Information Memo

NYSE

New York
Stock Exchange, Inc.

Member Firm Regulation

20 Broad Street
New York, NY 10005

Number 01-5
March 7, 2001

ATTENTION: CHIEF EXECUTIVE OFFICER, MANAGING PARTNERS, COMPLIANCE AND LEGAL DEPARTMENTS

TO: MEMBERS AND MEMBER ORGANIZATIONS

SUBJECT: LONG-TERM CERTIFICATES OF DEPOSIT - SALES PRACTICES

It has come to the attention of the Exchange that the manner in which long-term[1] Certificate of Deposit products ("CDs") are represented to customers by some member organizations could be misleading. Particular concerns fall into two categories: 1) the **absence of risk-factor disclosures** at or before the purchase of such CDs and 2) their post-purchase, **secondary market pricing**. This Memo is intended to outline the Exchange's concerns regarding these issues and to provide member organizations with guidance for effectively addressing them.

DISCLOSURE OF RISK FACTORS

There are risks associated with long-term CDs that must be disclosed to prospective purchasers. It is neither accurate nor appropriate to represent such CDs as "riskless" or as "no-risk" investments. **Member organizations' written procedures must require** r**egistered representatives to disclose each of the following material risks, as applicable, to potential long-term CD purchasers prior to the time an investment decision is made:**

Market Risk / Interest Rate Sensitivity

Typically, a long-term CD sold by a holder (customer) prior to maturity is subject to market price fluctuations that are primarily affected by then-prevailing interest rates. Disclosure must be made to customers that the pre-maturity sale price of a long-term CD may be less than its original purchase price, particularly if interest rates are higher at the time of the sale. Further, use of the term "no penalty for early withdrawal" is misleading in connection with the marketing of CDs *unless* the issuer guarantees redemption of full face value for a pre-maturity sale.

[1] CDs with a maturity beyond one year from date of issue.

Secondary Market

Customers must be informed that the secondary market for long-term CDs may be limited. If a member organization makes a secondary market for a long-term CD, disclosure such as "The firm may make a secondary market…" is not appropriate. An example of an acceptable disclosure is: "The firm currently makes a market in this CD but may not do so in the future."

Term / Call Provisions / Reinvestment Risk

The term of a CD is a material fact; a CD with a long-term maturity date may not be appropriate for certain customers, who must be advised accordingly.

Some CDs include a provision that allows the issuing depository institution to "call" or redeem the CD at a given price prior to maturity. Call features typically will be exercised when a long-term CD is trading at a premium to its call price in the secondary market. Customers must be informed that the long-term CD they are purchasing is callable at the sole discretion of the issuing depository institution and that in seeking to reinvest their redeemed funds they may be confronted with a less favorable interest rate environment than when their initial purchase was made.

When marketing long-term callable CDs, member organizations and registered representatives should be careful not to predict the likelihood that such CDs will be called.

Risks Associated with Long-term "Step-Rate" CDs

A "step-down" CD will generally pay an above-market interest rate for a given period (e.g., one year) but will then "step down" to a lower, predetermined rate that will be paid until maturity. Similarly, a "step-up" CD will generally pay a below market interest rate for a defined period of time and will "step-up" to a higher, predetermined rate that will be paid until maturity. Purchasers of step-rate long-term CDs must be made aware that the step-rate may be below or above then-prevailing market rates and that such CDs are also subject to secondary market risk and often will include a call provision by the issuing depository institution that would likewise subject them to reinvestment risk. Customers must be reminded that the initial rate is not the yield to maturity.

Written Communications

Best practice would be for member organizations to distribute written materials that describe the characteristics and risks of purchasing long-term CDs or prepare such for distribution if not made available by the issuer. Any such written materials must comply with Rule 472 ("Communications With The Public").

SECONDARY MARKET PRICE DISCLOSURE: CUSTOMER STATEMENTS

As discussed above, long-term CDs typically are subject to interest rate-driven secondary market fluctuations meaning that the resale prices of such CDs may, at a given time, be more or less than the customer paid. It has been observed, however, that not all member organizations provide timely, accurate pricing information on customer statements for long-term CD positions and that some lack the capacity to do so. Due to the difficulty in pricing long-term CDs, they are often priced at par value. This can be misleading to customers, particularly if the represented par value is included in a tabulation of an account's overall equity value.

NYSE Rule 409(a) requires that "[e]xcept with the permission of the Exchange, member organizations shall send to their customers statements of account showing security and money positions and entries at least quarterly to all accounts having an entry, money or security position during the preceding quarter". Implicit in this language is that the required security and money positions reflected on the account statement be accurate and not misleading.

Member organizations will be in compliance with Rule 409(a) by assigning an end-of-month market value[2] to long-term CD positions that appear on customer statements. Market value provides customers with an accurate representation of their holdings and *is expected to be included on customer statements as soon as possible but not later than the quarter-ending September 2001*. As an interim measure where market value is not used, firms must inform customers (either on the next statement or in a supplemental letter included with the next statement) as to when market value pricing of long-term CDs will be reflected on customer statements.

After September 2001, par pricing may not be utilized on statements for long-term CDs and if market value is not provided as described above, long-term CD positions must be reflected on customer statements as unpriced.

GOOD BUSINESS CONDUCT / SUITABILITY

The disclosure materials referenced in this Information Memo do not completely or comprehensively address member organizations' obligations under NYSE Rules (e.g., 401 ["Business Conduct"] and 405 ["Diligence as to Accounts"]) to adhere to the principles of good business practice and to exercise due diligence to learn the essential facts relative to every customer order.

[2] Market value may be determined by using actual values or by using a model or matrix. If actual pricing is not utilized, the pricing method utilized must be disclosed to the customer on the statement along with a caveat that such price may not be the actual price a customer would get in the event the long-term CD is sold prior to maturity.

Before making a recommendation of a long-term CD product, member organizations must determine whether it is a suitable investment for the customer. This determination requires attention to all appropriate facts, some of which may not have been included within the scope of this Memo.

TRAINING AND SUPERVISION OF SALES FORCE

In order to comply with all relevant regulatory requirements, it is essential that member organizations properly train their sales forces and closely supervise the marketing and sale of CD products.

Please also note that certain of the principles discussed in this memorandum may be equally applicable to other products as to which market price is not made readily available to customers.

Any questions regarding the foregoing may be directed to Steve Kasprzak at (212) 656-5226, Mary Anne Furlong at (212) 656-4823 or Michael Rufino at (212) 656-5685.

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