

MEMO# 6152

August 19, 1994

PROPOSED NASD BOARD INTERPRETATION REGARDING SUITABILITY OBLIGATIONS TO INSTITUTIONAL CLIENTS

August 19, 1994 TO: INVESTMENT ADVISERS COMMITTEE NO. 46-94 SEC RULES COMMITTEE NO. 96-94 RE: PROPOSED NASD BOARD INTERPRETATION REGARDING SUITABILITY OBLIGATIONS TO INSTITUTIONAL CLIENTS

_____ The National Association of Securities Dealers, Inc. ("NASD") has issued for public comment a proposed Interpretation of its Board of Governors to provide guidance to members on their suitability obligations under Article III, Section 2(a) of the NASD Rules of Fair Practice. The proposed Interpretation would apply only with respect to institutional customers, which include registered investment companies and registered investment advisers. In addition, the Interpretation would apply to transactions in debt and equity markets, except municipal securities. A copy of the NASD Notice, which describes and sets forth the proposed Interpretation, is attached. The proposed Interpretation states that underlying Article III, Section 2(a) is the assumption that a member's relationship with the customer gives rise to a duty to help the customer determine reasonable investment parameters. It recognizes, however, that in the case of certain institutional customers, this assumption may not reflect the reality of the member/customer relationship. Specifically, the proposed Interpretation states that "institutional customers may have developed resources and procedures in order to make their own independent investment decisions." Even if an institutional customer has developed resources and procedures to make independent investment decisions, the proposed Interpretation would require that certain factors be present that provide reasonable grounds for the belief that the customer is not relying on the member's recommendations in connection with a particular transaction or market product (e.g., a transaction initiated by an institutional customer on an unsolicited basis). The proposed Interpretation further provides that where an institutional customer has provided the member with explicit investment guidelines and the member's investment recommendations are consistent with such guidelines, the member generally should be regarded as having fulfilled its suitability obligations to the customer. The proposed Interpretation also clarifies that a member would not be considered to be fulfilling its suitability obligations if, prior to the transaction, the member "knows or can reasonably conclude, based on information available to it, that the customer is not capable of understanding the product or its risks, or of making an independent investment decision." *

* * * Comments are due to the NASD on the proposed Interpretation by September 30, 1994. If you have any comments that you would like the Institute to consider including in a

letter on the proposal, please provide them to me by September 13, 1994. My direct number is 202/326-5824. Amy B.R. Lancellotta Associate Counsel Attachment

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