

Notice to Members

MAY 2003

SUGGESTED ROUTING

Legal & Compliance
Operations
Senior Management

Rule 2260

SEC Approves Amendment to Rule 2260 to Expand the Definition of “Designated Investment Adviser”

KEY TOPICS

Designated Investment Adviser Definition
Rule Modernization
Rule 2260

Executive Summary

Rule 2260 requires member firms to forward proxy material, annual reports, information statements, and other material sent to security holders, the beneficial owner, or the beneficial owner’s designated investment adviser. The current definition of “designated investment adviser” in Rule 2260 is limited to certain persons registered under the Investment Advisers Act of 1940 (Advisers Act); however, on March 3, 2003, the Securities and Exchange Commission (SEC) approved SR-NASD-2002-124 to expand the definition of designated investment adviser in Rule 2260 to include state-registered investment advisers.¹ Accordingly, Rule 2260, as amended, will permit beneficial owners to designate state-registered investment advisers, in addition to persons registered under the Advisers Act, to receive proxy and other materials consistent with Rule 2260.

The amendments to Rule 2260 become effective on June 16, 2003.

Rule 2260, as amended, is set forth in Attachment A.

Questions concerning this *Notice* may be directed to Kosha K. Dalal, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-6903.

03-26

Background and Discussion

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 to accomplish their objectives while achieving investor protection. In addition, NASD established the Economic Advisory Board (EAB) to review and analyze NASD rules and rule proposals. In response to *Notice to Members 01-35*, NASD received 37 comment letters identifying rules that should be the focus of our rule modernization effort. After a review by NASD staff and the EAB of these comment letters, in *Notice to Members 02-10* (January 2002), NASD requested comment on certain proposals that were under consideration, including the possible expansion of Rule 2260. Based on comment letters to the proposed expansion of Rule 2260 and an analysis of the proposal by the EAB, NASD approved the proposed amendment to Rule 2260.

Rule 2260 requires member firms to forward proxy material, annual reports, information statements, and other material sent to security holders, the beneficial owner, or the beneficial owner's designated investment adviser. The rule currently 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. However, following the passage of the National Securities Markets Improvement Act (NSMIA) in 1996, certain state-registered investment advisers need not register under the Advisers Act. As a result, under current Rule 2260, beneficial owners cannot designate state-registered investment

advisers to receive proxy and other materials. The approved amendments to Rule 2260 expand the definition to include state-registered investment advisers.

Rule 2260 will continue to require that the 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 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.

Further, Rule 2260 continues 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. 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. One way that a member may verify registration of an investment adviser is through the use of the Investment Adviser Registration Depository ("IARD") system. Members must ensure that the designated investment adviser is exercising investment discretion over the customer's account pursuant to an advisory contract to vote proxies and/or receive proxy soliciting materials, annual reports, and other material. Members also must keep records substantiating this information.

Effective Date

The rule amendments become effective on June 16, 2003.

Endnotes

- 1 See Securities Exchange Act Release No. 47214 (January 17, 2003), 68 FR 3915 (January 27, 2003) (File No. SR-NASD-2002-124). See SEC Approval Order, Securities Exchange Act Release No. 47459 (March 6, 2003), 68 FR 12120 (March 13, 2003) (File No. SR-NASD-2002-124).

© 2003. NASD. All rights reserved. Notices to Members attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

ATTACHMENT A

New language is underlined; deletions are in brackets.

2260. Forwarding Proxy and Other Materials.

(a) through (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 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.

1 The term “state” as used herein shall have the meaning given to such term in Section 202(a)(19) of the Investment Advisers Act of 1940, and as such term may be amended from time to time therein.

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