

A.1.1.4 NYSE 440

Member Firm Regulation

Attention: Chief Executive Officer, Managing Partners, Compliance And Legal Departments

To: All Members and Member Organizations

Subject: New Rules - Supervision and Review of Communications with the Public Background

Technology has greatly expanded how communications between members, member organizations and their customers take place. These new means of communication (e.g., E-mail, Internet) will continue to significantly affect the manner in which members and member organizations and their associated persons conduct their business. While these changes allow timely and efficient communication with customers, prospective customers and others, the significant changes in communications media and capacity raise questions regarding **supervision, review, and retention of communications** with the public.

To address these issues, the Exchange formed a committee of membership representatives to make recommendations regarding appropriate supervisory policies and procedures. Predicated upon those recommendations, the Exchange believes that each member and member organization should have the flexibility to adopt and implement its own supervisory procedures relating to communications with the public based on the firm's structure; the nature and size of its business; and its customer base, rather than having a mandated pre-review requirement of all communications. In developing these procedures, member organizations should continue to provide for appropriate supervision of the public communications of their registered representatives and other associated persons, consistent with their overall duty to supervise their employees.

Amended Rules

The Exchange filed and received SEC approval (see Release No. 34-39511 dated December 31, 1997) of amendments to Rule 342 ("Offices - Approval, Supervision and Control"), Rule 440 ("Books and Records") and Rule 472 ("Communications With The Public"). (See Exhibit A for text of rule changes).

The amendments are effective immediately, however, members and member organizations should continue the pre-review of communications until such time as they are in compliance with the amended rules and the guidelines contained in this memorandum.

Rule 342.16, as amended, provides that procedures for review of communications with the public relating to a member or member

organization's business be designed to provide **reasonable** supervision for each registered representative, be described in an organization's written supervisory procedures and be evidenced in an appropriate manner.

New Rule 342.17 requires each member and member organization to develop **written** policies and procedures for review of communications with the public relating to its business **tailored** to its structure and the nature and size of its business and customers. This provision eliminates the current requirement to review, prior to use, all outgoing correspondence. The new rule, however, does require that **any organization that does not conduct either an electronic or manual pre-use review will be required to:**

- develop appropriate supervisory procedures;
- monitor and test to ensure these policies and procedures are being implemented and complied with;
- provide education and training to all appropriate employees concerning the organization's current policies and procedures governing communications. This training should be updated as policies and procedures are changed;
- maintain records documenting how and when employees are educated and trained.

The current interpretation under Rule 342 (NYSE INTERPRETATION HANDBOOK Rule 342 (a) and (b)/04, p. 3404), is being modified to require review of all incoming communications related to a member or member organization's business received in nonelectronic format directed to persons functioning as registered representatives, and is repositioned (to the interpretation under Rule 342.16/01, p. 3415). Incoming nonelectronic communications directed to associated persons (other than persons functioning as registered representatives) and all communications related to a member or member organization's business received in electronic format (e.g., E-mail and facsimile) will be subject to the overall supervisory and review procedures established by the member or member organization pursuant to amended Rule 342.16 and new Rule 342.17. The revised interpretation is attached to Interpretation Memo No. 98-1 which should be placed into the NYSE INTERPRETATION HANDBOOK.

Given the complexity and cost of establishing appropriate systems for effectively reviewing electronic communications, some member organizations may determine to continue a pre-use review of all outgoing communications (written or electronic).

Rule 472(a) specifies types of communication that continue to require **pre-use approval** e.g., advertisements, market letters and sales literature.¹

Rule 472(b) clarifies the **existing** requirement that research reports be (prepared or) approved **in advance** by a supervisory analyst. The retention requirements of Rule 472(c) cross-reference Rule 440 and state that the names of persons who prepared and reviewed and approved communications

must be readily ascertainable from the retained records.

The standards set forth in Rule 472 continue to apply to all communications that members or member organizations issue - regardless of the medium used for their transmission to the public or the policies and procedures adopted for their supervision and control.

Rule 440 states that these records must be retained in a format or medium that complies with Rule 17a-4 under the Securities Exchange Act of 1934.

Guidelines for Supervision and Review

In adopting review procedures pursuant to Rule 342, members and member organizations must:

- specify, in writing, the firm's policies and procedures for reviewing different types of communications;
- identify how supervisory reviews will be conducted and documented;
- identify what types of communications will be pre-reviewed or post-reviewed;
- identify the organizational position(s) responsible for conducting reviews of the different types of communications;
- specify the minimum frequency of the reviews for different types of communications;
- monitor the implementation of and compliance with the firm's procedures for reviewing public communications;
- periodically re-evaluate the effectiveness of the firm's procedures for reviewing public communications and consider any necessary revisions.

In conducting reviews, members and member organizations may use reasonable sampling techniques. As an example of appropriate **evidence of review**, E-mail related to the member organization's business may be reviewed electronically and the evidence of the review may be recorded electronically.

In developing supervisory procedures for the review of communications with the public, each member and member organization must consider its structure, the nature and size of its business, other pertinent characteristics and the appropriateness of implementing uniform firm-wide procedures, or tailored procedures (i.e., by specific function, office/location, individual, or group of persons).

In adopting review procedures pursuant to Rule 342, members and member organizations must, at a minimum:

- specify procedures for reviewing registered representatives' recommendations to customers;

- require supervisory review of some of each registered representative's public communications, including recommendations to customers;
- consider the complaint and overall disciplinary history, if any, of registered representatives and other employees (with particular emphasis on complaints regarding written or oral communications with clients); and
- consider the nature and extent of training provided registered representatives and other employees, as well as their experience levels in using communications media, (although a firm's procedures may not eliminate or provide for minimal supervisory reviews based on an employee's training or level of experience in using communications media).

Although members and member organizations may consider the number, size, and location of offices, as well as the volume of communications overall or in specific areas of the organization, members and member organizations must nonetheless develop appropriate supervisory policies and procedures in light of their duty to supervise their associated persons.

The factors listed above are not exclusive and members and member organizations must consider all appropriate factors when developing their supervisory procedures and implementing their supervisory reviews.

Supervisory policy and procedures must also:

- provide that all customer complaints, whether received via e-mail or in written form from the customer, are reported to the Exchange in compliance with Rule 351(d);²
- describe any firm standards for the **content** of different types of communications;
- address permitted and prohibited activities (e.g., lectures, seminars, mass media appearances, etc.); and prohibit registered representatives' and other employees' use of electronic communications to the public unless such communications are subject to supervisory and review procedures developed by the firm. For example, the Exchange would expect members and member organizations to prohibit communications with the public from employees' home computers or through third party computer systems unless the firm is capable of monitoring such communications.

Members and member organizations must continually assess the effectiveness of these supervisory systems.

Education and training must be timely (prior to or concurrent with implementation of the policies and procedures) and it must include all appropriate employees. Members and member organizations may incorporate the required education and training on communications into their

Continuing Education Firm Element Training Program (see Rule 345A - Continuing Education for Registered Persons). The requirement for training regarding communications may also apply to employees who are not included under the Continuing Education requirements.

Exchange examiners periodically will review member organizations' procedures and systems to ensure that they are **reasonable** in view of each firm's structure, and the nature and size of its business and customer base.

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Information Memo 98-3 (PDF)