Executive Summary
In Notice to Members 96-32, NASD Regulation, Inc. (NASD Regulation) informed the membership of its concerns over unusual and increased trading in speculative or low-priced securities. The Notice was intended, among other things, to remind members of their fair dealing and suitability responsibilities to customers under NASD® rules. NASD Regulation is publishing this Notice to supplement Notice to Members 96-32 and to clarify certain issues addressed in that Notice.

Questions regarding this Notice may be directed to Daniel M. Sibears, Member Regulation, NASD Regulation, at (202) 728-6911; or David Spotts, Office of General Counsel, NASD Regulation, at (202) 728-8014.

Suitability Obligation
NASD Rule 2310 (formerly Article III, Section 2 of the NASD Rules of Fair Practice) provides that in recommending to a customer the purchase, sale, or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of facts available, including other security holdings, financial situation, and needs.

The suitability rule was amended in 1990 to require that, for all accounts opened and recommendations made after January 1, 1991, members make reasonable efforts to obtain certain information from each non-institutional customer before executing a recommended transaction (excluding transactions in money market mutual funds) including the customer’s financial status, tax status, investment objectives, and other information considered to be reasonable in making recommendations to customers.

In discussing suitability determinations, Notice to Members 96-32 included a statement that the NASD Rules of Fair Practice “requires a careful review of the appropriateness of transactions in low-priced, speculative securities, whether solicited or unsolicited.” It is the reference to unsolicited transactions that NASD Regulation wishes to clarify.

A member’s suitability obligation under Rule 2310 applies only to securities that have been recommended by the member. It would not apply, therefore, to situations in which a member acts solely as an order-taker for persons who, on their own initiative, effect transactions without a recommendation from the member (See SEC Release No. 34-27160, August 22, 1989). However,
a broad range of circumstances may cause a transaction to be considered recommended, and this determination does not depend on the classification of the transaction by a particular member as “solicited” or “unsolicited.” In particular, a transaction will be considered to be recommended when the member or its associated person brings a specific security to the attention of the customer through any means, including, but not limited to, direct telephone communication, the delivery of promotional material through the mail, or the transmission of electronic messages.