SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40365; File No. SR–NASD–98–29]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 to Proposed Rule Change Relating to Standards for Individual Correspondence

August 26, 1998.

I. Introduction

On April 6, 1998, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association''), through its wholly-owned subsidiary, the NASD Regulation, Inc. (''NASDR''), submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend NASD Conduct Rule 2210 to require that written or electronic communications prepared for a single customer be subject to the general standards and those specific standards of NASD Rule 2210 that prohibit misleading statements. On April 30, 1998, the NASDR filed Amendment No. 1 to the proposed rule change.[3]

The proposed rule change, as amended, was published for comment in the **Federal Register** on May 8, 1998.[4] One comment letter was received on the proposal.[5] On August 4, 1998, the NASDR filed Amendment No. 2 to the proposed rule change.[6] The Commission solicits comments on Amendment No. 2 from interested persons. This order approves the proposed rule change and Amendment No. 1 thereto and approves Amendment No. 2 to the proposed rule change on an accelerated basis.

II. Background and Description of the Proposal

Currently, NASD Rule 2210 imposes various requirements on member communications with the public, designed to ensure that those communications are fair, balanced, and not misleading. However, NASD Rule 2210 does not expressly apply to the content of correspondence, defined as a communication to only one person. In addition, there is presently no definition of correspondence in the NASD rules, even though members are required to supervise the use of correspondence by their associated persons under NASD Rule 3010.

In June 1997, the NASDR requested comment on proposed amendments to NASD Rule 2210 to define ''correspondence'' and amend the rule to clarify which particular standards would apply to correspondence.[7] As first proposed, the amendments to NASD Rule 2210 would have required that communications prepared for a single customer be subject to the standards, but not the filing and review requirements, of NASD Rule 2210. The general standards of NASD Rule 2210 define or prohibit the dissemination of statements that could be considered misleading. The specific standards of NASD Rule 2210, set forth in subparagraph (d)(1) require certain additional disclosures to be included in certain cases. Most commenters supported applying to correspondence only the general standards of NASD Rule 2210, which, among other things, prohibit untrue statements of material facts, the omission of material facts, and statements that are exaggerated, misleading, or unwarranted. These commenters stated that imposing all of the specific standards on each item of correspondence, particularly those that require additional disclosure, would unduly complicate communication with clients and unnecessarily burden supervisory programs without materially contributing to the protection of investors.

The NASDR believes that certain statements pose similar dangers regardless of whether they are communicated to one person or many persons. Therefore, the NASDR proposed to subject correspondence to the general standards and those specific standards of NASD Rule 2210 that prohibit misleading statements, but not to the specific standards of the rule that require specific disclosure. The proposal would create a category defined as ''communications with the public'' to include the current definitions of ''advertisement'' and ''sales literature,'' and a new definition of ''correspondence.'' ''Correspondence'' is defined in the proposal as ''* * * [a]ny written or electronic communication prepared for delivery to a single current or prospective customer, and not for dissemination to multiple customers or the general public.'' The NASDR also proposes that in determining whether a written or electronic communication is prepared for delivery to a single current or prospective customer, NASD members should consider, and the staff of the NASDR should examine, among other things, the form and content of the communication. Thus, a written or electronic communication addressed to a single current or prospective customer, the content of which is substantially identical to that of written or electronic communications sent to one or more other current or prospective customers, is a form letter, not ''correspondence.'' Form letters are considered ''sales literature'' under NASD Rule 2210 and therefore, would be subject to all of the general and specific standards of NASD Rule 2210.

The proposed rule change would amend NASD Rule 2210 to subject individual correspondence to the general standards under subparagraph (d)(1) and the following specific standards under subparagraph (d)(2) of NASD Rule 2210: (i) subparagraph (d)(2)(C), which prohibits exaggerated, unwarranted, or certain other specific claims or opinions; (ii) subparagraph (d)(2)(E), which prohibits certain offers of free services; (iii) subparagraph (d)(2)(F), which prohibits certain claims for research services; (iv) subparagraph (d)(2)(G), which prohibits certain hedge clauses; (v) subparagraph (d)(2)(J), which prohibits the implication of endorsement or approval by regulatory organizations; and (vi) subparagraph (d)(2)(N), which prohibits predictions and projections of investment results.[8] Each of these specific provisions derive from members' general obligations not to make statements that are misleading or without a reasonable basis in fact. In addition, as the proposed rule change is not intended to change the current

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter from John Ramsay, Vice President and Deputy General Counsel, NASDR, to Katherine A. England, Assistant Director, Division of Market Regulation (''Division''), Commission, dated April 29, 1998 (''Amendment No. 1'').

[4] *See* Securities Exchange Act Release No. 39942 (May 1, 1998), 63 FR 25532.

[5] *See* Letter from Joseph P. Savage, Assistant Counsel, Investment Company Institute (''ICI''), to Jonathan G. Katz, Secretary, Commission, dated May 29, 1998 (''ICI Letter'').

[6] *See* Letter from John M. Ramsay, Vice President and Deputy General Counsel, NASDR, to Katherine A. England, Assistant Director, Division, Commission, dated August 4, 1998 (''Amendment No. 2''). In Amendment No. 2, the NASDR responds to the concerns raised in the ICI Letter and proposes to amend its filing to delete the phrase ''or a single customer'' in subparagraph (d)(1)(D)(ii) to NASD Rule 2210 and to revise subparagraph (d)(2)(L) to NASD Rule 2210 to specify that the requirements apply solely to advertisements and sales literature.

[7] *See* NASD Notice to Members 97–37 (June 1997).

[8] As initially proposed, subparagraph (d)(2)(L), which prohibits certain statements regarding tax free or tax exempt returns, also would have applied to correspondence. In response to the ICI Letter, the NASDR, in Amendment No. 2, eliminated this requirement. *See* Amendment No. 2, *supra* note 6.

application of Interpretive Memoranda under NASD Rule 2210, paragraph (a) to IM–2210–1, relating to collateralized mortgage obligations, has been amended to clarify that the interpretation applies only to advertisements and sales literature.

III. Summary of Comments

The Commission received one comment letter on the proposed rule change.[9] The commenter generally opposed the proposal. Specifically, the ICI believes the proposed changes are unnecessary given recent amendments to NASD Rule 3010 and 3110 and the fact that NASDR based the rule on three isolated incidents occurring more than two years ago. The ICI also requested: (1) clarification as to the applicability of correspondence to the Commission's advertising rules; (2) that the proposal be limited to correspondence made ''in connection with the offer or sale of any security;'' (3) that subparagraph (d)(1)(A) to NASD Rule 2210 be revised to limit the applicability of the ''sound basis'' requirement to advertisements and sales literature; (4) that the phrase ''or a single customer'' be deleted from subparagraph (d)(1)(D)(ii) to NASD Rule 2210; and (5) that subparagraph (d)(2)(L) to NASD Rule 2210 be revised to apply only to advertisements and sales literature.

In response, the NASDR proposes to amend its filing to delete the phrase ''or a single customer'' in subparagraph (d)(1)(D)(ii) to NASD Rule 2210 and to revise subparagraph (d)(2)(L) to NASD Rule 2210 to specify that the requirements apply solely to advertisements and sales literature.

IV. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.[10] Specifically, the Commission believes the proposal is consistent with the requirements of Section 15A(b)(6) of the Act [11] in that it is designed to prevent fraudulent and manipulative acts and practices and to protect investors and the public interest. The Commission believes that the proposal, which applies the general and certain specific standards of the NASD's communications rules to correspondence directed towards a single customer, is designed to protect existing and prospective customers by requiring that such correspondence not be misleading.

The NASDR proposes to define the word ''correspondence'' in new subparagraph (a)(3) to NASD Rule 2210 as ''. . .[a]ny written or electronic communication prepared for delivery to a single current or prospective member, and not for dissemination to multiple customers or the general public.'' The Commission believes that the proposed new definition of the word ''correspondence'' adequately addresses the type of communications sent by member firms to prospective and existing customers that satisfy the definitions of neither ''advertising'' nor ''sales literature'' under the rule. In addition, the Commission believes the proposal appropriately advises members and NASD examiners to consider, among other things, the form and content of the communication when determining whether a given communication constitutes correspondence.

As discussed above, the NASDR proposal would apply the general and certain specific standards of NASD Rule 2210 to correspondence directed towards a single customer. The Commission believes that the NASD Rule 2210 requirements, which are designed to ensure that communications are fair, balanced, and not misleading, are consistent with the Act. The Commission believes that the application of such standards to correspondence directed towards a single customer is appropriate, as such persons have as much, if not more, reason to rely on the veracity and accuracy of the content of such correspondence as would the recipient of a ''form'' letter, which is subject to all of the general and specific standards of NASD Rule 2210. The Commission recognizes that several existing NASD Rules, including NASD Rules 2110, 3010, and IM–2310–2,[12] impose broad-based requirements on NASD member firms to deal fairly with the public. Nonetheless, the Commission believes that the more specific requirements set forth in the current proposal should help to clarify member firms' obligations with respect to written and electronic correspondence directed towards a single existing or prospective customer.

The Commission also believes that the NASDR's proposal to apply only certain of the specific standards set forth in subparagraph (d)(2) to NASD Rule 2210 to correspondence directed towards a single customer is reasonable. To require each of the specific standards of NASD Rule 2210 to be applied would likely overwhelm the recipient of such correspondence with irrelevant, and possibly confusing, information. The Commission believes that the NASDR's proposal to apply certain of the specific standards set forth in subparagraph (d)(2) to NASD Rule 2210 reasonably balances member firms' need for workable regulatory guidelines with investors' need for reliable information. Accordingly, the Commission believes that the proposed rule change, as amended, is consistent with the Act.

The Commission finds good cause for approving proposed Amendment No. 2 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register.** In Amendment No. 2, the NASDR addresses the concerns raised in the one comment letter received by the Commission on this proposal. Amendment No. 2 modifies the original filing only slightly, in response to specific comments made in the ICI Letter. Specifically, Amendment No. 2 deletes the phrase ''or a single customer'' in subparagraph (d)(1)(D)(ii) to NASD Rule 2210 and limits the applicability of subparagraph (d)(2)(L) to NASD Rule 2210 to advertisements and sales literature. As the modifications proposed in Amendment No. 2 are reasonable and do not significantly alter the original proposal, the Commission believes that Amendment No. 2 raises no issues of regulatory concern. Accordingly, the Commission believes that it is consistent with Section 15A(b)(6) of the Act [13] to approve Amendment No. 2 to the proposed rule change on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2, including whether Amendment No. 2 consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the

[9] *See* ICI Letter, *supra* note 5.

[10] In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[11] 15 U.S.C. 78o–3(b)(6).

[12] NASD Rule 2110 requires that ''[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.'' NASD Rule 3010(d) sets forth members' responsibilities relating to the supervision of correspondence. IM–2310–2 sets forth member firms' obligations in their dealings with customers.

[13] 15 U.S.C. 78o–3(b)(6).

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, 450 Fifth Street, NW, Washington, DC 20549. Copies of all such filings will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR–NASD–98–29 and should be submitted by September 24, 1998.

VI. Conclusion

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,[14] that the proposed rule change (SR–NASD–98–29), as amended, is approved.

Jonathan G. Katz,

Secretary.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[15]

Jonathan G. Katz,

Secretary.

[FR Doc. 98–23769 Filed 9–2–98; 8:45 am]

BILLING CODE 8010–01–M

[14] 15 U.S.C. 78s(b)(2).

[15] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40378; File No. SR–NASD–98–57]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1Thereto by the National Association of Securities Dealers, Inc. Relating to Amendments to NASD Membership and Registration, Investigation and Sanctions, Conduct and Code of Procedure Rules

August 27, 1998.

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 August 7, 1998, the National Association of Securities Dealers, Inc. (''NASD'' or the ''Association''), through its regulatory subsidiary, 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 filing was amended on August 17, 1998,[3] and further amended on August 26, 1998.[4] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD Regulation is proposing to amend the Rules of the Association to permit the Department of Enforcement to amend complaints, without Hearing Officer approval, prior to the filing of responsive pleadings; to clarify and consolidate default provisions and shorten the call period for default decisions to 25 days; to require the Office of the General Counsel to issue decisions in settled cases; to change the trigger date for which the timing of motions to introduce new evidence is keyed; to permit Advertising Department staff to impose advertising pre-use filing requirements on members; to consolidate procedures for cancellation or suspension for failure to provide requested information; to simplify and expedite certain non-summary procedures in the Rule 9500 Series; and for other purposes.[5]

The text of the proposed rule change follows. Proposed new language is in italics; proposed deletions are in brackets.

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0100. GENERAL PROVISIONS

0120. Definitions

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(m) ''National *Adjudicatory Council* [Business Conduct Committee]''

The term ''National *Adjudicatory Council* [Business Conduct Committee]'' means the committee of [the Board of Directors of] NASD Regulation which may be authorized and directed to act for the Board of Directors of NASD Regulation in a manner consistent with the By-Laws of NASD Regulation, the Rules of the Association, and the Delegation Plan with respect to (1) an appeal or review of a disciplinary proceeding; (2) a statutory disqualification decision; (3) a review of a membership proceeding; (4) a review of an offer of settlement, a letter of acceptance, waiver, and consent, and a minor rule violation plan letter; (5) the exercise of exemptive authority; and (6) such other proceedings or actions authorized by the Rules of the Association.

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2000. BUSINESS CONDUCT

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2200. COMMUNICATIONS WITH CUSTOMERS AND THE PUBLIC

2210. Communications With The Public

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(c) Filing Requirements and Review Procedures

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(4)(A) Notwithstanding the foregoing provisions, [any District Business Conduct Committee of the Association] *the Department,* upon review of a member's advertising and/or sales literature, and after determining that the member has departed and there is a reasonable likelihood that the member will again depart from the standards of this Rule, may require that such member file all advertising and/or sales literature, or the portion of such member's material which is related to any specific types of classes of securities or services, with the Department [and/or the District Committee], at least ten days prior to use. The member must provide with each filing the actual or anticipated date of first use.

(B) The [Committee] *Department* shall notify the member in writing of the types of material to be filed and the length of time such requirement is to be in effect. The requirement shall not exceed one year, however, and shall not take effect until 30 days after the member receives the written notice, during which time the member may request a hearing [before the District Business Conduct Committee] *under Rule 9514,* and any such hearing shall be held in reasonable conformity with the hearing and appeal procedures of the [Code of Procedure as contained in the] Rule [9000] *9510* Series.

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2220. Options Communications with the Public

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(c) Association Approval Requirements and Review Procedures

(1) In addition to the approval required by paragraph (b) of this Rule, every advertisement and all educational material of a member or member organization pertaining to options shall

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Letter from Joan C. Conley, Secretary, NASD Regulation to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated August 17, 1998.

[4] E-mail from Eric Moss, Attorney, NASD Regulation to Mandy Cohen, Attorney, Division of Market Regulation, Commission, dated August 26, 1998.

[5] The filing proposes amendment to Rules 0120, 2210, 2220, 2320, 8210, the Rule 8220 Series, IM–8310–2, 9212, 9215, 9241, 9269, 9270, 9312, 9346, 9360, the Rule 9500 Series, and 9610, specifically.