales literature" includes "market letters." Incorporated NYSE Rule 472 similarly requires a qualified person to approve in advance of distribution any market letter, but contains no exception for market letters sent only to institutional investors. FINRA is concerned that the pre-approval requirements may, in some circumstances, inhibit the flow of information to traders and other investors who base their investment decisions on timely market analysis.

To address this concern, the proposed rule change would amend the definition of "sales literature" in NASD Rule 2210 to exclude market letters that qualify as a "correspondence" and further would amend "correspondence" in NASD Rule 2211 to include market letters (as well as any written letter or electronic mail message)

⁵ 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).

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. 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. The proposed 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, under the proposed rule change, all FINRA members would be permitted under FINRA rules to 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, under the proposed rules, a member also could 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, 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 member, prior principal approval would be required. 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 were 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 would 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.⁶

The proposed changes would allow firms to distribute most market letters in a timely manner without requiring a registered principal to review each market letter prior to distribution, but would maintain investor protection by requiring firms to review such correspondence in accordance with mandated supervisory policies and procedures.

The proposal also would create a new definition of the term "market letter" in NASD Rule 2211 – and modify 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;

⁶ See also Incorporated NYSE Rule 342. FINRA has proposed to amend the current requirements governing the supervision and review of correspondence. See Regulatory Notice 08-24 (May 2008) (Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls). That proposal, if adopted, would reorganize the supervision rules and codify existing guidance with respect to the supervision and review of correspondence. Thus, FINRA does not anticipate any significant changes to the supervision standards on which the proposed rule change is predicated.

- 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).

FINRA proposes to define market letters by reference to an exception from the definition of “research report” under NASD Rule 2711 and Incorporated NYSE Rule 472 to make clear that a firm may not supervise as correspondence communications that fall within the definition of “research report.” The proposed rule change would, however, increase a firm’s flexibility in supervising market letter communications that do not qualify as research reports.

FINRA would announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date would be the date FINRA publishes the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of

Section 15A(b)(6) of the Act,⁷ which requires, among other things, that FINRA 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. The proposed amendment would allow firms to distribute market letters in a timely and expedient manner, while still requiring firms to review and supervise these communications to ensure that they are fair, balanced and not misleading.

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

FINRA does not believe that the proposed rule change would 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

Written comments were neither solicited nor received.

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 the self-regulatory organization 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

⁷ 15 U.S.C. 78o-3(b)(6).

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change 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. Please include File Number SR-FINRA-2008-044 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2008-044. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the

principal office of FINRA. 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-FINRA-2008-044 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸

Florence E. Harmon
Acting Secretary

⁸ 17 CFR 200.30-3(a)(12).