

Commission expects the Exchange to continue to work towards establishing a linkage with the Nasdaq systems as requested in the January 1997 Order.²⁶ In connection with this effort, the Commission has requested an update on the information provided in the December 21, 1999 report using the Exchange's surveillance system. The Commission requests that the Exchange supplement the available trading data so that it can consider issues concerning the pilot program, including the circumstances involving orders that are not automatically executed through MAX, whether orders are given the NBBO shown at the time the order is received or the NBBO posted at the time the order is executed, and what explanations are available for price disimprovement. The Commission is extending the pilot program for one year so that the Exchange may continue to compile this data for the Commission's review.

The Commission also requests that the Exchange continue its effort to rewrite Article XX, Rule 37 and Article XX, Rule 43 of the Exchange's rules so these rules clearly explain the difference between how listed (or dually traded) securities and over-the-counter (or Nasdaq/NM) securities are routed and executed by the Exchange, and submit the new proposed language to the Commission for review and approval. Additionally, the Commission requests that the Exchange include in its rules an explanation of how the provisions of the Exchange's Best Rule interact with the Exchange's Rules governing automatic execution of orders.

The Commission does not want to interrupt the current operations of the Exchange while the above-described issues are being addressed. Therefore, the Commission finds that it is appropriate to accelerate the operative date of the proposed rule change.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, 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, DC 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 in the Commission's Public Reference Room in Washington, DC. Copies of the filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-CHX-00-36 and should be submitted by December 20, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁷

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43601; File No. SR-NASD-00-13]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 1 and 2 to the Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Valuation of Illiquid Direct Participation Program and Real Estate Investment Trust Securities on Customer Account Statements

November 21, 2000.

Introduction

On March 28, 2000, 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 ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and rule 19b-4 thereunder,² a proposal to amend its rules to require general securities members to provide valuations and disclosures relating to direct participation program ("DPP")

and real estate investment trust ("REIT") securities on customer account statements under certain circumstances. NASD Regulation amended its proposal on September 25, 2000,³ and on October 30, 2000.⁴

The Proposal was published for comment in the **Federal Register** on April 26, 2000.⁵ Five comment letters were received regarding the proposal.⁶ This order approves the proposed rule change, as amended. In addition, the Commission is publishing notice to solicit comments and is simultaneously approving, on an accelerated basis, Amendment Nos. 1 and 2.

II. Background and Description of the Proposal

A. Background

NASD Rule 2340, "Customer Account Statements," requires general securities

³ See letter from Suzanne E. Rothwell, Chief Counsel, Corporate Financing, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated September 21, 2000 ("Amendment No. 1"). In Amendment No. 1, NASD Regulation proposed to delete NASD Rule 2340(b)(A) and add new paragraph (b)(4) to NASD Rule 2340. NASD Rule 2340(b)(4) states that, notwithstanding the requirement in NASD Rule 2340(b)(1)(B), a member may refrain from including a per share estimated value for a DPP or REIT security on an account statement if the member can demonstrate the value was inaccurate as of the date of the valuation or is no longer accurate as a result of a material change in the operations or assets of the program or trust.

⁴ See letter from Suzanne E. Rothwell, Chief Counsel, Corporate Financing, NASD Regulation, to Katherine A. England, Assistant Director, Division, Commission, dated October 27, 2000 ("Amendment No. 2"). Amendment No. 2 revised NASD Rule 2340(b)(4) to indicate that a member must refrain from including a per share estimated value for a DPP or REIT security on an account statement if the member can demonstrate the value was inaccurate as of the date of the valuation or is no longer accurate as a result of a material change in the operations or assets of the program. NASD Regulation noted that the revised provision does not relieve a member of its obligation to provide an alternative per share estimated value when the member's obligation is triggered by NASD Rule 2340(b)(1)(B).

⁵ See Securities Exchange Act Release No. 42698 (April 18, 2000), 64 FR 24523.

⁶ See letter from Anne Rabbitt, Assistant Vice President, Director of Investor Services, Resourcephoenix.com, to the Honorable Arthur Levitt, Chairman, Commission, dated October 10, 2000 ("Resourcephoenix.com Letter"); letter from Larry E. Goff, National Sales Manager, CNL Investment Company, to the Honorable Arthur Levitt, Chairman, Commission, dated October 3, 2000 ("CNL Letter"); letter from Christopher L. Davis, President, Investment Program Association ("IPA"), to Secretary, Commission, dated June 30, 2000 ("IPA Letter"); letter from Anne Julie Ravane, Vice President and Senior Counsel, Private Client Counsel, Office of General Counsel, Merrill Lynch ("Merrill Lynch"), to Secretary, Commission, dated June 2, 2000 ("Merrill Lynch I"); and letter from Anne Julie Ravane, Vice President and Senior Counsel, Private client Counsel, Office of General Counsel, Merrill Lynch, to Secretary, Commission, dated June 5, 2000 ("Merrill Lynch I"). Merrill Lynch withdrew Merrill Lynch I and replaced it with Merrill Lynch II. See Merrill Lynch II.

²⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

²⁶ See January 1997 Order, *supra* note 7.

members to send account statements to customers on at least a quarterly basis.⁷ The statements must include a description of any securities position, money balances or account activity since the prior account statement was sent. An NASD member that does not carry customer accounts and does not hold customer funds and securities is exempt from the provisions of NASD Rule 2340.

In March 1994, the Subcommittee on Telecommunications and Finance of the U.S. House of Representatives ("House Subcommittee"), expressed concern to the NASD regarding the sufficiency of information provided on customer account statements with respect to the current value of illiquid partnership securities.⁸ The House Subcommittee noted that investors in non-traded partnerships should be able to know how their investments are performing and expressed a belief that there might be shortcomings in current valuation reporting to that group of investors.⁹

In June 1994, the Division requested information from the NASD concerning whether it would be appropriate for self-regulatory organizations to require that members make certain disclosures regarding illiquid partnerships on customer account statements.¹⁰ The Division suggested that, at a minimum, a member should disclose: (1) That there is no liquid market for most limited partnership interests; (2) that the value of a partnership, if any, reported on the account statement may not reflect a value at which customers can liquidate their positions; and (3) the source of any reported value, a short description of the methodology used to determine the value, and the date the value was last determined.¹¹

B. The 1997 Proposal

In response to the concerns raised by the House Subcommittee and the Division, NASD Regulation filed a proposed rule change relating to DPPs and REITs with the Commission in

⁷ A general securities member is any member that conducts a general securities business and is required to calculate its net capital pursuant to the provisions Rule 15c3-1(a) under the Act, except for paragraphs (a)(2) and (a)(3). See NASD Rule 2340(c).

⁸ See Letter from Edward J. Markey, Chairman, and Jack Fields, Ranking Republican Member, Subcommittee on Telecommunications and Finance, U.S. House of Representatives, to Joseph R. Hardiman, President and Chief Executive Officer, NASD, dated March 9, 1994 ("1994 Letter").

⁹ See 1994 Letter, *supra* note 10.

¹⁰ See Letter from Brandon Becker, Director, Division, Commission, to Richard G. Ketchum, Executive Vice President and Chief Operating Officer, NASD, dated June 14, 1994 ("Limited Partnership Letter").

¹¹ See Limited Partnership Letter, *supra* note 10.

February 1997 ("1997 Proposal").¹² Among other things, the 1997 Proposal required a general securities member that provided individual valuations for illiquid DPP or REIT securities on its retirement account statements to provide the same valuation to other customers owning those securities. The Commission published the 1997 Proposal for comment in the **Federal Register** on April 3, 1997,¹³ and received nine comment letters regarding the proposal.

According to NASD Regulation, concerns arose regarding potential conflicts between the requirements of the 1997 Proposal and the obligations of a member acting as a retirement account fiduciary under Employee Retirement Income Securities Act and Internal Revenue Service regulations. Therefore, NASD Regulation withdrew the 1997 Proposal and replaced it with the current proposal.¹⁴

C. NASD-00-13

In the current proposal, NASD Regulation proposes to amend its rules to require general securities members to list valuations for DPP and REIT securities on customer account statements under certain circumstances.¹⁵

1. Definitions

The proposal will apply to DPP and REIT securities sold in a public offering. The definitions of DPP and REIT in NASD Rule 2340 will exclude securities listed on a national securities exchange or Nasdaq, as well as securities that are in a depository and settle regular way. NASD Regulation believes that the excluded securities are more likely to trade regularly and, accordingly, that investors will have ready access to current market value information. The definition of DPP in NASD Rule 2340

¹² See File No. SR-NASD-97-12.

¹³ See Securities Exchange Act Release No. 38451 (March 27, 1997), 62 FR 15945.

¹⁴ See Letter from Suzanne E. Rothwell, Chief Counsel, Corporate Financing, NASD Regulation, to Katherine A. England, Assistant Director, Division, Commission, dated March 27, 2000.

¹⁵ Under the proposal, a DPP or DPP security refers to the publicly issued equity security of a DPP as defined in NASD Rule 2810 (including limited liability companies), but does not include securities on deposit in a registered security depository and settled regular way, securities listed on a national securities exchange or The Nasdaq Stock Market ("Nasdaq"), or a program registered as a commodity pool with the Commodity Futures Trading Commission. The proposal defines a REIT or REIT security to include the publicly issued equity securities of a REIT as defined in Section 856 of the Internal Revenue Code, but not REIT equity securities on deposit in a registered securities depository and settled regular way or REIT equity securities listed on a national securities exchange or Nasdaq. See NASD Rules 2340(c)(3) and (c)(4).

also will exclude any program registered as a commodity pool because those programs generally offer investors a security that is redeemable by the issuer at the customer's option at regular intervals and at ascertainable values.

2. Voluntary Estimated Value

NASD Rule 2340(b)(1)(A) allows a general securities member to provide a per share estimated value for a DPP or REIT on an account statement if the member satisfies the conditions of NASD Rules 2340(b)(2) and (b)(3).

3. Mandatory Estimated Value

NASD Rule 2340(b)(1)(B) requires a general securities member to include in a customer's account statement an estimated value of a DPP or REIT from an annual report,¹⁶ an independent valuation service, or any other source if: (1) The annual report of a DPP or REIT held in a customer's account or included on the customer's account statement includes a per share estimated value; and (2) the conditions of NASD Rules 2340(b)(2) and (b)(3) are satisfied. NASD Regulation notes that although the inclusion of the estimated value in the issuer's annual report triggers the member's obligation to provide a valuation on the customer's account statement, the estimated value included on the account statement could be obtained from the annual report, an independent valuation service or another source, *e.g.*, an estimated value generated by the member. The estimated value must be included in the first customer account statement issued after the annual report is available.

4. Reliability of Estimated Values

NASD Rule 2340(b)(2) requires that an estimated value be developed from data that is as of a date no more than 18 months prior to the date that the statement is issued. NASD Regulation believes that the 18-month standard provides sufficient time for the member and for an independent valuation source to develop an estimated value for DPP and REIT securities based on the audited financial statements contained in the Form 10-K of the DPP or REIT. For example, an estimated value based on December 31, 1999, financial statements could be used from January 1, 2000, through June 30, 2001, thereby allowing time between April and June 2001 for a new estimated value to be developed based on the December 31, 2000, financial statements.

¹⁶ NASD Rule 2340(c)(5) defines annual report to mean the most recent annual report of the DPP or REIT distributed to investors pursuant to Section 13(a) of the Act.

NASD Rule 2340(b)(4), as proposed in Amendment No. 1 and revised in Amendment No. 2, prohibits a member from including a per share estimated value for a DPP or REIT security on an account statement if the member can demonstrate that the value was inaccurate as of the date of the valuation or is no longer accurate as a result of a material change in the operations or assets of the program or trust.¹⁷

5. Required Disclosures

NASD Rule 2340(b)(3) requires an account statement that provides an estimated value for a DPP or REIT security to include: (1) a brief description of the estimated value, its source, and the method by which it was developed; and (2) disclosure that DPP or REIT securities are generally illiquid, and that the estimated value may not be realized when the investor seeks to liquidate the security.

NASD Rule 2340(b)(5) requires an account statement that does not provide an estimated value for a DPP or REIT security to include disclosure that: (1) DPP or REIT securities are generally illiquid; (2) the value of the security will be different from its purchase price; and (3) if applicable, that accurate valuation information is not available.

6. NASD Rule 2710 and 2810

NASD Regulation believes that the amendments to NASD Rule 2710, "Corporate Financing Rule—Underwriting Terms and Arrangements," and NASD Rule 2810, "Direct Participation Programs," will help to ensure that DPP general partners or sponsors and REIT trustees provide estimated per share values in their annual reports. NASD Rule 2710(c)(6), as amended, states that, when proposed in connection with the distribution of a public offering of securities, it shall be unfair and unreasonable for a member or associated person to participate in a public offering of REIT securities unless the trustee will disclose in each annual report distributed to investors pursuant to Section 13(a) of the Act a per share estimated value of the trust securities, the method by which it was developed, and the date of the data used to develop the estimated value.

New NASD rule 2810(b)(5) prohibits a member from participating in a public offering of DPP securities unless the general partner or sponsor of the program will disclose in each annual report distributed to investors pursuant to Section 13(a) of the Act a per share estimated value of the DPP securities,

the method by which it was developed, and the date of the data used to develop the estimated value.

D. Amendment Nos. 1 and 2

As discussed more fully below, one commenter, Merrill Lynch, expressed concern that NASD Rule 2340(b)(2)(A) would have required members to make an affirmative determination about the reliability of estimated values provided through an annual report of a DPP or REIT, by an independent valuation service, or through any other source.¹⁸ NASD Regulation responded to concerns raised by Merrill Lynch, and the issues raised by the other commenters, in Amendment No. 1. Among other things, Amendment No. 1 deletes NASD Rule 2340(b)(2)(A) and adopts NASD Rule 2340(b)(4), which stated that, notwithstanding the requirement in NASD Rule 2340(b)(1)(B), a member may refrain from including a per share estimated value for a DPP or REIT security on an account statement if the member can demonstrate that the value was inaccurate as of the date of the valuation or is no longer accurate as a result of a material change in the operations or assets of the program or trust. NASD Regulation also noted that NASD Rule 2340(b)(2)(A) was not intended to impose an obligation on members to guarantee the accuracy of an estimated value obtained from a third-party source.¹⁹

In Amendment No. 2, NASD Regulation revised NASD Rule 2340(b)(4) to prohibit a member from including an estimated per share value for a DPP or REIT security on an account statement if the member can demonstrate that the value was inaccurate as of the date of the valuation or is no longer accurate as a result of a material change in the operations or assets of the program or trust. According to NASD Regulation, the amended rule language is intended to clarify that a member is obligated to refrain from using an estimated per share value on customer account statements if the member can demonstrate that the estimated value is inaccurate.²⁰ NASD Regulation noted that the provision does not relieve a member of its obligation to provide an alternative per share

estimated value when the member's obligation is triggered by NASD Rule 2340(b)(1)(B).²¹

E. Implementation of the Proposed Rule Change

To provide members and their service organizations with sufficient time to modify their computer systems to comply with the proposed rule change, the NASD has requested that the proposed rule change become effective three months after notifying its members of Commission approval of the proposal.²² Following the Commission's approval of the proposal, the NASD will issue a Notice to Members announcing Commission approval of the proposed rule change and the anticipated effective date of the proposal.

III. Comments Received

The Commission received five comment letters from four commenters regarding the proposal.²³ Three commenters supported the proposal but recommended that NASD Regulation revise the proposal to require members to provide valuation information if a general partner makes an 8-K or 10-Q filing subsequent to the release of an annual report.²⁴ Another commenter, Merrill Lynch, expressed concern that proposed NASD Rule 2340(b)(2)(A) would have required a member to make an affirmative determination regarding the reliability of each estimated value provided to a member through an annual report of the DPP or REIT, by an independent valuation service, or by any other source.²⁵

Specifically, Merrill Lynch asserted that NASD Rule 2340(b)(2)(A) would impose an unfair obligation on a member to consider the accuracy of an estimated valuation, even if the member had obtained the estimated value from the DPP or REIT's annual report or from an independent valuation service that the member had retained to provide a valuation. Merrill Lynch recommended that NASD Regulation amend NASD Rule 2340(b)(2)(A) to include a provision from the 1997 Proposal that would prohibit a member from including on an account statement "an estimated value that the member believes is inaccurate as of the date of

²¹ See Amendment No. 2 *supra* note 4.

²² Telephone conversation among Suzanne Rothwell, Chief Counsel, Corporate Financing, NASD Regulation, and Katherine A. England, Assistant Director, Division, Commission, and Yvonne Fraticelli, Special Counsel Division, Commission on November 20, 2000 ("November 20 Conversation").

²³ See note 6, *supra*.

²⁴ See IPA Letter, CNL Letter, and Resourcephoenix.com Letter, *supra* note 6.

²⁵ See Merrill Lynch II, *supra* note 6.

¹⁷ See Amendment Nos. 1 and 2, *supra* notes 3 and 4.

¹⁸ See Merrill Lynch II, *supra* note 6. Proposed NASD Rule 2340 (b)(2)(A) permitted a member to provide a per share estimated value for a DPP or REIT on a customer account statement if "after considering any relevant information about the market and the particular investment in its possession, the member has no reason to believe that the estimated valuation is inaccurate."

¹⁹ See Amendment No. 1 *supra* note 3.

²⁰ See Amendment No. 2 *supra* note 4.

the valuation or is no longer accurate as a result of a material change in the operations or assets of the program or trust.”²⁶ Merrill Lynch believed that the revised language would prohibit a member from providing an estimated valuation that the member believes is inaccurate without imposing an affirmative duty on the member to determine that it has no reason to believe that the estimated value is inaccurate.²⁷

The IPA supported the proposal but expressed concern that some firms might omit valuation information from customer account statements by arguing that an action of an investment program since the date of an annual report, such as a purchase or sale, made the valuation information in the annual report inaccurate.²⁸ To prevent the omission of valuation information under those circumstances, the IPA recommended that the NASD amend the proposal to require members to include on customer account statements any estimated value published by the general partner in an 8-K or 10-Q filing made subsequent to the release of the annual report.²⁹ CNL and Resourcephoenix.com supported the IPA’s position.³⁰

IV. Discussion

The Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities association.³¹ In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 15A(b)(6) of the Act which provides, among other things, that the rules of a national securities association must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.³²

A. Definitions

The Commission finds that the proposed definitions of DPP and REIT in NASD Rule 2340(c) will facilitate compliance with the proposal by clearly

identifying the DPP and REIT securities that are subject to the proposal. As noted above, the proposal will apply to DPP and REIT securities sold in a public offering and will exclude: (1) DPP and REIT securities listed on a national securities exchange or Nasdaq; (2) DPP and REIT securities that are in a depository and settle regular way; and (3) any DPP program registered as a commodity pool. According to NASD Regulation, DPP and REIT securities listed on a national securities exchange or Nasdaq and DPP and REIT securities that are in a depository and settle regular way are more likely to trade regularly and investors should have ready access to current market value information concerning those securities. Similarly, NASD Regulation noted that a DPP program registered as a commodity pool generally offers investors a security that is redeemable by the issuer at the customer’s option at ascertainable values.

The Commission believes that the proposed definitions of DPP and REIT are consistent with the concerns raised in the 1994 Letter regarding the adequacy of ongoing valuation disclosures for non-publicly traded partnership securities. Because the 1994 Letter expressed concern with regard to the availability of valuation information for non-publicly traded partnership securities, the Commission believes that it is reasonable for NASD Regulation to exclude from the proposal those DPPs and REITs for which current valuation information is available.

The Commission believes that the proposal to define an “annual report” as the most recent annual report of the DPP or REIT distributed to investors pursuant to Section 13(a) of the Act is reasonable and will help to clarify the application of the rule.

B. Voluntary Estimated Value

NASD Rule 2340(b)(1)(A) allows a general securities member to provide a per share estimated value for a DPP or REIT on an account statement if the member satisfies the conditions of NASD Rules 2340(b)(2) and (b)(3). The Commission believes that NASD Rule 2340(b)(1)(A) will protect investors and public interest by ensuring that DPP and REIT valuations provided voluntarily in customer account statements are subject to the same requirements and disclosures as the mandatory DPP and REIT valuations required under NASD Rule 2340(b)(1)(B). The Commission believes that it is reasonable to provide identical treatment for DPP and REIT valuations provided voluntarily in customer account statements and for DPP and REIT valuations provided in

customer account statements to comply with the requirements of NASD rule 2340(b)(1)(B).

C. Mandatory Estimated Value

NASD Rule 2340(b)(1)(B) requires a general securities member to include in a customer account statement an estimated value of a DPP or REIT from an annual report, an independent valuation service, or any other source if: (1) The annual report of a DPP or REIT held in a customer’s account or included on the customer’s account statement includes a per share estimated value; and (2) the conditions of NASD Rules 2340(b)(2) and 2340(b)(3) are satisfied. The Commission believes that NASD Rule 2340(b)(1)(B) will protect investors and the public interest by requiring members to provide DPP and REIT valuation information on customer account statements under the circumstances specified in NASD Rule 2340(b)(1)(B). By providing investors with valuation information for their DPP or REIT investments, the Commission believes that NASD Rule 2340(b)(1)(B) will help to address the concerns raised in the 1994 Letter regarding the availability of valuation information for non-traded partnerships.

D. Reliability of Estimated Values

NASD Rule 2340(b)(2) allows a member to include a per share estimated value for a DPP or REIT on an account statement only if the estimated value has been developed from data that is as of a date no more than 18 months prior to the date that the statement is issued. The Commission believes that NASD Rule 2340(b)(2) will help to ensure the reliability of estimated valuations provided on customer account statements by requiring the valuations to be based on relatively recent data. In addition, as NASD Regulation noted in its proposal, the 18-month period should provide a member or an independent valuation source with sufficient time to develop a new valuation based on the audited financial statements provided in a DPP or REIT’s most recent Form 10-K.

In Amendment No. 1 NASD Regulation addressed Merrill Lynch’s concern that proposed NASD Rule 2340(b)(2)(A) would have imposed on broker-dealers an obligation to consider the accuracy of an estimated valuation obtained from an annual report of a DPP or REIT or from an independent valuation service retained by the member to provide a valuation. Specifically, Amendment No. 1 deleted proposed NASD Rule 2340(b)(2)(A) and adopted NASD Rule 2340(b)(4), which, as revised in Amendment No. 2,

²⁶ See Merrill Lynch II, *supra* note 6.

²⁷ See Merrill Lynch II, *supra* note 6.

²⁸ See IPA Letter, *supra* note 6.

²⁹ See IPA Letter, *supra* note 6.

³⁰ See CNL Letter Resourcephoenix.com Letter, *supra* note 6.

³¹ In reviewing this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78o-3(b)(8).

³² 15 U.S.C. 78o-3(b)(6).

prohibits a member from including a per share estimated value for a DPP or REIT security on an account statement if the member can demonstrate that the value was inaccurate as of the date of the valuation or is no longer accurate as a result of a material change in the operations or assets of the program or trust.³³

In Amendment No. 1 NASD Regulation also responded to the concerns of the IPA and other commenters, who believed that a broker-dealer might omit an estimated valuation from an account statement by asserting that a change in an investment program since the date of an annual report made the valuation information in the annual report inaccurate.³⁴ To address this concern, the IPA recommended that NASD Regulation require broker-dealers to include on customer account statements any estimated value published by the general partner or trustee in an 8-K or 10-Q filing subsequent to the release of the annual report.³⁵

In response, NASD Regulation stated that it did not believe that members would be able to rely inappropriately on NASD Rule 2340(b)(4) to omit estimated valuations from customer account statements. In this regard, NASD Regulation noted that once the publication of an estimated value in a DPP or REIT's annual report triggers a broker-dealer's obligation to provide a valuation on a customer account statement, the member must include on the customer account statement either the value published in the annual report, a value obtained from another third-party source, or a value developed by the member.³⁶ Thus, NASD Regulation concluded that a member would be required to develop a valuation to include on a customer account statement if the member determined that the values available from the annual report and third-party sources were inaccurate.³⁷

The Commission believes that NASD Rule 2340(b)(4) will protect investors and the public interest by helping to ensure the reliability of valuation information provided on customer account statements. Specifically, by

³³ See Amendment Nos. 1 and 2, *supra* notes 3 and 4.

³⁴ See IPA Letter, *supra* note 6. See also CNL Letter and Resourcephoenix.com Letter, *supra* note 6.

³⁵ See IPA Letter, *supra* note 6.

³⁶ See Amendment No. 1, *supra* note 3. Similarly, NASD Regulation noted in Amendment No. 2 that NASD Rule 2340(b)(4) does not relieve a member of its obligation to provide an alternative per share estimated value when NASD Rule 2340(b)(1)(B) triggers the member's obligation.

³⁷ See Amendment No. 1, *supra* note 3.

prohibiting a broker-dealer from including a per share estimated value for a DPP or REIT if the broker-dealer can demonstrate that the value was inaccurate as of the date of the valuation or is no longer accurate, NASD Rule 2340(b)(4) will help to prevent the dissemination of inaccurate valuation information.³⁸ In addition, the Commission notes that once an estimated valuation in a DPP or REIT's annual report triggers a member's obligation under NASD Rule 2340(b)(1)(B) to provide a valuation on customer account statements, the member must provide an alternative valuation obtained from a third-party source or developed by the member if the member demonstrates that the valuation provided in the annual report is inaccurate. If the member determines that values available from the annual report and from third-party sources are inaccurate, then the member would be required to develop a valuation to include on customer account statements.³⁹ Accordingly, the Commission believes that members will not be able to use NASD Rule 2340(b)(4) to avoid providing valuation information when a valuation is required under NASD Rule 2340(b)(1)(B).

E. Required Disclosures

NASD Rule 2340(b)(3) requires an account statement that provides an estimated value for a DPP or REIT to include: (1) A brief description of the estimated value, its source, and the method by which it was developed; and (2) disclosure that DPP or REIT securities are generally illiquid and that the estimated value may not be realized when the investor seeks to liquidate the security. The Commission notes that the disclosures required by NASD Rule 2340(b)(3) are consistent with the disclosures discussed in the Division's Limited Partnership Letter.⁴⁰ The Commission believes that a description of the estimated value provided on an account statement, its source, and the method by which it was developed will provide investors with useful information regarding the estimated valuation and may help them to assess the accuracy of the estimated valuation. In addition, the Commission believes that the disclosure that DPP or REIT

³⁸ However, a member is not obligated to confirm the accuracy of an estimated valuation provided in a DPP or REIT's annual report. Conversation between Suzanne Rothwell, Chief Counsel, Corporate Financing, NASD Regulation, and Yvonne Fraticelli, Special Counsel, Division, Commission, on November 9, 2000.

³⁹ See Amendment No. 1, *supra* note 3.

⁴⁰ See note 10, *supra*.

securities are generally illiquid and that the estimated value may not be realized when the investor seeks to liquidate the security will provide investors with an important reminder concerning the market for DPP and REIT securities and the potential for realizing the estimated value of their DPP or REIT upon liquidation of the security.⁴¹

NASD Rule 2340(b)(5) requires an account statement that does not provide an estimated value for a DPP or REIT security an account statement that does not provide an estimated value for a DPP or REIT security to include disclosure that: (1) DPP or REIT securities are generally illiquid; (2) the value of the security will be different from its purchase price; and (3) if applicable, that accurate valuation information is not available. The Commission believes that the disclosure required in NASD Rule 2340(b)(5) will provide investors with important information concerning the market for DPP and REIT securities, the difference between the purchase price and the current value of their security, and the availability of valuation information.

F. NASD rules 2710 and 2810

NASD Regulation proposes to amend NASD rule 2710(c)96) to provide that, when proposed in connection with the distribution of a public offering of securities, it shall be unfair and unreasonable for a member or associated person to participate in a public offering of REIT securities unless the trustee will disclose in each annual report distributed to investors pursuant to Section 13(a) of the Act a per share estimated value of the trust securities, the method by which it was developed, and the date of the data used to develop the estimated value.

NASD Regulation proposes to amend NASD Rule 2810(b) to prohibit a member from participating in a public offering of DPP securities unless the general partner or sponsor of the program will disclose in each annual report distributed to investors pursuant to Section 13(a) of the Act a per share estimated value of the DPP securities, the method by which it was developed, and the date of the data used to develop the estimated value.

The Commission believes that the amendments to NASD Rules 2710 and 2810 will encourage general partners and sponsors of DPPs and REIT trustees to provide estimated per share values in their annual reports, thereby helping to address the concerns raised in the 1994 Letter regarding ongoing disclosures of the values of non-traded partnership

⁴¹ See NASD Rule 2810.

securities. The Commission finds that the proposed amendments to NASD Rules 2710 and 2810 will protect investors and the public interest by helping to ensure that investors in DPPs and REITs that are sold in a public offering receive ongoing valuation information concerning their investments.

G. Implementation of the Proposed Rule Change

The NASD has requested that the proposed rule change become effective three months after the NASD notifies its members of Commission approval of the proposal.⁴² The Commission believes that the proposed period for implementing the proposal will provide NASD members and service organizations with time to modify their computer systems to comply with the proposal, thereby helping to ensure that NASD members are adequately prepared to implement the proposed changes.

H. Accelerated Approval of Amendment Nos. 1 and 2

The Commission finds good cause for approving Amendment Nos. 1 and 2 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 1 clarifies that an NASD member is not obligated to guarantee the accuracy of an estimated value obtained from a third-party source. Amendment No. 2 strengthens the proposal by prohibiting a member from using an estimated valuation on a customer account statement if the member can demonstrate that the value was inaccurate as of the date of the valuation or is no longer accurate. Accordingly, the Commission finds that it is consistent with Sections 15A(b)(5) and 19(b) of the Act to approve Amendment Nos. 1 and 2 on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendments Nos. 1 and 2, including whether Amendment Nos. 1 and 2 are 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, DC 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 in 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-00-13 and should be submitted by December 20, 2000.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁴³ that the proposed rule change (File No. SR-NASD-00-13), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴⁴

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00-30374 Filed 11-28-00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43616; File No. SR-NASD-99-65]

Self-Regulatory Organizations; Notice of Filing of Amendment Nos. 2 and 3 to Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Creation of a Corporate Bond Trade Reporting and Transaction Dissemination Facility and the Elimination of Nasdaq's Fixed Income Pricing System

November 24, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 17, 2000 and November 22, 2000, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") Amendment Nos. 2 and 3 to the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. The proposed rule change was published for comment in the **Federal Register** on December 10, 1999.³ The Commission is publishing this notice to solicit comments on Amendment Nos. 2 and 3

⁴³ 15 U.S.C. 78s(b)(2).

⁴⁴ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 42201 (Dec. 3, 1999), 64 FR 69305.

to the proposed rule change from interested persons.⁴

Amendment No. 2 reflects certain changes proposed by the commenters in response to the proposed rule change, as originally noticed, or changes suggested by the NASD staff after additional review. Amendment No. 3 sets forth the statutory basis of the proposed rule change. For convenience, the proposed NASD Rules in Amendment No. 2 are referred to as the TRACE Rules, in reference to the proposed facility, which is currently referred to as the Trade Reporting and Comparison Entry Service (TRACE).⁵

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NASD proposes the following amendments to the rule text (as originally proposed) in response to comment letters or suggestions by the NASD staff after additional review. Proposed additions are italicized; proposed deletions are in brackets.

* * * * *

6200. Trade Reporting and Comparison Entry Service (TRACE)

6210. Definitions

The terms used in this [paragraph] *Rule 6200 Series* shall have the same meaning as those defined in the Association's By-Laws and Rules unless otherwise specified.

(a) The term ["TRACE eligible Security"] "*TRACE-eligible security*" shall mean all United States dollar denominated debt securities that are registered with the Securities and Exchange Commission and issued by United States and/or foreign private corporations and that are depository eligible securities as defined in Rule 11310(d); all debt securities qualified as PORTAL securities pursuant to *the Rule 5000 Series*; all investment-grade rated debt securities that are issued pursuant to Section 4(2) of the Securities Act of 1933 and that are depository eligible securities pursuant to Rule 11310(d).

⁴ The NASD previously submitted Amendment No. 1 to reflect the Association's receipt of written comments from the Regional Municipal Operations Association. After consultation with the Commission staff, the NASD withdrew Amendment No. 1 and has incorporated RMOA's comments and the NASD's response in Amendment No. 2. As explained in the original proposal, the NASD represents that it will file a separate proposal to establish appropriate fees and charges for TRACE prior to implementation.

⁵ The NASD represents that it will rename TRACE. When a new name is selected, the NASD will amend the TRACE Rules prior to implementation of the service to reflect that name change.

⁴² See November 20 Conversation, *supra* note 22.