

Fund or have had, at any time since the beginning of the last two completed fiscal years of any Private Fund or Underlying Fund, a material business or professional relationship with any Private Fund or Underlying Fund.

9. A Fund, each Private Fund, and/or ML Entity, as applicable, will bear its own expenses associated with the disposition of portfolio securities. The expenses, if any, of distributing and registering securities under the Securities Act of 1933 sold by the Fund, one or more Private Funds, and/or the ML Entity, as applicable, at the same time will be shared by the Fund, the selling Private Fund(s), and/or each ML Entity, as applicable, in proportion to the relative amounts they are selling.

10. Merrill Lynch and its affiliates will receive no commissions, fees, or other compensation from a Fund or an Underlying Fund in connection with a purchase by the Fund of an interest in the Underlying Fund.<sup>3</sup>

11. The Fund will maintain all records required of it by the Act, and all records referred to or required under these conditions will be available for inspection by the Commission. The Fund will also maintain the records required by section 57(f)(3) of the Act as if the Fund was a business development company and the Co-Investments were approved by the non-interested Individual Trustees under section 57(f).

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40606; File No. SR-NASD-98-51]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Microcap Initiatives-Amendments to NASD Rules 6530 and 6540

October 27, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"

or "Exchange Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 20, 1998, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly-owned subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. On October 7, 1998, the NASD filed with the Commission Amendment No. 1 to the proposal.<sup>3</sup> 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 Association is proposing amendments to NASD Rules 6530 and 6540 to limit quotations on the OTC Bulletin Board® ("OTCBB") to the securities of issuers that are current in their reports filed with the SEC or other regulatory authority, and to prohibit a member from quoting a security on the OTCBB unless the issuer has made current filings, respectively. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

#### 6530. OTCBB Eligible Securities

*A Member shall be permitted to quote the [The] following categories of securities [shall be eligible for quotation] in the Service:*

(a) any domestic equity security that *satisfies the requirements of paragraph (1) and either paragraph (2) or (3) or (4) below;*

(1) *the security is not listed on The Nasdaq Stock Market ("Nasdaq") or a registered national securities exchange in the U.S., except that an equity security [securities that are] shall be considered eligible if it:*

(A) *is listed on one or more regional stock exchanges, and*  
(B) *[2] [do] does not qualify for disseminating of transactions reports via the facilities of the Consolidated Tape [shall be considered eligible.]; and*

(2) *the issuer of the security is required to file reports pursuant to Section 13 or 15(d) of the Act or the security is described in Section*

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

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

<sup>3</sup> Letter from Robert E. Aber, General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated October 7, 1998 ("Amendment No. 1"). The substance of Amendment No. 1 is incorporated into this notice.

*12(g)(2)(B) of the Act, and, subject to a thirty calendar day grace period, the issuer of the security is current in its reporting obligations, or*

(3) *the security is described in Section 12(g)(2)(G) of the Act and, subject to a sixty calendar day grace period, the issuer or the security is current in its reporting obligations, or*

(4) *the issuer of the security is a bank or savings association that is not required to file reports with the Commission pursuant to Section 13 or 15(d) of the Act and, subject to a sixty calendar day grace period, the issuer of the security is current with all required filings with its appropriate Federal banking agency or State bank supervisor (as defined in 12 U.S.C. 1813).*

(b) any foreign equity security or American Depositary Receipt (ADR) that meets all of the following criteria:

(1) [prior to April 1, 1998, is not listed on Nasdaq or a registered national securities exchange in the U.S., except that a foreign equity security or ADR shall be considered eligible if it is:

(A) listed on one or more regional stock exchanges, and

(B) does not qualify for dissemination of transaction reports via the facilities of the Consolidated Tape.

(2) after March 31, 1998,] *the security is registered with the Securities and Exchange Commission pursuant to Section 12 of the [Securities Exchange Act] Act [of 1934] and the issuer of the security is current in its reporting obligating; or the security satisfies the requirements of paragraph (a)(2) or (3) or (4) above; and*

(2) *the security is not listed on Nasdaq or a registered national securities exchange in the U.S., except that a foreign equity security or ADR shall [be considered eligible] meet this subparagraph (2) if it is:*

(A) listed on one or more regional stock exchanges, and

(B) does not qualify for dissemination of transaction reports via the facilities the Consolidated Tape.

(c) any equity security that [is] *meets the following criteria:*

(1) *the security is undergoing delisting from either the New York Stock Exchange, Inc. (NYSE) or the American Stock Exchange, Inc. (AMEX) for non-compliance with maintenance-of-listing standards; and*

(2) *the security is subject to a trading suspension imposed by the NYSE or*

<sup>4</sup> The proposed rule text was changed from "subparagraph (3)" to "subparagraph (2)" to correct the internal cross-reference. Telephone conversation between Sara Nelson Bloom, Associate General Counsel, Nasdaq, and Robert B. Long, Attorney, Division Commission, on October 28, 1998.

<sup>3</sup> This condition does not limit arrangements in which an Underlying Fund initially pays a placement fee to Merrill Lynch but is reimbursed or credited with such amount so that the sponsor of the Underlying Fund effectively bears the cost of the placement fee.

AMEX preceding the actual delisting; and

(3) *the security satisfies the requirements of paragraph (a)(2) or (3) or (4) above.*

(d) any *Direct* [District] Participation Program as defined in Rule 6910 that is not listed on Nasdaq or a registered national securities exchange in the U.S. and that satisfies the requirements of paragraph (a)(2) or (3) or (4) above.

(e) Paragraphs (a)(2) and (3) and (4) above will not apply with respect to any domestic equity security quoted in the Service on the effective date of this rule change until six months after that date.

\* \* \* \* \*

Rule 6540. Requirements Applicable to Market Makers

(a) No change.

(b) No change.

(1) Permissible Quotation Entries: no change.

(2) Impermissible Quotation Entries.

(A) *No member or person associated with a member shall enter into the Service a priced bid and/or offer, an unpriced indication of interest (including "bid wanted" or "offer wanted" indications), or a bid or offer accompanied by a modifier to reflect unsolicited customer interest in any security that does not satisfy the requirements of Rule 6530.*

(B) *No member or person associated with a member shall enter into the Service a priced bid and/or offer, an unpriced indication of interest (including "bid wanted" or "offer wanted" indications), or a bid or offer accompanied by a modifier to reflect unsolicited customer interest in any security of an issuer that does not make filing with the Securities and Exchange Commission through the Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system (or in paper format, if specifically permitted by Commission Rules) unless the member:*

(i) *notifies the Association of the issuer of the security's schedule for the filing of all periodic reports or financial reports required pursuant to the Act or regulatory authority, respectively, and the identity of the regulatory authority with which such reports are filed, or ensures that such notice is provided; and*

(ii) *provides to the Association the issuer's periodic reports required pursuant to the Act, or the issuer's financial reports required by regulatory authority, prior to the expiration of the grace period described in Rule 6530(a)(3), or ensures that the required periodic reports are provided to the Association within that time period.*

(3) [(2)] Voluntary Termination of Registration

No change.

(4) [(3)] More Than One Trading Location

No change.

(5) [(4)] Clearance and Settlement

No change.

(c) *Compliance With Market Maker Requirements*

*Failure of a member or a person associated with a member to comply with this Rule may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110.*

\* \* \* \* \*

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

In its filing with the Commission, the NASD 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. The NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

#### 1. Purpose

The NASD has actively studied the OTC market in an effort to address abuses in the trading and sales of thinly traded, thinly capitalized (microcap) securities. These securities are not listed on Nasdaq or any exchange and trade on the OTCBB, in the "pink sheets" published by the National Quotation Bureau, Inc. ("Pink Sheets"), and in other quotation media where there are no listing requirements. With respect to its examination of the OTCBB in particular, the NASD noted the lack of reliable and current financial information about the issuers, and the perception by the public that the OTCBB is similar to a highly regulated market, such as the registered exchanges or Nasdaq.<sup>5</sup>

<sup>5</sup> In addition, the NASD has filed a proposed rule change through its subsidiary, NASD Regulation, to require a member to review current financial statements and other business information about the issuer of a security that is not listed on Nasdaq or a national securities exchange before that member could recommend a transaction to a customer in the security and to provide certain disclosure information on the trade confirmation for all customer transactions (solicited and unsolicited) in such securities. See SR-NASD-98-50.

The OTCBB provides a real-time quotation medium that NASD member firms can use to enter, update, and retrieve quotation information (including unpriced indications of interest) for equity securities trade over-the-counter that are neither listed on Nasdaq nor on a primary national securities exchange. Eligible securities include national, regional, and foreign equity issues, warrants, units. Direct Participation Programs ("DPPs"),<sup>6</sup> and American Depositary Receipts ("ADRs")<sup>7</sup> not listed on any other U.S. national securities market or exchange. Unlike Nasdaq or registered exchanges where individual companies apply for listing on the market—and must meet and maintain strict listing standards—there are no listing standards for the OTCBB, and there currently is no requirement that issuers of securities on the OTCBB make current, publicly-available reports with the SEC or other regulator. In fact, over half of the companies that are currently quoted on the OTCBB are not subject to any public reporting requirements.

The proposed rule change was developed in an effort to balance the benefits that the transparency of the OTCBB provides with the public need for information about the issuers being quoted. The NASD is concerned that where there is no public information available regarding a security, the broad-based automated display of quotations in that security creates an unjustified perception of reliability. While the NASD realizes that the new rule may result in the lack of real-time quotations for those securities that become ineligible for the OTCBB, it believes that this loss is outweighed by the benefit to investors who would, under the proposed rule, have access to information about the companies in which they may invest. In addition, transactions in securities ineligible for the OTCBB would still be subject to real-time last sale trade reporting. These reports are publicly disseminated through market data vendors on a real-time basis.

### Amendment to Rule 6530

This proposed amendment to rule 6530 would limit quotations on the OTCBB to the securities of issuers that make current filings pursuant to

<sup>6</sup> DPPs are securities offerings that permit investors to directly participate in the cash flow and tax consequences of the underlying investments. DPPs provide for the "flow through" of tax results. Thus, gains and losses are taxed to the investor not the issuer of the security.

<sup>7</sup> ADRs are receipts for shares of foreign corporations that are held by U.S. banks and bought and sold in the U.S. by investors, without utilizing overseas markets.

Sections 13<sup>8</sup> and 15(d) of the Act,<sup>9</sup> securities of depository institutions that are not required to make filings under the Act, but file publicly-available reports with their appropriate regulatory agencies, registered closed-end investment companies, and insurance companies that are exempt from registration under Section 12(g)(2)(G) of the Act.<sup>10</sup>

To remain eligible for quotation on the OTCBB, as issuer must remain current in its filings with the SEC or applicable regulatory authority. A member would be required to inform the NASD of the issuer's reporting schedule. Based upon that schedule, the NASD will affix a modifier on the security's symbol if the NASD has not received information that the report was timely filed.<sup>11</sup> The addition of the modifier to the symbol, as well as any changes to the symbol necessary to accommodate the modifier, will be publicly reported on the OTCBB Daily List, which is available to market makers and investors through the OTCBB web site as <http://www.otcbb.com>. Once an issuer is delinquent in filing a required report (e.g., Form 10-K, Form 10-Q, Form 20-F, Insurance Company Annual Statement, or call report), a security of the issuer may continue to be quoted on the OTCBB for a 30 or 60 calendar day grace period from the due date of the report, depending on the type of issuer. After the grace period, quotations in the security of the delinquent issuer would not be permitted on the OTCBB.

Filings for most OTCBB issuers are available through the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system.<sup>12</sup> Foreign issuers are generally permitted to file in paper format and copies of these filings are available from the Commission. Exchange Act filings of banks and thrifts are available upon filing from the financial institution's primary bank regulatory agency. The grace period for these issuers is 30 days. In the case of banks and thrifts that are not required to make Exchange Act filings, members can obtain call report information from the National Information Center of Banking Information website (<http://www.ffiec.gov/nic>) or the Federal Deposit Insurance Corporation's website (<http://www.fdic.gov>). Call reports are filed 30 days after the end of each

calendar quarter and are available to the public within 15 days of filing. Insurance companies file annual statements with the National Association of Insurance Commissioners ("NAIC") by March 1 of each year. This information is released to the public by NAIC by April 1. Because of the delay in the availability of call reports and insurance company annual statements, the proposed rule permits a 60 calendar day grace period for the quotation of securities of these companies after the deadline for the issuer to submit a report to the appropriate regulator.

#### Amendment to Rule 6540

This proposed amendment to Rule 6540 would prohibit member firms from quoting an issuer's security if the issuer has not made current reports with the SEC or the appropriate regulatory authority. Members must also provide such reports to the NASD, although the reports may be provided by any market maker in the security. The NASD is exploring ways to reduce the burden of this requirement for members, particularly with respect to issuers who are EDGAR filers. As discussed above, the NASD will affix a modifier to the security's symbol if the NASD has not received information that the report was timely filed. This indication will provide members with notice that the NASD has not received information that the issuer's report was timely filed. Once the NASD provides this notice, the member will have the opportunity to acquire the necessary report and provide it to the NASD before the end of the grace period.

#### Phase-In

The new requirements will be immediately effective upon approval of the rule for securities not previously quoted on the OTCBB. Securities quoted on the OTCBB on the date the rule becomes effective will be afforded at least six months to comply with the new requirements. Specifically, and in order to accommodate the resource demands that may be placed upon the SEC when certain issuers elect to file current public reports, the new requirements will be applied in a month-by-month staggered manner for a period from six to eighteen months from the date the rule is approved. The NASD will apply the new rule to approximately the same number of issuers for each month during that period in order to evenly distribute the SEC's anticipated work load. The delayed effectiveness of the rule should also enable market makers, investors, and issuers to take appropriate action. It should be noted that for issuers who file a Form 10 or

Form 10SB with the SEC to register under Section 12(g) of the Exchange Act,<sup>13</sup> all SEC comments, if any, must be cleared with the SEC before securities can be quoted on the OTCBB.

#### 2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)<sup>14</sup> of the Act, which requires, among other things, that the Association's rules 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. In addition, Section 15A(b)(11)<sup>15</sup> of the Act requires that the rules of a registered national securities association be designed to produce fair and informative quotations, prevent fictitious or misleading quotations and to promote orderly procedures for collecting, distributing, and publishing quotations. The NASD believes the proposed rule change, which will address actual and potential fraud in the quotation and trading of non-listed securities and the investor perception that the OTCBB is equivalent to Nasdaq or exchange markets in terms of standards, regulatory structure and oversight, will accordingly protect investors and the public interest. Further, the NASD believes limiting the OTCBB to companies that provide public information will prevent fictitious and misleading quotations.

#### B. Self-Regulatory Organization's Statement on Burden on Competition

The NASD does not believe that the proposed rule change will impose any inappropriate burden on competition.

#### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

The proposed rule change was published for comment in NASD Notice to Members 98-14 ("Notice" or "NTM") in January, 1998. A total of 44 comments were received in response to the Notice.

Of the 44 responses received, 18 responses (or 41%) were from broker/dealer firms or registered persons and the balance of 26 comments (or 59%) were from individual investors, issuers, various state agencies, trade associations, and other interested parties. In providing comments, a majority of commenters expressed a

<sup>8</sup> 15 U.S.C. 78m.

<sup>9</sup> 15 U.S.C. 78o-(d).

<sup>10</sup> 15 U.S.C. 78(g)(2)(G).

<sup>11</sup> It is contemplated that the modifier will be affixed one to two days after the report is due.

<sup>12</sup> EDGAR is the SEC system for the receipt, acceptance, and review of documents submitted in electronic format.

<sup>13</sup> 15 U.S.C. 78I(G).

<sup>14</sup> 15 U.S.C. 78o-3(b)(6).

<sup>15</sup> 15 U.S.C. 78o-3(b)(11).

position (*i.e.*, approval or disapproval) regarding each specific proposal. Other commenters did not provide a stated position on each proposal, but identified particular issues with certain proposals and provided written comment.

Twenty-two commenters opposed the proposal, 19 commenters supported it, and three did not take a definitive position. Those commenters who disapproved of the proposed changes generally believed that the changes would decrease transparency and liquidity and would increase the regulatory burden that small issuers face. One commenter opined that the annual cost to an issuer to comply with the Exchange Act reporting requirements would be \$150,000.

Those commenters supporting the proposed changes generally felt the changes will help eliminate fraud by providing investors with reliable information. These commenters thought the deterrence of fraud and increased availability of information outweighed the increase burden on companies.

Commenters indicated that the rule as proposed in the Notice should be modified to recognize issuers filing under Section 15(d) of the Exchange Act.<sup>16</sup> A commenter encouraged the NASD to accept reports filed with regulatory agencies outside of the Exchange Act, such as call reports filed by financial institutions. The rule as published in the Notice would have permitted members to maintain quotes in a security in which an issuer is delinquent in its reports with the SEC or regulatory authorities for a period of ten days. Other commenters supported an expansion of the grace period for filing a report with the SEC to 30 days after its due date.

After the public comment process, the staff recommended and the Boards of the NASD and Nasdaq approved the following modifications to the proposed rules. As to NASD Rule 6530, the proposed delinquency grace period was expanded from ten days to thirty days for issuers filing Exchange Act forms and to sixty days for insurance companies and financial institutions that do not file Exchange Act forms. This extended grace period is consistent with the proposed review period in the SEC's Rule 15c2-11 proposal.<sup>17</sup> Further, in the original Notice, the staff solicited comment on whether certain non-Exchange Act depository institutions that provide publicly-available financial

reports to banking regulators should be eligible for quotation on the OTCBB. Based on the comments received, the nature of the issuers, the independent oversight of banking regulators, and the SEC's position that reports filed with federal or state bank supervisory agencies contain information analogous to Exchange Act reports,<sup>18</sup> the proposed rule allows securities of these issuers to be quoted on the OTCBB if the issuer provides timely reports to the appropriate Federal banking agency or State bank supervisor and the information is publicly available. Finally, consistent with comments received, the proposed rule includes securities of issuers who are currently filing reports with the SEC pursuant to Section 15(d) of the Act as eligible securities for the OTCBB. An issuer becomes subject to Section 15(d) as a result of registering securities under the Securities Act of 1933 ("Securities Act") and is thereby required to make timely filings with the SEC such as Forms 10-K, 10-Q, and 8-K or 20-F for at least a year following the Securities Act registration.<sup>19</sup>

The staff and the NASD and Nasdaq Boards considered commenters' objection that the proposed rule would decrease transparency for securities no longer eligible for the OTCBB. However, this objection was outweighed by the benefit of ensuring that there was publicly-available information regarding issuers that are afforded the visibility and credibility of the OTCBB. In this regard, the NASD considered that in granting permanent approval to the OTCBB, the SEC noted: "As a general matter, transparency benefits the markets. However, in the context of the inclusion of unregistered foreign securities on the OTCBB, the benefits may be outweighed by the potential harm from including unregistered securities on a visible U.S. market operated by a self-regulatory organization."<sup>20</sup> The SEC also noted that "the OTCBB may be inconsistent with the full disclosure goals of the securities laws in allowing a regulated public marketplace for unregistered securities."<sup>21</sup> While these comments

were made in the context of unregistered foreign securities, the NASD believes that the same concerns exist with respect to domestic securities for which no public information is available.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the publication of this notice in **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal 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. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD.

All submissions should refer to File SR-NASD-98-51 and should be submitted by November 25, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>22</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**BILLING CODE 8010-01-M**

<sup>22</sup> 17 CFR 200.30-3(a)(12).

<sup>16</sup> 15 U.S.C. 78o-(d).

<sup>17</sup> Exchange Act Release No. 39670 (February 17, 1998), 63 FR 9661 (February 25, 1998).

<sup>18</sup> *Id.* 9667-68.

<sup>19</sup> In addition to its requirements under Section 15(d), an issuer may voluntarily register under Section 12(g) or be required to register under Section 12(g) if it has 500 or more shareholders of record and total assets of more than \$10 million. Under both scenarios, the issuer's securities would continue to qualify as eligible securities for purposes of the OTCBB Rules if the issuer maintains current filings with the SEC.

<sup>20</sup> Exchange Act Release No. 38456 (March 31, 1997), 62 FR 16635 at 16638 (April 7, 1997).

<sup>21</sup> *Id.*