

August 7, 2003

BY HAND

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

Re: SR-NASD-2003-126; Notice of Intent to File Proposed Amendment to Expiration Date of Rules Relating to Bond Fund Volatility Ratings

Dear Ms. England:

We are providing this notice of intent to file the above-referenced proposed rule change. The purpose of the rule change is to extend the expiration date of the NASD's bond fund volatility ratings rules, which will expire on August 31, 2003. The proposal contains no substantive changes to the way in which the pilot has operated during the past two years; it only seeks to extend the pilot period by an additional two years. We will be requesting that the Commission waive the requirement that the rule change not become operative for 30 days after the date of the filing, as set forth in Rule 19b-4(f)(6)(iii), to prevent the existing pilot period from lapsing.

If you have any questions, please contact Joseph P. Savage, Counsel, Investment Companies Regulation, NASD, at (240) 386-4534, email: joe.savage@nasd.com, or Philip Shaikun, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8451, email: philip.shaikun@nasd.com. The fax number for Office of General Counsel is (202) 728-8264.

Very truly yours,

Patrice M. Gliniecki
Senior Vice President and
Deputy General Counsel

Enclosures

August 7, 2003

BY HAND

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

Re: File No. SR-NASD-2003-126; Amendment to Expiration Date of Rules Relating to Bond Mutual Fund Volatility Ratings

Dear Ms. England:

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

If you have any questions, please contact Joseph P. Savage, Counsel, Investment Companies Regulation, NASD, at (240) 386-4534, email: joe.savage@nasd.com, or Philip Shaikun, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8451, email: philip.shaikun@nasd.com. The fax number for Office of General Counsel is (202) 728-8264.

Very truly yours,

Patrice M. Gliniecki
Senior Vice President and
Deputy General Counsel

Enclosures

File No. SR-NASD-2003-126
Consists of 15 Pages
August 7, 2003

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 extend the expiration date of Rule 2210(c)(3) and Interpretive Material 2210-5 from August 31, 2003 to August 31, 2005. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are bracketed.

* * * * *

IM-2210-5. Requirements for the Use of Bond Mutual Fund Volatility Ratings

(This rule and Rule 2210(c)(3) will expire on August 31, [2003] 2005, unless extended or permanently approved by [the Association] NASD at or before such date.)

(a) through (c) 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, Inc. at its meeting on July 30, 2003, 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 NASD to Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on July 31, 2003.

No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) and (iii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules and interpretations of rules without recourse to the membership for approval.

The proposed rule change will become effective upon filing, will be implemented on August 31, 2003, and will expire on August 31, 2005.

(b) Questions regarding this rule filing may be directed to Joseph P. Savage, Counsel, Investment Companies Regulation, NASD at (240) 386-4534, or Philip Shaikun, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8451.

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

(a) Purpose

Background and Description of the NASD's Rules on Bond Mutual Fund Volatility Ratings

On February 29, 2000, the SEC approved the adoption of NASD Interpretive Material 2210-5, which permits members and their associated persons to include bond fund volatility ratings in supplemental sales literature (mutual fund sales material that is accompanied or preceded by a fund prospectus). The SEC also approved at that time new NASD Rule 2210(c)(3), which sets forth the filing requirements and review procedures applicable to sales literature containing bond mutual fund volatility ratings. Previously, the NASD staff interpreted NASD rules to prohibit the use of bond fund volatility ratings in sales material.

IM-2210-5 permits the use of bond fund volatility ratings only in supplemental sales literature and only if certain conditions are met:

- The word “risk” may not be used to describe the rating.
- The rating must be the most recent available and be current to the most recent calendar quarter ended prior to use.
- The rating must be based exclusively on objective, quantifiable factors.
- The entity issuing the rating must provide detailed disclosure on its rating methodology to investors through a toll-free telephone number, a web site, or both.
- A disclosure statement containing all of the information required by the rule must accompany the rating. The statement must include such information as the name of the entity issuing the rating, the most current rating and the date it was issued, and a description of the rating in narrative form containing certain specified disclosures.

Rule 2210(c)(3) requires members to file bond mutual fund sales literature that includes or incorporates volatility ratings with the Advertising Regulation Department of NASD (“Department”) at least 10 days prior to use for Department approval. If the Department requests changes to the material, the material must be withheld from publication or circulation until the requested changes have been made or the material has been refiled and approved.

IM-2210-5 and the new Rule 2210(c)(3) initially were approved on an 18-month trial basis that was scheduled to expire on August 31, 2001. On August 10, 2001, NASD filed with the

Commission a proposed rule change that was effective upon filing that extended the effectiveness of IM-2210-5 and Rule 2210(c)(3) an additional two years until August 31, 2003.

Proposed Rule Change to Extend the Expiration Date of IM-2110-5 and Rule 2210(c)(3)

As indicated in the SEC's order approving IM-2210-5 and Rule 2210(c)(3), NASD requested the 18-month trial period to provide an opportunity to assess whether the rule had facilitated the dissemination of useful, understandable information to investors, and whether it had prevented the dissemination of inappropriate and misleading information.¹ During the rule pilot's initial 18-month term, the Department received very few filings that contained bond fund volatility ratings. Although these filings generally met the rule's requirements, the staff did not believe that it had received a sufficient number of filings to adequately evaluate the rule's effectiveness.

Accordingly, in July 2001, the NASD Regulation, Inc. Board of Directors approved a two-year extension of the rule pilot, which is now set to expire on August 31, 2003.

Since August 2001, the Department has continued to receive very few filings under this rule. During the entire period from February 2000, when the rule was first approved, until the present, NASD has received a total of 41 submissions from three NASD members. In general, these filings met the requirements of IM-2210-5. However, the staff does not believe that it has received a sufficient number of filings to adequately evaluate the rule's effectiveness.

In particular, NASD believes that, because of the low interest rates over the last two years, bond mutual funds have had little reason to distribute sales material that contains volatility ratings. NASD believes that it needs to review the rule in an environment in which there is greater demand for sales literature that includes bond mutual fund volatility ratings to determine

¹ See SEC Release No. 34-42476 (February 29, 2000), 65 Fed. Reg. 12305, 12306 (Mar. 8, 2000).

the rule's effectiveness. NASD believes there is a reasonable probability that such environment will exist over the next two years.

Accordingly, NASD is proposing to extend the expiration date of IM-2210-5 and Rule 2110(c)(3) for an additional two years, until August 31, 2005, to allow more filings to be made. Before this period expires, the staff will evaluate the rule and determine whether to recommend that the rule be eliminated, modified, or permanently approved as is. The proposal contains no substantive changes to the way in which the pilot has operated during the past two years; it only seeks to extend the pilot period by an additional two years.

(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 the NASD'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. NASD believes that extending the expiration date of IM-2210-5 and Rule 2210(c)(3) will provide the additional experience necessary to fully analyze and evaluate the provisions.

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

NASD believes that the proposed rule change would not 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.

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)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder², in that the proposed rule change does not significantly affect the protection of investors or the public interest and does not impose any significant burden on competition. In accordance with Rule 19b-4, NASD submitted written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing.

NASD has requested that the Commission waive the requirement that the rule change not become operative for 30 days after the date of the filing, as set forth in Rule 19b-4(f)(6)(iii), to prevent the existing pilot period from lapsing. IM-2110-5 and Rule 2210(c)(3) will expire on August 31, 2003. NASD adopted IM-2110-5 to benefit investors by allowing independent third parties to issue ratings of bond mutual funds provided adequate disclosures are made concerning the ratings. However, the NASD staff believes it has not yet had adequate experience with the operation of the rule to make an informed determination as to whether the rule should be eliminated, modified, or permanently approved as is. Accordingly, NASD believes it is in the interest of investors and the public for the provisions of IM-2210-5 and Rule 2210(c)(3) to remain in effect without interruption.

² 17 CFR 240.19b-4(f)(6).

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

NASD

BY:

Patrice M. Gliniecki, Senior Vice President and
Deputy General Counsel

Date: August 7, 2003

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2003-126)

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Extend the Expiration Date of Rules Concerning Bond Mutual Fund Volatility Ratings

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹, notice is hereby given that on August 7, 2003, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission" or "SEC") 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. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change. This order approves the proposed rule change on an accelerated basis.

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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), NASD is proposing to extend the expiration date of the NASD's rules concerning bond mutual fund volatility ratings from August 31, 2003 until August 31, 2005, and clarify the rules that will expire on that date. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are bracketed.

* * * * *

¹ 15 U.S.C. 78s(b)(1).

IM-2210-5. Requirements for the Use of Bond Mutual Fund Volatility Ratings

(This rule and Rule 2210(c)(3) will expire on August 31, [2003] 2005, unless extended or permanently approved by [the Association] NASD at or before such date.)

(a) through (c) No change.

* * * * *

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. 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) - (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

Background and Description of the NASD's Rules on Bond Mutual Fund Volatility Ratings

On February 29, 2000, the SEC approved the adoption of NASD Interpretive Material 2210-5, which permits members and their associated persons to include bond fund volatility ratings in supplemental sales literature (mutual fund sales material that is accompanied or preceded by a fund prospectus). The SEC also approved at that time new NASD Rule 2210(c)(3), which sets forth the filing requirements and review procedures applicable to sales literature containing bond mutual fund volatility ratings. Previously, the NASD staff interpreted NASD rules to prohibit the use of bond fund volatility ratings in sales material.

IM-2210-5 permits the use of bond fund volatility ratings only in supplemental sales literature and only if certain conditions are met:

- The word “risk” may not be used to describe the rating.
- The rating must be the most recent available and be current to the most recent calendar quarter ended prior to use.
- The rating must be based exclusively on objective, quantifiable factors.
- The entity issuing the rating must provide detailed disclosure on its rating methodology to investors through a toll-free telephone number, a web site, or both.
- A disclosure statement containing all of the information required by the rule must accompany the rating. The statement must include such information as the name of the entity issuing the rating, the most current rating and the date it was issued, and a description of the rating in narrative form containing certain specified disclosures.

Rule 2210(c)(3) requires members to file bond mutual fund sales literature that includes or incorporates volatility ratings with the Advertising Regulation Department of NASD (“Department”) at least 10 days prior to use for Department approval. If the Department requests changes to the material, the material must be withheld from publication or circulation until the requested changes have been made or the material has been refiled and approved.

IM-2210-5 and the new Rule 2210(c)(3) initially were approved on an 18-month trial basis that was scheduled to expire on August 31, 2001. On August 10, 2001, NASD filed with the

Commission a proposed rule change that was effective upon filing that extended the effectiveness of IM-2210-5 and Rule 2210(c)(3) an additional two years until August 31, 2003.

Proposed Rule Change to Extend the Expiration Date of IM-2110-5 and Rule 2210(c)(3)

As indicated in the SEC's order approving IM-2210-5 and Rule 2210(c)(3), NASD requested the 18-month trial period to provide an opportunity to assess whether the rule had facilitated the dissemination of useful, understandable information to investors, and whether it had prevented the dissemination of inappropriate and misleading information.² During the rule pilot's initial 18-month term, the Department received very few filings that contained bond fund volatility ratings. Although these filings generally met the rule's requirements, the staff did not believe that it had received a sufficient number of filings to adequately evaluate the rule's effectiveness. Accordingly, in July 2001, the NASD Regulation, Inc. Board of Directors approved a two-year extension of the rule pilot, which is now set to expire on August 31, 2003.

Since August 2001, the Department has continued to receive very few filings under this rule. During the entire period from February 2000, when the rule was first approved, until the present, NASD has received a total of 41 submissions from three NASD members. In general, these filings met the requirements of IM-2210-5. However, the staff does not believe that it has received a sufficient number of filings to adequately evaluate the rule's effectiveness.

In particular, NASD believes that, because of the low interest rates over the last two years, bond mutual funds have had little reason to distribute sales material that contains volatility ratings. NASD believes that it needs to review the rule in an environment in which there is greater demand for sales literature that includes bond mutual fund volatility ratings to determine

² See SEC Release No. 34-42476 (February 29, 2000), 65 Fed. Reg. 12305, 12306 (Mar. 8, 2000).

the rule's effectiveness. NASD believes there is a reasonable probability that such environment will exist over the next two years.

Accordingly, NASD is proposing to extend the expiration date of IM-2210-5 and Rule 2110(c)(3) for an additional two years, until August 31, 2005, to allow more filings to be made. Before this period expires, the staff will evaluate the rule and determine whether to recommend that the rule be eliminated, modified, or permanently approved as is. The proposal contains no substantive changes to the way in which the pilot has operated during the past two years; it only seeks to extend the pilot period by an additional two years.

(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 the NASD'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. NASD believes that extending the expiration date of IM-2210-5 and Rule 2210(c)(3) will provide the additional experience necessary to fully analyze and evaluate the provisions.

(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.

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

The proposed rule change has been filed NASD as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder.³ In addition, NASD has requested that the Commission waive the requirement that the rule change not become operative for 30 days after the date of the filing, as set forth in Rule 19b-4(f)(6)(iii), to prevent the current pilot program from lapsing. The Commission finds good cause for the proposed rule change to become operative prior to the 30th day after the date of publication of notice of filing.

Since the foregoing proposed rule change does not significantly affect the protection of investors or the public interest and does not impose any significant burden on competition, and since NASD provided the Commission with notice of its intent to file the proposed rule change at least five days prior to the filing date and there is good cause for the proposed rule change to become operative prior to the 30th day after the date of publication of notice of this filing, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing including whether the proposed rule change is consistent with the act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange

³ 17 CFR 240.19b-4(f)(6).

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 this 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.

Margaret H. McFarland
Deputy Secretary