

September 18, 2002

Katherine A. England
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-2002-124**– Proposed Amendment to Rule 2260 to Expand the
Definition of “Designated Investment Adviser”

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find 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 Kosha K. Dalal, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-6903; e-mail kosha.dalal@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President
and Corporate Secretary

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) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD Rule 2260 to expand the definition of “designated investment adviser” to include all state registered investment advisers. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

Rule 2260. Forwarding Proxy and Other Materials.

(a) – (e) No change.

(f) For purposes of this Rule, the term “designated investment adviser” is a person registered under the Investment Advisers Act of 1940 or registered as an investment adviser under the laws of a state,¹ who exercises investment discretion pursuant to an advisory contract for the beneficial owner and is designated in writing by the beneficial owner to receive proxy and related materials and vote the proxy, and to receive annual reports and other material sent to security holders.

(1) The written designation must be signed by the beneficial owner; be addressed to the member; and include the name of the designated investment adviser.

(2) Members who receive such a written designation from a beneficial owner must ensure that the designated investment adviser is registered with the Commission pursuant to the Investment Advisers Act of 1940 or with a state as an investment adviser

¹ The term “state” as used herein shall have the meaning given to such term in Section 3(a)(16) of the Securities Exchange Act of 1934, and as such term may be amended from time to time therein.

under the laws of such state,² and that the investment adviser is exercising investment discretion over the customer's account pursuant to an advisory contract to vote proxies and/or to receive proxy soliciting material, annual reports and other material. Members must keep records substantiating this information.

(3) Beneficial owners have an unqualified right at any time to rescind designation of the investment adviser to receive materials and to vote proxies. The rescission must be in writing and submitted to the member.

(g) No change.

* * * * *

(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 July 24, 2002, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have 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. NASD's Board of Governors had an opportunity to review the proposed rule change at its meeting on July 25, 2002. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of NASD's By-Laws permits NASD's Board of Governors to adopt amendments to NASD Rules without recourse to the

² Members may verify registration of an investment adviser through the use of the Investment Adviser Registration Depository ("IARD") system.

membership for approval. 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 Kosha K. Dalal, Assistant General Counsel, NASD Regulatory Policy and Oversight, Office of General Counsel, at (202) 728-6903.

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

(a) Purpose

Rule Modernization

In July 2001, NASD announced in *Notice to Members 01-35* its intention to move forward with an initiative designed to ensure that NASD rules are as streamlined as possible and impose the least burden necessary to accomplish their objectives while achieving investor protection. In response to *Notice to Members 01-35*, some commenters asked NASD to review Rule 2260 to consider expanding the categories of persons to whom a member may forward proxy and other materials.

Based on the research and analysis of Rule 2260 conducted by NASD staff and the Economic Advisory Board (“EAB”), which was formed by NASD to assist with an economic analysis of certain NASD rules, the EAB made a formal recommendation to expand the definition of “designated investment adviser” in Rule 2260 to include all state registered investment advisers.

Proposed Expansion

Currently, NASD Rule 2260 requires members to forward proxy material, annual reports, information statements and other material sent to security holders to the beneficial owner or the beneficial owner's "designated investment adviser."³ The rule defines a "designated investment adviser" as a person registered under the Investment Advisers Act of 1940 ("Advisers Act") who exercises investment discretion pursuant to an advisory contract for the beneficial owner and is designated in writing by the beneficial owner to receive proxy and related materials and vote the proxy, and to receive annual reports and other material sent to security holders.

Rule 2260 was amended in 1995 to include federally registered investment advisers.⁴ However, as a result of the passage in 1996 of the National Securities Markets Improvement Act ("NSMIA"), certain state registered investment advisers need not be registered under the Advisers Act.⁵ Rule 2260 was not updated to account for this change. As a result, under the current rule, beneficial owners cannot designate state registered investment advisers to receive proxy and other materials. The proposed rule change would expand the definition of "designated investment adviser" to include persons registered under the Advisers Act and persons registered by a state as an investment adviser.

NASD believes that the current exclusion of state registered investment advisers serves no valid investor protection purpose. Rule 2260 will continue to require that the

³ In April 2002, the SEC approved a proposed rule change to Rule 2260 making its provisions applicable to non-municipal debt securities. The rule change became effective on July 9, 2002. (Release No. 34-45736; SR-NASD-2002-11).

⁴ See SR-NASD-95-06, as approved by the Commission in Release No. 34-35681 (May 15, 1995).

⁵ National Securities Markets Improvement Act of 1996, Pub.L. No. 104-290, 110 Stat. 3416 (1996).

beneficial owner execute a written designation addressed to the member that includes the name of the designated investment adviser. The beneficial owner will continue to have an unqualified right at anytime to rescind designation of the investment adviser to receive materials and to vote proxies. The recession must be in writing and submitted to the member.

The proposed rule change will continue to require that a member that receives a written designation from a beneficial owner must ensure that the beneficial owner's designated investment adviser is registered under the Advisers Act. In addition, for state registered investment advisers, a member must ensure that the beneficial owner's designated investment adviser is registered as an investment adviser under the laws of the state. A member may verify registration of an investment adviser through the use of the Investment Adviser Registration Depository ("IARD") system. Under the proposed rule change, members must continue to ensure that the designated investment adviser is exercising investment discretion pursuant to an advisory contract for the beneficial owner; and is designated in writing by the beneficial owner to receive and vote proxies for stock that is in the possession of the members. Members also must continue to keep records substantiating this information.

(b) Statutory Basis

NASD 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 NASD'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 believes that the proposed rule change to expand the definition of “designated investment adviser” in Rule 2260 is designed to accomplish these ends by updating Rule 2260 to be consistent with the goals of NSMIA and to address an inconsistency in the treatment of federally-registered versus state-registered investment advisers that does not serve a valid investor protection purpose.

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

NASD 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 neither solicited nor received for this proposed rule change. In connection with its rule modernization initiative, NASD issued *Notice to Members* 02-10 (January 2002) that surveyed members on a broad range of topics that included subject matter related to this rule proposal. However, as NASD views the responses received as general survey material, it is not included in this filing.

6. Extension of Time Period for Commission Action

NASD 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)

Not applicable.

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

Not applicable.

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

NASD, INC.

BY: _____
Barbara Z. Sweeney , Senior Vice President and
Corporate Secretary

Date: September 18, 2002

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- [leave space] ; File No. SR-NASD-2002-124)
[leave space for date]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Proposed Amendment to Rule 2260 to expand the definition of “designated investment adviser”

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 [leave space], the National Association of Securities Dealers, Inc. (“NASD”) 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. 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

NASD is proposing to amend NASD Conduct Rule 2260 to expand the definition of “designated investment adviser” to include all state registered investment advisers. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

Rule 2260. Forwarding Proxy and Other Materials.

(a)– (e) No change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(f) For purposes of this Rule, the term “designated investment adviser” is a person registered under the Investment Advisers Act of 1940 or registered as an investment adviser under the laws of a state,³ who exercises investment discretion pursuant to an advisory contract for the beneficial owner and is designated in writing by the beneficial owner to receive proxy and related materials and vote the proxy, and to receive annual reports and other material sent to security holders.

(1) The written designation must be signed by the beneficial owner; be addressed to the member; and include the name of the designated investment adviser.

(2) Members who receive such a written designation from a beneficial owner must ensure that the designated investment adviser is registered with the Commission pursuant to the Investment Advisers Act of 1940 or with a state as an investment adviser under the laws of such state,⁴ and that the investment adviser is exercising investment discretion over the customer’s account pursuant to an advisory contract to vote proxies and/or to receive proxy soliciting material, annual reports and other material. Members must keep records substantiating this information.

(3) Beneficial owners have an unqualified right at any time to rescind designation of the investment adviser to receive materials and to vote proxies. The rescission must be in writing and submitted to the member.

(g) No change.

³ The term “state” as used herein shall have the meaning given to such term in Section 3(a)(16) of the Securities Exchange Act of 1934, and as such term may be amended from time to time therein.

⁴ Members may verify registration of an investment adviser through the use of the Investment Adviser Registration Depository (“IARD”) system.

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 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 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**

Rule Modernization

In July 2001, NASD announced in *Notice to Members 01-35* its intention to move forward with an initiative designed to ensure that NASD rules are as streamlined as possible and impose the least burden necessary to accomplish their objectives while achieving investor protection. In response to *Notice to Members 01-35*, some commenters asked NASD to review Rule 2260 to consider expanding the categories of persons to whom a member may forward proxy and other materials.

Based on the research and analysis of Rule 2260 conducted by NASD staff and the Economic Advisory Board (“EAB”), which was formed by NASD to assist with an economic analysis of certain NASD rules, the EAB made a formal recommendation to expand the definition of “designated investment adviser” in Rule 2260 to include all state registered investment advisers.

Proposed Expansion

Currently, NASD Rule 2260 requires members to forward proxy material, annual reports, information statements and other material sent to security holders to the beneficial owner or the beneficial owner's "designated investment adviser."⁵ The rule defines a "designated investment adviser" as a person registered under the Investment Advisers Act of 1940 ("Advisers Act") who exercises investment discretion pursuant to an advisory contract for the beneficial owner and is designated in writing by the beneficial owner to receive proxy and related materials and vote the proxy, and to receive annual reports and other material sent to security holders.

Rule 2260 was amended in 1995 to include federally registered investment advisers.⁶ However, as a result of the passage in 1996 of the National Securities Markets Improvement Act ("NSMIA"), certain state registered investment advisers need not be registered under the Advisers Act.⁷ Rule 2260 was not updated to account for this change. As a result, under the current rule, beneficial owners cannot designate state registered investment advisers to receive proxy and other materials. The proposed rule change would expand the definition of "designated investment adviser" to include persons registered under the Advisers Act and persons registered by a state as an investment adviser.

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beneficial owner execute a written designation addressed to the member that includes the name of the designated investment adviser. The beneficial owner will continue to have an unqualified right at anytime to rescind designation of the investment adviser to receive materials and to vote proxies. The recession must be in writing and submitted to the member.

The proposed rule change will continue to require that a member that receives a written designation from a beneficial owner must ensure that the beneficial owner's designated investment adviser is registered under the Advisers Act. In addition, for state registered investment advisers, a member must ensure that the beneficial owner's designated investment adviser is registered as an investment adviser under the laws of the state. A member may verify registration of an investment adviser through the use of the Investment Adviser Registration Depository ("IARD") system. Under the proposed rule change, members must continue to ensure that the designated investment adviser is exercising investment discretion pursuant to an advisory contract for the beneficial owner; and is designated in writing by the beneficial owner to receive and vote proxies for stock that is in the possession of the members. Members also must continue to keep records substantiating this information.

(b) Statutory Basis

NASD 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 NASD'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 believes that the proposed rule change to expand the definition of “designated investment adviser” in Rule 2260 is designed to accomplish these ends by updating Rule 2260 to be consistent with the goals of NSMIA and to address an inconsistency in the treatment of federally-registered versus state-registered investment advisers that does not serve a valid investor protection purpose.

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

NASD 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 neither solicited nor received for this proposed rule change. In connection with its rule modernization initiative, NASD issued *Notice to Members* 02-10 (January 2002) that surveyed members on a broad range of topics that included subject matter related to this rule proposal. However, as NASD views the responses received as general survey material, it is not included in this filing.

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

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 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].

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

Jonathan G. Katz
Secretary