

Notice to Members

APRIL 2005

SUGGESTED ROUTING

Advertising
Investment Companies
Legal & Compliance
Senior Management
Variable Contracts

KEY TOPICS

Advertising
Communications with the Public
NASD Rule 2210

REQUEST FOR COMMENT

New Products Sales Material and Television, Video, and Radio Advertisements

NASD Requests Comment on Proposal to Require Pre-Use Filing of Advertisements and Sales Literature for New Types of Securities and of Television, Video and Radio Advertisements; **Comment Period Expires May 20, 2005**

Executive Summary

NASD is proposing to amend its advertising rules to require members to file certain additional categories of advertisements and sales literature with NASD. First, NASD is proposing to require members to file the initial advertisement or item of sales literature concerning a type of security that the member has not previously offered at least 10 business days prior to first use or publication (and continue to do so for the following 90 calendar days). Second, NASD is proposing to require members to file all television, video (including Web site video), radio, or similar broadcasts of 15 seconds or longer at least 10 business days prior to the date of first use or broadcast.

Questions/Further Information

Questions concerning this *Notice* may be directed to Thomas M. Selman, Senior Vice President, Investment Companies/Corporate Financing, at (240) 386-4533; Joseph P. Savage, Associate Vice President, Investment Companies Regulation, at (240) 386-4534; or Philip A. Shaikun, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8451.

05-25

Action Requested

NASD encourages all interested parties to comment on the proposed rule change. Comments must be received by May 20, 2005. Members and other interested parties can submit their comments using the following methods:

- Mail** comments in hard copy to the address below; or
- E-mail** comments to *pubcom@nasd.com*.

To help NASD process and review comments more efficiently, persons commenting on this proposal should use only one method. Comments sent by hard copy should be mailed to:

Barbara Z. Sweeney
Office of Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1500

Important Notes: The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the NASD Web site. Generally, comments will be posted on the NASD Web site one week after the end of the comment period.¹

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the NASD Board, and then must be approved by the SEC, following publication in the *Federal Register*.²

Background and Discussion

Sales Material Concerning New Types of Securities

Currently, NASD requires pre-use filing of, among other things, new member advertisements, advertisements or sales literature that include fund-created rankings, sales literature containing bond fund volatility ratings, and advertisements concerning collateralized mortgage obligations or security futures. The proposal would expand the 10-business day pre-use filing requirements to include advertisements and sales literature for new types of securities that the member has not previously offered.

This proposed amendment would serve two purposes. First, it would alert NASD when the industry promotes a new type of security to retail investors. For example, when a regulated firm first promotes a non-conventional investment to its retail customers, such as a new type of asset-backed security, distressed debt, or derivative product, the firm would have to file its initial advertisement or sales literature for these securities at least 10 business days prior to use and continue to file such material for the following 90 calendar days. This pre-use filing requirement should provide NASD with more time to address any sales practice issues that the new type of security presents.

Second, the amendment would subject the sales material for these securities to review by the NASD Advertising Regulation Department (Department). We have found that so-called “launch” material for products that a firm has not previously offered often presents significant compliance issues under our advertising rules. The new security pre-use filing requirement thus would serve a purpose similar to the new member pre-use filing requirement, which permits the Department to pre-review sales material of members that have no experience in advertising compliance. Similarly, under this proposal, the Department could review prior to use sales material for securities with which the member has no experience.

The pre-use filing requirement would not apply to:

- ◆ Sales material concerning a type of security that the member has previously offered.
- ◆ Sales material that is already subject to any filing requirement, such as mutual fund and variable annuity sales material.
- ◆ Sales material that is otherwise specifically excluded from the filing requirements, such as correspondence and institutional sales material.³
- ◆ Sales material concerning securities that previously were traded in the secondary market, such as research reports on exchange-listed securities or publicly traded bonds.

NASD recognizes that the proposed requirement to file advertisements and sales literature for a “type of security that the member has not previously offered” may raise interpretive issues. In general, NASD intends to require the filing of sales material for new categories of investments that the member has not previously offered. For example, if a member previously only offered registered investment companies, and planned on offering unregistered hedge funds to its client base, the proposal would require the member to file its initial sales materials for these products at least 10 business days prior to use and continue to pre-use file all its advertisements and sales literature for these products for the 90-day period following the initial filing. NASD requests comment on whether the term “type of security that the member has not previously offered” needs further clarification, and if so, how NASD should define this term.

Another issue on which we request comment is whether the pre-use filing requirement also should apply to advertisements and sales literature for products that the member has previously offered, but now is offering to a new class of investors for the first time. For example, should the pre-use filing requirement apply if a member prepares sales literature that offers funds of hedge funds to retail investors for the first time, if the member previously had offered funds of hedge funds only to institutional investors? If so, how should this requirement be described in the rule amendment?

Television, Video, and Radio Advertisements

The second proposed amendment would require members to file all television, video (including Web site video), radio, or similar broadcasts of 15 seconds or longer at least 10 business days prior to the date of first use or broadcast. Members could meet this requirement for television and video by filing draft versions, "story boards," or scripts of these advertisements, as long as the member also files the final filmed version of the advertisement within at least 10 business days of first use.

NASD is concerned that in the past some members used broadcast advertisements that raised regulatory issues. For example, several years ago television advertisements for day trading and electronic brokerage firms presented regulatory concerns, which could not be fully addressed until those advertisements were filed with the Department. These issues could have been resolved before the advertisements reached numerous retail investors had the advertisements been filed prior to use with NASD.

NASD recognizes that the minimum, 15-second length requirement could enable firms to distribute shorter, noncompliant broadcasts without filing them prior to use with NASD. The 15-second threshold, however, represents the typical minimum length of broadcast commercials. We are not proposing to require the filing of short sponsorship announcements, Internet banner advertisements, and similar communications. Of course, even these shorter communications must comply with the advertising rules and must obtain registered principal pre-use approval. NASD requests comment on whether the 15-second threshold is an appropriate standard for the pre-use filing requirement.

NASD also is aware that registered representatives sometimes host television or radio shows in which a representative answers questions that viewers or listeners have telephoned or emailed to the representative. In general, the pre-use filing requirement would not apply to such shows, since unscripted appearances on television and radio shows constitute public appearances rather than advertisements. If all or a portion of the show were scripted, however, NASD would regard the scripted portion as an advertisement for the member, and thus the pre-use filing requirement would apply to this portion.

Endnotes

- 1 See *Notice to Members 03-73* (Nov. 2003) (NASD Announces Online Availability of Comments). Personal identifying information, such as names or email addresses, will not be edited from submissions. Persons commenting on this proposal should submit only information that they wish to make publicly available.
- 2 Section 19 of the Securities Exchange Act of 1934 (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and rules thereunder.
- 3 The proposal would exclude institutional sales material from the pre-use filing requirement. Accordingly, if a member only distributed sales material for its hedge funds to persons meeting the definition of "institutional investor" under NASD Rule 2211, the pre-use filing requirement would not apply. However, we note that the definition of "institutional investor" under Rule 2211 differs in some respects from similar terms in SEC rules, such as the definition of "accredited investor" in SEC Regulation D under the Securities Act of 1933.

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ATTACHMENT A

New language is underlined and deletions are bracketed.

Text of Rule Change

2210. Communications with the Public

(a) and (b) No change.

(c) **Filing Requirements and Review Procedures**

(1) through (3) No change.

(4) Requirement to File Certain Material Prior to Use

At least 10 business days prior to first use or publication (or such shorter period as the Department may allow), a member must file the following communications with the Department and withhold them from publication or circulation until any changes specified by the Department have been made:

(A) through (C) No change.

(D) The initial advertisement or sales literature concerning a type of security that the member has not previously offered, and all advertisements and items of sales literature for this type of security that are used or distributed during the 90 calendar days following the filing of the initial advertisement or sales literature. This requirement does not apply to an advertisement or item of sales literature:

(i) that any member has previously filed with the Department, and that has not been materially changed;

(ii) that is required to be filed with NASD pursuant to paragraphs (c)(2) or (c)(3) of Rule 2210;

(iii) concerning securities that previously have been traded in the secondary market; or

(iv) concerning a type of security that the member has previously offered.

(5) No change.

(6) Filing of Television, Video, and Radio Advertisements

Television, video (including Web site video), radio and similar advertisements of 15 seconds or longer must be filed at least 10 business days prior to use. A member may satisfy this requirement for television and video advertisements by filing a draft version or "story board" of the advertisement. The member must file the final filmed version of the advertisement within 10 business days of first use. The member must withhold use of the advertisement until changes specified by the Department have been made.

[If a member has filed a draft version or "story board" of a television or video advertisement pursuant to a filing requirement, then the member also must file the final filmed version within 10 business days of first use or broadcast.]