

“would not necessarily provide useful information to investors and other market participants or could adversely affect liquidity and be misleading.”¹³ Furthermore, the TBMA believes that trading activity that is limited to a single trade may reflect insufficient market interest to justify dissemination.

III. Discussion

The Commission must approve a proposed MSRB rule change if the Commission finds that the proposal is consistent with the requirements set forth under the Act and the rules and regulations thereunder, which govern the MSRB.¹⁴ The language of Section 15B(b)(2)(C) of the Act requires that the MSRB's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in regulating, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.¹⁵

After careful review, the Commission finds that the MSRB's proposed rule change relating to Rule G-14, on Reports of Sales or Purchases, meets the requisite statutory standard. The Commission believes that this proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder. In addition, the Commission finds that the proposed rule is consistent with the requirements of Section 15B(b)(2)(C) of the Act, as set forth above.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,¹⁶ that the proposed rule change (File No. SR-MSRB-2002-07) be and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46376; File No. SR-NASD-99-04]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Microcap Initiative—Recommendation Rule

August 19, 2002.

I. Introduction

On February 19, 1999, the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change that would require members to review current financial statements of, and current material business information about, an issuer prior to recommending a transaction to a customer in an over-the-counter (“OTC”) equity security.

The proposed rule change was published for comment in the **Federal Register** on March 1, 1999.³ The Commission received six comment letters on the Original Proposal. On January 11, 2002, the NASD filed Amendment No. 1 to the proposed rule change, which among other things addressed the issues raised by commenters.⁴ Amendment No. 1 was published for comment in the **Federal Register** on January 22, 2002.⁵ On July 26, 2002, the NASD filed Amendment No. 2 to the proposed rule change.⁶

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 41075 (February 19, 1999), 64 FR 10037 (“Original Proposal”).

⁴ In the Original Proposal, the NASD proposed subparagraph (e) to NASD Rule 6740. That provision would have permitted a member to submit a certification to the NASD stating that the firm complied with the requirements of SEC Rule 15c2-11, 17 CFR 240.15c2-11, including the member's review obligation, if the documents the firm was required to review were contained in the Commission's Electronic Data Gathering and Retrieval System, in lieu of submitting a copy of the documents reviewed. This proposed rule text was deleted as part of Amendment No. 1, although the change was not reflected in the narrative portion of the Amendment.

⁵ See Securities Exchange Act Release No. 45277 (January 14, 2002), 67 FR 2937.

⁶ See Letter from Marc Menchel, Senior Vice President and General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market

The Commission received no comments regarding the proposal as amended. This order approves the proposed rule change, as amended.

II. Description of Proposal

To respond to concerns about abuses in the trading and sales of thinly traded, thinly capitalized securities (*i.e.*, microcap securities) quoted in the OTC market, NASD Regulation has proposed to amend NASD rules to include new NASD Rule 2315, entitled “Recommendations to Customers in OTC Equity Securities” (“Recommendation Rule” or “Rule”). In the view of NASD Regulation, the lack of reliable and current financial information about issuers of microcap securities can create the potential for fraud and manipulation.

The proposed rule would be limited to equity securities that are published or quoted in a quotation medium and that either: (1) Are not listed on Nasdaq or a national securities exchange, or (2) are listed on a regional securities exchange and do not qualify for dissemination of transaction reports via the Consolidated Tape (“covered securities”).⁷ The requirements in the Recommendation Rule is intended to supplement requirements under the federal securities laws and under NASD rules that a broker-dealer that recommends securities to its customers is required to have a reasonable basis for those recommendations.⁸ In addition, the proposed rule is not intended to act or operate as a presumption or as a safe harbor for purposes of determining suitability or for any other legal

Regulation (“Division”), Commission, dated July 26, 2002 (“Amendment No. 2). In Amendment No. 2, the NASD amended proposed NASD Rule 2315(a) to clarify that members conducting transactions in securities that are listed on a regional securities exchange, but do not qualify for dissemination of transaction reports via the Consolidated Tape, must comply with the review requirements of the Recommendation Rule if such securities are published or quoted in a quotation medium. The NASD also amended NASD Rule 2315(e)(1)(G)(2) to substitute “NASD” for the reference to “the Association” contained in the Rule.

⁷ “Quotation medium” is defined as a system of general circulation to brokers or dealers that regularly disseminates quotations or indications of interest of identified brokers or dealers; or a publication, alternative trading system or other device that is used by brokers or dealers to disseminate quotations or indications of interest to others. The Recommendation Rule is intended to cover equity securities that are published or quoted in a quotation medium and that either: (1) Are not listed on Nasdaq or a national securities exchange, or (2) are listed on a regional securities exchange and do not qualify for dissemination of transaction reports via the Consolidated Tape.

⁸ See NASD Rule 2310 (Suitability Rule), which requires a member to have reasonable grounds for believing that a recommendation to a customer is suitable based on facts disclosed, other security holdings and financial situation and needs.

¹³ See *id.* at page 2.

¹⁴ Additionally, in approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹⁵ 15 U.S.C. 78o-4(b)(2)(C).

¹⁶ 15 U.S.C. 78s(b)(2).

¹⁷ 17 CFR 200.30-3(a)(12).

obligation or requirement imposed under NASD rules or the federal securities laws.

A. Review Requirements

Proposed NASD Rule 2315 would require a member and its associated persons to review the current financial statements of an issuer and current material business information about an issuer prior to recommending the purchase or short sale of any OTC equity security to a customer.⁹ Under the proposed rule, members must designate a person who is registered as a Series 24 principal, or who is supervised by a Series 24 principal, to conduct the required review. The person designated by the member must have the requisite skills, background and knowledge to conduct the review. Members are also required to document the information reviewed, the date of the review, and the name of the person performing the review of the required information.

B. Information To Be Reviewed

As stated above, members must review the "current financial statements" of the issuer, as well as "current material business information" about the issuer, before recommending the purchase or short sale of an OTC security. NASD Regulation has stated that current material business information includes material information that is available or relates to events that have occurred within the last 12 months prior to the recommendation. Under the Recommendation Rule, because of differences in accounting practices, what constitutes "current financial statements" depends on whether the issuer is or is not a foreign private issuer.

1. Issuers That Are Not Foreign Private Issuers

The current financial statements of issuers that are not foreign private issuers that must be reviewed prior to a recommendation to purchase or sell short a covered security are as follows:

- Publicly available financial statements and other financial reports filed during the 12 months preceding the date of the recommendation with the issuer's principal financial or securities regulatory authority in its home jurisdiction;

⁹ The current financial and business information that a broker-dealer must review prior to recommending the purchase or short sale of a covered security is similar to that required by Rule 15c2-11 under the Act for those broker-dealers initiating or resuming quotations for securities covered by that rule. 17 CFR 240.15c2-11.

- All publicly available financial information filed with the Commission during the 12 months preceding the date of the recommendation contained in registration statements or Regulation A filings;

- A balance sheet as of a date less than 15 months before the date of recommendation; and
- A statement of profit and loss for the 12 months preceding the date of the balance sheet.

However, if the balance sheet is not as of a date less than 6 months before the date of the recommendation, the member must review additional statements of profit and loss for the period from the date of the balance sheet to a date less than 6 months before the date of the recommendation.

2. Issuers That Are Foreign Private Issuers

The current financial statements of issuers who are foreign private issuers that must be reviewed prior to a recommendation for purchase or short sale are as follows:

- Publicly available financial statements and other financial reports filed during the 12 months preceding the date of the recommendation and up to the date of the recommendation with the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, bank and insurance regulators;
- A balance sheet as of a date less than 18 months before the date of the recommendation; and
- A statement of profit and loss for the 12 months preceding the date of the balance sheet.

However, if the balance sheet is not as of a date less than 9 months before the date of the recommendation, the member must review additional statements of profit and loss for the period from the date of the balance sheet to a date less than 9 months before the date of the recommendation, if any such statements have been prepared by the issuer.

In addition, if any issuer has not made current filings required by the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, or bank and insurance regulators, the required review must include an inquiry into the circumstances concerning the failure to make current filings, and a determination, based on all the facts and circumstances, that a recommendation is appropriate under the circumstances.

Such a determination must be made in writing and maintained by the member.

C. Exemptions

Under the Recommendation Rule, there are several transactions that are not subject to the Rule. Broker-dealers are not required to comply with the Recommendation Rule when effecting the following transactions:

- Transactions that meet the requirements of Rule 504 of Regulation D of the Securities Act of 1933 ("Securities Act")¹⁰ and transactions by¹¹ an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act;¹²
- Transactions with or for an account that qualifies as an "institutional account" under NASD Rule 3110(c)(4) or with a customer that is a "qualified institutional buyer" under Rule 144A of the Securities Act¹³ or "qualified purchaser" under Section 2(a)(51) of the Investment Company Act of 1940;¹⁴
- Transactions in an issuer's securities if the issuer has at least \$50 million in total assets and \$10 million in shareholder's equity are exempt;
- Transactions in securities of a bank as defined in Section 3(a)(6) of the Act¹⁵ and/or insurance company subject to regulation by a state or federal bank or insurance regulatory authority are exempt;
- Transactions involving securities with a worldwide daily trading volume value of at least \$100,000 during each month of the six full calendar months immediately before the date of the recommendation, and transactions involving any convertible security based on a security meeting this requirement are exempt;¹⁶ and
- Transactions involving securities that have a bid price, as published in a quotation medium, of at least \$50 per share.¹⁷

¹⁰ 17 CFR 230.504.

¹¹ Proposed NASD Rule 2315(e)(1)(A) contained a typographical error. In pertinent part, the Rule should read "transactions by an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act" instead of "transactions with an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act." (Emphasis added.) Telephone conversation between Phil Shaikun, Associate General Counsel, NASD Regulation, and Jennifer Colihan, Special Counsel, Division, Commission, on August 12, 2002.

¹² 15 U.S.C. 77d(2).

¹³ 15 U.S.C. 77(a).

¹⁴ 15 U.S.C. 80a-2(a)(51).

¹⁵ 15 U.S.C. 78c(a)(6).

¹⁶ See Securities Exchange Act Release No. 41110 (February 25, 1999), 64 FR 11124 (March 8, 1999) ("Rule 15c2-11 Reproposing Release"). This exemption is consistent with exemptions contained proposed Rules 15c2-11(h)(6) and (7).

¹⁷ This exemption is consistent with an exemption contained in proposed Rule 15c2-

In addition, under the proposed rule the NASD may, for good cause shown, exempt any person, security or transaction, or any class or classes of person, securities or transactions, either unconditionally or on specified terms, from any or all of the requirements of the Rule if it determines that such exemption is consistent with the purpose of the rule, the protection of investors and the public interest.¹⁸

III. Discussion

For the reasons discussed below, the Commission finds that the proposed rule is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁹ which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

A. Review Requirements

Manipulative and fraudulent schemes often have involved infrequently-traded securities of little-known issuers. Unscrupulous broker-dealers have recommended that customers purchase the securities of unseasoned issuers whose securities do not trade in a listed market, without giving due regard to the fundamentals regarding these issuers. Among the most critical pieces of information that a broker-dealer should have before making a recommendation regarding a security are the financial condition of, and business information about, the issuer, particularly with respect to those issuers whose securities are not listed on a national securities exchange or Nasdaq. Therefore, the Commission finds that the NASD's proposal to require broker-dealers to independently review current financial and business information about these issuers prior to making a recommendation to purchase or sell short covered securities is consistent with the Act, particularly its mandate that the Association's rules be designed to prevent fraudulent and manipulative acts.²⁰

11(h)(8). See Rule 15c2-11 Reproposing Release, *supra* note 16.

¹⁸ As part of this proposed rule change, the NASD has added the Recommendation Rule to NASD Rule 9610, which provides the procedures for requesting exemptive relief from various Association rules.

¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁰ The Recommendation Rule will apply to equity securities that are quoted on the OTCBB, in The Pink Sheets, or in any other system that regularly disseminates indications of interest and quotation information among broker-dealers and those securities either: (1) Are not listed on Nasdaq or a national securities exchange, or (2) are listed on a regional securities exchange and do not qualify for

While the Commission considers the review requirement to be appropriate, it also believes that the requirement is properly tailored to meet the Rule's objectives without over-burdening members. Under the Recommendation Rule, broker-dealers are required to review publicly available current financial statements and material business information. The Commission believes that the Recommendation Rule establishes appropriate parameters regarding what constitutes "current financial information" and "current material business information" that members and their sales personnel must review before making a recommendation as a means to lessen the opportunity for abusive practices when broker-dealers recommend covered securities to investors.

1. Foreign Private Issuers vs. Non-foreign Private Issuers

Further, as detailed above, these definitions also distinguish between information that must be reviewed for issuers that are foreign private issuers and those that are not. The Commission believes that this is an important distinction because the customary accounting periods for foreign issuers are often different from those for domestic issuers. Foreign issuers maybe permitted to report financial information on a semi-annual basis, rather than on a quarterly basis, as is required for domestic issuers. Therefore, the Commission believes that it is appropriate to establish different time parameters regarding when financial information should be considered "current" for foreign private issuers in order to address this difference in accounting practices.

2. Delinquent Issuers

The Commission notes that the Recommendation Rule contains a provision covering the situation when the issuer has not made current filings

dissemination of transaction reports via the Consolidated Tape. See Proposed NASD Rule 2315(a). As part of its application to become a national securities exchange, Nasdaq has filed rules to operate the OTCBB, which is expected to be renamed the Bulletin Board Service ("BBS"). NASD Regulation has advised the Commission that the Recommendation Rule will apply to BBS securities when Nasdaq operates the BBS. The Commission is also aware that Nasdaq intends to develop the OTCBB/BBS into a listed market, which will be called the Bulletin Board Exchange ("BBX"). See NASD-2001-82, pending before the Commission. Securities trading on the BBX would be listed securities, and therefore would not be covered under the current wording of the Recommendation Rule. NASD Regulation has advised the Commission that it will amend the Recommendation Rule at the appropriate time to ensure that securities listed on the BBX are covered by the Rule.

as required by the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, and bank and insurance regulators. In the event the issuer is delinquent with its filings, the Recommendation Rule requires that the member make an inquiry into the circumstances concerning the failure to make current filings and make a determination that a recommendation is appropriate under the circumstances.

The Commission believes that the Rule is appropriately limited in that it does not prohibit recommendations in the event the issuer's filings are delinquent, nor does it require that a member confirm that the issuer is not delinquent in its filings with any regulatory authority prior to making a recommendation. Rather, the Rule requires that a member conduct an inquiry in the event that an issuer has been delinquent in its filings with its principal financial or securities regulatory authority in its home jurisdiction and then determine whether the recommendation is appropriate. The Commission believes that this requirement strikes a proper balance in those cases where the issuer has failed to make current filings.

3. Persons Responsible for Review

The Commission believes that it is appropriate to require that the person responsible for conducting the financial information review be registered as a Series 24 principal or be someone who is supervised by a Series 24 principal, as these individuals are under the jurisdiction of the NASD. Registered Series 24 principals are persons who are associated with a member and are permitted to manage or supervise the member's investment banking or securities business for corporate securities, direct participation programs, and investment company products/variable contracts. Therefore, the Commission believes that this requirement will ensure that financial information is reviewed by individuals who have the proper skills, background and knowledge to conduct a thorough analysis of the information prior to the firm or its associated persons making a recommendation.

B. Exemptions From Recommendation Rule

As indicated above, the Recommendation Rule lists several transactions that are exempt from the Rule and provides the Association with the authority, for good cause, to grant additional exemptions from its provisions. The Commission believes

that these provisions are appropriately tailored to serve the purposes of the Rule so that only those transactions that are more likely to raise risks for retail investors are subject to the Rule, and that those transactions that are less likely to be the subject of fraudulent sales practices are not covered by the Rule.

C. Interaction With Other NASD Rules and Federal Securities Laws

Finally, as noted in the Preliminary Note to the Recommendation Rule, the Commission emphasizes that the requirements of the Rule are in addition to other existing broker-dealer obligations under NASD rules and the federal securities laws, including obligations to determine the suitability of particular securities transactions with customers and to have a reasonable basis for any recommendation made to a customer. The Commission reiterates that the Recommendation Rule is not intended to act or operate as a presumption or as a safe harbor for purposes of determining suitability or for any other legal obligation or requirement imposed under NASD rule or the federal securities laws.

D. Operational Date

The Commission notes that the NASD will announce the operational date of the proposed rule change in a Notice to Members to be published no later than 60 days following the date of approval by the Commission. The operational date will be 30 days following the date of publication of the Notice to Members announcing Commission approval.

IV. Amendment No. 2

The Commission finds good cause for approving Amendment No. 2 prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. In Amendment No. 2, the NASD amended NASD Rule 2315(a) to add a category of equity securities that, pursuant to NASD Rule 6530(b)(2), are eligible for quotation on the OTCBB. This change provides that members conducting transactions in securities that are listed on a regional securities exchange, but do not qualify for dissemination of transaction reports via the Consolidated Tape, must comply with the review requirements of the Recommendation Rule if such securities are published or quoted in a quotation medium.

Because securities that are listed on a regional securities exchange but not eligible for the reporting of transactions to the Consolidated Tape are eligible for quotation on the OTCBB, and thus fall within the category of securities

contemplated to be covered by the Recommendation Rule, the Commission believes that it is appropriate for these securities to be covered by the Recommendation Rule.

In Amendment No. 2, the NASD also amended NASD Rule 2315(e)(1)(G)(2) to substitute "NASD" for the reference to "the Association" contained in the Rule. The Commission believes that this is a technical, non-substantive change to the proposal.

In sum, the Commission finds that the NASD's proposed changes in Amendment No. 2 further strengthen and clarify the proposed rule change and raise no new regulatory issues. Further, the Commission believes that Amendment No. 2 does not significantly alter the original proposal, which was subject to a full notice and comment period. Therefore, the Commission finds that granting accelerated approval to Amendment No. 2 is appropriate and consistent with Section 19(b)(2) of the Act.²¹

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether the proposed amendment is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed amendment that are filed with the Commission, and all written communications relating to the amendment 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 also will be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-99-04 and should be submitted by [insert date 21 days from date of publication].

VI. Conclusion

For all of the aforementioned reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.

²¹ 15 U.S.C. 78s(b)(2).

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²² that the proposed rule change (SR-NASD-99-04), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²³

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46374; File No. SR-NSCC-2002-07]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Revising the Fee Schedule

August 16, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on July 29, 2002, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The proposed rule change will adjust the fees NSCC charges for the Initial Application Information ("APP") of its Insurance Processing Service ("IPS").²

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections A, B,

²² 15 U.S.C. 78s(b)(2).

²³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² The new fee schedule is attached as Exhibit A to NSCC's filing.