

April 9, 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-98-32**
Proposed Rule Excluding Research Reports from Filing Requirements

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith 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.

If you have any questions, please contact Thomas M. Selman, Vice President, Investment Companies/Corporate Financing, NASD Regulation, Inc., at (202) 728-8068. His fax number is (202) 728-6976.

Very truly yours,

Joan C. Conley
Secretary

Attachment

File No. SR-NASD-98-32
Consists of 14 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

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 ("Act"), NASD Regulation, Inc. ("NASD Regulation") is herewith filing a proposed rule change to Rule 2210 of the Conduct Rules of the National Association of Securities Dealers, Inc. ("NASD" or "Association") to exclude independently-prepared research reports from the filing requirements of Rule 2210. Below is the text of the proposed rule change. Proposed new language is underlined. There are no proposed deletions.

AMENDMENTS TO NASD CONDUCT RULE 2210

Paragraph (c)(6) of Conduct Rule 2210 is amended by adding new paragraph (G), as follows:

(6) The following types of material are excluded from the foregoing filing requirements and (except for research reports under paragraph (G)) the foregoing spot-check procedures:

* * *

(G) any research report concerning an investment company registered under the Investment Company Act of 1940, provided that:

- (i) the report is prepared by an entity (the "research firm") that is independent of the investment company, its affiliates, and the member using the report;
- (ii) the services of the research firm have not been procured by the investment company, any of its affiliates or any member in order to prepare the report;
- (iii) the research firm prepares and distributes similar types of reports with respect to a substantial number of investment companies;
- (iv) the report is distributed and updated with reasonable regularity in the normal course of the research firm's business; and
- (v) the content of the report has not been materially altered by the member using the report.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of NASD Regulation at its meeting on March 18, 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. Article VII, Section 1(a)(2) 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.

Questions regarding this rule filing may be directed to Thomas M. Selman, Vice President, NASD Regulation, Investment Companies/Corporate Financing, at (202) 728-8068.

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

(a) NASD Conduct Rule 2210 requires that any "advertisement" or "sales literature" (as defined by the rule) concerning a registered investment company be filed with the Advertising/Investment Companies Regulation Department and meet the content standards of that rule, as well as all applicable Commission rules. The rule defines "sales literature" to include a research report. Consequently, Rule 2210 requires that NASD members file all investment company research reports, including any research report that has been prepared by an entity that is independent of the investment company and its affiliates and of any NASD member, and whose services are not procured by the investment company or any of its affiliates or any NASD member to prepare the report ("independent research firms").

As the investment company industry has grown in recent years, so too has the coverage of this industry by independent research firms. Many of these firms publish reports that analyze a wide variety of investment companies and provide information, such as each investment company's historical performance, the investment company's fees and expenses, and a description and narrative analysis of the investment company's investment strategies and portfolio management style.

NASD members use these independently-prepared research reports in a number of ways. Some members may make the entire research service available to customers at a branch office. Members may also distribute an independently-prepared research report concerning a particular investment company as part of the selling process.

The proposed rule change would clarify the meaning, administration and enforcement of Rule 2210 insofar as it may appear to apply to certain types of independently-prepared research reports. The proposed rule change would clarify that these types of independently-prepared research reports would not have to be filed with the Advertising/Investment Companies Regulation Department of NASD Regulation, Inc. (NASD Regulation does not believe that these research reports would have to be filed with the SEC under Section 24(b) of the Investment Company Act of 1940 if the proposed rule change were adopted.)

Under the proposed rule change, these research reports would continue to be subject to the Department's spot-check procedures. Moreover, the proposed rule change would impose certain conditions designed to ensure that the opinions in the research reports are objective, that the presentation is balanced, and that investors have access to regular updates of the reports. In particular, the proposed rule change would impose several requirements derived from an

analogous SEC rule, Rule 139, which provides a safe harbor from the definition of "offer for sale" and "offer to sell" in the Securities Act of 1933.

Thus, under the proposed rule change, a published article that analyzes only a few funds or that is not regularly updated in the normal course of business would have to be filed with the Department if it is to be distributed or made generally available to customers or the public. Moreover, while a member could distribute an independently-prepared research report concerning a particular fund without filing the report with the Department, if the member alters the report in any material way, then the member would have to file it with the Department if it is to be distributed or made generally available to customers or the public.

NASD Regulation believes that the proposed rule change would not raise significant investor protection concerns. In its filing and review program, the Department rarely has found significant issues with the types of research reports that would be excepted by the proposed rule change. Moreover, to ensure that investors are adequately protected, the proposed rule change would except these types of research reports only from the filing requirements, and not the content requirements of applicable NASD rules. Under the proposed rule change, these research reports would continue to be subject to the content requirements of Rule 2210 as well as Conduct Rule 2110 (requiring that a member "observe high standards of commercial honor and just and equitable principles of trade"); Rule 2120 (prohibiting use of manipulative, deceptive or other fraudulent devices); and IM-2310-2 (requiring fair dealing with customers, including an avoidance of fraud violations). In addition, Conduct Rule 2210 would continue to require that these research reports be approved prior to use by a registered principal of the member.

The proposed rule change would apply to independently-prepared research reports that are contained in software or that are electronically communicated, as well as those on paper.

(b) NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which require that the Association adopt and amend its rules to promote just and equitable principles of fair trade, and generally provide for the protection of investors and the public interest in that the proposed rule change allows the dissemination of certain research reports, subject to the content requirements of the NASD Conduct Rules.

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. The proposed rule change would reduce regulatory burdens and allow the

dissemination of information that may be useful to investors, without raising any significant investor protection issue.

Because NASD Regulation believes that the proposed rule change would reduce regulatory burdens and allow the dissemination of information that may be useful to investors, without raising any significant investor protection issue, 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.

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: _____

Joan C. Conley, Secretary

Date: April 9, 1998

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-98-32)

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Filing Requirements for Independently Prepared Research Reports

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 , the 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 to amend Rule 2210 of the Conduct Rules of the National Association of Securities Dealers, Inc. ("NASD" or "Association") to exclude independently-prepared research reports from the filing requirements of Rule 2210. Below is the text of the proposed rule change. Proposed new language is in italics.

AMENDMENTS TO NASD CONDUCT RULE 2210

Paragraph (c)(6) of Conduct Rule 2210 is amended by adding new paragraph (G), as follows:

(6) The following types of material are excluded from the foregoing filing requirements and (except for research reports under paragraph (G)) the foregoing spot-check procedures:

* * *

(G) any research report concerning an investment company registered under the Investment Company Act of 1940, provided that:

- (i) the report is prepared by an entity (the “research firm”) that is independent of the investment company, its affiliates, and the member using the report;
- (ii) the services of the research firm have not been procured by the investment company, any of its affiliates or any member in order to prepare the report;
- (iii) the research firm prepares and distributes similar types of reports with respect to a substantial number of investment companies;
- (iv) the report is distributed and updated with reasonable regularity in the normal course of the research firm's business; and
- (v) the content of the report has not been materially altered by the member using the report.

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) NASD Conduct Rule 2210 requires that any "advertisement" or "sales literature" (as defined by the rule) concerning a registered investment company be filed with the

Advertising/Investment Companies Regulation Department and meet the content standards of that rule, as well as all applicable Commission rules. The rule defines "sales literature" to include a research report. Consequently, Rule 2210 requires that NASD members file all investment company research reports, including any research report that has been prepared by an entity that is independent of the investment company and its affiliates and of any NASD member, and whose services are not procured by the investment company or any of its affiliates or any NASD member to prepare the report ("independent research firms").

As the investment company industry has grown in recent years, so too has the coverage of this industry by independent research firms. Many of these firms publish reports that analyze a wide variety of investment companies and provide information, such as each investment company's historical performance, the investment company's fees and expenses, and a description and narrative analysis of the investment company's investment strategies and portfolio management style.

NASD members use these independently-prepared research reports in a number of ways. Some members may make the entire research service available to customers at a branch office. Members may also distribute an independently-prepared research report concerning a particular investment company as part of the selling process.

The proposed rule change would clarify the meaning, administration and enforcement of Rule 2210 insofar as it may appear to apply to certain types of independently-prepared research reports. The proposed rule change would clarify that these types of independently-prepared research reports would not have to be filed with the Advertising/Investment Companies Regulation Department of NASD Regulation, Inc. (NASD Regulation does not believe that these

research reports would have to be filed with the SEC under Section 24(b) of the Investment Company Act of 1940 if the proposed rule change were adopted.)

Under the proposed rule change, these research reports would continue to be subject to the Department's spot-check procedures. Moreover, the proposed rule change would impose certain conditions designed to ensure that the opinions in the research reports are objective, that the presentation is balanced, and that investors have access to regular updates of the reports. In particular, the proposed rule change would impose several requirements derived from an analogous SEC rule, Rule 139, which provides a safe harbor from the definition of "offer for sale" and "offer to sell" in the Securities Act of 1933.

Thus, under the proposed rule change, a published article that analyzes only a few funds or that is not regularly updated in the normal course of business would have to be filed with the Department if it is to be distributed or made generally available to customers or the public. Moreover, while a member could distribute an independently-prepared research report concerning a particular fund without filing the report with the Department, if the member alters the report in any material way, then the member would have to file it with the Department if it is to be distributed or made generally available to customers or the public.

NASD Regulation believes that the proposed rule change would not raise significant investor protection concerns. In its filing and review program, the Department rarely has found significant issues with the types of research reports that would be excepted by the proposed rule change. Moreover, to ensure that investors are adequately protected, the proposed rule change would except these types of research reports only from the filing requirements, and not the content requirements of applicable NASD rules.

Under the proposed rule change, these research reports would continue to be subject to the content requirements of Rule 2210 as well as Conduct Rule 2110 (requiring that a member "observe high standards of commercial honor and just and equitable principles of trade"); Rule 2120 (prohibiting use of manipulative, deceptive or other fraudulent devices); and IM-2310-2 (requiring fair dealing with customers, including an avoidance of fraud violations). In addition, Conduct Rule 2210 would continue to require that these research reports be approved prior to use by a registered principal of the member.

The proposed rule change would apply to independently-prepared research reports that are contained in software or that are electronically communicated, as well as those on paper.

(b) NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)¹ of the Act, which require that the Association adopt and amend its rules to promote just and equitable principles of fair trade, and generally provide for the protection of investors and the public interest in that the proposed rule change allows the dissemination of certain research reports, subject to the content requirements of the NASD Conduct Rules.

(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.

¹ 15 U.S.C. § 78q-3.

(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

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 the date of publication of notice of filing thereof in that accelerated approval will reduce regulatory burdens and allow the dissemination of information that may be useful to investors, without raising any significant investor protection issue.

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