

June 16, 2000

Katherine A. England, Esq.
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-00-38** - Application of Rules of the Association and Interpretive Materials thereunder to Certain Exempted Securities

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed is the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Stephanie M. Dumont, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8176, e-mail Stephanie.Dumont@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins
Senior Vice President
and General Counsel

Enclosures

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Exchange Act” or “Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to: (1) codify a staff interpretation that the non-cash compensation provisions set forth in NASD Rule 2820(g) apply to group variable contracts that are exempted securities; and (2) to enumerate those Rules of the Association and Interpretive Materials thereunder that apply to exempted securities, except municipal securities, as previously approved by the Commission. Below is the text of the proposed rule change. Proposed new language is underlined.

* * *

0100. GENERAL PROVISIONS

0110. Adoption and Application of Rules

0116. Application of Rules of the Association to Exempted Securities

(a) For purposes of this Rule, the terms “exempted securities” and “municipal securities” shall have the meanings specified in Sections 3(a)(12) and 3(a)(29) of the Act, respectively.

(b) Unless otherwise indicated within a particular provision, the following Rules of the Association and Interpretive Materials thereunder are applicable to transactions and business activities relating to exempted securities, except municipal securities, conducted by members and

associated persons: 2110, 2120, 2210, IM-2210-1, IM-2210-2, IM-2210-3, 2250, 2270, 2300, 2310, IM-2310-2, IM-2310-3, 2320, 2330, IM-2330, 2340, 2430, 2450, 2510, 2520, IM-2520, 2770, 2780, 2820(g), 2910, 3010, 3020, 3030, 3040, 3050, 3060, 3070, 3110, IM-3110, 3120, 3130, IM-3130, 3131, 3140, 3230, 3310, IM-3310, 3320, IM-3320 and 3330.

* * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation at its meeting on March 29, 2000, which authorized the filing of the rule change with the SEC. The Nasdaq Stock Market has been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on March 30, 2000. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

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

(b) Questions regarding this rule filing may be directed to Stephanie M. Dumont, Assistant General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-8176.

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

(a) Purpose

The Government Securities Act Amendments of 1993 (“GSAA”)¹ eliminated the statutory limitations on the NASD’s authority to apply sales-practice rules to members’ transactions in exempted securities (including government securities), other than municipal securities.² As a result, on August 20, 1996, the SEC approved certain NASD rule amendments implementing the NASD’s expanded sales-practice authority.³ The SEC’s Approving Release and NASD Notice to Members 96-66 (October 1996), among other things, set forth a list of those NASD rules that apply to members’ transactions in exempted securities (other than municipal securities).⁴

At the time the NASD identified those NASD rules that would apply to exempted securities (other than municipal securities), Rule 2820(g), the non-cash compensation rule, had not been

¹ Government Securities Act Amendments of 1993, Pub. L. No. 103-202, § 1(a), 107 Stat. 2344 (1993).

² The terms exempted securities, government securities, and municipal securities are defined in Sections 3(a)(12), 3(a)(42), and 3(a)(29) of the Exchange Act, respectively. Rules for municipal securities are promulgated by the Municipal Securities Rulemaking Board.

³ See Exchange Act Rel. No. 37588 (Aug. 20, 1996) (“Approving Release”).

⁴ Specifically, the Approving Release and Notice to Members 96-66 provide that the following NASD Rules and Interpretative Materials are applicable to transactions and business activities relating to exempted securities (other than municipal securities) conducted by members and associated persons: 2110, 2120, 2210, IM-2210-1, IM-2210-2, IM-2210-3, 2250, 2270, 2300, 2310, IM-2310-2, IM-2310-3, 2320, 2330, IM-2330, 2340, 2430, 2450, 2510, 2520, IM-2520, 2770, 2780, 2910, 3010, 3020, 3030, 3040, 3050, 3060, 3070, 3110, IM-3110, 3120, 3130, IM-3130, 3131, 3140, 3230, 3310, IM-3310, 3320, IM-3320 and 3330. This list currently is not included in the NASD Manual. As further discussed herein, the proposed rule change will codify the list.

adopted, and therefore was not listed as one of the provisions applicable to exempted securities. Rule 2820(g), as amended in July 1998, limits the manner in which members may pay or accept non-cash compensation in connection with the sale or distribution of variable contracts.⁵

Because certain group variable contracts are exempted securities under the Exchange Act, questions have arisen regarding whether Rule 2820(g) applies to group variable contracts.⁶ NASD Regulation staff, since the adoption of Rule 2820(g), has interpreted the provision to apply to group variable contracts. In order to clarify the application of Rule 2820(g) to group variable contracts, NASD Regulation is proposing a rule change that would codify the current staff interpretation that Rule 2820(g) applies to these products.⁷ To effect this codification, NASD Regulation is proposing Rule 0116, which would enumerate all NASD Rules and Interpretative Materials that are applicable to exempted securities (other than municipal securities). Rule 0116 would include Rule 2820(g) as being applicable to group variable contracts that are exempted securities. Although the list of NASD rules applicable to exempted securities is included in the Approving Release and NASD Notice to Members 96-66, the list was not incorporated in a specific NASD rule. NASD Regulation believes that it would be useful to codify the information provided in the Approving

⁵ See Exchange Act Rel. No. 40214 (July 15, 1998). When originally adopted, the non-cash compensation rule was paragraph (h) of Rule 2820. Subsequently, other provisions of Rule 2820 were amended, and, as a result, the non-cash compensation rule is now paragraph (g) of Rule 2820.

⁶ Section 3(a)(12)(A)(iv) of the Exchange Act includes as an exempted security "... any security arising out of a contract issued by an insurance company, which ... security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph."

⁷ Because Rule 2820(g) applies only to transactions in variable products, the proposed rule change would result in Rule 2820(g) expressly applying to all variable products, including variable products that are

Release in an NASD rule to enable members and other interested parties to identify the rules in a more efficient manner.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that the proposed rule change will assist members and associated persons in more easily identifying those NASD rules applicable to transactions and business activities relating to exempted securities (other than municipal securities).

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were not solicited. NASD Regulation received, however, a letter dated April 16, 1999, from the National Association for Variable Annuities ("NAVA"), which argues that the non-cash compensation rules do not apply to sales of group variable annuities for several

exempted securities, such as group variable or similar products. NASD Regulation is not at this time

reasons. First, NAVA contends that the specific language of Rule 2820 limits its application to activities of members in connection with variable contracts, to the extent such activities are subject to regulation under the federal securities laws.⁸ However, although certain provisions of the federal securities laws do not apply to exempted securities, other provisions of the federal securities laws do apply, including the anti-fraud provisions. Therefore, Rule 2820(a) does not restrict the application of Rule 2820(g) to group variable activities.

Second, NAVA argues that because Rule 2820(g) was not specifically included in the 1996 listing of NASD Rules applicable to exempted securities, that the non-cash compensation provisions do not apply to sales of group variables. As described in this rule filing, at the time the NASD identified those NASD rules that would apply to exempted securities (other than municipal securities), Rule 2820(g), the non-cash compensation rule, had not been adopted, and therefore was not listed as one of the provisions applicable to exempted securities.

Third, NAVA argues that if the non-cash compensation rules do apply to group variables, separate contests should be permissible for group variable products given their different design, cost structures and commission payouts. With respect to the allowance of separate contests for group variable products, the NASD Regulation staff has stated in Question #22 of Notice to Member 99-55 (July 1999) that a member may structure a non-cash arrangement that is limited only to a specific

recommending that other provisions of Rule 2820 apply to exempted securities.

division of the firm. Therefore, if a separate sales force or division sells group variable contracts, as the NAVA letter indicates often occurs, then a separate contest may be appropriate. However, where the same salesperson sells both group variable products and individual variable annuities, separate contests would not be permissible, i.e. the contest must be based on the entire universe of products within a specific product category that the individual sells.

6. Extension of Time Period for Commission Action

NASD Regulation does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

NASD Regulation requests the Commission to find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after its publication in the Federal Register. Because the proposed rule change is codifying the application of NASD rules as previously approved by the SEC and an existing staff interpretation, NASD Regulation requests the Commission to accelerate the effectiveness of the proposed rule change prior to the 30th day after its publication in the Federal Register.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

⁸ Rule 2820(a) states “[t]his Rule shall apply exclusively (and in lieu of Rule 2830) to the activities of members in connection with variable contracts, to the extent such activities are subject to regulation under the federal securities laws.”

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD

Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: _____

Alden S. Adkins

Senior Vice President and General Counsel

Date: June 16, 2000

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-00-38)

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Application of Rules of the Association and Interpretive Materials thereunder to Certain Exempted Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the National Association of Securities Dealers, Inc. (“NASD”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”) 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 NASD Regulation. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Regulation is proposing a rule change to: (1) codify a staff interpretation that the non-cash compensation provisions set forth in NASD Rule 2820(g) apply to group variable contracts that are exempted securities; and (2) to enumerate those Rules of the Association and

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Interpretive Materials thereunder that apply to exempted securities, except municipal securities, as previously approved by the Commission. Below is the text of the proposed rule change. Proposed new language is underlined.

* * *

0100. GENERAL PROVISIONS

0110. Adoption and Application of Rules

0116. Application of Rules of the Association to Exempted Securities

(a) For purposes of this Rule, the terms “exempted securities” and “municipal securities” shall have the meanings specified in Sections 3(a)(12) and 3(a)(29) of the Act, respectively.

(b) Unless otherwise indicated within a particular provision, the following Rules of the Association and Interpretive Materials thereunder are applicable to transactions and business activities relating to exempted securities, except municipal securities, conducted by members and associated persons: 2110, 2120, 2210, IM-2210-1, IM-2210-2, IM-2210-3, 2250, 2270, 2300, 2310, IM-2310-2, IM-2310-3, 2320, 2330, IM-2330, 2340, 2430, 2450, 2510, 2520, IM-2520, 2770, 2780, 2820(g), 2910, 3010, 3020, 3030, 3040, 3050, 3060, 3070, 3110, IM-3110, 3120, 3130, IM-3130, 3131, 3140, 3230, 3310, IM-3310, 3320, IM-3320 and 3330.

* * *

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation 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. NASD Regulation 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

(a) Purpose

The Government Securities Act Amendments of 1993 (“GSAA”)³ eliminated the statutory limitations on the NASD’s authority to apply sales-practice rules to members’ transactions in exempted securities (including government securities), other than municipal securities.⁴ As a result, on August 20, 1996, the SEC approved certain NASD rule amendments implementing the NASD’s expanded sales-practice authority.⁵ The SEC’s Approving Release and NASD Notice to Members 96-66 (October 1996), among other things, set forth a list of those NASD rules that apply to members’ transactions in exempted securities (other than municipal securities).⁶

³ Government Securities Act Amendments of 1993, Pub. L. No. 103-202, § 1(a), 107 Stat. 2344 (1993).

⁴ The terms exempted securities, government securities, and municipal securities are defined in Sections 3(a)(12), 3(a)(42), and 3(a)(29) of the Exchange Act, respectively. Rules for municipal securities are promulgated by the Municipal Securities Rulemaking Board.

⁵ See Exchange Act Rel. No. 37588 (Aug. 20, 1996) (“Approving Release”).

⁶ Specifically, the Approving Release and Notice to Members 96-66 provide that the following NASD Rules and Interpretative Materials are applicable to transactions and business activities relating to exempted securities (other than municipal securities) conducted by members and associated persons: 2110, 2120, 2210, IM-2210-1, IM-2210-2, IM-2210-3, 2250, 2270, 2300, 2310, IM-2310-2, IM-2310-3, 2320, 2330, IM-2330,

At the time the NASD identified those NASD rules that would apply to exempted securities (other than municipal securities), Rule 2820(g), the non-cash compensation rule, had not been adopted, and therefore was not listed as one of the provisions applicable to exempted securities. Rule 2820(g), as amended in July 1998, limits the manner in which members may pay or accept non-cash compensation in connection with the sale or distribution of variable contracts.⁷

Because certain group variable contracts are exempted securities under the Exchange Act, questions have arisen regarding whether Rule 2820(g) applies to group variable contracts.⁸ NASD Regulation staff, since the adoption of Rule 2820(g), has interpreted the provision to apply to group variable contracts. In order to clarify the application of Rule 2820(g) to group variable contracts, NASD Regulation is proposing a rule change that would codify the current staff interpretation that Rule 2820(g) applies to these products.⁹ To effect this codification, NASD Regulation is proposing Rule 0116, which would enumerate all NASD Rules and Interpretative Materials that are applicable to exempted securities (other than municipal securities). Rule 0116 would include Rule 2820(g) as

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⁷ See Exchange Act Rel. No. 40214 (July 15, 1998). When originally adopted, the non-cash compensation rule was paragraph (h) of Rule 2820. Subsequently, other provisions of Rule 2820 were amended, and, as a result, the non-cash compensation rule is now paragraph (g) of Rule 2820.

⁸ Section 3(a)(12)(A)(iv) of the Exchange Act includes as an exempted security "... any security arising out of a contract issued by an insurance company, which ... security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph."

⁹ Because Rule 2820(g) applies only to transactions in variable products, the proposed rule change would result in Rule 2820(g) expressly applying to all variable products, including variable products that are exempted securities, such as group variable or similar products. NASD Regulation is not at this time recommending that other provisions of Rule 2820 apply to exempted securities.

being applicable to group variable contracts that are exempted securities. Although the list of NASD rules applicable to exempted securities is included in the Approving Release and NASD Notice to Members 96-66, the list was not incorporated in a specific NASD rule. NASD Regulation believes that it would be useful to codify the information provided in the Approving Release in an NASD rule to enable members and other interested parties to identify the rules in a more efficient manner.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that the proposed rule change will assist members and associated persons in more easily identifying those NASD rules applicable to transactions and business activities relating to exempted securities (other than municipal securities).

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were not solicited. NASD Regulation received, however, a letter dated April 16, 1999, from the National Association for Variable Annuities (“NAVA”), which argues that the non-cash compensation rules do not apply to sales of group variable annuities for several reasons. First, NAVA contends that the specific language of Rule 2820 limits its application to activities of members in connection with variable contracts, to the extent such activities are subject to regulation under the federal securities laws.¹⁰ However, although certain provisions of the federal securities laws do not apply to exempted securities, other provisions of the federal securities laws do apply, including the anti-fraud provisions. Therefore, Rule 2820(a) does not restrict the application of Rule 2820(g) to group variable activities.

Second, NAVA argues that because Rule 2820(g) was not specifically included in the 1996 listing of NASD Rules applicable to exempted securities, that the non-cash compensation provisions do not apply to sales of group variables. As described in this rule filing, at the time the NASD identified those NASD rules that would apply to exempted securities (other than municipal securities), Rule 2820(g), the non-cash compensation rule, had not been adopted, and therefore was not listed as one of the provisions applicable to exempted securities.

Third, NAVA argues that if the non-cash compensation rules do apply to group variables, separate contests should be permissible for group variable products given their different design, cost structures and commission payouts. With respect to the allowance of separate contests for group variable products, the NASD Regulation staff has stated in Question #22 of Notice to Member 99-55 (July 1999) that a member may structure a non-cash arrangement that is limited only to a specific division of the firm. Therefore, if a separate sales force or division sells group variable contracts, as the NAVA letter indicates often occurs, then a separate contest may be appropriate. However, where the same salesperson sells both group variable products and individual variable annuities, separate contests would not be permissible, i.e. the contest must be based on the entire universe of products within a specific product category that the individual sells.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

NASD Regulation has requested that the Commission find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NASD and, in particular, the requirements of Section 15A and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after

¹⁰ Rule 2820(a) states “[t]his Rule shall apply exclusively (and in lieu of Rule 2830) to the activities of members in connection with variable contracts, to the extent such activities are subject to regulation under the federal securities laws.”

the date of publication of notice of filing thereof in that accelerated approval will benefit NASD members by enabling members and other interested parties to identify which NASD rules apply to exempted securities in a more efficient manner.

Within 35 days of the date of publication of this notice in the 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 such 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary