

three years.<sup>5</sup> The Commission subsequently has extended GSCC's registration through January 14, 2000.<sup>6</sup>

In the most recent extension of GSCC's temporary registration, the Commission stated that it planned in the near future to seek comment on granting GSCC permanent registration as a clearing agency. This extension of GSCC's temporary registration will enable the Commission to do so within the next few months.

Interested persons are invited to submit written data, views, and arguments with respect to whether the Commission should grant GSCC permanent registration as a clearing agency. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. Copies of the amended application for registration and all written comments will be available for inspection at the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. All submissions should refer to File No. 600-23 and should be submitted by February 11, 2000.

*IT IS THEREFORE ORDERED* pursuant to Sections 17A(b) and 19(a) of the Act that GSCC's temporary registration as a clearing agency (File No. 600-23) be and hereby is extended through July 31, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42340; File No. SR-NASD-98-32]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 Thereto Relating to Filing Requirements for Independently Prepared Research Reports

January 13, 2000.

#### 1. Introduction

On April 9, 1998, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation"), submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the Conduct Rules of the NASD to exclude independently prepared research reports from the filing requirements of NASD Rule 2210. NASD Regulation filed an amendment to the proposed rule change on May 14, 1998, which was published in the original notice in the **Federal Register**.<sup>3</sup>

The proposed rule change was published for comment in the **Federal Register** on June 15, 1998.<sup>4</sup> The Commission received four comments on the proposal.<sup>5</sup> NASD Regulation filed amendments to the proposed rule change on April 19, 1999,<sup>6</sup> and

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Letter from John Ramsay, Vice President, Deputy General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 13, 1998 ("Amendment No. 1").

<sup>4</sup> See Exchange Act Release No. 40074 (June 4, 1998), 63 FR 32690 (June 15, 1998).

<sup>5</sup> See Letter from Donald Phillips, President, Morningstar, Inc., to Jonathan G. Katz, Secretary, Commission, dated July 6, 1998 ("Morningstar Letter"); Letter from Lawrence H. Kaplan, Chairman, Investment Company Committee, Securities Industry Association, to Margaret H. McFarland, Deputy Secretary, Commission, dated July 1, 1998 ("SIA Letter"); Letter from Henry H. Hopkins, Managing Director and Chief Legal Counsel, T. Rowe Price Associates, Inc., to Jonathan G. Katz, Secretary, Commission, dated July 6, 1998 ("T. Rowe Price Letter"); Letter from Joseph P. Savage, Assistant Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Commission, dated July 6, 1998 ("ICI Letter").

<sup>6</sup> See Letter to Katherine A. England, Assistant Director, Division, Commission, from Thomas M. Selman, Vice President, Investment Companies/Corporate Financing, NASD Regulation, dated April 19, 1999 ("Amendment No. 2").

November 10, 1999.<sup>7</sup> This order approves the proposed rule change, as amended.

#### II. Description

NASD Conduct Rule 2210 currently requires that any "advertisement" or "sales literature" concerning a registered investment company be filed with NASD Regulation's Advertising/Investment Companies Regulation Department ("Department") and meet the content standards of that rule, as well as all applicable Commission rules. The rule defines "sales literature" to include a research report. Consequently, Rule 2210 requires that NASD member file all investment company research reports, even when the report is prepared by "independent research firms" (*i.e.*, those firms that are independent of the investment company, its affiliates, or any NASD member, and whose services are not procured by the investment company, any of its affiliates, or any NASD member).

NASD Regulation notes that as the investment company industry has grown in recent years so too has the coverage of this industry by independent research firms. Many of these firms publish reports that analyze a wide variety of investment companies and provide information about the investment companies, including each investment company's historical performance, the investment company's fees and expenses, and a description and narrative analysis of the investment company's investment strategies and portfolio management style.

NASD states that members use these independently prepared research reports in a number of ways. Some members may make the entire research service available to customers at a branch office. Members may also distribute an independently prepared research report concerning a particular investment company as part of the selling process.

NASD Regulation proposed the rule change to clarify the meaning, administration and enforcement of rule 2210 insofar as it applies to certain types of independently prepared research reports. The proposed rule change would clarify that certain types of independently prepared research reports would not have to be filed with the Department. The Department intends to interpret the term "independent" in (G)(i) of the proposed

<sup>7</sup> See Letter to Katherine A. England, Assistant Director, Division, Commission, from Thomas M. Selman, Vice President, Investment Companies/Corporate Financing, NASD Regulation, dated November 9, 1999 ("Amendment No. 3").

<sup>5</sup> Securities Exchange Act Release No. 25740 (May 24, 1988), 53 FR 19639.

<sup>6</sup> Securities Exchange Act Release Nos. 29067 (April 11, 1991), 56 FR 15652; 32385 (June 3, 1993), 58 FR 32405; 35787 (May 31, 1995), 60 FR 30324; 36508 (November 27, 1995), 60 FR 61719; 37983 (November 25, 1996), 61 FR 64183; 38698 (May 30, 1997), 62 FR 30911; 39696 (February 24, 1998), 63 FR 10253; 41104 (February 24, 1999), 64 FR 10510; and 41805 (August 27, 1999), 64 FR 48682.

<sup>7</sup> 17 CFR 200.30-3(a)(16).

rule change in a manner similar to the use of that term in NASD Rule IM-2210-3, regarding rankings.

Under the proposed rule change, these research reports would continue to be subject to the Department's spot check procedures. Moreover, the proposed rule change would impose certain conditions designed to ensure that the opinions in the research reports are objective, that the presentation is balanced, and that investors have access to regular updates of the reports. In particular, the proposed rule change would impose several requirements derived from an analogous SEC Rule—Rule 139—which provides a safe harbor from the definition of “offer for sale” and “offer to sell” in the Securities Act of 1933 (“Securities Act”).

Thus, under the proposed rule change, a published article that analyzes only a few funds or that is not regularly updated in the normal course of business would have to be filed with the Department if it is to be distributed or made generally available to customers or the public. Moreover, while a member could distribute an independently prepared research report concerning a particular fund without filing the report with the Department, if the member alters the report in any material way, then the member would have to file it with the Department if it is to be distributed or made generally available to customers or the public.

NASD Regulation believes that the proposed rule change does not raise significant investor protection concerns. In its filing and review program, NASD Regulation represents that the Department rarely has found significant issues with the types of research reports that would be excepted by the proposed rule change. Furthermore, the exception in the proposed rule change only exempts these types of research reports from the filing requirements; the research reports must still comply with applicable NASD rules. In particular, under the proposed rule change, these research reports would continue to be subject to the content requirements of Rule 2210 as well as Conduct Rule 2110 (requiring that a member “observe high standards of commercial honor and just and equitable principles of trade”), and Rule 2120 (prohibiting use of manipulative, deceptive or other fraudulent devices). In addition, Conduct Rule 2210 requires that the research reports be approved prior to use by a registered principal of the member.

The proposed rule change would apply to independently prepared research reports that are contained in software or that are electronically

communicated, as well as those on paper.

### III. Summary of Comments

The Commission received four comment letters on the proposed rule change, all of which were generally supportive, but requested clarification.<sup>8</sup>

Morningstar and the ICI requested clarification of a provision in the rule that would prohibit an investment company, its affiliated and any NASD member that would reply on the filing exemption from procuring the services of a research firm. Specifically, they sought clarification that the rule would not be interpreted to prohibit members relying on the filing exemption from: (i) Using research firms that charge funds or members subscription fees or fees for producing, distributing and redistributing their reports; or (ii) paying fees to research firms that are retained on a “by request” basis to create customized reports or perform other separate research services based on a repackaging of information already published by the research firm.<sup>9</sup>

NASD Regulation responded by amending the rule proposal to clarify that the exemption is not available with respect to the commissioning of research. Rather, the exemption will be available with respect to the procurement of a research firm's services. Furthermore, NASD Regulation will now permit research firms and members to develop customized reports, provided that the reports include only information that the research firm already has compiled and published in another non-customized report and the reports do not omit information necessary to make them fair and balanced.<sup>10</sup>

Morningstar also requested clarification that the requirement in the exemption that a research firm prepare and distribute similar types of reports with respect to a substantial number of investment companies would not be interpreted to require that each report be in an identical format or contain identical information. In response, NASD Regulation amended the filing to provide that, in order to qualify for the filing exemption, the research firm must prepare and distribute reports “based on similar research.” The provision requiring that the research firm prepare and distribute “similar types of reports” is being eliminated.

Morningstar sought clarification that the exemption requirement that research reports be distributed and updated with

reasonable regularity in the normal course of the research firm's business would not prohibit the distribution of customized reports prepared upon request. It noted that such reports are entirely comprised of information that is otherwise issued under a distribution cycle and, when aggregated with reports issued under a distribution cycle, should be considered to have been distributed with reasonable regularity in the ordinary course of the firm's research business.<sup>11</sup>

NASD Regulation responded that the proposed rule change would still exempt from the filing requirements customized reports prepared on request that are entirely comprised of information completed and published in another report, provided that the customized report does not omit information necessary to make it fair and balanced.

Morningstar and the ICI also requested clarification that the filing exemption would be available with respect to research reports containing performance information that does not meet the currentness standards of Rule 482 under the Securities Act, as long as the reports are accompanied by information that complies with those currentness standards.<sup>12</sup>

NASD Regulation noted that its Department has a long-standing informal interpretation that members may distribute a research report that does not meet the currentness standards of Securities Act Rule 482, as long as the research report represents the most recent version issued by the research firm and is accompanied by information that meets those standards. NASD Regulation further noted that the proposed rule change would not affect this interpretation.

T. Rowe Price, the SIA and the ICI sought clarification that the proposed rule change would not be interpreted to prohibit a member from supplementing an independent research report with additional information, such as a clarification of terms and/or ranking systems, or additional disclosure required by NASD or Commission rules. Morningstar also requested clarification that a research report that did not meet the NASD and Commission content requirements, but was accompanied by additional information necessary for the report to meet the applicable content requirements, would still be eligible for the exemption.

NASD Regulation confirmed that the exemption would explicitly permit material alterations necessary to make

<sup>8</sup> See *supra* note 5.

<sup>9</sup> See Morningstar Letter; and ICI Letter.

<sup>10</sup> See Amendment No. 2.

<sup>11</sup> See Morningstar Letter.

<sup>12</sup> See Morningstar Letter; and ICI Letter.

the report consistent with NASD, Commission or other applicable standards. Furthermore, the proposal would not require the filing of material that would accompany the report and that would merely clarify terms or other information in the report itself.

Morningstar and the SIA noted that, although the proposed rule change would eliminate the requirement to file certain research reports with NASD Regulation, Section 24(b) of the Investment Company Act of 1940 Act ("1940 Act") and Rule 24b-3 under that Act would still require that the reports be filed with the Commission if they are not filed with NASD

Regulation.<sup>13</sup> Commenters added that such a result would be inconsistent with the purpose of the proposed rule change, especially if funds and fund underwriters choose to file with NASD Regulation to satisfy the requirements of Section 24(b). NASD Regulation has amended the proposed rule change to clarify that although the qualifying research reports are exempted from the filing requirement, they will be deemed filed with NASD Regulation in order to satisfy Section 24(b) of the 1940 Act and Rule 24b-3 thereunder.<sup>14</sup>

The ICI proposed that NASD Regulation include a definition of "research report" to clarify that it is a report that provides an in-depth analysis of a particular fund, but is not intended to cover reprints of articles that appear in widely circulated financial magazines.<sup>15</sup> T. Rowe Price supported the ICI's proposed definition but suggested that it also include article reprints sent to institutional customers in order to exclude such reprints from the filing requirements. T. Rowe Price also suggested including a definition of "institutional customer" in the proposed rule change.<sup>16</sup>

NASD Regulation responded by noting that the proposed rule change would not apply to article reprints, which NASD Rule 2210 includes in the definition of "sales literature." NASD Regulation believed that the proposed rule change provided sufficient guidance to members concerning the meaning of "research report." NASD Regulation added that it also reviewing the treatment of institutional sales material, but did not modify the proposal as a result of the comments.

The ICI requested confirmation that the proposal would exempt independent research reports that included performance ranking

information, provided that the reports meet the proposed exemption criteria.<sup>17</sup> NASD Regulation confirmed that the proposal would exempt such reports, provided that they meet the exemption criteria. NASD Regulation also noted that such reports would be required to comply with the content requirements of IM-2210-3, regarding rankings, as well as any other applicable Commission and NASD requirements.

#### Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the Association and, in particular, with the requirements of Section 15A(b) of the Act.<sup>18</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act in that it promotes just and equitable principles of trade, and generally provides for the protection of investors and the public interest.<sup>19</sup>

The Commission believes that the proposed rule change should reduce regulatory burdens for NASD members while maintaining investor protection safeguards regarding the dissemination of useful fund information. Specifically, although the proposed rule reduces the filing obligations for qualifying independent research reports, investor protection objectives should be served because the exempted independent research reports must still comply with the content requirements of NASD Conduct Rules 2210, 2110, 2120, and IM-2310-2.<sup>20</sup> In addition, Conduct Rule 2210 would continue to require that these research reports be approved by a registered principal of the member prior to use. The exempted independent research reports would also remain subject to NASD Regulation's spot-check procedures.

The Commission notes that two of the commenters asserted that, although the proposed rule change would eliminate the NASD filing requirement for qualifying independent research reports, Section 24(b) of the 1940 Act and Rule 24b-3 thereunder would still require

that such reports be filed with the Commission. In response, NASD Regulation amended the proposed rule change to clarify that research reports satisfying the filing exemption will be deemed filed with the NASD for the purposes of Section 24(b) of the 1940 Act and Rule 24b-3 thereunder.

The Commission finds good cause to approve Amendment No. 2 to the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 2 addresses several issues. First, it clarifies that the exemption is not available with respect to the commissioning of research, but is available with respect to the procurement of an independent research firm's services. Second, Amendment No. 2 confirms that a customized report prepared on request would still be exempted from the filing requirements if it is entirely comprised of information published in another report, and provided that the customized report does not omit information necessary to make it fair and balanced.<sup>21</sup> Third, Amendment No. 2 clarifies that, to qualify for the filing exemption, an independent research firm must prepare and distribute reports based on similar research. This affirms that the reports do not have to be identical in format or contain identical information to qualify for the exemption. Fourth, Amendment No. 2 clarifies that material changes to exempted independent research reports will be permitted when the changes are necessary to make them consistent with NASD, Commission or other applicable standards. Finally, Amendment No. 2 does not raise any new or novel regulatory issues. Accordingly, the Commission believes that it is consistent with Section 15A(b)(6) and 19(b)(2) of the Act to approve Amendment No. 2 to the proposed rule change on an accelerated basis.

The Commission finds good cause to approve Amendment No. 3 to the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 3 clarifies

<sup>21</sup> NASD Regulation also asserts that the rule change will not have any effect on its longstanding informal interpretation that allows members to distribute a research report that does not meet the currentness standards of Commission Rule 482, as long as the report represents the most recent version issued and is accompanied by information that satisfies the currentness standards. See Amendment No. 2. Although this "informal interpretation" is not part of the proposed rule change and, as such, is not being formally approved by this order, the Commission's Division of Investment Management indicates that the informal interpretation conforms with the intent of Rule 482, provided that the information is not presented in a materially misleading manner.

<sup>17</sup> See ICI Letter.

<sup>18</sup> 15 U.S.C. 78o-3(b).

<sup>19</sup> See 15 U.S.C. 78o-3(b)(6). In approving this rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation, consistent with Section 3 of the Act. *Id.* at 78c(f).

<sup>20</sup> NASD Conduct Rule 2110 requires that a member "observe high standards of commercial honor and just and equitable principles of trade." Rule 2120 prohibits the use of manipulative, deceptive or other fraudulent violations. IM-2310-2 requires fair dealing with customers, including avoiding fraud violation.

<sup>13</sup> See Morningstar Letter; and SIA Letter.

<sup>14</sup> See Amendment No. 3.

<sup>15</sup> See ICI Letter.

<sup>16</sup> See T. Rowe Price Letter.

that independent research reports that are eligible for the filing exemption will be deemed to be filed with the NASD for the purposes of Section 24(b) of the 1940 Act and Rule 24b-3 thereunder. The staff of the Commission's Division of Investment Management supports this aspect of the proposal. Amendment No. 3 also amends paragraph (G)(ii) in the proposed rule change to clarify that a member may not alter an exempted research report except as necessary to make the report consistent with applicable *regulatory* standards. The Commission believes that this clarification should help members to understand that the exemption relates solely to legal and regulatory standards, and not industry or other standards. Accordingly, the Commission believes that it is consistent with Sections 15A(b)(6) and 19(b)(2) of the Act to approve Amendment No. 3 to the proposed rule change on an accelerated basis.

#### V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 2 and 3, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-98-32 and should be submitted by February 11, 2000.

#### VI. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (SR-NASD-98-32) is approved, as amended.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

**Jonathan G. Katz,**  
*Secretary.*

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### SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-42341; File No. SR-NASD-99-70)

#### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Establish a FEE For Historical Research and Administrative Reports Provided Through Nasdaq's Web Sites

January 14, 2000.

#### I. Introduction

On November 24, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission" or "SEC") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to establish a fee for historical research and administrative reports provided through Nasdaq's web sites. Notice of the proposed rule change appeared in the **Federal Register** on December 14, 1999.<sup>3</sup> The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

#### II. Description of the Proposal

Nasdaq proposes to establish a fee which it will charge to investors who request historical research reports pertaining to Nasdaq, Over-the-Counter Bulletin Board ("OTCBB") or other Over-the-Counter ("OTC") issues. Nasdaq has provided such reports on an *ad hoc* basis to customers requesting this information by telephone. Investors would contact a member of Nasdaq's staff via telephone, describe the type of customized report desired, and arrange for an appropriate billing and delivery method before having the Nasdaq staff member compile the report. Charges for these reports were based on hourly rates

relative to the time required for compilation and delivery of the reports. Nasdaq believes the system was an inefficient and time consuming arrangement that was both burdensome to Nasdaq staff and an impediment to the accessibility of the information for the investor.

As the number of individual investors in today's market directing their own investment decisions has increased significantly, the volume of requests for this information also has increased. To alleviate the demand upon staff resources and increase the quality, speed and availability of the information, Nasdaq has developed an automated request and delivery system that will facilitate the delivery of these reports in a timely and systematic manner at a fixed price, based on a standardized pricing methodology. Investors will be able to access the reports through the Internet on the Nasdaq Trader.com (for Nasdaq issues) and OTCBB.com (for OTCBB and other OTC issues) web sites (or their successor sites, by directing an Internet browser to the appropriate web site. Once at the proper location within the web site, investors would choose from a list of standardized reports, input the necessary information pertaining to the desired security or market participant, and provide credit card information for payment.<sup>4</sup> Once the request has been completed, the report would be sent via e-mail directly to the investor.

Nasdaq proposes to provide historical research reports that fall into two categories: "Daily Detailed Reports" and "Summary Level Activity Reports." Examples of Daily Detailed Reports include a Market Maker Price Movement Report (displays all market maker quote changes and the best bid and offer throughout a chosen day for a selected security) and a Time and Sales Report (provides a record of media-reported trades in the selected security, indicating the reported time, price and share volume). Summary Level Activity Reports would provide trade and/or quote information over a monthly or quarterly period.

Fees for the Daily Detailed Reports would be set on a two-tiered basis to reflect the amount of information provided. Nasdaq proposes to assess a fee of \$7 for reports with 15 or fewer fields of information<sup>5</sup> for each trading

<sup>4</sup> Credit card information will be obtained through a secure web site connection.

<sup>5</sup> Examples of fields, depending on the type of report chosen, could include reported volume, reported price, reported time, inside bid/ask, short sale indicator, etc.

<sup>23</sup> 17 U.S.C. 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 47707 (December 8, 1999), 64 FR 69811.

<sup>22</sup> 15 U.S.C. 78s(b)(2).