



“A Call to Action:” A New Suitability Policy Statement for Online Firms

April 24, 2001

The NASD Regulation, Inc. (“NASDR”) yesterday issued a significant new Policy Statement affecting suitability duties of online firms and created new standards to assess whether online brokers deliver recommendations to customers and thereby raise suitability issues.¹ The new standards focus on the “content, context and presentation of information” and whether a firm’s services suggest a “call to action” (a suggestion to a reasonable person that the customer should engage in a particular securities transaction) that would constitute a recommendation. Recognizing the significant benefits online firms have offered clients by making such data available, as well as the rapid changes in technology, NASDR clarified that online firms can continue to offer many of the services currently offered to clients without such services being considered recommendations.

Relationship to Current Suitability Rule

The Policy Statement is not a safe harbor rule and does not exempt online firms from all suitability considerations. NASDR determined that its general suitability rule, which is invoked only when making recommendations to customers, applies to online activities where the member recommends securities to its customers.² The Policy Statement contains examples providing guidance as to when electronic communications may, and may not, constitute recommendations. The Policy Statement does not seek to create new obligations or expand the rule, or to create a bright line test; rather, NASDR will continue to use a facts and circumstances test to evaluate suitability using new objective standards.

“A Call to Action” – A New Objective Standard Based on Content, Context and Presentation

In evaluating whether an electronic communication³ constitutes a “recommendation,” NASDR issued a new standard – whether a firm’s online communications suggest a “call to action.” Firms

¹ NASDR Notice to Members 01-23 (April 2001) “Online Suitability: Suitability Rule and Online Communications” available at <www.nasdr.com> (the “Policy Statement”).

² NASDR also clarified that a member can collect data from customers, including data normally captured to perform a suitability analysis. The mere “possession” or collection of such data does not invoke a suitability analysis in the absence of a recommendation, online or otherwise. NASDR also clarified that members have a “know your customer” obligation, to assess customer credit risk.

³ NASDR recognizes that firms may communicate with customers electronically through the firm’s Web site, e-mail, Web phones, personal digital assistants, and hand held pagers. NASDR also anticipates changes in technology, and

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should ask, according to the Policy Statement, whether their electronic communications to customers “could be viewed by a reasonable person as a ‘call to action’ or a suggestion that the customer engage in a particular securities transaction.” This determination should be based on an objective standard after a review of the “content, context and presentation” of the particular communication. NASDR also would expect firms to assess how tailored the communication is to a specific customer or “targeted group” of customers about a specific security or “group of securities.” The more tailored the communication the more likely the communication may be viewed as a recommendation.

Services NOT Defined as “Recommendations”

Online firms now can take greater comfort that many of the services offered on or through their Web sites are not recommendations, even if self-directed customers can use such services and narrow investment choices down to an individual security. In essence, NASDR has recognized the concepts of customer expectations and investor empowerment without imposing suitability duties on firms. For example:

Research Reports and Electronic Libraries: NASDR confirmed that Web sites containing electronic libraries or research sources (*e.g.*, news, quotes and charts) or individual research reports (which may include buy/sell recommendations) would not be providing customer-specific recommendations.

Search Engines: Web site search engines enabling customers on their own to evaluate performance of stocks and funds, company data and industry sector information would not rise to the level of a recommendation even though a customer could evaluate individual securities. Such tools may rank securities using objective data and display news, quotes and links to other sites.

Stock Screening: Firms may offer research tools to help customers search possible investment choices on their own by screening types of securities or groups of securities and identifying individual investments without making recommendations. NASDR cautions, however, that in response to customer inquiries, firms may not use these tools to then generate lists of stocks in which it makes a market or makes “buy” recommendations.

E-Mail Alerts: Firms offering e-mail alerts or “watch lists” highlighting news events, price changes and important event notices and similar information requested by customers would not be viewed as having given a “call to action” or a recommendation. NASDR agrees that it is the customer that is setting these parameters and choosing information it wants the firm to send.

Services that DO Involve “Recommendations”

By contrast, NASDR noted the following examples as to which it would view the communications as constituting a “recommendation”:

Customer-Specific E-Mails or Pop-up Screens Encouraging a Trade. In contrast to customer driven e-mail alerts, NASDR would view as a recommendation any customer-specific communication, such as an e-mail or pop-up screen, to a targeted customer or customer group encouraging the customer(s) to purchase a security.

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that many of the interpretations may also apply to traditional concepts of providing recommendations in person, by telephone or through the mail.

Direct E-Mails Urging Investment in Sector Stocks. Similarly, e-mails directed to a customer stating that all customers should be invested in stocks in a particular industry or sector ***and*** which urges those customers to purchase one or more securities on a “buy” list would be viewed by NASDR to be a recommendation.

Portfolio Analysis Tools, Coupled with Buy Lists. Providing customers with a portfolio analysis tool which allows the customer to indicate an investment goal and input personalized suitability-type information ***and*** also provides the customer with a list of securities which the broker suggests the customer could buy or sell to meet the investment goals the customer has indicated would be considered a recommendation.

Data Mining and Push Technology. If a firm uses data-mining technology (the electronic collection of information on Web site users) to analyze a customer’s online activity and then, based on those observations, sends (or “pushes”) specific investment suggestions that the customer purchase or sell a particular security or securities, such communications will fall within the definition of a recommendation.

General Guidelines

NASDR suggests that member firms review and evaluate their online communications to determine whether they may be subject to suitability issues.

Disclaimers Alone are Not Sufficient. Firms cannot avoid or discharge suitability obligations through a disclaimer where the particular communication would be viewed as a recommendation.⁴

Review Communications that Suggest a “Call to Action”. Firms should analyze any communication about a security that could reasonably be viewed as a “call to action” that they direct to a particular individual or targeted group of individuals.

Scrutinize Communications that Advocate a Transaction. Firms should scrutinize any communication to a customer that advocates the purchase, sale or exchange of a security – as opposed to simply providing objective data about a security – so as to determine whether a recommendation is being made.

Review Unrequested Alerts and Communications by Firm or Third Parties. Firms should carefully review the circumstances under which unrequested information, particularly information about particular securities, is being provided to customers, including the manner in which the information is delivered, the content of the communications and the original source of the information.

Review Context and Presentation – the Degree to which Communications will Influence Investors. Firms should be aware that the degree to which the communication would influence a reasonable investor to trade a particular security or group of securities – either through context or manner of presentation or the language used in the communication – may be considered in determining whether a recommendation is being made to a customer.

⁴ NASDR does, however, encourage the inclusion of clear explanations of the “use and limitations” of the tools offered on Web sites.

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NASDR's Policy Statement provides some long-awaited guidelines for online firms who have been debating the circumstances under which suitability obligations may apply. As technology and the online industry advances, these guidelines will likely require more interpretation from NASDR. Hopefully, these guidelines will allow online firms to act with greater confidence under a more certain regulatory environment.

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If you have any questions about the contents of this memorandum, want a copy of the Policy Statement or if we can be of any other assistance, please contact the Rosenman & Colin attorney with whom you usually work, or any of the following:

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