

MEMO# 13307

March 27, 2001

NASDR ISSUES POLICY STATEMENT RELATING TO APPLICATION OF THE SUITABILITY RULE TO ONLINE COMMUNICATIONS

[13307] March 27, 2001 TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 4-01 BROKER/DEALER ADVISORY COMMITTEE No. 7-01 SEC RULES MEMBERS No. 25-01 SMALL FUNDS MEMBERS No. 7-01 RE: NASDR ISSUES POLICY STATEMENT RELATING TO APPLICATION OF THE SUITABILITY RULE TO ONLINE COMMUNICATIONS NASD Regulation, Inc. (NASDR) recently published a Policy Statement to provide NASD members with guidance relating to the application of the general suitability rule (Rule 2310) to online communications.* The Policy Statement clarifies the types of electronic communications that may be considered “recommendations” for purposes of the suitability rule, which is triggered only when a member makes a “recommendation.” As discussed in the Policy Statement, “[w]hether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances” and “the test for determining whether any communications (electronic or traditional) constitutes a ‘recommendation’ remains a ‘facts and circumstances’ inquiry to be conducted on a case-by-case basis.” In general, however, the more individually tailored the communication to a targeted group or individual, the more likely it may be viewed as a recommendation. The Policy Statement provides examples of communications that generally fall within and outside the definition of recommendation. The examples of those communications that generally would fall within the definition include the following: • An electronic communication to a targeted customer or group of customers encouraging the purchase of a security; • Providing a portfolio analysis tool that allows a customer to indicate an investment goal and input personalized information (e.g., age, financial condition, and tolerance) and, in response thereto, the member provides the customer a list of securities to consider based on the customer’s profile; or • The use of data-mining technology to analyze a customer’s financial or online activity -- whether or not known to the customer -- and then, based upon such information, sending specific investment suggestions to the customer. * See NASD Notice to Members 01-23 (April 2001). 2In addition to these specific examples, the Policy Statement sets forth some general guidelines for evaluating a member’s suitability obligations. For example, in evaluating whether a communication is a recommendation, the Policy Statement encourages members to be aware of the degree to which such communication reasonably would influence an investor to trade a particular security. The Policy Statement notes that a member cannot avoid or discharge its suitability obligation through a disclaimer where the particular communication reasonably would be viewed as a “recommendation” given its content, context, and presentation. A copy of NASDR’s Policy Statement, which has been

effective since March 19, 2001, is attached. Tamara K. Reed Associate Counsel Attachment
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