

MEMO# 8843

April 30, 1997

INSTITUTE COMMENTS ON NASAA PROPOSAL RELATING TO SUITABILITY

April 30, 1997 TO: BROKER/DEALER ADVISORY COMMITTEE No. 9-97 COMPLIANCE
ADVISORY COMMITTEE No. 16-97 INVESTMENT ADVISERS COMMITTEE No. 15-97 SEC RULES
COMMITTEE No. 47-97 STATE LIAISON COMMITTEE No. 9-97 RE: INSTITUTE COMMENTS ON
NASAA PROPOSAL RELATING TO SUITABILITY

In March, the Sales Practices Committee of the North American Securities Administrators Association ("NASAA") published for comment a proposed Statement of Policy relating to "Dishonest or Unethical Sales Practices in Connection with Customer Suitability", which would impose suitability requirements beyond those of the NASDR Rules of Conduct. In particular, the proposal would require broker-dealers, investment advisers, and their representatives to obtain eleven different items of information from each customer prior to making a recommendation to such customer. Additionally, if a broker-dealer or investment adviser had reason to know that an unsolicited order was unsuitable, the broker-dealer or investment adviser would be required to warn the customer of its unsuitability. In response to the Committee's request for comments, the Institute has filed the attached letter. The Institute's letter notes that the Committee is developing a Statement of Policy defining dishonest or unethical practices in connection with the offer or sale of investment company securities. Accordingly, we strongly recommend that the suitability concerns relating to investment company securities be expressly excluded from the Committee's suitability proposal and included instead in the investment company proposal. In case the Committee rejects our recommendation, the Institute's letter discusses in detail both general and specific concerns we have with the Committee's proposal. Discussed under our general concerns are the following: There is no indication that the Rules of Conduct of the NASDR (1) are inadequate to redress unsuitable recommendations and (2) should be replaced with the more extensive requirements proposed by the Committee. The proposal would inappropriately impose on all securities transactions suitability standards that, under the rules of the NASDR, are tailored to specific risky securities transactions, such as penny stocks or options. The proposal would reduce a flexible suitability standard to a mechanized function, to the disservice of customers, and could result in a person being found to have violated the Statement of Policy even in the absence of such person effecting an unsuitable transaction. The proposal would require inquiries that likely would be considered by many customers to be unduly intrusive, offensive, and patronizing. The provision in the proposal imposing a duty to warn investors of unsuitable transactions is completely contrary to existing securities law and attempts to shift responsibility to a broker-dealer for conduct that is not and should not be the broker-dealer's responsibility. The proposal would result in current compliance systems having to be completely revamped. A significant portion of the proposal appears to be violative of the National Securities Markets Improvement Act of

1996 ("NSMIA"). Under our specific concerns we recommend that each discrete portion of the rule be amended to be substantively identical to the requirements of the NASDR Rules of Conduct. Attached is a copy of the Committee's proposal as well as the Institute's comment letter. Tamara Cain Reed Associate Counsel Attachments (in.pdf format)

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