

Comment Letter on NASDR Day Trading Rules Proposal, June 1999

May 31, 1999

Joan C. Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1500

Re: NASD Special Notice to Members No. 99-32 Proposing Rules 2360 and 2361 Relating to Intra-Day Trading Accounts

Dear Ms. Conley:

The Investment Company Institute¹ is writing in response to NASD Special Notice to Members No. 99-32 (the "Notice") in which NASD Regulation, Inc. ("NASDR") has proposed two new rules to address intra-day trading accounts. In general, the proposed rules, Rules 2360 and 2361, would require NASDR member firms that "recommend" a day trading strategy to customers to approve the account for such trading and provide the customer a disclosure statement that discusses the risks of day trading. For purposes of the proposed rules, NASDR has set forth a new interpretation of the term "recommendation" and has requested comment on whether this term should be defined.

The Institute has no objection to efforts by NASDR to regulate day trading. We are, however, concerned that the interpretation of "recommendation" as set forth in the Notice may have implications beyond the proposed rules. For this reason, we urge that NASDR clarify that it intends to interpret the term "recommendation" in a manner that is consistent with the term's usage in other NASDR rules.

In its discussion of the activities that would be covered by the proposed rules, the Notice states as follows:

In general, a member would be recommending a day-trading strategy for purposes of the proposed rules if it affirmatively promoted day trading through advertising, training seminars, or direct outreach programs, and an individual engaged in day trading in response to these solicitations.²

This interpretation is far broader than NASDR's current interpretation of the term recommendation.³ For example, under this interpretation, if a brokerage firm distributes a brochure to customers that promotes all of its available services, including the firm's facilities to accommodate day-trading by investors, such brochure might be viewed as a recommendation that customers engage in day trading. Such an interpretation would not be consistent with the manner in which the term is interpreted in other NASDR rules.

Our concern in this regard is similar to the concern we expressed to NASDR in connection with Notice to Members 96-60. In that Notice, NASDR attempted to clarify the fair dealing and suitability responsibilities of members in connection with the offer and sale of speculative and low-priced securities. The Institute noted that the language in the Notice could be misinterpreted to extend NASDR suitability requirements to the distribution of advertisements and sales literature by mutual funds.⁴ In response to the Institute's letter, NASDR staff affirmed that "a reference to an investment company or an offer of investment company shares in an advertisement or piece of sales literature would not by itself constitute a 'recommendation' for purposes of NASDR Rule 2310."⁵ Unfortunately, the current Notice has raised the same concerns. Accordingly, the Institute believes that NASDR should clarify that the position expressed by NASDR in its 1997 correspondence remains NASDR's position on this issue.⁶

The Institute appreciates the opportunity to express its views on this issue.

Sincerely,

Tamara K. Reed
Associate Counsel

cc: R. Clark Hooper, NASDR
Thomas M. Selman, NASDR
Joseph Savage, NASDR

ENDNOTES

¹ The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,546 open-end investment companies ("mutual funds"), 457 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about \$5.730 trillion, accounting for approximately 95% of total industry assets, and have over 73 million individual shareholders.

² This portion of the Notice goes on to add: "The fact that customers of a firm generally were engaged in day trading would reinforce a determination that the firm had promoted itself in this way. However, merely providing general investment research or having a Web site that allows the multiple entry of intra-day purchases and sales of the same securities would not constitute a recommendation under the proposal."

³ Moreover, this interpretation appears somewhat inconsistent with the substance of proposed Rules 2360 and 2361. In particular, the proposed rules would only apply to a member "that has recommended an intra-day trading strategy to a customer" (emphasis added)—this seems to indicate that the recommendation must be more than a mere advertisement promoting day trading.

⁴ See letter from Craig S. Tyle, Investment Company Institute, to R. Clark Hooper, NASDR, dated December 17, 1996.

⁵ See letter from Thomas M. Selman, Director, Advertising/Investment Companies Regulation, NASDR, to Craig S. Tyle, dated March 4, 1997.

⁶ In the Notice, NASDR requested comment on whether it should define the term "recommendation" in the proposed rules. The Institute does not believe that this is necessary; we believe that previously articulated interpretations of the term (e.g., in the 1997 correspondence referenced above) provide sufficient guidance to NASD members. Moreover, given the variety of facts and circumstances that might be considered in determining whether a particular transaction or investment strategy was recommended, the Institute believes it would be difficult, if not impossible, to define the term definitively.