

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-59096; File No. SR-FINRA-2008-044)

December 12, 2008

Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change Relating to the Supervision of Market Letters

I. Introduction

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”), 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> a proposed rule change relating to the supervision of market letters. The proposed rule change was published for comment in the Federal Register on October 1, 2008.<sup>3</sup> The Commission received four comment letters on the proposal.<sup>4</sup> This order approves the proposed rule change.

II. Description of the Proposal

FINRA proposed 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

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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> See Securities Exchange Act Release No. 58648 (September 25, 2008); 73 FR 57177, 57179 (October 1, 2008).

<sup>4</sup> William A. Jacobson, The Cornell Securities Law Clinic (October 20, 2008) (the “Cornell Letter”); Neal E Nakagiri, NPB Financial Group LLC (October 20, 2008); Dale E. Brown, Financial Services Institute (October 22, 2008); Michael Mungenast, president, ProEquities (Nov. 7, 2008).

supervision of market letters.<sup>5</sup> 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.

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.<sup>6</sup> “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, FINRA proposed to amend the definition of “sales literature” in NASD Rule 2210 to exclude market letters that qualify as a “correspondence” and

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<sup>5</sup> 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.

<sup>6</sup> 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).

further to amend “correspondence” in NASD Rule 2211 to include market letters (as well as 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. 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, prior principal approval would be 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 member. 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.<sup>7</sup>

The proposed rule 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:

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<sup>7</sup> 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 reorganized 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.

- 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).

FINRA proposed to define market letters by reference to an exception from the definition of “research report” in 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.

### III. Comment Letters

The Commission received four comment letters on the proposal, all of which expressed support for the proposed rule change.<sup>8</sup> For example, one commenter stated that it supported the effort to provide more timely information to a subset of investors

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<sup>8</sup> See footnote 3.

while retaining procedures for review and supervision of correspondence and maintaining consistency across NASD and NYSE rules.<sup>9</sup>

#### IV. Discussion and Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.<sup>10</sup> In particular, the Commission believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>11</sup> 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 Commission concludes that the proposed rule would increase the flow of timely information to investors while providing appropriate safeguards from potential abuse and fraud.

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<sup>9</sup> See Cornell Letter.

<sup>10</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>12</sup> that the proposed rule change (SR-FINRA-2008-044) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Florence E. Harmon  
Acting Secretary

Action as set forth or recommended herein  
APPROVED pursuant to authority delegated by  
the Commission under Public Law 87-592.

For the Division of Trading and Markets

by: \_\_\_\_\_

December 12, 2008

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<sup>12</sup> 15 U.S.C. 78s(b)(2).

<sup>13</sup> 17 CFR 200.30-3(a)(12).