

change.<sup>5</sup> The Commission published the amended proposal for comment in the **Federal Register** on March 28, 2003.<sup>6</sup> The Commission received no comments on the proposal. On May 8, 2003, Amex submitted Amendment No. 4 to the proposal.<sup>7</sup> This order approves the proposal rule change, as amended by Amendments No. 1, 2, 3, and 4. The Commission also solicits comment from interested persons on Amendment No. 4.

Three Amex fees would apply to Linkage trades other than satisfaction orders: a per transaction per contract side fee of \$.26; a \$.05 options floor brokerage fee; and a \$.05 options comparison fee. Each of these Linkage-related fees would be implemented as a one-year pilot, expiring on January 31, 2004.

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 exchange<sup>8</sup> and, in particular, the requirements of Section 6 of the Act.<sup>9</sup> The Commission finds that the proposed rule change is consistent with Section 6(b)(4) of the Act,<sup>10</sup> which requires that the rules of an exchange provide equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities. The Commission believes the one-year pilot will give the Exchange and the Commission the opportunity to evaluate whether these fees are appropriate.

The Commission finds good cause, consistent with Section 19(b)(2) of the Act,<sup>11</sup> to approve Amendment No. 4 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission notes that the notice that was published in the **Federal Register**<sup>12</sup> indicated that the Linkage fees were subject to a one-

year pilot and Amendment No. 4 merely specifies the expiration date. Therefore, Amex's proposal for the one-year pilot program to expire on January 31, 2004 was subject to notice and comment. Accordingly, the Commission believes good cause exists, pursuant to Sections 6(b)(5) and 19(b) of the Act<sup>13</sup> to accelerate approval of Amendment No. 4 to the proposed rule change.

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 4, including whether it 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 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 Amex. All submissions should refer to File No. SR-Amex-2003-14 and should be submitted by June 9, 2003.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-Amex-2003-14), as amended, is approved on a pilot basis until January 31, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Jill M. Peterson,**  
*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47820; File No. SR-NASD-00-12]

### Self-Regulatory Organization; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3 and 4 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. Concerning Amendments to Rules Governing Member Communications With the Public

May 9, 2003.

#### I. Introduction

On June 9, 2000, the National Association of Securities Dealers, Inc. ("NASD") and through its subsidiary, NASD Regulation, Inc. ("NASD Regulation"), 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> filed a proposed rule change to amend NASD Rule 2210 and the Interpretive Materials thereunder, promulgate new NASD Rule 2211, and renumber existing NASD Rule 2211.<sup>3</sup> On August 8, 2001, NASD Regulation filed Amendment No. 1 to the proposed rule change. On December 12, 2001, NASD Regulation filed Amendment No. 2 to the proposed rule change. The proposed rule change, as amended, was published for comment in the **Federal Register** on December 31, 2001.<sup>4</sup> The Commission received ten comment letters on the proposed rule change.<sup>5</sup>

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

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

<sup>3</sup> The NASD originally submitted the proposed rule change to the Commission on March 21, 2000, however, because the submission did not comply with the requirements of Exchange Act Rule 19b-4, the Commission does not consider the proposed rule change filed on the date. Rather, the Commission considers the proposed rule change to be filed on June 9, 2000, the date on which the deficiencies were corrected.

<sup>4</sup> See Securities Exchange Act Release No. 45181 (December 20, 2001), 66 FR 67586.

<sup>5</sup> See letters from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Commission, dated February 13, 2002 ("ICI Letter"); Christopher R. Franke, Chairman, Self-Regulatory and Supervisory Practices Committee, Securities Industry Association, to Jonathan G. Katz, Secretary, Commission, dated February 14, 2002 ("SIA Letter"); James R. Anderson, Vice President and Chief Compliance Officer, AIM Distributors, Inc. to Jonathan G. Katz, Secretary, Commission, dated February 13, 2002 ("AIM Letter"); James Anderson, Vice President and Chief Compliance Officer, Fund Management Company, to Jonathan G. Katz, Secretary, Commission, dated February 13, 2002 ("FMC Letter"); Michel de Konkoly Thege, Vice President and Associate General Counsel, The Bond Market Association, to Jonathan G. Katz, Secretary, Commission, dated February 15, 2002 ("BMA Letter"); Brandon Becker, Wilmer, Cutler &

<sup>5</sup> See letter from Jeffrey P. Burns, Assistant General Counsel, Amex, to Jennifer Lewis, Attorney, Division, Commission, dated March 20, 2003 ("Amendment No. 3").

<sup>6</sup> See Securities Exchange Act Release No. 47562 (March 21, 2003), 68 FR 15250.

<sup>7</sup> See letter from Jeffrey P. Burns, Assistant General Counsel, Amex, to Jennifer Lewis, Attorney, Division, Commission, dated May 8, 2003 ("Amendment No. 4"). In Amendment No. 4, Amex proposes to amend its fee schedule to clarify that the one-year pilot program for Linkage fees expires on January 31, 2004.

<sup>8</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78f.

<sup>10</sup> 15 U.S.C. 78f(b)(4).

<sup>11</sup> 15 U.S.C. 78s(b)(2).

<sup>12</sup> See *supra* note 6.

<sup>13</sup> 13 U.S.C. 78f(b)(5) and 15 U.S.C. 78s(b).

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> CFR 200.30-3(a)(12).

On November 6, 2002, NASD Regulation filed Amendment No. 3 to the proposed rule change.<sup>6</sup> On March 6, 2003, NASD Regulation filed Amendment No. 4 to the proposed rule change.<sup>7</sup> This notice and order approves the proposed rule change, as amended, and solicits comments from interested persons on Amendment Nos. 3 and 4.

## II. Description of Proposed Rule Change

### A. Summary

The NASD submitted the proposed rule change to modernize and clarify the rules governing member communications with the public. Among other things, the proposed rule change would exclude all communications to institutional investors from member pre-use approval and NASD filing requirements and from many of the content standards. Form letters and group e-mail to existing retail customers and fewer than 25 prospective retail customers also would be eligible for these exclusions, provided that a member developed appropriate policies and procedures to supervise and review such communications. In addition, the proposed rule change would exclude independently prepared reprints, and excerpts there from, from the filing and many of the content standards, and would exclude certain press releases from the filing requirements. The proposed rule change generally would simplify the content standards applicable to member communications.<sup>8</sup>

Pickering, to Jonathan G. Katz, Secretary, Commission, dated February 25, 2002 ("Wilmer-Becker Letter"); Forrest Fost, Associate Legal Counsel and Danielle Nicholson Smith, Senior Legal Analyst, T. Rowe Price Associates, Inc., to Jonathan G. Katz, Secretary, Commission, dated February 14, 2002 ("T. Rowe Letter"); Yoon-Young Lee, Wilmer, Cutler & Pickering, to Jonathan G. Katz, Secretary, Commission, dated February 13, 2002 ("Wilmer-Lee Letter"); Alexander C. Gavis, Associate General Counsel, Fidelity Investments, to Jonathan G. Katz, Secretary, Commission, dated February 15, 2002 ("Fidelity Letter"); Sullivan & Cromwell, to Jonathan G. Katz, Secretary, Commission, dated February 22, 2002 ("Sullivan Letter").

<sup>6</sup> See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated November 4, 2002 ("Amendment No. 3").

<sup>7</sup> See letter from Philip Shaikun, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated March 6, 2003 ("Amendment No. 4").

<sup>8</sup> NASD member broker/dealers that are dually registered as investment advisers will remain subject to the advertising standards of the Investment Advisers Act of 1940 and Commission rules thereunder, to the extent that their sales material promotes advisory products or services.

### B. Description of Proposed Rule Change

#### 1. Reorganization of Rule 2210

The proposed rule change would create new NASD Rule 2211, which would apply to institutional sales material and correspondence. The proposed rule change also would provide cross-references between NASD Rule 2210 and NASD Rule 2211 in appropriate places. Existing NASD Rule 2211, concerning telemarketing, would be renumbered as NASD Rule 2212.

#### 2. Definition of "Public Appearance"

Existing NASD Rule 2210(d)(1)(C) provides that NASD members who engage in public appearances or speaking activities must follow the content standards of NASD Rules 2210(d) and (f). Consequently, public appearances already are subject to strict content requirements. The proposed rule change would clarify the application of NASD Rule 2210 to public appearances by defining "public appearance" as a type of communication with the public. Public appearances would include participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity.

#### 3. Institutional Sales Material

The proposed rule change would eliminate the pre-use approval and filing requirements applicable to communications that are distributed or made available only to institutional investors contained in NASD Rule 2210. Institutional sales material would be subject to new supervision and review requirements that are modeled on those in NASD Rule 3010, which apply to correspondence. Moreover, institutional sales material would continue to be subject to the record-keeping requirements and some, but not all, of the content standards in NASD Rule 2210.<sup>9</sup>

Under the proposed rule change, no member could treat a communication as having been distributed to an institutional investor if the member had reason to believe that the communication or any excerpt thereof would be forwarded or made available to any person other than an institutional

<sup>9</sup> The proposed rule change would revise the content standards to specifically indicate which type of communication is subject to each standard. Therefore, standards that apply only to "advertisements" or "sales literature" would not apply to institutional sales material. For example, the ranking guidelines in proposed IM-2210-3 would apply only to advertisements and sales literature and therefore would not apply to institutional sales material.

investor. For example, if a member had reason to believe that such a communication would be forwarded or made available to 401(k) plan participants or other beneficiaries of institutional accounts, it would be treated as retail sales material. NASD Regulation believes that plan participants and other beneficiaries of institutional accounts should receive the same protections under the advertising rules as other retail investors. Similarly, an advertisement in a publication designed for broker/dealers or other institutional investors may not be treated as institutional sales material if the member has reason to believe that the publication will be made available to any person other than an institutional investor.

The proposed rule change amended the definition of "institutional investor," first, to include governmental entities and their subdivisions. Second, the definition was amended to include employee benefit plans that meet the requirements of section 403(b) or section 457 of the Internal Revenue Code and have at least 100 participants.<sup>10</sup> Third, the definition was amended to apply to qualified plans with at least 100 participants.<sup>11</sup> Fourth, the proposed rule change would define "institutional investor" to include any person acting solely on behalf of any institutional investor. Fifth, NASD Regulation clarified that the term "institutional investor" includes only associated persons who are registered with an NASD member.<sup>12</sup> Sixth, the definition would clarify that no member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any person other than an institutional investor. Thus, for example, if a member has reason to believe the employer sponsor of a retirement plan will make sales material available for inspection by the plan participants, then the member may not treat the sales material as having been distributed only to an institutional investor.

<sup>10</sup> This category of institutional investor does not include participants of such plans.

<sup>11</sup> Again, this category of institutional investor does not include participants of such plans.

<sup>12</sup> The "broker/dealer-only" exception, which would become a part of the institutional investor definition, recognizes the special expertise that NASD members have with respect to brokerage products and services. While registered persons should have this expertise, as demonstrated by their completion of the qualifications process, there can be no assurance that other associated persons would.

The definition of "institutional investor" would include persons described in NASD Rule 3110(c)(4), which defines "institutional account" to include any entity with total assets of at least \$50 million.

#### 4. Form Letters and Group Electronic Mail

NASD Rule 2210 currently treats any letter or e-mail sent to more than one person as "sales literature" subject to the content standards applicable to all other sales literature, and to the member pre-use approval and NASD filing requirements. The proposed rule change would define "correspondence" to include form letters and group e-mail sent to existing retail customers and to fewer than 25 prospective retail customers within any 30 calendar-day period ("Group Correspondence"), as well as written and electronic communications prepared for delivery to a single retail customer. The proposed rule change would subject Group Correspondence to the strict supervisory procedures in NASD Rule 3010(d), which governs the approval and review of correspondence, and to those content standards that apply to correspondence.<sup>13</sup> Form letters and group e-mail sent to 25 or more prospective retail customers within any 30 calendar-day period would be subject to the pre-use approval, filing, and record-keeping requirements of NASD Rule 2210, and to all of the content standards applicable to sales literature.<sup>14</sup>

In order to ensure that its review of Group Correspondence meets these

<sup>13</sup> Notice to Members 98-11 provides guidance to members concerning NASD Rule 3010(d). The Notice makes clear that, at a minimum, a member must develop procedures for the review of some of each registered representative's correspondence with the public relating to the member's investment banking or securities business, tailored to its structure and the nature and size of its business and customers.

The Notice provides that members must:

- Specify in writing the firm's policies and procedures for reviewing different types of correspondence;
- Identify what types of correspondence will be pre- or post-reviewed by a registered principal; and
- Periodically re-evaluate the effectiveness of the firm's procedures for reviewing public correspondence and consider any necessary revisions.

<sup>14</sup> The proposed rule change would permit members to treat form letters or group e-mail sent to a combination of existing customers and fewer than 25 prospective retail customers within any 30 calendar-day period as correspondence.

Of course, members could not "sanitize" sales literature by enclosing it with Group Correspondence. For example, an item that a member has distributed as sales literature would remain sales literature for purposes of Rule 2210 when the member encloses it in Group Correspondence.

standards, a member would be expected to review its procedures to ensure that they adequately address potential concerns with the distribution of Group Correspondence. The NASD encourages members to consider whether to adopt stricter procedures that require registered principal pre-use approval of Group Correspondence that presents a higher risk to investors, based on factors such as its content, purposes or targeted audience.

"Existing retail customer" would be defined as any person, other than an institutional investor, for whom the member or a clearing broker or dealer on behalf of the member carries an account, or who has an account with any registered investment company for which a member serves as principal underwriter. The new language would make clear that a person who has opened an account with an investment company or with a transfer agent for such an investment company could qualify as an existing retail customer. NASD also has amended the language to make it more consistent with existing NASD Rule 2211(d).

#### 5. Article Reprints

NASD Rule 2210 currently defines "sales literature" to include "reprints or excerpts of any \* \* \* published article." Article reprints may have to be filed with the Department, depending upon their content, such as whether they pertain to registered investment companies. The proposed rule change would define a new type of communication with the public, an "independently prepared reprint," and exclude independently prepared reprints from the filing and most of the content standards. An independently prepared reprint would consist of any article reprint that meets certain standards that are designed to ensure that the reprint was issued by an independent publisher and was not materially altered by the member. The proposed rule change would provide that a member may alter the contents of an independently prepared reprint in a manner necessary to make it consistent with applicable regulatory standards or to correct factual errors.

An article reprint would qualify as an "independently prepared reprint" under Rule 2210(a)(6)(A) only if, among other things, its publisher is not an affiliate of the member using the reprint or any underwriter or issuer of the security mentioned in the reprint or excerpt that the member is promoting. For purposes of this provision, "affiliate" has the same meaning as that term is defined in NASD Rule 2720(b)(1)(A) and (B). The term "affiliate" as used in NASD Rule

2210(a)(6)(B) (regarding investment company research reports) also has this meaning.

Some, but not all, content standards would apply to independently prepared reprints. For example, NASD Rule 2210(d)(1) would impose various content standards on all communications with the public, including independently prepared reprints. However, paragraph (d)(1)(D) (concerning predictions and projections of performance) would not apply to a statement in an independently prepared reprint that represents the author's opinion about the prospects for a member's business, products or services.<sup>15</sup>

The proposed rule change also would include certain investment company research reports within the definition of independently prepared reprints. NASD Rule 2210 was amended to exclude these research reports from the filing requirements.<sup>16</sup> Because these research reports present essentially the same issues as independently prepared reprints, the proposed rule change would subject these research reports to the same content and other requirements that apply to independently prepared reprints.

Independently prepared reprints would continue to be subject to the pre-use approval and record-keeping requirements of NASD Rule 2210. Moreover, article reprints and research reports that do not meet the definition of "independently prepared reprint" would continue to constitute sales literature that would have to meet all of the requirements applicable to sales literature.

#### 6. Press Releases

NASD Rule 2210 defines "sales literature" to include "any written or electronic communication distributed or made generally available to customers or the public," which the Department has interpreted to include press releases. The proposed rule change would codify this interpretation by amending the definition of "sales literature" to include press releases concerning a member's product or service. The proposed rule change would exclude from the filing requirements press releases that are made available only to members of the media.<sup>17</sup>

<sup>15</sup> Nevertheless, a projection made in the reprint by a person other than the author, such as a mutual fund's portfolio manager or an associated person of a member, would be subject to paragraph (d)(1)(D).

<sup>16</sup> See Securities Exchange Act Release No. 42340 (January 13, 2000), 65 FR 3510 (January 21, 2000).

<sup>17</sup> The proposed rule change would exclude all press releases made available only to members of

## 7. Television and Video Advertisements

The proposed rule change would require members that have filed a draft version or "story board" of a television or video advertisement pursuant to a filing requirement also to file the final filmed version within ten business days of first use or broadcast. This rule change would codify an existing Department policy regarding television and video sales material. NASD Rule 2210 would impose a filing fee only when the draft version or story board is filed. No additional fee would be assessed when the final filmed version is filed.

## 8. Approval and Record-keeping

The proposed rule change would make three additional modifications to the pre-use approval and record-keeping requirements. First, it would clarify that the pre-use approval requirement could be met with respect to a research report concerning any debt or equity security, including non-corporate securities, by signature or initial of a supervisory analyst under New York Stock Exchange Rule 344. Second, the proposed rule change would clarify that members must maintain a file with the name of the registered principal who approved any advertisement or sales literature. Members would not be required to maintain a file with the name of the person who prepared those items, however.<sup>18</sup> Third, the proposed rule change would clarify that members must maintain a file with information concerning the source, but not necessarily the data, of any statistical table, chart, graph or other illustration.

## 9. Filing Requirements

The proposed rule change would retain the existing provision concerning the obligation of a member that has not filed an advertisement with the Department, to pre-file its advertisements for a one-year period.

The proposed rule change also would clarify that advertisements and sales literature for continuously offered closed-end funds must be filed with the Department. This clarification codifies a long-standing position of the Department.<sup>19</sup>

The proposed rule change would clarify that members need not file advertisements and sales literature that previously have been filed and that are

the media, without limiting the exclusion to press releases concerning investment companies.

<sup>18</sup> Proposed NASD Rule 2211 would require members to maintain all institutional sales material in a file that includes the name of the person who prepared each item.

<sup>19</sup> See, e.g., NASD Regulatory and Compliance Alert (April 1995) at p. 9.

to be used without material change.

This provision would codify existing practice, which excludes from the filing requirement material that has been filed previously, but in which performance data is updated or there are other changes that are not material for purpose of the filing requirement.

The proposed rule change would specifically list institutional sales material as one type of communication that need not be filed. The proposed rule change also would list correspondence, independently prepared reprints, and certain press releases as other types of communications that need not be filed. In addition, the proposed rule change would state that when these items concern investment companies, then they will be deemed filed with the NASD for purposes of section 24(b) of the Investment Companies Act of 1940 and Rule 24b-3 thereunder. This provision would eliminate the need to file this material with the SEC.

The proposed rule change also would exclude from the filing requirement announcements as a matter of record that a member has participated in a private placement.

Members are not required to file shareholder reports that only consist of statistical reporting information such as financial statements and portfolio holdings. However, members must file the management's discussion of fund performance ("MDFP") portion of a report (as well as any supplemental sales material attached to or distributed with the report) with the Department.

## 10. Standards Applicable to Member Communications

The proposed rule change would substantially shorten and simplify the standards applicable to communications with the public that are contained in NASD Rule 2210(d). The proposed rule change would relocate certain standards from NASD Rule 2210(d) to a new Interpretive Material 2210-1, Guidelines to Ensure that Communications Are Not Misleading.<sup>20</sup> New proposed IM-2210-1 would make clear that members have the primary responsibility to ensure that their communications with the public are not misleading, and would rewrite many standards to make them more clear and consistent with the principles of plain English.

Proposed IM-2210-1 would not contain certain of the specific standards currently in NASD Rule 2210. The proposed rule change would eliminate

<sup>20</sup> The current IM-2210-1 concerning collateralized mortgage obligations would be redesignated as IM-2210-7.

the specific standards regarding non-existent or self-conferred degrees or designations, offers of free service, claims for research facilities, hedge clauses, recruiting advertising, and periodic investment plans. To the extent that these provisions prohibit statements that are misleading, unbalanced, or inaccurate regarding particular types of communications, the rule already prohibits the use of such statements. Moreover, certain required disclosures, such as those currently applicable to statements concerning periodic investment plans, may not be necessary depending upon the context in which they are made.

The proposed rule change also would clarify which guidelines concerning references to tax free or tax exempt income apply to all communications with the public, and which guidelines apply only to advertisements or sales literature.

## 11. Legends and Footnotes

NASD Rule 2210 cautions members concerning the placement of footnotes, and in the filing review process the Department has insisted that members adopt an appropriate use of footnotes. The proposed rule change would provide that information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication. Thus, for example, footnotes in especially small type in an advertisement might be deemed to inhibit an investor's understanding of the advertisement. Similarly, an advertisement that presents bold claims that are supposedly "balanced" only with footnote disclosure might not comply with this content standard.

## 12. Hypothetical Illustrations

In proposed NASD Rule 2210(d)(1)(D), NASD Regulation would insert language similar to the existing language. Under the proposed rule change, a member could present a hypothetical illustration of mathematical principles, provided that the illustration does not predict or project the performance of an investment or investment strategy and is not used in such a manner. The proposed rule change thus would permit the use of mutual fund cost calculators and other hypothetical illustrations that are permitted by existing NASD Rule 2210.

## 13. Testimonials

The proposed rule change would apply testimonial standards to advertisements or sales literature concerning the investment advice or

investment performance of a member or its products.

#### 14. Recommendations

The proposed rule change would clarify certain aspects of the existing standards governing recommendations in order to provide investors with adequate disclosure about the financial interests that research analysts, other associated persons, or their firms may have in securities that they recommend.

#### 15. Use and Disclosure of a Member's Name

The proposed rule change would simplify the provisions concerning disclosure of member names. In addition, the proposed rule change would make clear that the requirement to disclose the member's name applies to advertisements, sales literature, and correspondence, which for purposes of this provision would include business cards and letterhead.<sup>21</sup> The provision would clarify that the advertisement, sales literature or correspondence must "reflect" (rather than disclose) any relationship between the member and the other named person and the products and services offered by the member.

#### 16. Ranking Guidelines

The proposed rule change would modify the ranking guidelines in several respects. First, the proposed rule change would make clear that no advertisement, item of sales literature or correspondence may present a ranking other than rankings: (1) Created and published by a Ranking Entity, which the ranking guidelines define to include certain independent entities; or (2) created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.<sup>22</sup> Second, the proposed rule change would make clear that the ranking guidelines in IM-2210-3 apply only to advertisements and sales literature.

Third, the proposed rule change would permit the use of investment company family rankings even in sales material that advertises only one investment company in the family. The proposed rule change would permit the presentation of investment company family rankings, provided that when a particular investment company is being advertised, the individual rankings for that investment company also must be presented. The definition of

<sup>21</sup> The requirement thus would not apply to institutional sales material.

<sup>22</sup> The application of this limitation to correspondence would appear in new NASD Rule 2211(d)(3) rather than in IM-2210-3.

"investment company family" is substantially similar to the definition of "group of investment companies" in section 12(d)(1)(G) of the Investment Company Act of 1940. Use of an investment company family ranking would have to comply with the other applicable requirements of NASD Rule 2210. The proposed rule change would retain existing language concerning the required ranking periods.

The proposed rule change also would eliminate the requirement that certain disclosures appear in "close proximity" to any headline or other prominent statement that refers to a ranking. The NASD has represented that the subjective nature of this requirement has complicated the Department's administration of the ranking guidelines without providing meaningful additional protection to investors. The proposed rule change would eliminate certain disclosure requirements applicable to investment company rankings that are based on subcategories of funds or categories created by an investment company or its affiliate.

#### 17. Limitations on Use of the Association's Name

The proposed rule change would simplify and shorten the requirements in IM-2210-4 concerning the use of the NASD's name. The proposed rule change also would delete current NASD Rule 2210(d)(2)(f) concerning references to regulatory organizations.

#### 18. Communications About Collateralized Mortgage Obligations

The proposed rule change would rewrite existing IM-2210-1 (the CMO Guidelines), which governs communications about collateralized mortgage obligations ("CMOs") and renumber it as IM-2210-7. The current CMO Guidelines may give the impression that different standards apply to educational material, advertisements and "communications." The proposed rule change would simplify, shorten and reorganize the CMO Guidelines to provide a more straightforward and uniform list of disclosure requirements.

The content standards of NASD Rule 2210, in their current form and as they would be amended, prohibit a member from making these statements in any communication with the public. The proposed rule change would make clear that paragraphs (b)(1) and (c) apply only to advertisements, sales literature and correspondence. Also, the proposed rule change would clarify that paragraph (b)(2) does not apply to the sale of a CMO to an institutional investor.

### III. Summary of Comments

The Commission received ten comment letters in response to the proposed rule change as modified by Amendment Nos. 1 and 2 addressing a broad range of issues.<sup>23</sup>

#### A. Proposed Definition of "Institutional Investor"

AIM, FMC, BMA, Fidelity, ICI, T. Rowe and Wilmer-Lee all commented that NASD should broaden the scope of its proposed definition of "institutional investor." These commenters recommended that NASD lower the asset dollar threshold of the "catch-all" category of institutional investors under NASD Rule 3110(c)(4)(C) from \$50 million to either \$10 million or \$5 million. Commenters cited the definition of "accredited investor" in SEC Regulation D under the Securities Act of 1933 in support of a \$5 million threshold. Two commenters also cited NASD IM-2310-3 in support of lowering the threshold to \$10 million, which indicates that an investor that has at least \$10 million invested in securities may be considered an institutional investor for purposes of NASD's suitability rule.<sup>24</sup>

In responding to these comments, the NASD noted that it received similar comments when it first published its Advertising Modernization proposal for comment in September 1999.<sup>25</sup> At that time, the NASD concluded that the \$50 million threshold is appropriate, particularly in light of the importance of the principal approval and filing requirements. In addition, it had previously accommodated concerns that the definition was too narrow by expanding it to include governmental entities and qualified plans with at least 100 participants. Accordingly, the NASD believes that the \$50 million threshold is appropriate.

AIM, Fidelity, and the ICI commented that the definition should include employee benefit plans that meet the requirements of sections 403(b) or 457 of the Internal Revenue Code, in addition to "qualified plans," as defined in section 3(a)(12)(C) of the Exchange Act,<sup>26</sup> that have at least 100 participants.<sup>27</sup> Fidelity also noted that the definition should refer to

<sup>23</sup> See *supra* note 5.

<sup>24</sup> See Wilmer-Lee Letter and BMA Letter.

<sup>25</sup> See Notice to Members 99-79 (September 1999).

<sup>26</sup> 15 U.S.C. 78c(a)(12)(C).

<sup>27</sup> Fidelity also commented that the requirement for a qualified plan to have 100 participants should be eliminated. The NASD disagreed with this comment, stating that it believes that small employee benefit plans may lack the sophistication to qualify as institutional investors.

“participants” rather than “beneficiaries.” The NASD agreed and amended the proposed rule change accordingly.

BMA and Wilmer-Lee objected to the limitation that a member may not treat sales material as institutional sales material if the member has “reason to believe” that the material will be forwarded to retail investors. BMA argued that as long as institutional sales material includes a disclosure that it is limited to institutional investors, that should be sufficient. Wilmer-Lee argued that the standard should be changed to whether a member “knowingly permits” the forwarding of institutional sales material to retail investors. Wilmer-Lee also argued that as long as material includes appropriate disclosure, members should be able to rely on the institutional sales material exceptions. The NASD disagreed with these comments because the proposed changes would not ensure that institutional sales material is kept out of the hands of retail investors, and declined to make the changes recommended.

BMA and Wilmer-Lee also requested that NASD include a “reasonable belief” safe harbor for members relying on the institutional sales material exceptions. In other words, members could treat sales material as institutional sales material as long as they reasonably believed the material is only being distributed to institutional investors. The NASD also disagreed with this comment. The NASD stated that while it recognizes that members may occasionally distribute institutional sales material to retail investors by accident, it expects members to make every effort ensure that institutional sales material does not go to retail investors.

Wilmer-Lee also commented that the definition of “institutional investor” should not include NASD members and their associated persons since broker/dealer-only communications are not covered by NASD Rule 2210. Fidelity had a similar comment. The NASD disagreed with this contention noting that while NASD Rule 2210 excepts internal-use only materials from its filing requirements,<sup>28</sup> the NASD has long taken the position that broker/dealer-only materials must meet the rule’s content requirements.<sup>29</sup>

#### *B. Proposed Definition of “Existing Retail Customer”*

The proposed rule change would define “correspondence” to include any written letter or electronic mail message distributed by the member to one or more existing retail customers. As correspondence, these communications would not be subject to NASD Rule 2210’s filing and principal approval requirements. The ICI requested that the NASD “clarify” that the definition of “existing retail customer” includes existing customers of affiliates of NASD members and participants of employee retirement plans. The NASD disagreed with these comments explaining that often there is no nexus between a customer of an affiliate (such as a bank or credit card company) and a member broker/dealer that merits exempting communications with these customers from the filing and principal approval requirements. This exemption is intended to cover routine administrative communications with current brokerage customers.

Further, the NASD noted that retirement plan participants often change regularly as individuals take new jobs with or leave the employment of the employer plan sponsor. Thus, these new employees are new to the products and services of a broker/dealer that services the plan. The NASD believes that these participants should receive the same level of investor protection as any other prospective retail customer.

#### *C. Definitions of “Advertisement,” “Sales Literature,” and “Correspondence”*

Sullivan, T. Rowe and Wilmer-Lee had a number of comments on the definitions of “advertisement,” “sales literature” and “correspondence.” Sullivan recommended that the NASD clarify that the term “advertisement” does not include sales literature and that “public appearances” are excluded from the definitions of “advertisement” and “sales literature.” The NASD responded to this comment by stating that while it believes that these concepts should be self-evident, it will provide this clarification in the Notice to Members announcing Commission approval of the proposal to the extent necessary.

Sullivan and Wilmer-Lee also recommended that the NASD clarify that password-protected Web sites of members are sales literature rather than advertisements. Sullivan also commented that the current definition of “advertisement” does not reflect the latest technologies, such as CDs or

DVDs, and recommended that the NASD broaden the definition to include these media. The NASD responded that it recognized that the definitions of “advertisement” and “sales literature” do not list all technologies through which sales material may be delivered, and it does not believe that it is useful to attempt to do so through rule language, especially given how quickly these technologies change. The NASD explained that it has already announced its position with regard to password-protected Web sites,<sup>30</sup> and it believes it is best to address these issues going forward through interpretations rather than rule language.

Sullivan also recommended that the NASD exclude various communications from the definitions of “advertisement” and “sales literature” based upon the content of the communication, such as material not related to the member’s products or services, customer-generated material, and governmental material. In response to this comment, the NASD explained that it defined these terms based on the communication medium rather than content. The NASD believes that any attempt to define these terms based on content would raise numerous interpretive issues as to the purpose of a communication, which is secondary to whether a communication is fair and balanced. Accordingly, the NASD stated that it believed that it would not be appropriate or productive to attempt to draft such content-based definitions.

T. Rowe commented that the definition of “advertisement” should be revised from “material published, or *designed for use* in, any electronic or other public media \* \* \*” to “*used* in any electronic or other public media \* \* \*” (emphasis added). T. Rowe pointed out that sales material could be “designed for use” but the member never actually uses it with the public. The NASD amended the proposed rule change in response to this comment.

Proposed NASD Rule 2211(a)(1) would define “correspondence” as any written letter or electronic mail message distributed to one or more existing retail customers and fewer than 25 prospective retail customers within any 30-day period. Wilmer-Lee requested that “correspondence” be defined as “communications with prospective retail customers for marketing purposes.” The NASD declined to adopt this definition for several reasons. First, the NASD noted that correspondence also includes communications with

<sup>28</sup> See NASD Rule 2210(c)(7)(D).

<sup>29</sup> See, e.g., NASD Regulatory and Compliance Alert, “Ask the Analyst” (September 1998); NASD Regulatory and Compliance Alert, “Ask the Analyst” (July 1996).

<sup>30</sup> See “Internet Guide for Registered Representatives,” which can be found on the NASD Web site (<http://www.nasdr.4040b.htm>).

existing retail customers. Second, the NASD explained that it does not intend this term to be limited to marketing related communications. Third, the NASD explained that the definition would encompass virtually all sales material.

Sullivan inquired whether the fact that a member sent a mail message to 25 or more prospective retail customers during the course of a 30-day period causes the first 24 messages to become sales literature retroactively. The NASD acknowledged that this situation may arise; however, it stated that it would expect members to know in advance whether they intend to send a mail message to more than 25 prospective retail customers within 30 days, and if this possibility is likely, the member would be expected to obtain principal approval of the message before it is distributed, and file it as required. The NASD stated that it intends to deal with these situations on a case-by-case basis.

#### D. Article Reprints

The proposed rule change would exempt "independently prepared reprints" from NASD Rule 2210's filing requirements. The proposed rule change defines "independently prepared reprint" in part as a reprint or excerpt of any article, provided that "the publisher is not an affiliate of the member using the reprint or any underwriter or issuer of a security mentioned in the reprint." ICI and T. Rowe argued that this requirement is too broad, since a publisher could be affiliated with a security mentioned in an article without compromising its independence. They suggest only that the publisher should not be affiliated with the member. ICI also requested clarification that the requirements apply to any article *or excerpt*. T. Rowe requested that the requirement that the member using the reprint not materially alter its contents except as necessary to make it consistent with regulatory requirements be modified to allow removing information about investment companies not offered by the member.

The NASD acknowledged the concern regarding affiliates, but believes that the deletion proposed by the commenters is too narrow. The NASD noted, for example, an article published by an affiliate of a third-party mutual fund being sold by the member would qualify as "independent" under the proposed test. Therefore, the NASD revised the rule language to indicate that the publisher may not be affiliated with either the member or any underwriter or issuer of a security mentioned in the reprint that the member is promoting. The NASD clarified that the

requirements apply to article excerpts as well as full articles. As for the request to allow removal of information from articles about non-offered investment companies, the NASD stated that it believes that these issues are best addressed on a case-by-case basis.

Wilmer-Lee requested clarification that article reprints that would otherwise constitute correspondence (such as reprints sent to existing retail customers) or institutional sales literature do not require principal approval or filing, even if they do not meet the definition of an "independently prepared reprint." The NASD explained that an article reprint that is sent to existing retail customers may not qualify as correspondence, since this category includes only written letters and group emails sent to existing retail customers. Nevertheless, to the extent clarification is needed, the NASD indicated that it would do so through interpretations in the future.

Wilmer-Lee also requested that the definition not be limited to articles about investment companies, and that the term "reprint" include any type of document. The NASD disagreed with this comment for two reasons. First, the NASD stated that the definition is not limited to articles about investment companies. Second, the NASD explained that it is intentionally limited to independent press articles, noting that if the term were expanded to include "any document," the exception would encompass all sales material regardless of source and lose all meaning.

#### E. Filing Issues

AIM, Fidelity and ICI all urged NASD to permit electronic filing of sales material as soon as possible. In response, the NASD explained that recently it began implementing an electronic filing system. Currently, members may receive email notifications when the Advertising Regulation Department ("Department") has reviewed filed material, and may view the NASD comments on the filed material online. The NASD explained that it is working on expanding this system to permit electronic filing of sales material in the future. In this regard, it plans to fully implement the electronic filing program in 2003.

ICI and T. Rowe commented that NASD should eliminate the current requirement in NASD Rule 2210(c)(3)(A) to file a copy of any ranking or comparison used in advertisements or sales literature. In response to this comment, the NASD noted that it received this comment in response to Notice to Members 99-79,

and continues to believe that this backup filing requirement is necessary to properly review sales material that includes rankings. The NASD stated that the Department has found through experience that sales material that includes rankings often does not meet the NASD ranking guidelines contained in IM-2210-3, which necessitates review of the backup ranking materials. The NASD explained that the filing requirement expedites the Department's review of this backup material.

Under the proposed rule change, the NASD may require a member to submit pre-filings if it determines that the member has departed from the standards contained in NASD Rule 2210. The NASD also eliminated the restriction of one-year during which it could require a member to submit pre-filings upon such a finding. ICI objected to the deletion of language in current NASD Rule 2210(c)(4)(A) that requires the Department to find that there is a reasonable likelihood that a member will depart again from NASD Rule 2210's standards before the Department may require a member to pre-file all or a portion of the member's sales material. ICI also objected to deletion of language in current NASD Rule 2210(c)(4)(B) that limits the imposition of a pre-use filing requirement to one year. While the NASD stated that it recognizes these concerns, it explained that the pre-use filing requirement is an important tool to ensure compliance with its advertising standards. The NASD stated that it would use this requirement judiciously.

ICI and Wilmer-Lee also commented that NASD should exempt investment company shareholder reports from NASD Rule 2210's filing requirements, and ICI commented that generic investment company advertisements also should be exempt. The NASD stated that it addressed these comments previously in response to Notice to Members 99-79. As the NASD explained at that time, the management's discussion in shareholder reports sometimes contains misleading sales material that triggers comments from the NASD staff. In addition, the NASD stated, members sometimes miscategorize investment company advertisements as "generic" ads. When this error occurs, the sales material will omit the disclosures required by these rules. For these reasons, the NASD continues to believe that shareholder reports and investment company generic advertisements should be filed with NASD.

NASD Rule 2210 requires new members to file advertisements (including Web sites) at least 10 days

prior to use for a period of one year.<sup>31</sup> Sullivan commented that NASD should amend the rule to allow the Department to “pre-clear” certain elements of a new member’s Web site so that the member can update the Web site daily or more frequently without a 10-day pre-filing review. The NASD stated that it has found that new members are the most likely to commit violations of Rule 2210’s content standards, which is the basis for the new member pre-use filing requirement. Consequently, it will not relax this standard.

#### F. Predictions and Projections

Current NASD Rule 2210(d)(2)(N) prohibits member communications from predicting or projecting investment results, but allows the presentation of hypothetical illustrations of mathematical principles such as dollar-cost averaging, tax-free compounding, or the mechanics of variable insurance products. The proposed rule change retains this provision, but the NASD has moved it to proposed NASD Rule 2210(d)(1)(D). ICI expressed concern that the new proposed provision provides that a hypothetical illustration may not “predict or project the performance of an investment or investment strategy.” Similarly, Wilmer-Becker requested that the NASD interpret current Rule 2210(d)(2)(N) to allow members to use certain portfolio analysis tools.

The NASD filed a proposed rule with the Commission on February 3, 2003 that would allow members to provide customers with access to certain investment analysis tools that otherwise would be prohibited by Rule 2210(d)(2)(N).<sup>32</sup> The Commission published this proposed rule change for public comment on April 3, 2003.<sup>33</sup> The NASD stated that the outcome of this rulemaking process will address the concerns raised by ICI and Wilmer-Becker.

#### G. Other Comments

ICI commented that its members have complained about receiving inconsistent comments on filed materials based upon the subjective views of the Department analyst reviewing the material. The NASD responded to this comment by stating that the Department continues to work toward providing uniform guidance through the filing and comment process. It explained that NASD procedures include frequent meetings among managers and analyst

teams to ensure that everyone is interpreting the advertising rules consistently, particularly with respect to new products and advertising campaigns. The NASD represented that as a result of this effort, it receives relatively few complaints concerning inconsistent interpretations, and when it does receive such a complaint, it reviews it to determine whether an inconsistent interpretation has occurred and what if any action should be taken.

Sullivan advocated relaxing the requirement for a principal to pre-approve advertisements and sales literature that are posted on a member’s Web site. Sullivan has argued because this material changes frequently, the pre-approval requirement should be waived in certain circumstances, or members should be allowed to delegate this function to affiliates or others. The NASD disagreed with this comment stating that the principal approval requirement is vital to ensuring that advertising is fair and balanced.

Sullivan also requested that the NASD permit special record retention procedures for Web sites and other new technologies. The NASD addressed certain of these issues in an interpretive letter to T. Rowe Price.<sup>34</sup> The NASD plans to address any additional issues as they arise on a case-by-case basis rather than through the rulemaking process.

Proposed NASD Rule 2210(d)(2)(C)(i) would require member sales material to “prominently” disclose the member’s name. T. Rowe commented that this requirement should be changed to require members to “clearly” disclose their names. T. Rowe argued that most members that distribute mutual funds feature the fund’s name rather than the name of the member so that there is little room for confusion as to whom to contact for more information. The NASD acknowledged this concern, but noted that member advertisements that do not prominently indicate the member’s name sometimes suggest that securities products are offered by a non-member entity rather than the member, which can be misleading and confusing to investors. The NASD stated that its staff often cites the current prominence requirement in Rule 2210(f)(2)(A) to comment upon these deficiencies. For this reason, it is retaining the prominence requirement.

Wilmer-Lee commented that the proposed rule change should provide NASD with broader authority to grant exemptions from the filing

requirements. The NASD disagreed, and accordingly declined to amend the proposed rule change to expand this authority.

Wilmer-Lee also opposed a requirement in both current NASD Rule 2210(d)(2)(M) and proposed NASD Rule 2210(d)(2)(B) that any comparison in advertisements or sales literature between investments or services must disclose all material differences between them, including investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, and tax features. Wilmer-Lee argued that having to disclose these differences is burdensome on members and that the standard is vague. The NASD disagreed explaining that the standard is quite specific as to the types of differences it is looking for. In addition, any burden on members is justified. Without this standard, the NASD stated, members would be permitted to include misleading comparisons of products or services in sales material that do not disclose material differences.

Wilmer-Lee also objected to proposed NASD Rule 2210(e), which provides that violations of any rule of the SEC, SIPC or MSRB applicable to member communications is deemed a violation of NASD Rule 2210. Wilmer-Lee argued that this provision has no incremental benefit and is “anathema to efficient regulation.” Again, the NASD disagreed with this comment. The NASD explained that its examinations and enforcement actions regularly apply non-NASD rules to member communications, and that proposed NASD Rule 2210(e) will assist regulatory efforts in ensuring compliance with all applicable advertising rules.

Sullivan also had several comments on NASD Rule 2220, which governs member communications about options, however, because the NASD is not proposing at this time to revise Rule 2220, these comments are beyond the scope of this rule proposal.

#### IV. Discussion

After careful review, 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.<sup>35</sup> In particular, the Commission believes the proposal is consistent with the requirements of

<sup>31</sup> See NASD Rule 2210(c)(4)(A).

<sup>32</sup> See NASD Notice to Members 02–51 (August 2002).

<sup>33</sup> See Securities Exchange Act Release No. 47590 (March 28, 2003), 68 FR 16325.

<sup>34</sup> See Letter from Thomas M. Selman, Senior Vice President, NASD, to Forrest Foss, Vice President, T. Rowe Price Associates (January 28, 2002).

<sup>35</sup> In approving this rule proposal, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

section 15A(b)(6) of the Act,<sup>36</sup> which requires, among other things, that the Association's rules are 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.

The primary purpose of this proposed rule change is to modernize and clarify the rules governing member communications with the public. To this end, the NASD has proposed to reorganize NASD Rule 2210 and create new NASD Rule 2211. As discussed in detail below, the proposal also makes changes to several definitions, which affect the filing and pre-use requirements.

#### A. Definition of "Public Appearance"

The Commission believes that categorizing "Public Appearances" as a type of communication with the public and thus subjecting these appearances to the same content standards as other forms of communications with the public is appropriate. The Commission believes that the proposed rule change will simplify the standards which members must comply with when making public appearances, and will likely enhance compliance with the rules. Further, the Commission believes that codifying the NASD staff's position that Internet chat rooms constitute public appearances rather than advertisements or sales literature for purposes of NASD Rule 2210 by defining "Public Appearance" to include interactive electronic forums will also help to ensure compliance with the Rule.

#### B. Institutional Sales Material

The Commission believes that the proposed treatment of "Institutional Sales Material," as amended in response to concerns expressed by commenters and Commission staff, adequately balances the needs of members to contact sophisticated institutional investors without being subjected to pre-use approval and filing requirements, while still providing protection to ensure that inappropriate materials do not reach retail customers without first being reviewed for content by the NASD. For example, the proposed definition of "institutional investor" includes any "employee benefit plan that meets the requirements of section 403(b) or section 457 of the Internal Revenue Code and has at least 100 participants, but does not include any participant of such a plan." This provision allows members to use sales

material with the sponsors, administrators or consultants of such plans without having to file the material with the NASD while also preventing such material from reaching individual plan participants who are clearly not institutional investors.

#### C. Form Letters and Group Electronic Mail

The Commission agrees with the NASD's proposal to treat form letters and group electronic mail sent to existing retail customers and to fewer than 25 prospective customers as a separate category of communication ("Group Correspondence"), and to subject these communications to procedures governing the approval and review of correspondence, and applicable content standards. The Commission notes that the NASD has stated that it expects that each member will review its procedures to ensure that they adequately address potential concerns with the distribution of Group Correspondence and consider whether to adopt stricter procedures that require registered principal pre-use approval and filing with NASD of Group Correspondence that presents a higher risk to investors. The Commission similarly encourages members to be proactive in this regard.

#### D. Article Reprints

The Commission believes that the NASD's proposal to create a new category of article reprint, "independently prepared reprint" is appropriate. An independently prepared reprint would consist of any article reprint that meets certain standards that are designed to ensure that the reprint was issued by an independent publisher and was not materially altered by a member.<sup>37</sup> The proposed rule would exempt such reprints, and any excerpt therefrom, from filing requirements and most content standards. The new rule recognizes that reprints are often available to the public through large-circulation periodicals that are published by firms that are not NASD members, and that it would not be productive to require members to file such reprints.

#### E. Press Releases

The Commission believes that it is appropriate to exempt press releases that are made available only to members of the media from the filing

requirements of NASD Rule 2210. The Commission recognizes that often these releases are time-sensitive and that the filing requirements may represent an unnecessary regulatory burden. However, the Commission notes that although these releases do not need to be filed, they are still subject to applicable content, pre-use approval and record-keeping requirements.

#### F. Television and Video Advertisements

The Commission believes that it is appropriate for the NASD to codify in the proposed rules an existing policy that requires members to file the final filmed version of any television or video advertisement within ten business days of its first use or broadcast.

#### G. Filing and Record-keeping Requirements

The Commission believes that the NASD's proposed changes to the Filing and Record-keeping Requirements are appropriate. The proposed rules clarify members' responsibilities for retaining documents as well as simplify members' obligations for filing documents with the NASD for approval. Further, the proposed rules appropriately codify current NASD practices regarding the types of materials that must be filed with the NASD. The Commission believes that the proposed change will assist members in complying with filing and record-keeping requirements.

#### H. Standards Applicable to Member Communications

The NASD proposed to shorten and simplify the standards applicable to communications with the public that are contained in NASD Rule 2210(d). The rules clarify that members will be required to examine their communications with the public to ensure that statements are not misleading, unbalanced or inaccurate. The Commission supports the proposed changes to the rule, as they will make clear to members that they have the primary responsibility for ensuring that their communications with the public are not inappropriate.

#### I. Legends and Footnotes

The Commission believes that the NASD's proposal to limit information that can be placed in a footnote or legend is appropriate and will aid in the protection of investors from misleading information contained in sales material. Specifically, the NASD proposed rule change provides that information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication. The Commission

<sup>37</sup> The Commission notes that under the proposed rule change, members would be permitted to alter the content of an independently prepared reprint in a manner necessary to make it consistent with applicable regulatory standards or to correct factual errors.

<sup>36</sup> 15 U.S.C. 78o-3(b)(6).

believes that this is an appropriate limitation.

#### *J. Hypothetical Illustrations*

The proposed NASD rules would permit a member to present a hypothetical illustration of mathematical principles, but would not permit the illustration to predict or project the performance of an investment or investment strategy. The Commission believes that this rule strikes an appropriate balance in that members may still use, for example, mutual fund cost calculators and other hypothetical illustrations, but they may not make predictions based on those calculations, which could be misleading to investors.

#### *K. Testimonials*

The NASD proposed rules regarding establishing standards for testimonials would apply only to advertisements or sales literature concerning the investment advice or investment performance of a member or its products. The Commission believes that the application of these standards is appropriately tailored to ensure that the standards imposed on testimonials on investment performance do not inadvertently encompass testimonials regarding matters other than investment performance, such as the member's general services.

#### *L. Use and Disclosure of Member's Name*

The Commission believes that the NASD's proposal to simplify the provisions concerning disclosure of member names is appropriate. The proposed rule requires that all advertisements and sales literature must prominently disclose the name of the member sponsoring the advertisement or sales literature, as well as reflect any relationship between the member and any non-member who is also named. The Commission believes that requiring that such information be provided will help assure that members do not mislead investors about their relationships with non-members involved with an advertisement or sales literature.

#### *M. Ranking Guidelines*

The Commission believes that the changes proposed to the NASD's rules regarding ranking guidelines are appropriate. The proposed guidelines are designed to ensure that investors do not receive misleading or inaccurate information in advertisements or sales literature about potential investments, but are also narrowly tailored so that

members are not subject to unduly restrictive requirements in this regard.

#### *N. Communications About Collateralized Mortgage Obligations*

The Commission believes that the NASD's proposed changes to the rule governing Communications about Collateralized Mortgage Obligations ("CMOs") will aid retail investors in making informed decisions about these investments products by ensuring that they are provided with appropriate information and disclosure in all advertisements and sales literature regarding these products. Further, the Commission believes that the NASD appropriately simplified the rule, which will likely enhance compliance with provisions thereof.

#### *O. Operational Date*

The Commission notes that the NASD will publish a Notice to Members announcing the Commission's approval of the proposed rule change within 60 calendar days of the Commission's order, and that the proposed rule changes will take effect on Monday, November 3, 2003.<sup>38</sup>

#### **V. Amendment Nos. 3 and 4**

The Commission finds good cause for accelerating approval of Amendments Nos. 3 and 4 to the proposed rule change prior to the thirtieth day after publication of notice of the filings thereof in the Federal Register. The Commission is accelerating approval of Amendment Nos. 3 and 4 because these amendments are consistent with section 15A(b)(6) of the Act,<sup>39</sup> and address issues raised by commenters and Commission staff on the original proposal. The changes made in these amendments are described below.

First, in Amendment No. 3, the NASD amended the proposed definition of "institutional investor" to include employee benefit plans that meet the requirements of sections 403(b) or 457 of the Internal Revenue Code and also to change the term "beneficiary" to "participant" with respect to qualified plans as defined in section 3(a)(12)(C) of the Act. In Amendment No. 4, the NASD clarified that for purposes of the definition of "institutional investor," employee benefit plans and qualified plans do not include any participant of such a plan. The NASD explained that the purpose of including certain large employee benefit plans within the definition of "institutional investor"

<sup>38</sup> See letter from Patrice Gliniecki, Vice President and Deputy General Counsel, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated May 8, 2003.

<sup>39</sup> 15 U.S.C. 78o-3(b)(6).

was so that members could use sales material with the sponsors, administrators or consultants of those plans without having to file the material with the NASD or have a registered principal approve the material. The NASD stated that it did not intend to include sales material that is distributed to the participants of those plans in the definition of institutional sales material. The Commission concurs with this analysis, and believes that the proposed changes to the definition of institutional investor are appropriate.

Second, in Amendment No. 3, the NASD revised the definition of "advertisement." In the original proposal, the NASD described an advertisement as "material published, or designed for use in any electronic or other public media \* \* \*" In response to a commenter that pointed out that sales material could be "designed for use" but never actually used, the NASD amended the definition to describe advertisements as "material published, or used in any electronic or other public media \* \* \*" The Commission believes that this change appropriately narrows the scope of the definition.

Third, with respect to the proposal to exempt "independently prepared reprints" from filing requirements, the NASD made two changes to the proposed rule change in Amendment No. 3. The NASD amended NASD Rule 2210 to indicate that to qualify for the exemption, a publisher may not be affiliated with either the member or any underwriter or issuer of a security mentioned in a reprint that the member is promoting in an effort to narrow the exclusion from the exemption. Further, the NASD clarified that the requirements apply to article excerpts as well as full articles. The Commission believes that these changes will appropriately exempt members from filing requirements in situations where there is no regulatory need for review of an advertisement or sales literature.

Fourth, the NASD made changes NASD 2210 and IM-2210-7 to incorporate new requirements relating to securities futures. Specifically, the Commission notes that on October 15, 2002, it approved rule changes that, among other things, amended Rule 2210 and created a new Interpretive Material 2210-7 to regulate communications with the public regarding security futures.<sup>40</sup> The original Proposal did not include the newly approved provisions concerning security futures. Therefore, in Amendment No. 3, the NASD incorporated the approved changes to

<sup>40</sup> See Securities Exchange Act Release No. 46663, 67 FR 64944 (October 22, 2002).

Rule 2210 and the creation of IM-2210-7 into the proposed rule text. The Commission believes that these are technical changes, as the proposed changes have already been addressed by the Commission in a separate filing, and therefore do not need to be readdressed here.

Fifth, in Amendment No. 3, the NASD made changes to NASD Rule 2210's disclosure requirements for recommendations. These changes were made to conform the rule to the requirements contained in NASD Rule 2711,<sup>41</sup> which governs research analysts and research reports. Previously, only NASD Rule 2210 imposed disclosure requirements on research reports.

The new disclosure requirements imposed by NASD Rule 2711 differ from those contained in current NASD Rule 2210, therefore, for consistency, the NASD amended NASD Rule 2210 to be more similar to the new requirements imposed by NASD Rule 2711 and to incorporate references to security futures. The Commission believes that coordinating the disclosure requirements contained in NASD Rules 2210 and 2711 is appropriate and will aid members in complying the rules.

## VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 3 and 4, including whether the Amendments are 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 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-00-12 and should be submitted by June 9, 2003.

<sup>41</sup> See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002).

## VII. Conclusion

*It is therefore ordered* pursuant to section 19(b)(2) of the Act,<sup>42</sup> that the proposed rule change (SR-NASD-00-12), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>43</sup>

**Margaret H. McFarland**

*Deputy Secretary*

[FR Doc. 03-12451 Filed 5-16-03; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47830; File No. SR-NASD-2003-37]

### Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. to Permanently Expand Order Entry Firm Access to SIZE in Nasdaq's SuperMontage System

May 12, 2003.

#### I. Introduction

On March 12, 2003, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission"), 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 for the permanent approval of a pilot program which permits NNMS Order Entry Firms ("OE Firms") to enter non-marketable limit orders into SuperMontage using the SIZE Marker Maker Identifier ("SIZE MMID" or "SIZE").<sup>3</sup> On March 26, 2003, Nasdaq filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The proposed rule change, as amended, was published for comment in the **Federal**

<sup>42</sup> 15 U.S.C. 78s(b)(2).

<sup>43</sup> 17 CFR 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> On January 31, 2003, the Commission approved File No. SR-NASD-2002-173 on a 90-day pilot basis, which allowed OE Firms to enter non-marketable limit orders into Nasdaq's SuperMontage system using SIZE. See Securities Exchange Act Release No. 47301 (January 31, 2003), 68 FR 6236 (February 6, 2003). The 90-day pilot commenced on February 10, 2003. This filing seeks to make permanent the ability of OE Firms to enter orders into SuperMontage under essentially the same terms and conditions approved in the pilot program.

<sup>4</sup> See letter from Thomas Moran, Office of General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 25, 2003.

**Register** on April 3, 2003.<sup>5</sup> The Commission received three comment letters regarding the pilot as originally approved,<sup>6</sup> and the instant proposal, as amended.<sup>7</sup> On May, 2, 2003, Nasdaq submitted a comment response letter.<sup>8</sup> This order approves the proposed rule change, as amended.

## II. Description of the Proposed Rule Change

As noted above, this filing seeks the permanent approval of the 90-day pilot program that allows OE Firms<sup>9</sup> to enter non-marketable limit orders into SuperMontage using SIZE. Under the proposal, OE Firms may voluntarily enter non-marketable limit orders into SuperMontage with a Good-till-Cancelled ("GTC") or "Day" designation for display or execution through SIZE.<sup>10</sup> OE Firms may enter multiple orders (with or without reserve size) at single or multiple price levels, use any available execution algorithm (price/time, price/time-with-fee-consideration, or price/size). Non-marketable limit orders entered by OE Firms would be subject to the automatic execution functionality of the system. If elected by the OE Firm, its orders on opposite sides of the market could match off against each other only if such

<sup>5</sup> See Securities Exchange Act Release No. 47588 (March 28, 2003), 68 FR 16323.

<sup>6</sup> See Securities Exchange Act Release No. 47301 (January 31, 2003), 68 FR 6236 (February 6, 2003).

<sup>7</sup> See letters to Jonathan G. Katz, Secretary, Commission, from S. Jeffrey Martin, President, Automated Trading Desk Financial Services, LLC, and Steve Swanson, President, Automated Trading Brokerage Services, LLC, dated February 27, 2003 and March 6, 2003 ("ATD Letter"); from Duncan L. Niederauer, Managing Director and Co-Chief Executive Officer, Spear, Leeds & Kellogg, L.P., dated May 1, 2003 ("SLK Letter"); and from John Hughes, Chairman, and John C. Giese, President and Chief Executive Officer, Security Traders Association, dated April 9, 2003 ("STA Letter"). The two comment letters from ATD appear to be identical and, therefore, are being treated as one comment letter.

<sup>8</sup> See letter from Thomas P. Moran, Office of General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated May 1, 2003 ("Response Letter").

<sup>9</sup> Nasdaq submitted a letter to clarify that it interprets the term "NNMS Order Entry Firm" in a manner that may encompass NNMS Market Makers that are registered market makers in other stocks. In the SuperMontage system, such firms are treated the same as other OE Firms when placing orders into the system for stocks in which they do not make a market. Nasdaq notes that the provision of order-entry system access to firms that elect to register as market makers in less than the total universe of Nasdaq stocks also took place in the systems preceding SuperMontage—SelectNet and SuperSoes. See letter from Thomas P. Moran, Office of General Counsel, Nasdaq, to Marc McKayle, Special Counsel, Division, Commission, dated May 8, 2003.

<sup>10</sup> Prior to the pilot, OE Firms were limited to the entry of market orders or limited orders designated as Immediate or Cancel ("IOC"). OE Firms may continue to submit IOC orders under the proposal.