

May 7, 1998

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Mail Stop 10-1

Re: **SR-NASD-98-35**
Proposed Rule Relating to Books and Records

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith is the above-numbered rule filing. This rule filing supersedes and replaces rule filing SR-NASD-98-30, which NASD regulation, Inc. hereby withdraws. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register.

If you have any questions, please contact Joseph E. Price, Counsel, Advertising/Investment Companies Regulation, at (202) 728-8877. The fax number is (202) 728-6976.

Very truly yours,

John M. Ramsay
Vice President and Deputy General Counsel

Attachment

File No. SR-NASD-98-35
Consists of 20 Pages

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

Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (the “Act”), NASD Regulation, Inc. (“NASD Regulation”) is herewith filing a proposed rule change to amend Rule 3110 (the “Books and Records Rule”) of the Conduct Rules of the National Association of Securities Dealers, Inc. (“NASD” or “Association”) to: (1) change the definition of “institutional account” to include the accounts of investment advisers that, under the National Securities Markets Improvement Act of 1996 and new rules adopted by the SEC, are now required to register with the states; and (2) exclude certain customer accounts from the requirement to obtain certain tax and employment information from the customer. Below is the text of the proposed rule amendments. Proposed new language is underlined; proposed deletions are bracketed.

3100. BOOKS AND RECORDS, AND FINANCIAL CONDITION

3110. Books and Records

(a) Requirements

Each member shall keep and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of this Association.

* * * * *

(c) Customer Account Information

Each member shall maintain accounts opened after January 1, 1991 as follows:

(1) for each account, each member shall maintain the following information:

(A) customer's name and residence;

(B) whether customer is of legal age;

(C) signature of the registered representative introducing the account and signature of the member or partner, officer, or manager who accepts the account; and

(D) if the customer is a corporation, partnership, or other legal entity, the names of any persons authorized to transact business on behalf of the entity;

(2) for each account, other than an institutional account, and accounts in which investments are limited to transactions in [money market funds] open-end investment company shares that are not recommended by the member or its associated persons, each member shall also make reasonable efforts to obtain, prior to the settlement of the initial transaction in the account, the following information to the extent it is applicable to the account:

(A) customer's tax identification or Social Security number;

(B) occupation of customer and name and address of employer;

and

(C) whether customer is an associated person of another member; and

(3) for discretionary accounts, in addition to compliance with subparagraphs (1) and (2) above, and Rule 2510(b) of these Rules, the member shall:

(A) obtain the signature of each person authorized to exercise discretion in the account;

(B) record the date such discretion is granted; and

(C) in connection with exempted securities other than municipals, record the age or approximate age of the customer.

(4) For purposes of this Rule and Rule 2310 the term “institutional account” shall mean the account of:

(A) a bank, savings and loan association, insurance company, or registered investment company;

(B) an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or

(C) any other entity (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.

* * * * *

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 19, 1998, and the Board of Governors of the NASD determined not to review the proposed rule change at its meeting on March 19, 1998, which authorized the filing of the rule change with the SEC . No other action by the NASD is necessary for the filing of the rule change. Section 1(a)(2) to Article VII of the By-Laws permits the NASD Board of Governors to adopt amendments to the Conduct Rules without recourse to the membership for approval. The staff of NASD Regulation

has provided an opportunity for the staff of The Nasdaq Stock Market, Inc. 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 will make the proposed amendments effective within 45 days of Commission approval.

(b) Questions regarding this rule filing may be directed to Joseph E. Price, Counsel, Advertising/Investment Companies Regulation, at (202) 728-8877.

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

(a)

Background

The Books and Records Rule requires members obtain certain information for all accounts. In addition, the Rule requires that for accounts other than institutional accounts and accounts limited to money market funds members must make reasonable attempts to obtain: (i) a customer's tax identification or social security number; (ii) a customer's occupation and the name and address of the employer; and (iii) information about whether the customer is an associated person of another member ("Retail Customer Information"). An "institutional account" is defined in the Rule to include the account of an investment adviser registered with the SEC.

1. *Accounts of Registered Investment Advisers*

The National Securities Market Improvement Act of 1996 and new rules recently adopted by the SEC under the Investment Advisers Act of 1940 ("Advisers Act") allocate regulatory oversight of investment advisers between the SEC and the states. Under the new rules, advisers to registered investment companies and those with assets under

management of at least \$25 million generally will register exclusively with the SEC. Most others will register exclusively with the states.

The Books and Records Rule provides that for purposes of both the Books and Records Rule and NASD Conduct Rule 2310 (“Suitability Rule”), the term “institutional account” includes the account of an investment adviser *registered with the SEC*. Consequently, advisory accounts that were considered to be “institutional accounts” when the Retail Customer Information provision in the Books and Records Rule was adopted now are technically excluded from the definition because they have migrated to state regulation.

2. Accounts Limited to Mutual Fund Shares

At its meeting on February 23, 1998, the Investment Companies Committee, a standing committee of the NASD Regulation Board of Directors, considered a proposal by the NASD Regulation staff to amend the Books and Records Rule to exclude directly marketed mutual funds from the obligation to obtain Retail Customer Information. The Committee concurred with the NASD Regulation staff’s conclusion that the requirement to obtain Retail Customer Information is burdensome and largely unnecessary as it applies to members who distribute directly marketed mutual funds and other unsolicited accounts that are limited to mutual fund shares and for which no recommendations are made. A primary purpose of obtaining Retail Customer Information is to help a member evaluate the suitability of a recommendation. Consequently, the same regulatory requirement does not apply with respect to accounts that are limited to mutual funds and for which no recommendations are made. Members would continue to be required to make reasonable efforts to obtain Retail Customer Information for retail accounts that are

not subject to these limitations. At its meeting on March 19, 1998, the NASD Regulation Board of Directors approved proposed changes to amend NASD Conduct Rule 3110 and authorized the filing of the rule change with the SEC.

Purpose

1. *Institutional Account Definition*

The Books and Records Rule requires members to maintain certain information for all retail and institutional customer accounts. For retail accounts that are not limited to money market funds, members also must make reasonable efforts to obtain Retail Customer Information. Members do not have to seek this information with respect to their institutional accounts.

Similarly, the Suitability Rule requires members to make reasonable efforts to obtain certain information, such as the customer's financial status and investment objectives, from *retail* customers prior to the execution of a transaction. IM-2310-3 describes members' suitability obligation in making recommendations to *institutional* customers. The primary considerations under IM-2310-3 include the customer's capability to evaluate risk independently and the extent to which individual judgment is exercised when making investment decisions.

The proposed amendments would treat the state-regulated advisory accounts as "institutional accounts" for purposes of the Books and Records Rule and the Suitability Rule. The proposed changes would amend the Books and Records Rule to take into account the bifurcation of investment adviser regulation between the SEC and the states by changing the definition of "institutional account" to include both investment advisers required to register with the SEC and those required to register with the states.

B. Accounts Limited to Transactions in Mutual Fund Shares

The requirement in the Books and Records Rule to obtain customer employment information was designed to assist members in making suitable recommendations. This information is unnecessary for those accounts that are limited to mutual fund transactions and for which the member can determine that no recommendations have or will be made. With regard to the requirement in the Books and Records Rule to obtain a customer's tax identification or social security number, the tax laws already impose obligations on funds to obtain this information.¹ Finally, the requirement to determine whether a customer is an associated person of another member also is unnecessary because NASD Conduct Rule 3050, which provides the obligations of executing members when the member knows that a person associated with an employing member has an interest in an account, expressly excludes accounts that are limited to transactions in mutual fund shares.

This change will not affect the need to obtain any information from customers or others in order to meet any other regulatory obligations that may exist.

Basis

NASD Regulation believes that the proposed rule changes are consistent with the provisions of Section 15A(b)(6) of the Securities Exchange Act of 1934, which require, 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, remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. NASD Regulation believes the proposed amendments, which would amend the Books and Records Rule eliminate requirements to

obtain Retail Customer Information for institutional accounts and accounts that are limited to mutual fund shares and for which no recommendations are made, are consistent with these principles.

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 neither solicited nor received.

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. NASD Regulation believes that the proposed rule change, by including in the definition of “institutional account” investment advisers required to register with the states under the National Securities Markets Improvement Act of 1996 and new rules adopted by the SEC, permits such advisers to continue to be excluded from requirements in the Books and Records Rule to provide certain Retail Customer Information. NASD Regulation also believes that the proposed rule change, by

¹ If a customer refuses to provide tax identification, IRS rules require a fund to withhold 31% of all

excluding customer accounts that invest only in unrecommended transactions in mutual funds from requirements to provide certain Retail Customer Information, eliminates an unnecessary requirement with respect to such transactions. Therefore, NASD Regulation requests that the Commission accelerate approval of the proposed rule change to the date of publication of the proposed rule change, since the proposed rule change appropriately preserves the current operation of the Book and Records Rule with respect to institutional accounts and eliminates an unnecessary requirement in the Books and Records Rule with respect to certain accounts which invest only in unrecommended mutual funds.

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

Not applicable.

9. Exhibit

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: _____

John M. Ramsay, Vice President and Deputy General Counsel

May 7, 1998

redemptions or distributions.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-98-35)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Concerning Books and Records Requirements.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on , NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I through VI 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.

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

NASD Regulation is proposing to amend Rule 3110 (the "Books and Records Rule") of the Conduct Rules of the National Association of Securities Dealers, Inc. ("NASD" or "Association") to: (1) amend the definition of "institutional account" to include the accounts of investment advisers that, under the National Securities Markets Improvement Act of 1996 and new rules adopted by the SEC, are now required to register

with the states; and (2) exclude certain customer accounts from the requirement to obtain certain tax and employment information from the customer. Below is the text of the proposed rule amendments. Proposed new language is underlined; proposed deletions are bracketed.

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(B) whether customer is of legal age;

(C) signature of the registered representative introducing the account and signature of the member or partner, officer, or manager who accepts the account; and

(D) if the customer is a corporation, partnership, or other legal entity, the names of any persons authorized to transact business on behalf of the entity;

(2) for each account, other than an institutional account, and accounts in which investments are limited to transactions in [money market funds] open-end

investment company shares that are not recommended by the member or its associated persons, each member shall also make reasonable efforts to obtain, prior to the settlement of the initial transaction in the account, the following information to the extent it is applicable to the account:

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(C) whether customer is an associated person of another member; and

(3) for discretionary accounts, in addition to compliance with subparagraphs (1) and (2) above, and Rule 2510(b) of these Rules, the member shall:

(A) obtain the signature of each person authorized to exercise discretion in the account;

(B) record the date such discretion is granted; and

(C) in connection with exempted securities other than municipals, record the age or approximate age of the customer.

(4) For purposes of this Rule and Rule 2310 the term "institutional account" shall mean the account of:

(A) a bank, savings and loan association, insurance company, or registered investment company;

(B) an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or

(C) any other entity (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.

* * * * *

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

(a)

Background

The Books and Records Rule requires members obtain certain information for all accounts. In addition, the Rule requires that for accounts other than institutional accounts and accounts limited to money market funds members must make reasonable attempts to obtain: (i) a customer's tax identification or social security number; (ii) a customer's occupation and the name and address of the employer; and (iii) information about whether the customer is an associated person of another member ("Retail Customer Information"). An "institutional account" is defined in the Rule to include the account of an investment adviser registered with the SEC.

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new rules, advisers to registered investment companies and those with assets under management of at least \$25 million generally will register exclusively with the SEC. Most others will register exclusively with the states.

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make reasonable efforts to obtain Retail customer Information for retail accounts that are not subject to these limitations. At its meeting on March 19, 1998, the NASD Regulation Board of Directors approved proposed changes to amend NASD Conduct Rule 3110 and authorized the filing of the rule change with the SEC.

(b)

Purpose

1. *Institutional Account Definition*

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The proposed amendments would continue to treat the state-regulated advisory accounts as "institutional accounts" for purposes of the Books and Records Rule and the Suitability Rule. The proposed changes would amend the Books and Records Rule to take into account the bifurcation of investment advisers regulation between the SEC and

the states by changing the definition of “institutional account” to include both investment advisers required to register with the SEC and those required to register with the states.

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This change will not affect the need to obtain any information from customers or others in order to meet any other regulatory obligations that may exist.

(c)

Basis

NASD Regulation believes that the proposed rule changes are consistent with the provisions of Section 15A(b)(6) of the Securities Exchange Act of 1934, which require, 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, remove

impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. NASD Regulation believes the proposed amendments, which would amend the Books and Records Rule eliminate requirements to obtain Retail Customer Information for institutional accounts and accounts that are limited to mutual fund shares and for which no recommendations are made, are consistent with these principles.

III. 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.

IV. 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.

V. 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 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 the date of publication of notice of filing thereof in that the proposed rule change appropriately preserves the current operation of the Books and

² If a customer refuses to provide tax identification, IRS rules require a fund to withhold 31% of all

Records Rule with respect to institutional accounts and eliminates an unnecessary requirement in the Books and Records Rule with respect to certain accounts which invest only in unrecommended mutual funds.

VI. 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 45 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