

March 15, 2000

Katherine A. England  
Assistant Director  
Division of Market Regulation  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549  
Mail Stop 5-1/Room 5200

Re: File No. **SR-NASD-00-12** - Amendments to Rules Governing Member  
Communications With the Public

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 (other than the public comment letters) in Word 7.0 to facilitate production of the Federal Register. Due to the complexity of this proposed rule change and the necessity for extensive public comment we respectfully request that the Commission provide members of the public with at least 45 days in which to comment.

If you have any questions, please contact Joseph Savage, Counsel, Advertising/Investment Companies Regulation, NASD Regulation, Inc., at (202) 974-8233. The fax number is (202) 974-2732.

Very truly yours,

Joan C. Conley  
Secretary

Attachment

cc (without Exhibits):

*Securities and Exchange Commission:*

Katherine A. England

March 15, 2000

Page 2

Paul F. Roye, Director  
Division of Investment Management

Cynthia M. Fornelli, Attorney Fellow  
Division of Investment Management

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File No. SR-NASD-00-12  
Consists of 325 Pages

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C.

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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 (the “Act”), NASD Regulation, Inc. (“NASD Regulation”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend Rule 2210 and Interpretive Materials thereunder, promulgate new Rule 2211, and renumber existing Rule 2211, of the National Association of Securities Dealers, Inc. (“NASD” or “Association”). The proposed rule change would modernize and clarify the rules governing member communications with the public. Among other provisions, the proposed rule change would exclude all communications to institutional investors from member pre-use approval and NASD Regulation filing requirements. Form letters and group e-mail to existing customers and fewer than 25 prospective retail customers also would be eligible for these exclusions. Additionally, the proposed rule change would exclude independently prepared reprints from the filing and most content standards and would exclude certain press releases from the filing requirements. The proposed rule change also would simplify the content standards applicable to member communications.

Below is the text of the proposed rule amendments. The amendments would replace existing Rule 2210, IM-2210-1, IM-2210-3 and IM-2210-4 in their entirety. The amendments also would create new Rule 2211 and renumber existing Rule 2211 as new Rule 2212.

### **2210. Communications with the Public**

#### **(a) Definitions**

For purposes of this Rule and any interpretation thereof, “communications with the public” consist of:

(1) “Advertisement.” Any material, other than an independently prepared reprint and institutional sales material, that is published or designed for use in any electronic or other public media, including any Web site; newspaper, magazine or other periodical; radio, television, telephone or tape recording; videotape display; sign or billboard; motion picture; or telephone directory (other than routine listings).

(2) “Sales Literature.” Any written or electronic communication, other than an advertisement, independently prepared reprint, institutional sales material and correspondence, that is generally distributed or made available to customers or the public, including circulars; research reports; market letters; performance reports or summaries; form letters; telemarketing scripts; seminar texts; reprints or excerpts of any other advertisement, sales literature or published article; and press releases concerning a member’s products or services.

(3) “Correspondence” as defined in Rule 2211.

(4) “Institutional Sales Material” as defined in Rule 2211.

(5) “Public Appearance.” Participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity.

(6) “Independently Prepared Reprint.”

(A) Any reprint or excerpt of any article issued by a publisher, provided that:

(i) the publisher is not an affiliate of the member using the reprint or any underwriter or issuer of a security mentioned in the reprint;

(ii) neither the member using the reprint nor any underwriter or issuer of a security mentioned in the reprint has commissioned the reprinted article; and

(iii) the member using the reprint has not materially altered its contents except as necessary to make the reprint consistent with applicable regulatory standards or to correct factual errors; and

(B) Any report concerning an investment company registered under the Investment Company Act of 1940, provided that:

(i) the report is prepared by an entity that is independent of the investment company, its affiliates, and the member using the report (the “research firm”);

(ii) the report’s contents have not been materially altered by the member using the report except as necessary to make the report consistent with applicable regulatory standards or to correct factual errors;

(iii) the research firm prepares and distributes reports based on similar research with respect to a substantial number of investment companies;

(iv) the research firm updates and distributes reports based on its research of the investment company with reasonable regularity in the normal course of the research firm’s business;

(v) neither the investment company, its affiliates nor the member using the research report has commissioned the research used by the research firm in preparing the report; and

(vi) if a customized report was prepared at the request of the investment company, its affiliate or a member, then the report includes only information that the research firm has already compiled and published in another report, and does not omit information in that report necessary to make the customized report fair and balanced.

**(b) Approval and Recordkeeping**

**(1) Registered Principal Approval for Advertisements, Sales Literature and Independently Prepared Reprints**

A registered principal of the member must approve by signature or initial and date each advertisement, item of sales literature and independently prepared reprint before the earlier of its use or filing with the Association's Advertising/Investment Companies Regulation Department ("Department"). With respect to debt and equity securities that are the subject of research reports as that term is defined in Rule 472 of the New York Stock Exchange, this requirement may be met by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock Exchange.

**(2) Record-keeping**

(A) Members must maintain all advertisements, sales literature, and independently prepared reprints in a file for a period of three years from the date of last use. The file must include the name of the registered principal who approved each advertisement, item of sales literature, and independently prepared reprint and the date that approval was given.

(B) Members must maintain in a file information concerning the source of any statistical table, chart, graph or other illustration used by the member in communications with the public.

Cross Reference -- NASD Conduct Rule 3010 (Supervision) and Rule 3110 (Books and Records)

**(c) Filing Requirements and Review Procedures**

**(1) Date of First Use and Approval Information**

The member must provide with each filing under this paragraph the actual or anticipated date of first use, the name and title of the registered principal who approved the advertisement or sales literature, and the date that the approval was given.

**(2) Requirement to File Certain Material**

Within 10 business days of first use or publication, a member must file the following advertisements and sales literature with the Department:

(A) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts, continuously offered closed-end funds, and unit investment trusts) not included within the requirements of paragraph (c)(3). The filing of any advertisement or sales literature that includes or incorporates a performance ranking or performance comparison of the investment company with other investment companies must include a copy of the ranking or comparison used in the advertisement or sales literature.

(B) Advertisements and sales literature concerning public direct participation programs (as defined in Rule 2810).

(C) Advertisements concerning government securities (as defined in Section 3(a)(42) of the Act).

**(3) Requirement to File Certain Material Prior to Use**

At least 10 business days prior to first use or publication (or such shorter period as the Department may allow), a member must file the following communications with the Department and withhold them from publication or circulation until any changes specified by the Department have been made:

(A) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts, continuously offered closed-end funds and unit investment trusts) that include or incorporate performance rankings or performance comparisons of the investment company with other investment companies when the ranking or comparison category is not generally published or is the creation, either directly or indirectly, of the investment company, its underwriter or an affiliate. Such filings must include a copy of the data on which the ranking or comparison is based.

(B) Advertisements concerning collateralized mortgage obligations.

**(4) Requirement for Certain Members to File Material Prior to Use**

(A) Each member that has not previously filed an advertisement with the Department (or with a registered securities exchange having standards comparable to those contained in this rule) must file its initial advertisement with the Department at least 10 business days prior to use and must continue to file its advertisements at least 10 business days prior to use, for a period of one year.

(B) Notwithstanding the foregoing provisions, the Department upon review of a member's advertisements or sales literature, and after determining that the member has departed from the standards of this Rule, may require that the member file all advertisements and sales literature, or the portion of the member's material that is related to any specific type or class of securities or services, with the Department at least 10 business days prior to use. The Department will 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. Any filing requirement imposed under this

paragraph will take effect 30 calendar days after the member receives the written notice, during which time the member may appeal pursuant to the hearing and appeal procedures of the Code of Procedure contained in the Rule 9000 Series.

Cross Reference – Section 13 of Schedule A to the By-Laws of the NASD (Review Charge for Advertisement, Sales Literature, and Other Such Material Filed or Submitted)

**(5) Filing of Television or Video Advertisements**

If a member has filed a draft version or "story board" of a television or video advertisement pursuant to a filing requirement, then the member must also file the final filmed version within 10 business days of first use or broadcast.

**(6) Spot-Check Procedures**

In addition to the foregoing requirements, each member's written and electronic communications with the public may be subject to a spot-check procedure. Upon written request from the Department, each member must submit the material requested in a spot-check procedure within the time frame specified by the Department.

**(7) Exclusions from Filing Requirements**

The following types of material are excluded from the filing requirements and (except for the material in paragraphs (G) through (J)) the foregoing spot-check procedures:

(A) Advertisements and sales literature that previously have been filed and that are to be used without material change.

(B) Advertisements and sales literature solely related to recruitment or changes in a member's name, personnel, electronic or postal address, ownership, offices, business structure, officers or partners, telephone or teletype numbers, or concerning a merger with, or acquisition by, another member.

(C) Advertisements and sales literature that do no more than identify the Nasdaq or other national securities exchange symbol of the member or identify a security for which the member is a Nasdaq registered market maker.

(D) Advertisements and sales literature that do no more than identify the member or offer a specific security at a stated price.

(E) Prospectuses, preliminary prospectuses, fund profiles, offering circulars and similar documents that have been filed with the Securities and Exchange Commission (the "SEC") or any state, or that concern a securities offering that is exempt from such registration, except that an investment company prospectus published pursuant to SEC Rule 482 under the Securities Act of 1933 will not be considered a prospectus for purposes of this exclusion.



(F) Advertisements prepared in accordance with Section 2(10)(b) of the Securities Act of 1933, as amended, or any rule thereunder, such as SEC Rule 134, and announcements as a matter of record that a member has participated in a private placement, unless the advertisements are related to direct participation programs or securities issued by registered investment companies.

(G) Press releases that are made available only to members of the media.

(H) Independently prepared reprints.

(I) Correspondence.

(J) Institutional sales material.

Although the material described in paragraphs (c)(7)(G) through (J) is excluded from the foregoing filing requirements, investment company communications described in those paragraphs shall be deemed filed with the Association for purposes of Section 24(b) of the Investment Companies Act of 1940 and Rule 24b-3 of the Commission thereunder.

(8) Material that refers to investment company securities, direct participation programs, government securities or exempted securities (as defined in Section 3(a)(12) of the Act) solely as part of a listing of products or services offered by the member, is excluded from the requirement of paragraphs (c)(2) and (c)(3).

(9) Pursuant to the Rule 9600 Series, the Association may exempt a member or person associated with a member from the pre-filing requirements of this paragraph (c) for good cause shown.

**(d) Content Standards**

**(1) Standards Applicable to All Communications with the Public**

(A) All member communications with the public must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service. No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communication to be misleading.

(B) No member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public. No member may publish, circulate or distribute any communication with the public that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

(C) Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication.

(D) Communications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. A hypothetical illustration of mathematical principles is permitted, provided that it does not predict or project the performance of an investment or investment strategy. This paragraph (d)(1)(D) shall not apply to a statement in an independently prepared reprint that represents the opinion of the article's author concerning the prospects for a member's business, products or services.

(E) If any testimonial in a communication with the public concerns a technical aspect of investing, the person making the testimonial must have the knowledge and experience to form a valid opinion.

## **(2) Standards Applicable to Advertisements and Sales Literature**

(A) Advertisements or sales literature providing any testimonial concerning the investment advice or investment performance of a member or its products must state the following:

(i) The fact that the testimonial may not be representative of the experience of other clients.

(ii) The fact that the testimonial is no guarantee of future performance or success.

(iii) If more than a nominal sum is paid, the fact that it is a paid testimonial.

(B) Any comparison in advertisements or sales literature between investments or services must disclose all material differences between them, including (as applicable) investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, and tax features.

(C) All advertisements and sales literature must:

(i) prominently disclose the name of the member and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction;

(ii) reflect any relationship between the member and any non-member or individual who is also named; and

(iii) if it includes other names, reflect which products or services are being offered by the member.

This paragraph (C) does not apply to so-called “blind” advertisements used to recruit personnel.

**(e) Violation of Other Rules**

Any violation by a member of any rule of the SEC, the Securities Investor Protection Corporation or the Municipal Securities Rulemaking Board applicable to member communications with the public will be deemed a violation of this Rule.

Cross Reference - SEC Rules Concerning Investment Company Sales Literature and Advertising (SEC Rules and Regulation T Tab)

Cross Reference -- Conduct Rule 3010(g)(2) (Concerning branch office locations, telephone directory line listings, business cards and letterhead).

## **IM-2210-1. Guidelines to Ensure That Communications With the Public Are Not Misleading**

Every member is responsible for determining whether any communication with the public, including material that has been filed with the Department, complies with all applicable standards, including the requirement that the communication not be misleading. In order to meet this responsibility, member communications with the public must conform with the following guidelines. These guidelines do not represent an exclusive list of considerations that a member must make in determining whether a communication with the public complies with all applicable standards.

(1) Members must ensure that statements are not misleading within the context in which they are made. A statement made in one context may be misleading even though such a statement could be appropriate in another context. An essential test in this regard is the balanced treatment of risks and potential benefits. Member communications should be consistent with the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield inherent to investments.

(2) Members must consider the nature of the audience to which the communication will be directed. Different levels of explanation or detail may be necessary depending on the audience to which a communication is directed. Members must keep in mind that it is not always possible to restrict the audience that may have access to a particular communication with the public. Additional information or a different presentation of information may be required depending upon the medium used for a particular communication and the possibility that the communication will reach a larger or different audience than the one initially targeted.

(3) Member communications must be clear. A statement made in an unclear manner can cause a misunderstanding. A complex or overly technical explanation may be more confusing than too little information.

(4) In communications with the public, income or investment returns may not be characterized as tax free or exempt from income tax when tax liability is merely postponed or deferred, such as when taxes are payable upon redemption.

(5) In advertisements and sales literature, references to tax free or tax exempt income must indicate which income taxes apply, or which do not, unless income is free from all applicable taxes. For example, if income from an investment company investing in municipal bonds is subject to state or local income taxes, this fact must be stated, or the illustration must otherwise make it clear that income is free only from federal income tax.

**(6) Recommendations.**

(A) In making a recommendation in advertisements and sales literature, whether or not labeled as such, a member must have a reasonable basis for the recommendation and must disclose any of the following situations which are applicable:

(i) that the member usually makes a market in the securities being recommended, or in the underlying security if the recommended security is an option, or that the member or associated persons will sell to or buy from customers on a principal basis;

(ii) that the member and/or its officers or partners own options, rights or warrants to purchase any of the securities of the issuer whose securities are recommended, unless the extent of such ownership is nominal;

(iii) that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years.

(B) The member shall also provide, or offer to furnish upon request, available investment information supporting the recommendation. Recommendations on behalf of corporate equities must provide the price at the time the recommendation is made.

(C) A member may use material referring to past recommendations if it sets forth all recommendations as to the same type, kind, grade or classification of securities made by a member within the last year. Longer periods of years may be covered if they are consecutive and include the most recent year. Such material must also name each security recommended and give the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and indicate the general market conditions during the period covered.

(D) A member may use material that does not make any specific recommendation but which offers to furnish a list of all recommendations made by a member within the past year or over longer periods of consecutive years, including the most recent year, if this list contains all the information specified in subparagraph (C). Neither the list of recommendations, nor material offering such list, shall imply comparable future performance. Reference to the results of a previous specific recommendation, including such a reference in a follow-up research report or market letter, is prohibited if the intent or the effect is to show the success of a past recommendation, unless all of the foregoing requirements with respect to past recommendations are met.

**IM-2210-2. Communications with the Public About Variable Life Insurance and Variable Annuities**

Paragraph (b)(2) of IM-2210-2 is changed to read as follows:

“A comparison of investment products may be used provided the comparison complies with applicable requirements set forth in Rule 2210. Particular attention must be paid to the standards regarding comparisons set forth in Rule 2210(d)(2)(B).”

**IM-2210-3. Use of Rankings in Investment Company Advertisements and Sales Literature**

**(a) Definition of "Ranking Entity"**

For purposes of the following guidelines, the term "Ranking Entity" refers to any entity that provides general information about investment companies to the public, that is independent of the investment company and its affiliates, and whose services are not procured by the investment company or any of its affiliates to assign the investment company a ranking.

**(b) General Prohibition**

Members may not use investment company rankings in any advertisement or item of sales literature other than (1) rankings created and published by Ranking Entities or (2) rankings created by an investment company or an investment company affiliated but based on the performance measurements of a Ranking Entity. Rankings in advertisements and sales literature also must conform to the following requirements.

**(c) Required Disclosures**

**(1) Headlines/Prominent Statements**

A headline or other prominent statement may not state or imply that an investment company or investment company family is the best performer in a category unless it is actually ranked first in the category.

**(2) Required Prominent Disclosure**

All advertisements and sales literature containing an investment company ranking must disclose prominently:

- (A) the name of the category (e.g., growth);
- (B) the number of investment companies or, if applicable, investment company families in the category;
- (C) the name of the Ranking Entity and, if applicable, the fact that the investment company or an affiliate created the category or subcategory;
- (D) the length of the period (or the first day of the period) and its ending date; and
- (E) the criteria on which the ranking is based (e.g., total return, risk-adjusted performance).

**(3) Other Required Disclosure**

All advertisements and sales literature containing an investment company ranking also must disclose:

(A) the fact that past performance is no guarantee of future results;

(B) for investment companies that assess front-end sales loads, whether the ranking takes those loads into account;

(C) if the ranking is based on total return or the current SEC standardized yield, and fees have been waived or expenses advanced during the period on which the ranking is based and the waiver or advancement had a material effect on the total return or yield for that period, a statement to that effect;

(D) the publisher of the ranking data (e.g., "ABC Magazine, June 1999");  
and

(E) if the ranking consists of a symbol (e.g., a star system) rather than a number, the meaning of the symbol (e.g., a four-star ranking indicates that the fund is in the top 30% of all investment companies).

**(d) Time Periods**

**(1) Current Rankings**

Any investment company ranking included in an advertisement or sales literature must be, at a minimum, current to the most recent calendar quarter ended, in the case of an advertisement, prior to the submission for publication, or, in the case of sales literature, prior to use. If no ranking that meets this requirement is available from the Ranking Entity, then a member may only use the most current ranking available from the Ranking Entity unless use of the most current ranking would be misleading, in which case no ranking from the Ranking Entity may be used.

**(2) Rankings Time Periods; Use of Yield Rankings**

Except for money market mutual funds:

(A) advertisements and sales literature may not present any ranking that covers a period of less than one year, unless the ranking is based on yield;

(B) an investment company ranking based on total return must be accompanied by rankings based on total return for a one year period for investment companies



in existence for at least one year; one and five year periods for investment companies in existence for at least five years, and one, five and ten year periods for investment companies in existence for at least ten years supplied by the same Ranking Entity, relating to the same investment category, and based on the same time period; provided that, if rankings for such one, five and ten year time periods are not published by the Ranking Entity, then rankings representing short, medium and long term performance must be provided in place of rankings for the required time periods; and

(C) an investment company ranking based on yield may be based only on the current SEC standardized yield and must be accompanied by total return rankings for the time periods in paragraph (d)(2)(B).

**(e) Categories**

(1) The choice of category (including a subcategory of a broader category) on which the investment company ranking is based must be one that provides a sound basis for evaluating the performance of the investment company.

(2) An investment company ranking must be based only on (A) a category or subcategory created and published by a Ranking Entity or (B) a category or subcategory created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.

(3) An advertisement or sales literature may not use any category or subcategory that is based upon the asset size of an investment company or investment company family, whether or not it has been created by a Ranking Entity.

**(f) Multiple Class/Two-Tier Funds**

Investment company rankings for more than one class of investment company with the same portfolio must be accompanied by prominent disclosure of the fact that the investment companies or classes have a common portfolio.

**(g) Investment Company Families**

Advertisements and sales literature may contain rankings of investment company families, provided that these rankings comply with the guidelines above, and further provided that no advertisement or sales literature for an individual investment company may provide a ranking of an investment company family unless it also prominently discloses the various rankings for the individual investment company supplied by the same Ranking Entity, as described in paragraph (d)(2)(B). For purposes of this IM-2210-3, the term “investment company family” means any two or more registered investment companies that hold themselves out to investors as related companies for purposes of investment and investor services.

#### **IM-2210-4. Limitations on Use of Association's Name in Communications With the Public**

##### **(a) Statements of Membership**

Members may indicate membership in the Association in conformity with Article XV, Section 2 of the NASD By-Laws in the following ways:

(1) in any communication with the public, provided that the communication complies with the applicable standards of Rule 2210 and neither states nor implies that the Association or any other regulatory organization endorses, indemnifies, or guarantees the member's business practices, selling methods, the class or type of securities offered, or any specific security;

(2) in a confirmation statement for an over-the-counter transaction that states: "This transaction has been executed in conformity with the Uniform Practice Code of the National Association of Securities Dealers, Inc."

##### **(b) Certification of Membership**

Upon request to the Association, a member will be entitled to receive an appropriate certification of membership, which may be displayed in the principal office or a registered branch office of the member. The certification will remain the property of the Association and must be returned by the member upon request of the NASD Board or the Chief Executive Officer of the Association.

**IM-2210-5. Presentation of Mutual Fund Related Performance Information**

**[RESERVED, AWAITING SEC DETERMINATION CONCERNING  
PREVIOUSLY FILED PROPOSAL]**

## **IM-2210-6 Communications with the Public About Collateralized Mortgage Obligations (CMOs)**

### **(a) Definition**

For purposes of the following guidelines, the term "collateralized mortgage obligation" (CMO) refers to a multiclass debt instrument backed by a pool of mortgage pass-through securities or mortgage loans, including real estate mortgage investment conduits (REMICs) as defined in the Tax Reform Act of 1986.

### **(b) Disclosure Standards and Required Educational Material**

#### **(1) Disclosure Standards**

All advertisements, sales literature and correspondence concerning CMOs:

(A) must include within the name of the product the term "Collateralized Mortgage Obligation;"

(B) may not compare CMOs to any other investment vehicle, including a bank certificate of deposit;

(C) must disclose, as applicable, that a government agency backing applies only to the face value of the CMO and not to any premium paid; and

(D) must disclose that a CMO's yield and average life will fluctuate depending on the actual rate at which mortgage holders prepay the mortgages underlying the CMO and changes in current interest rates.

#### **(2) Required Educational Material**

Before the sale of a CMO to any person other than an institutional investor, a member must offer to the customer educational material that includes the following:

(A) a discussion of:

(i) characteristics and risks of CMOs including credit quality, prepayment rates and average lives, interest rates (including their effect on value and prepayment rates), tax considerations, minimum investments, transaction costs and liquidity;

(ii) the structure of a CMO, including the various types of tranches that may be issued and the rights and risks pertaining to each (including the fact that

two CMOs with the same underlying collateral may be prepaid at different rates and may have different price volatility); and

(iii) the relationship between mortgage loans and mortgage securities;

(B) questions an investor should ask before investing; and

(C) a glossary of terms.

**(c) Promotion of Specific CMOs**

In addition to the standards set forth above, advertisements, sales literature and correspondence that promote a specific security or contain yield information must conform to the standards set forth below. An example of a compliant communication appears at the end of this section.

(1) The advertisement, sales literature or correspondence must present the following disclosure sections with equal prominence. The information in Sections 1 and 2 must be included. The information in Section 3 is optional; therefore, the member may elect to include any, all or none of this information. The information in Section 4 may be tailored to the member's preferred signature.

Section 1 Title - Collateralized Mortgage Obligations  
Coupon Rate  
Anticipated Yield/Average Life  
Specific Tranche - Number & Class  
Final Maturity Date  
Underlying Collateral

Section 2 Disclosure Statement:  
"The yield and average life shown above consider prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life. Please contact your representative for information on CMOs and how they react to different market conditions."

Section 3 Product Features (Optional):  
Minimum Denominations  
Rating Disclosure  
Agency/Government Backing  
Income Payment Structure  
Generic Description of Tranche (e.g., PAC, Companion)  
Yield to Maturity of CMOs Offered at Par

Section 4 Company Information:  
Name, Memberships

Address  
Telephone Number  
Representative's Name

**(2) Additional Conditions**

The following conditions must also be met:

(A) All figures in Section 1 must be in equal type size.

(B) The disclosure language in Section 2 may not be altered and must be given equal prominence with the information in Section 1.

(C) The prepayment assumption used to determine the yield and average life must either be obtained from a nationally recognized service or the member firm must be able to justify the assumption used. A copy of either the service's listing for the CMO or the firm's justification must be attached to the copy of the communication that is maintained in the firm's advertising files in order to verify that the prepayment scenario is reasonable.

(D) Any sales charge that the member intends to impose must be reflected in the anticipated yield.

(E) The communication must include language stating that the security is "offered subject to prior sale and price change." This language may be included in any one of the four sections.

(F) If the security is an accrual bond that does not currently distribute principal and interest payments, then Section 1 must include this information.

**(3) Radio/Television Advertisements**

(A) The following oral disclaimer must precede any radio or television advertisement in lieu of the Title information set forth in Section 1:

"The following is an advertisement for Collateralized Mortgage Obligations. Contact your representative for information on CMOs and how they react to different market conditions."

(B) Radio or television advertisements must contain the following oral disclosure statement in lieu of the legend set forth in Section 2:

"The yield and average life reflect prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life."

**(4) Standardized CMO Communication Example**

Collateralized Mortgage Obligations

7.50% Coupon  
7.75% Anticipated Yield to 22-Year Average Life  
FNMA 9532X, Final Maturity March 2023  
Collateral 100% FNMA 7.50%

The yield and average life shown above reflect prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life. Please contact your representative for information on CMOs and how they react to different market conditions.

\$5,000 Minimum  
Income Paid Monthly  
Implied Rating/Volatility Rating  
Principal and Interest Payments Backed by FNMA  
PAC Bond

Offered subject to prior sale and price change.

Call Mary Representative at (800)555-1234

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## **2211 Institutional Sales Material and Correspondence**

### **(a) Definitions**

For purposes of Rule 2210, this Rule, and any interpretation thereof:

- (1) “Correspondence” consists of form letters and electronic mail messages distributed by a member only to:
  - (A) its existing retail customers; and
  - (B) fewer than 25 prospective retail customers within any 30 calendar-day period.
- (2) “Institutional Sales Material” consists of any communication that is distributed or made available only to institutional investors.
- (3) “Institutional Investor” means any:
  - (A) person described in Rule 3110(c)(4), regardless of whether that person has an account with an Association member;
  - (B) governmental entity or subdivision thereof;
  - (C) qualified plan, as defined in Section 3(a)(12)(C) of the Act, that has at least 100 beneficiaries;
  - (D) Association member or registered associated person of such a member; and
  - (E) person acting solely on behalf of any such institutional investor.

No member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any person other than an institutional investor.

- (4) “Existing Retail Customer” means any person for whom the member or a clearing broker or dealer on behalf of the member carries an account, or who has an account with any registered investment company for which the member serves as principal underwriter, and who is not an institutional investor. “Prospective Retail Customer” means any person who has not opened such an account and is not an institutional investor.



**(b) Approval and Recordkeeping**

**(1) Registered Principal Approval**

(A) Correspondence. Correspondence need not be approved by a registered principal prior to use, but is subject to the supervision and review requirements of Rule 3010(d).

(B) Institutional Sales Material. Each member shall establish written procedures that are appropriate to its business, size, structure, and customers for the review by a registered principal of institutional sales material used by the member and its registered representatives. Such procedures should be in writing and be designed to reasonably supervise each registered representative. Where such procedures do not require review of all institutional sales material prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing institutional sales material, documentation of such education and training, and surveillance and follow-up to ensure that such procedures are implemented and adhered to. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to the Association upon request.

**(2) Record-keeping**

(A) Members must maintain all institutional sales material in a file for a period of three years from the date of last use. The file must include the name of the person who prepared each item of institutional sales material.

(B) Members must maintain in a file information concerning the source of any statistical table, chart, graph or other illustration used by the member in communications with the public.

Cross Reference -- NASD Conduct Rule 3010 (Supervision) and Rule 3110 (Books and Records)

**(c) Spot-Check Procedures**

Each member's correspondence and institutional sales literature may be subject to a spot-check procedure under Rule 2210. Upon written request from the Advertising/Investment Companies Regulation Department (the "Department"), each member must submit the material requested in a spot-check procedure within the time frame specified by the Department.

**(d) Content Standards Applicable to Institutional Sales Material and Correspondence**

(1) All institutional sales material and correspondence are subject to the content standards of Rule 2210(d)(1) and the applicable Interpretive Materials under Rule 2210.

(2) All correspondence (which for purposes of this provision includes business cards and letterhead) must:

(A) prominently disclose the name of the member and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction;

(B) reflect any relationship between the member and any non-member or individual who is also named; and

(C) if it includes other names, reflect which products or services are being offered by the member.

(3) Members may not use investment company rankings in any correspondence other than rankings created and published by Ranking Entities as defined in IM-2210-3(a) or rankings created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.

**(e) Violation of Other Rules**

Any violation by a member of any rule of the SEC, the Securities Investor Protection Corporation or the Municipal Securities Rulemaking Board applicable to institutional sales material or correspondence will be deemed a violation of this Rule and Rule 2210.

Cross Reference - SEC Rules Concerning Investment Company Sales Literature and Advertising (SEC Rules and Regulation T Tab)

Cross Reference -- Conduct Rule 3010(g)(2) (Concerning branch office locations, telephone directory line listings, business cards and letterhead)

## **Rule 2211 (Telemarketing)**

Rule 2211 shall be renumbered as new Rule 2212.

### **2. *Procedures of the Self-Regulatory Organization***

(a) The Board of Directors of NASD Regulation approved the proposed rule change and authorized the filing of the proposed rule amendments with the Securities and Exchange Commission (“Commission”) at its meeting on July 28, 1999. The Board of Governors of the NASD had the opportunity to review the proposed rule at its meeting on July 29, 1999. No other action is necessary for the filing of the rule amendments. 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 announce the effective date of the proposed amendments in a Notice to Members published no later than 60 days following Commission approval. The effective date will be at least 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Joseph Savage, Counsel, Advertising/Investment Companies Regulation, at (202) 728-8233 or Robert Smith, Assistant General Counsel, Office of General Counsel, NASD Regulation, 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**

The proposed rule change would modernize and clarify the rules governing member communications with the public. Among other provisions, the proposed rule change would exclude all communications to institutional investors from member pre-use approval and NASD Regulation filing requirements and from many of the content standards. Form letters and group e-mail to existing retail customers and fewer than 25 prospective retail customers also would be eligible for these exclusions. Additionally, the proposed rule change would exclude independently prepared reprints from the filing and many of the content standards, and would exclude certain press releases from the filing requirements. The proposed rule change would simplify the content standards applicable to member communications.

As discussed in greater detail below, the proposed rule change reflects many of the comments and suggestions received by NASD Regulation in response to Notice to Members 99-79 (“NTM 99-79”). In NTM 99-79, NASD Regulation requested comment from members and other interested parties to an earlier version of the proposed rule change (“NTM Version”).

The comment period on NTM 99-79 closed on October 29, 1999. NASD Regulation received 72 comment letters in response to NTM 99-79. In developing the proposed rule change, NASD Regulation also consulted with five of its member committees, its district committees, and its National Adjudicatory Council, and considered comments received to Notice to Members 98-81, which requested comment generally on how the NASD rules and By-Laws could be modernized.

## **Description**

### *Reorganization of Rule 2210*

The proposed rule change would create new Rule 2211, which would apply to institutional sales material and correspondence. The creation of a separate rule for institutional sales material and correspondence should facilitate a reader's ability to determine how the advertising rules apply to those communications. In order to further simplify this process, the proposed rule change would provide cross-references between Rule 2210 and Rule 2211 in appropriate places. Existing Rule 2211, concerning telemarketing, would be renumbered as Rule 2212.

### *Definition of "Public Appearance"*

Existing Rule 2210(d)(1)(C) provides that members who engaged in public appearances or speaking activities must follow the content standards of Rule 2210(d) and (f). Consequently, public appearances already are subject to strict content requirements.

The proposed rule change would clarify the application of Rule 2210 to public appearances by defining "public appearance" as a type of communication with the public. Public appearances would include participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or speaking activity.

The proposed rule change also would provide members with more flexibility than they have today, by subjecting public appearances only to some, but not all of the content standards of Rule 2210. Several commenters to NTM 99-79 argued that none of the content standards should apply to public appearances. These commenters asserted that by subjecting public appearances to any of the content standards, the proposed rule change would impose impractical constraints on television and other public appearances by members.

NASD Regulation disagrees with the suggestion that statements made in public appearances should be excluded from all of the content standards. While some accommodation of the practical concerns raised by commenters may be necessary, leaving investors virtually unprotected from public statements that are misleading, unbalanced or unwarranted is not an acceptable solution. Therefore, the proposed rule change would subject public appearances to some of the content standards, while providing members with more flexibility than they have today to provide useful information in their public appearances.

In addition, by defining “public appearance” to include an interactive electronic forum, the proposed rule change would codify the NASD Regulation staff’s position that Internet chat rooms constitute public appearances rather than advertisements or sales literature for purposes of Rule 2210.

### *Institutional Sales Material*

Today Rule 2210 does not distinguish between retail and institutional sales material. Moreover, the rule currently defines “sales literature” to include any “form letter,” which the NASD has interpreted to mean written communications, including e-mail messages, sent to at least two persons. Consequently, any communication sent to two or more institutional investors is deemed “sales literature,” must comply with the content standards of Rule 2210, must be pre-approved by a registered principal, and may have to be filed with the Advertising/Investment Companies Regulation Department of NASD Regulation (the “Department”) if it concerns certain types of products, such as registered investment companies.

The proposed rule change would eliminate the pre-use approval and filing requirements applicable to communications that are distributed or made available only to institutional investors. Institutional sales material would be subject to new supervision and review requirements that are modeled on those in Rule 3010, which apply to correspondence. Moreover, institutional sales material would continue to be subject to the record-keeping requirements and some, but not all, of the content standards in Rule 2210.<sup>1</sup>

Under the proposed rule change, no member could treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any person other than an institutional investor. For example, if a member had reason to believe that such a communication would be forwarded or made available to 401(k) plan participants or other beneficiaries of institutional accounts, it would be treated as retail sales material. NASD Regulation believes that plan participants and other beneficiaries of institutional accounts should receive the same protections under the advertising rules as other retail investors. Similarly, an advertisement in a publication designed for broker/dealers or other institutional investors may not be treated as institutional sales material if the member has reason to believe that the publication will be made available to any person other than an institutional investor.

The proposed rule change would define “institutional investor” as any:

(1) person described in Rule 3110(c)(4), regardless of whether that person has an account with an Association member;<sup>2</sup>

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<sup>1</sup> The proposed rule change would revise the content standards to specifically indicate which type of communication is subject to each standard. Therefore, standards that apply only to “advertisements” or “sales literature” would not apply to institutional sales material. For example, the ranking guidelines in proposed IM-2210-3 would apply only to advertisements and sales literature and therefore would not apply to institutional sales material.

<sup>2</sup> Rule 3110(c)(4) defines “institutional account” to mean the account of a bank, savings and loan, insurance company, registered investment company, or registered investment adviser. It also includes the account of any other entity or natural person with total assets of at least \$50 million. For purposes of Rule 2210 and Rule (cont’d)

- (2) governmental entity or subdivision thereof;
  - (3) qualified plan, as defined in Section 3(a)(12)(C) of the Securities Exchange Act of 1934, that has at least 100 beneficiaries;
  - (4) Association member or registered associated person of such a member;<sup>3</sup>
- and
- (5) person acting solely on behalf of any such institutional investor.

Several elements of this definition were amended as a result of comments to NTM 99-79. First, the definition was amended to include governmental entities and their subdivisions. Second, the definition would apply to qualified plans with at least 100 beneficiaries. NASD Regulation believes that qualified plans with 100 beneficiaries generally have the level of sophistication and expertise to justify their treatment as institutional investors under the advertising rules. Various statutory provisions similarly distinguish these qualified plans from smaller ones.<sup>4</sup>

Third, the proposed rule change would define “institutional investor” to include any person acting solely on behalf of any institutional investor. Several commenters urged NASD Regulation to define “institutional investor” to include pension consultants and others acting on behalf of institutional investors. Rather than establishing a new category based upon a person’s occupation, NASD Regulation has determined to include any person acting on behalf of an institutional investor.

Fourth, in response to one commenter, NASD Regulation would clarify that the term “institutional investor” includes only associated persons who are registered with an NASD member. The “broker/dealer-only” exception, which would become a part of the institutional investor definition, recognizes the special expertise that NASD members have with respect to brokerage products and

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2211, the term “institutional investor” would include trust companies organized under state law that come within the definition of “bank” in Article I(b) of the NASD By-Laws. In addition, the proposed rule change is not intended to require a member to verify that an investment adviser that is required to register with the SEC or a state has in fact done so, in order for the member to treat this investment adviser as an “institutional investor.”

<sup>3</sup> Some commenters expressed concern about the proposal to include broker/dealer-only material within the definition of institutional sales material. These commenters asserted that currently broker/dealer-only material is excluded from the content standards of Rule 2210, and that by treating it as institutional sales material and subjecting it to some of the content standards, the proposed rule change would reduce the flexibility that members now have to place various types of information in broker/dealer-only material.

This comment reflects an apparent misunderstanding about the current scope of the content standards. Today all content standards of Rule 2210 apply to advertisements and sales literature sent only to members or their registered persons. By including this material within the definition of institutional sales material, and subjecting it only to those standards applicable to institutional sales material, the proposed rule change would provide members with more flexibility to include various information in broker/dealer-only material.

<sup>4</sup> See, e.g., ERISA § 103(a)(3)(A) (auditing requirements) and 104(a)(2)(A) (annual reporting).

services. While registered persons should have this expertise, as demonstrated by their completion of the qualifications process, there can be no assurance that other associated persons would.

Fifth, the definition would clarify that no member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded *or made available to* any person other than an institutional investor. Thus, for example, if a member has reason to believe the employer sponsor of a retirement plan will make sales material available for inspection by the plan beneficiaries, then the member may not treat the sales material as having been distributed only to an institutional investor.

The definition of “institutional investor” would include persons described in Rule 3110(c)(4), which defines “institutional account” to include any entity with total assets of at least \$50 million. Several commenters asserted that this threshold level is too high in light of the purposes of the proposed rule change, and recommended that NASD Regulation reduce it to a level such as \$5 million, a level used in Regulation D under the Securities Act of 1933.

NASD Regulation has determined that the \$50 million threshold is appropriate, particularly in light of the significant effect that the definition of “institutional investor” would have on the filing, pre-approval and content requirements. Moreover, the amendment to include qualified plans with at least 100 beneficiaries should address many of the concerns expressed by those who proposed a reduction in the asset size threshold.

#### *Form Letters and Group Electronic Mail*

Rule 2210 currently treats any letter or e-mail sent to more than one person as “sales literature” subject to the panoply of content standards applicable to all other sales literature, and to the member pre-use approval and NASD Regulation filing requirements. The use of group electronic mail has become commonplace in many firms. For example, registered representatives may provide customers with information concerning their accounts, changes in market conditions, or current economic conditions. Given the volume of form letters and group e-mail that members and their associated persons may send, and the speed with which this material can be dispatched to customers, a pre-use approval requirement may be less practical than supervisory procedures that are more specifically tailored to these forms of communication.

NASD Regulation believes that Conduct Rule 3010(d), which governs the approval and review of correspondence, provides the most effective means of supervising form letters and group e-mail sent to existing and a limited number of prospective retail customers. Rule 3010(d) requires members to adopt written procedures for the review of correspondence by registered principals. Any member that does not pre-approve all correspondence must educate and train associated persons as to NASD rules governing communications with the public and the firm’s procedures must document this training and must monitor adherence to these procedures. Members must retain all correspondence of registered representatives related to the member’s investment banking or securities business.

The proposed rule change would define “correspondence” as form letters and group e-mail sent to existing retail customers and to fewer than 25 prospective retail customers within any 30 calendar-

day period (“Group Correspondence”). The proposed rule change would subject Group Correspondence to the strict supervisory procedures in Rule 3010(d) and to those content standards that apply to correspondence. Form letters and group e-mail sent to 25 or more prospective retail customers within any 30 calendar-day period would be subject to the pre-use approval, filing, and record-keeping requirements of Rule 2210, and to all of the content standards applicable to sales literature.<sup>5</sup>

The NTM Version would have applied a 90-day rather than a 30-day period to the determination of whether form letters and group e-mail have been sent to fewer than 25 prospective retail customers. One commenter questioned the feasibility of monitoring the issuance of form letters and group e-mail to prospective customers over a rolling 90-day period. The proposed rule change would reduce this period to 30 calendar days, to make the monitoring responsibility more manageable.

The term “existing retail customer” has been modified in response to comments to NTM 99-79. “Existing retail customer” would be defined as any person, other than an institutional investor, for whom the member or a clearing broker or dealer on behalf of the member carries an account, or who has an account with any registered investment company for which a member serves as principal underwriter. The new language would make clear that a person who has opened an account with an investment company or with a transfer agent for such an investment company could qualify as an existing retail customer. NASD Regulation also has amended the language to make it more consistent with existing Conduct Rule 2211(d).

#### *Article Reprints*

Rule 2210 currently defines “sales literature” to include “reprints or excerpts of any . . . published article.” Article reprints thus may have to be filed with the Department, depending upon their content, such as whether they pertain to registered investment companies. For some time, NASD Regulation has received comments that third-party article reprints should not be subject to the filing requirements of Rule 2210. Some have argued that reprints often are available to the public through large-circulation periodicals published by firms that are not NASD members, and that it makes little sense to require members to file reprints, especially when they have no control over the content of these articles. In NTM 99-79, NASD Regulation therefore proposed to exclude article reprints from the filing requirements. Several commenters to NTM 99-79 argued that article reprints also should be exempt from most of the content standards of Rule 2210.

In response to these comments, the proposed rule change would define a new type of communication with the public, an “independently prepared reprint,” and exclude independently prepared reprints from the filing and most of the content standards. An independently prepared reprint

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<sup>5</sup> The proposed rule change would permit members to treat form letters or group e-mail sent to a *combination* of existing customers and fewer than 25 prospective retail customers within any 30 calendar-day period as correspondence.

Of course members could not “sanitize” sales literature by enclosing it with Group Correspondence. For example, an item that a member has distributed as sales literature would remain sales literature for purposes of Rule 2210 when the member encloses it in Group Correspondence.



would consist of any article reprint that meets certain standards that are designed to ensure that the reprint was issued by an independent publisher and was not materially altered by the member. In response to comments to NTM 99-79, the proposed rule change would provide that a member may alter the contents of an independently prepared reprint in a manner necessary to make it consistent with applicable regulatory standards or to correct factual errors.

Some, but not all, content standards would apply to independently prepared reprints. For example, Rule 2210(d)(1) would impose various content standards on all communications with the public, including independently prepared reprints. However, paragraph (d)(1)(D) (concerning predictions and projections of performance) would not apply to a statement in an independently prepared reprint that represents the author's opinion about the prospects for a member's business, products or services.<sup>6</sup>

The proposed rule change also would include certain investment company research reports within the definition of independently prepared reprints. Rule 2210 was recently amended to exclude these research reports from the filing requirements. Because these research reports present essentially the same issues as independently prepared reprints, the proposed rule change would subject these research reports to the same content and other requirements that apply to independently prepared reprints.

Independently prepared reprints would continue to be subject to the pre-use approval and record-keeping requirements of Rule 2210. Moreover, article reprints and research reports that do not meet the definition of "independently prepared reprint" would continue to constitute sales literature that would have to meet all of the requirements applicable to sales literature.

### *Press Releases*

Rule 2210 defines "sales literature" to include "any written or electronic communication distributed or made generally available to customers or the public," which the Department has interpreted to include press releases. The proposed rule change would codify this interpretation by amending the definition of "sales literature" to include press releases concerning a member's product or service. The proposed rule change would exclude from the filing requirements press releases that are made available only to members of the media.<sup>7</sup> This exclusion would recognize the time-sensitive nature of these press releases, and the fact that press releases generally do not raise significant concerns in the filing process.

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<sup>6</sup> Nevertheless, a statement made by a person other than the author, such as a mutual fund's portfolio manager or an associated person of a member, and quoted in the independently prepared reprint, would be subject to paragraph (d)(1)(D).

<sup>7</sup> The proposed rule change, unlike the NTM Version, would exclude all press releases made available only to members of the media, without limiting the exclusion to press releases concerning investment companies. Some commenters to NTM 99-79 stated that the limitation might create confusion concerning whether other press releases that must be filed under existing Rule 2210, such as those concerning variable products, would be similarly excluded.

Some commenters to NTM 99-79 recommended that NASD Regulation exclude press releases from most of the content standards, or even exclude press releases from Rule 2210 entirely. Some of these commenters asserted that press releases are not part of a member's effort to market its products and services, and therefore need not be subject to Rule 2210. In fact, press releases often announce the availability of new products or services and members frequently circulate press releases to their customers with other marketing material. While NASD Regulation recognizes that the media may substantially edit a press release or even refrain from using the press release at all, we disagree with the assertion that press releases concerning a member's products or services have little to do with its marketing efforts. Consequently, the proposed rule would exempt from the filing requirements those press releases that are made available only to members of the media, but would subject them to the content, pre-use approval and record-keeping requirements of Rule 2210.

#### *Television and Video Advertisements*

The proposed rule change would require members that have filed a draft version or "story board" of a television or video advertisement pursuant to a filing requirement also to file the final filmed version within ten business days of first use or broadcast. This rule change would codify an existing Department policy regarding television and video sales material. Rule 2210 would impose a filing fee only when the draft version or story board is filed. No additional fee would be assessed when the final filmed version is filed.

#### *Approval and Record-keeping*

The proposed rule change would make three additional modifications to the pre-use approval and record-keeping requirements in response to comments to NTM 99-79. First, it would clarify that the pre-use approval requirement could be met with respect to a research report concerning any debt or equity security, including non-corporate securities, by signature or initial of a supervisory analyst under New York Stock Exchange Rule 344. Second, the proposed rule change would clarify that members must maintain a file with the name of the registered principal who approved any advertisement or sales literature. Members would not be required to maintain a file with the name of the person who prepared those items, however.<sup>8</sup> Third, the proposed rule change would clarify that members must maintain a file with information concerning the source, but not necessarily the data, of any statistical table, chart, graph or other illustration.

#### *Filing Requirements*

The proposed rule change would reinstate the existing provision concerning the obligation of a member that has not filed an advertisement with the Department, to pre-file its advertisements for a one-year period. The NTM Version appeared to cause some confusion concerning this pre-filing obligation. The proposed rule change would modify the existing language slightly, to make it more

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<sup>8</sup> Proposed Rule 2211 would require members to maintain all institutional sales material in a file that includes the name of the person who prepared each item.

clear and consistent with standards of plain English. The proposed rule change also has been modified from the NTM version to clarify that advertisements and sales literature for continuously offered closed-end funds must be filed with the Department. This clarification codifies a long standing position of the Department.<sup>9</sup>

Rule 2210 does not require members who are subject to this pre-filing requirement to await completion of the Department's review of its advertisements before using them. Nevertheless, NASD Regulation encourages these members to do so, in order to better ensure that their advertisements reflect the Department's comments and that these members do not incur the expense of revising advertisements already in use.

The proposed rule change would clarify that members need not file advertisements and sales literature that previously have been filed and that are to be used without material change. This provision would codify existing practice, which excludes from the filing requirement material that has been filed previously, but in which performance data is updated or there are other changes that are not material for purpose of the filing requirement. Members are encouraged to file material that is particularly aged, to ensure that the material has not fallen out of compliance due to changes in rules or other circumstances.

In response to comments received on NTM 99-79, the proposed rule change would specifically list institutional sales material as one type of communication that need not be filed. The proposed rule change also would list correspondence, independently prepared reprints, and certain press releases. In addition, the proposed rule change would state that when these items concern investment companies, then they will be deemed filed with the Association for purposes of Section 24(b) of the Investment Companies Act of 1940 and Rule 24b-3 thereunder. Based on our conversations with the SEC staff, we understand that this provision would eliminate the need to file this material with the SEC.

The proposed rule change also would exclude from the filing requirement announcements as a matter of record that a member has participated in a private placement.

Several commenters to NTM 98-81 and NTM 99-79 argued that investment company annual and semi-annual reports should be excluded from the filing requirements. These commenters note that shareholder reports are already subject to specific content requirements under SEC rules and are filed with the SEC, and argue that these requirements should address any investor protection concerns.

Members are not required to file shareholder reports that only consist of statistical reporting information such as financial statements and portfolio holdings. However, members must file the management's discussion of fund performance (MDFP) portion of a report (as well as any supplemental sales material attached to or distributed with the report) with the Department. In the Department's experience, members frequently use the MDFP or other supplemental information as marketing material that goes far beyond the SEC regulatory requirements for shareholder reports.

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<sup>9</sup> See, e.g., NASD Regulatory and Compliance Alert (April 1995) at p. 9.

While NASD Regulation carefully considered the comments suggesting an exemption for shareholder reports, we have decided not to propose such an exclusion from the filing requirement.

Several commenters to NTM 98-81 and NTM 99-79 also requested that NASD Regulation eliminate the requirement that members file a copy of the ranking or comparison used in sales material that contains rankings. These comments appear to assume that the filing is pro forma because the ranking or comparison information is reflected in the sales material itself, or that the ranking or comparison information is readily available to the Department. In fact, it is not unusual for the Department to comment on sales material that presents a ranking or comparison in a manner inconsistent with the backup ranking information. Additionally, sales material often contains rankings or comparisons that are not readily available. Because the Department relies on the backup filings when reviewing sales material that contains rankings or comparisons, elimination of this requirement could significantly delay completion of the staff's review. Accordingly, while NASD Regulation carefully considered the comments suggesting an exclusion for backup material, the proposed rule change would not eliminate this filing requirement.

Several commenters to NTM 98-81 and 99-79 also recommended that NASD Regulation eliminate the requirement to file generic mutual fund advertisements that comply with Rule 135a under the Securities Act of 1933. Members rarely file generic advertisements. To the extent the Department has received generic advertisements, however, it has found that members sometimes misunderstand the content requirements of Rule 135a, and sometimes misclassify advertising that falls under other rules as generic advertisements. We are concerned that an exclusion for generic advertisements could lead some members not to file investment company sales material that should be filed due to their misunderstanding of Rule 135a. Accordingly, NASD Regulation does not propose to exclude generic fund advertisements from the filing requirements.

#### *Standards Applicable to Member Communications*

The proposed rule change would substantially shorten and simplify the standards applicable to communications with the public that are contained in Rule 2210(d). The proposed rule change would relocate certain standards from Rule 2210(d) to a new Interpretive Material 2210-1, Guidelines to Ensure that Communications Are Not Misleading. New proposed IM-2210-1 would make clear that members have the primary responsibility to ensure that their communications with the public are not misleading, and would rewrite many standards to make them more clear and consistent with the principles of plain English.

Proposed IM-2210-1 would not contain certain of the specific standards currently in Rule 2210. Partially in response to comments received to NTM 98-81, the proposed rule change would eliminate the specific standards regarding non-existent or self-conferred degrees or designations, offers of free service, claims for research facilities, hedge clauses, recruiting advertising, and periodic investment plans. To the extent that these provisions prohibit statements that are misleading, unbalanced, or inaccurate regarding particular types of communications, the rule already prohibits the use of such statements. Moreover, certain required disclosures, such as those currently applicable to statements concerning periodic investment plans, may not be necessary depending upon the context in which they are made.

Proposed IM-2210-1(4) in the NTM version has been turned into new paragraphs (4) and (5) to clarify which guidelines concerning references to tax free or tax exempt income apply to all communications with the public, and which guidelines apply only to advertisements or sales literature.

### *Legends, Footnotes, and Hyperlinks*

Rule 2210 cautions members concerning the placement of footnotes, and in the filing review process the Department has insisted that members adopt an appropriate use of footnotes. The NTM Version would have required that material information appear in the main text of a communication and not be relegated to footnotes. Commenters expressed concern that the NTM Version would eliminate much of the flexibility that members now have concerning the placement of footnotes in specific items of sales material. Moreover, commenters noted that a requirement to include all “material” information in the text might have unintended litigation consequences.

The proposed rule change would attempt to balance these concerns with the need to ensure that Rule 2210 provides clear direction to members concerning their responsibility to avoid inappropriate reliance on legends and footnotes. Consequently, the proposed rule change would provide that information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor’s understanding of the communication. Thus, for example, footnotes in especially small type in an advertisement might be deemed to inhibit an investor’s understanding of the advertisement. Similarly, an advertisement that presents bold claims that are supposedly “balanced” only with footnote disclosure might not comply with this content standard.

### *Hypothetical Illustrations*

The NTM Version would have deleted from Rule 2210 the statement that “a hypothetical illustration of mathematical principles is not considered a prediction or projection of performance.” Commenters objected to this change, arguing that this provision has permitted members to provide educational information in their sales material, and that its elimination might interfere with presentations such as a mutual fund cost calculator.

In proposed Rule 2210(d)(1)(D), NASD Regulation would insert language similar to the existing language. Under the proposed rule change, a member could present a hypothetical illustration of mathematical principles, provided that the illustration does not predict or project the performance of an investment or investment strategy and is not used in such a manner. The proposed rule change thus would permit the use of mutual fund cost calculators and other hypothetical illustrations that are permitted by existing Rule 2210.

### *Testimonials*

The NTM Version would have applied specific standards to testimonials concerning “a member’s products and services.” Commenters indicated that this change would cause confusion about whether the testimonial standards would apply even when the testimonial concerns matters other than investment performance, such as the member’s general services. In order to clarify this matter,

the proposed rule change would apply the testimonial standards to advertisements or sales literature concerning the investment advice or investment performance of a member or its products.

### *Recommendations*

The NTM Version would have clarified certain aspects of the existing standards governing recommendations. Some commenters argued that the proposal went too far, and that it would inhibit legitimate discussion about the prospects for various investments. Nevertheless, NASD Regulation continues to share the concerns of SEC Chairman Levitt and others about the need to provide investors with adequate disclosure about the financial interests that research analysts, other associated persons, or their firms may have in securities that they recommend. NASD Regulation has determined to consider this issue further, and to work with the SEC staff on the possible development of more detailed disclosure requirements. In the meantime, the proposed rule change would make no amendment to the existing standards governing recommendations.

### *Use and Disclosure of a Member's Name*

The proposed rule change would dramatically simplify the provisions concerning disclosure of member names. In addition, the proposed rule change would make clear that the requirement to disclose the member's name applies to advertisements, sales literature, and correspondence, which for purposes of this provision would include business cards and letterhead.<sup>10</sup> In response to comments to NTM 99-79, the provision would clarify that the advertisement, sales literature or correspondence must "reflect" (rather than disclose) any relationship between the member and the other named person and the products and services offered by the member. This change would help ensure that members do not mislead investors concerning these relationships and offerings, but would not mandate disclosure that may be unnecessary to achieve this objective.

### *Ranking Guidelines*

The proposed rule change would modify the ranking guidelines in several respects. First, the proposed rule change would make clear that no advertisement, item of sales literature or correspondence may present a ranking other than rankings (1) created and published by a Ranking Entity, which the ranking guidelines define to include certain independent entities, or (2) created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.<sup>11</sup> Second, the proposed rule change would make clear that the ranking guidelines in IM-2210-3 apply only to advertisements and sales literature.

Third, the proposed rule change would permit the use of investment company family ranking even in sales material that advertises only one investment company in the family. Several commenters to NTM 99-79 urged NASD Regulation to permit the use of investment company family rankings.

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<sup>10</sup> The requirement thus would not apply to institutional sales material.

<sup>11</sup> The application of this limitation to correspondence would appear in new Rule 2210(d)(3) rather than in IM-2210-3.

These types of rankings are not currently permitted under the Rule 2210, due to concern that sales material that presents a family ranking might confuse investors about the true ranking of the advertised investment company. The proposed rule change attempts to strike a balance between the interest in presenting some form of family ranking, and the need to ensure that presentations of family rankings do not mislead investors about the ranking of an individual investment company. The proposed rule change thus would permit the presentation of investment company family rankings, provided that when a particular investment company is being advertised, the individual rankings for that investment company also must be presented. The definition of “investment company family” is substantially similar to the definition of “group of investment companies” in SEC Rule 11a-3 under the Investment Company Act of 1940. Of course, as with all performance rankings, use of an investment company family ranking would have to comply with the other applicable requirements of Rule 2210.

The proposed rule change would reinsert existing language concerning the required ranking periods. The NTM Version would have required rankings only for short, medium and long-term periods. Commenters to NTM 99-79 suggested that this provision would allow members to “cherry pick” ranking periods, to the detriment of investors. The proposed rule change would reinstate the existing language, but with some modifications to clarify the language and make it more consistent with principles of plain English.

The proposed rule change also would eliminate the requirement that certain disclosures appear in “close proximity” to any headline or other prominent statement that refers to a ranking. The subjective nature of this requirement has complicated the Department’s administration of the ranking guidelines without providing meaningful additional protection to investors. The proposed rule change would eliminate certain disclosure requirements applicable to investment company rankings that are based on subcategories of funds or categories created by an investment company or its affiliate.

#### *Limitations on Use of the Association’s Name*

The proposed rule change would simplify and shorten the requirements in IM-2210-4 concerning the use of the NASD’s name. The proposed rule change also would delete current Rule 2210(d)(2)(J) concerning references to regulatory organizations.

#### *Communications About Collateralized Mortgage Obligations*

The proposed rule change would rewrite existing IM-2210-1 (the CMO Guidelines), which governs communications about collateralized mortgage obligations and renumber it as IM-2210-6. The current CMO Guidelines may give the impression that different standards apply to educational material, advertisements and “communications.” The proposed rule change would simplify, shorten and reorganize the CMO Guidelines to provide a more straightforward and uniform list of disclosure requirements.

The proposed rule change would modify the NTM Version in several respects. First, the proposed rule change would eliminate prohibitions of certain statements concerning the safety, liquidity, potential guarantees, and simplicity of CMOs. The content standards of Rule 2210, in their current form and as they would be amended, already prohibit a member from making these statements

in any communication with the public. Second, the proposed rule change would make clear that paragraphs (b)(1) and (c) apply only to advertisements, sales literature and correspondence. Third, the proposed rule change would clarify that paragraph (b)(2) does not apply to the sale of a CMO to an institutional investor.

**(b) Statutory Basis**

NASD Regulation 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 Association's rules must 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. The NASD believes that the proposed rule change will more appropriately address the issues related to member communications with the public, will promote the safety and soundness of member firms, and will further investor protection.

**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**

Notice to Members 99-79 solicited comments on the proposed amendments. The comment period expired on October 29, 1999. Seventy-two comment letters were received in response to the notice. A copy of Notice to Members 99-79 is attached as Exhibit 2. A summary of comments received in response to NTM 99-79 is attached as Exhibit 3. NASD Regulation's responses to comments are addressed above in Section 3, the Statement of Purpose.

**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)**

Not applicable.

**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*.
2. Notice to Members 99-79 (September 1999).
3. Summary of Comments Received in Response to Notice to Members 99-79.
4. Comment Letters Received in Response to Notice to Members 99-79.

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: March 15, 2000

## EXHIBIT 1

### SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-00-12)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Modernization of the Rules Governing Member Communications.

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 March 15, 2000, 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.

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

NASD Regulation is proposing to amend Rule 2210 of the rules of the National Association of Securities Dealers, Inc. ("NASD" or "Association") and certain Interpretive Materials that follow Rule 2210, to adopt new Rule 2211, and to renumber existing Rule 2211. The proposed rule change would modernize the rules governing member communications with the public. Below is the text of the proposed rule amendments, which would replace Rule 2210, IM-2210-1, IM-2210-3, and IM-2210-4 in their entirety. Existing Rule 2211 would be renumbered as Rule 2212.

#### **2210. Communications with the Public**

##### **(a) Definitions**

For purposes of this Rule and any interpretation thereof, "communications with the public" consist of:

(1) "Advertisement." Any material, other than an independently prepared reprint and institutional sales material, that is published or designed for use in any electronic or other public media, including any Web site; newspaper, magazine or other periodical; radio, television, telephone or tape recording; videotape display; sign or billboard; motion picture; or telephone directory (other than routine listings).

(2) "Sales Literature." Any written or electronic communication, other than an advertisement, independently prepared reprint, institutional sales material and correspondence, that is generally distributed or made available to customers or the public, including circulars;

research reports; market letters; performance reports or summaries; form letters; telemarketing scripts; seminar texts; reprints or excerpts of any other advertisement, sales literature or published article; and press releases concerning a member's products or services.

(3) "Correspondence" as defined in Rule 2211.

(4) "Institutional Sales Material" as defined in Rule 2211.

(5) "Public Appearance." Participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity.

(6) "Independently Prepared Reprint."

(A) Any reprint or excerpt of any article issued by a publisher, provided that:

(i) the publisher is not an affiliate of the member using the reprint or any underwriter or issuer of a security mentioned in the reprint;

(ii) neither the member using the reprint nor any underwriter or issuer of a security mentioned in the reprint has commissioned the reprinted article; and

(iii) the member using the reprint has not materially altered its contents except as necessary to make the reprint consistent with applicable regulatory standards or to correct factual errors; and

(B) Any report concerning an investment company registered under the Investment Company Act of 1940, provided that:

(i) the report is prepared by an entity that is independent of the investment company, its affiliates, and the member using the report (the "research firm");

(ii) the report's contents have not been materially altered by the member using the report except as necessary to make the report consistent with applicable regulatory standards or to correct factual errors;

(iii) the research firm prepares and distributes reports based on similar research with respect to a substantial number of investment companies;

(iv) the research firm updates and distributes reports based on its research of the investment company with reasonable regularity in the normal course of the research firm's business;

(v) neither the investment company, its affiliates nor the member using the research report has commissioned the research used by the research firm in preparing the report; and

(vi) if a customized report was prepared at the request of the investment company, its affiliate or a member, then the report includes only information that the research firm has already compiled and published in another report, and does not omit information in that report necessary to make the customized report fair and balanced.

**(b) Approval and Recordkeeping**

**(1) Registered Principal Approval for Advertisements, Sales Literature and Independently Prepared Reprints**

A registered principal of the member must approve by signature or initial and date each advertisement, item of sales literature and independently prepared reprint before the earlier of its use or filing with the Association's Advertising/Investment Companies Regulation Department ("Department"). With respect to debt and equity securities that are the subject of research reports as that term is defined in Rule 472 of the New York Stock Exchange, this requirement may be met by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock Exchange.

**(2) Record-keeping**

(A) Members must maintain all advertisements, sales literature, and independently prepared reprints in a file for a period of three years from the date of last use. The file must include the name of the registered principal who approved each advertisement, item of sales literature, and independently prepared reprint and the date that approval was given.

(B) Members must maintain in a file information concerning the source of any statistical table, chart, graph or other illustration used by the member in communications with the public.

Cross Reference -- NASD Conduct Rule 3010 (Supervision) and Rule 3110 (Books and Records)

**(c) Filing Requirements and Review Procedures**

**(1) Date of First Use and Approval Information**

The member must provide with each filing under this paragraph the actual or anticipated date of first use, the name and title of the registered principal who approved the advertisement or sales literature, and the date that the approval was given.

**(2) Requirement to File Certain Material**

Within 10 business days of first use or publication, a member must file the following advertisements and sales literature with the Department:

(A) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts, continuously offered closed-end funds, and unit investment trusts) not included within the requirements of paragraph (c)(3). The filing of any advertisement or sales literature that includes or incorporates a performance ranking or performance comparison of the investment company with other investment companies must include a copy of the ranking or comparison used in the advertisement or sales literature.

(B) Advertisements and sales literature concerning public direct participation programs (as defined in Rule 2810).

(C) Advertisements concerning government securities (as defined in Section 3(a)(42) of the Act).

**(3) Requirement to File Certain Material Prior to Use**

At least 10 business days prior to first use or publication (or such shorter period as the Department may allow), a member must file the following communications with the Department and withhold them from publication or circulation until any changes specified by the Department have been made:

(A) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts, continuously offered closed-end funds and unit investment trusts) that include or incorporate performance rankings or performance comparisons of the investment company with other investment companies when the ranking or comparison category is not generally published or is the creation, either directly or indirectly, of the investment company, its underwriter or an affiliate. Such filings must include a copy of the data on which the ranking or comparison is based.

(B) Advertisements concerning collateralized mortgage obligations.

**(4) Requirement for Certain Members to File Material Prior to Use**

(A) Each member that has not previously filed an advertisement with the Department (or with a registered securities exchange having standards comparable to those contained in this rule) must file its initial advertisement with the Department at least 10 business days prior to use and must continue to file its advertisements at least 10 business days prior to use, for a period of one year.

(B) Notwithstanding the foregoing provisions, the Department upon review of a member's advertisements or sales literature, and after determining that the member has

departed from the standards of this Rule, may require that the member file all advertisements and sales literature, or the portion of the member's material that is related to any specific type or class of securities or services, with the Department at least 10 business days prior to use. The Department will 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. Any filing requirement imposed under this paragraph will take effect 30 calendar days after the member receives the written notice, during which time the member may appeal pursuant to the hearing and appeal procedures of the Code of Procedure contained in the Rule 9000 Series.

Cross Reference – Section 13 of Schedule A to the By-Laws of the NASD (Review Charge for Advertisement, Sales Literature, and Other Such Material Filed or Submitted)

**(5) Filing of Television or Video Advertisements**

If a member has filed a draft version or "story board" of a television or video advertisement pursuant to a filing requirement, then the member must also file the final filmed version within 10 business days of first use or broadcast.

**(6) Spot-Check Procedures**

In addition to the foregoing requirements, each member's written and electronic communications with the public may be subject to a spot-check procedure. Upon written request from the Department, each member must submit the material requested in a spot-check procedure within the time frame specified by the Department.

**(7) Exclusions from Filing Requirements**

The following types of material are excluded from the filing requirements and (except for the material in paragraphs (G) through (J)) the foregoing spot-check procedures:

(A) Advertisements and sales literature that previously have been filed and that are to be used without material change.

(B) Advertisements and sales literature solely related to recruitment or changes in a member's name, personnel, electronic or postal address, ownership, offices, business structure, officers or partners, telephone or teletype numbers, or concerning a merger with, or acquisition by, another member.

(C) Advertisements and sales literature that do no more than identify the Nasdaq or other national securities exchange symbol of the member or identify a security for which the member is a Nasdaq registered market maker.

(D) Advertisements and sales literature that do no more than identify the member or offer a specific security at a stated price.

(E) Prospectuses, preliminary prospectuses, fund profiles, offering circulars and similar documents that have been filed with the Securities and Exchange Commission (the "SEC") or any state, or that concern a securities offering that is exempt from such registration, except that an investment company prospectus published pursuant to SEC Rule 482 under the Securities Act of 1933 will not be considered a prospectus for purposes of this exclusion.

(F) Advertisements prepared in accordance with Section 2(10)(b) of the Securities Act of 1933, as amended, or any rule thereunder, such as SEC Rule 134, and announcements as a matter of record that a member has participated in a private placement, unless the advertisements are related to direct participation programs or securities issued by registered investment companies.

(G) Press releases that are made available only to members of the media.

(H) Independently prepared reprints.

(I) Correspondence.

(J) Institutional sales material.

Although the material described in paragraphs (c)(7)(G) through (J) is excluded from the foregoing filing requirements, investment company communications described in those paragraphs shall be deemed filed with the Association for purposes of Section 24(b) of the Investment Companies Act of 1940 and Rule 24b-3 of the Commission thereunder.

(8) Material that refers to investment company securities, direct participation programs, government securities or exempted securities (as defined in Section 3(a)(12) of the Act) solely as part of a listing of products or services offered by the member, is excluded from the requirement of paragraphs (c)(2) and (c)(3).

(9) Pursuant to the Rule 9600 Series, the Association may exempt a member or person associated with a member from the pre-filing requirements of this paragraph (c) for good cause shown.

**(d) Content Standards**

**(1) Standards Applicable to All Communications with the Public**

(A) All member communications with the public must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service. No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communication to be misleading.

(B) No member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public. No member may publish, circulate or distribute any communication with the public that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

(C) Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication.

(D) Communications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. A hypothetical illustration of mathematical principles is permitted, provided that it does not predict or project the performance of an investment or investment strategy. This paragraph (d)(1)(D) shall not apply to a statement in an independently prepared reprint that represents the opinion of the article's author concerning the prospects for a member's business, products or services.

(E) If any testimonial in a communication with the public concerns a technical aspect of investing, the person making the testimonial must have the knowledge and experience to form a valid opinion.

## **(2) Standards Applicable to Advertisements and Sales Literature**

(A) Advertisements or sales literature providing any testimonial concerning the investment advice or investment performance of a member or its products must state the following:

(i) The fact that the testimonial may not be representative of the experience of other clients.

(ii) The fact that the testimonial is no guarantee of future performance or success.

(iii) If more than a nominal sum is paid, the fact that it is a paid testimonial.

(B) Any comparison in advertisements or sales literature between investments or services must disclose all material differences between them, including (as applicable) investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, and tax features.



(C) All advertisements and sales literature must:

(i) prominently disclose the name of the member and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction;

(ii) reflect any relationship between the member and any non-member or individual who is also named; and

(iii) if it includes other names, reflect which products or services are being offered by the member.

This paragraph (C) does not apply to so-called “blind” advertisements used to recruit personnel.

**(e) Violation of Other Rules**

Any violation by a member of any rule of the SEC, the Securities Investor Protection Corporation or the Municipal Securities Rulemaking Board applicable to member communications with the public will be deemed a violation of this Rule.

Cross Reference - SEC Rules Concerning Investment Company Sales Literature and Advertising (SEC Rules and Regulation T Tab)

Cross Reference -- Conduct Rule 3010(g)(2) (Concerning branch office locations, telephone directory line listings, business cards and letterhead).

## **IM-2210-1. Guidelines to Ensure That Communications With the Public Are Not Misleading**

Every member is responsible for determining whether any communication with the public, including material that has been filed with the Department, complies with all applicable standards, including the requirement that the communication not be misleading. In order to meet this responsibility, member communications with the public must conform with the following guidelines. These guidelines do not represent an exclusive list of considerations that a member must make in determining whether a communication with the public complies with all applicable standards.

(1) Members must ensure that statements are not misleading within the context in which they are made. A statement made in one context may be misleading even though such a statement could be appropriate in another context. An essential test in this regard is the balanced treatment of risks and potential benefits. Member communications should be consistent with the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield inherent to investments.

(2) Members must consider the nature of the audience to which the communication will be directed. Different levels of explanation or detail may be necessary depending on the audience to which a communication is directed. Members must keep in mind that it is not always possible to restrict the audience that may have access to a particular communication with the public. Additional information or a different presentation of information may be required depending upon the medium used for a particular communication and the possibility that the communication will reach a larger or different audience than the one initially targeted.

(3) Member communications must be clear. A statement made in an unclear manner can cause a misunderstanding. A complex or overly technical explanation may be more confusing than too little information.

(4) In communications with the public, income or investment returns may not be characterized as tax free or exempt from income tax when tax liability is merely postponed or deferred, such as when taxes are payable upon redemption.

(5) In advertisements and sales literature, references to tax free or tax exempt income must indicate which income taxes apply, or which do not, unless income is free from all applicable taxes. For example, if income from an investment company investing in municipal bonds is subject to state or local income taxes, this fact must be stated, or the illustration must otherwise make it clear that income is free only from federal income tax.

**(6) Recommendations.**

(A) In making a recommendation in advertisements and sales literature, whether or not labeled as such, a member must have a reasonable basis for the recommendation and must disclose any of the following situations which are applicable:

(i) that the member usually makes a market in the securities being recommended, or in the underlying security if the recommended security is an option, or that the member or associated persons will sell to or buy from customers on a principal basis;

(ii) that the member and/or its officers or partners own options, rights or warrants to purchase any of the securities of the issuer whose securities are recommended, unless the extent of such ownership is nominal;

(iii) that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years.

(B) The member shall also provide, or offer to furnish upon request, available investment information supporting the recommendation. Recommendations on behalf of corporate equities must provide the price at the time the recommendation is made.

(C) A member may use material referring to past recommendations if it sets forth all recommendations as to the same type, kind, grade or classification of securities made by a member within the last year. Longer periods of years may be covered if they are consecutive and include the most recent year. Such material must also name each security recommended and give the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and indicate the general market conditions during the period covered.

(D) A member may use material that does not make any specific recommendation but which offers to furnish a list of all recommendations made by a member within the past year or over longer periods of consecutive years, including the most recent year, if this list contains all the information specified in subparagraph (C). Neither the list of recommendations, nor material offering such list, shall imply comparable future performance. Reference to the results of a previous specific recommendation, including such a reference in a follow-up research report or market letter, is prohibited if the intent or the effect is to show the success of a past recommendation, unless all of the foregoing requirements with respect to past recommendations are met.

**IM-2210-2. Communications with the Public About Variable Life Insurance and Variable Annuities**

Paragraph (b)(2) of IM-2210-2 is changed to read as follows:

“A comparison of investment products may be used provided the comparison complies with applicable requirements set forth in Rule 2210. Particular attention must be paid to the standards regarding comparisons set forth in Rule 2210(d)(2)(B).”

### **IM-2210-3. Use of Rankings in Investment Company Advertisements and Sales Literature**

#### **(a) Definition of "Ranking Entity"**

For purposes of the following guidelines, the term "Ranking Entity" refers to any entity that provides general information about investment companies to the public, that is independent of the investment company and its affiliates, and whose services are not procured by the investment company or any of its affiliates to assign the investment company a ranking.

#### **(b) General Prohibition**

Members may not use investment company rankings in any advertisement or item of sales literature other than (1) rankings created and published by Ranking Entities or (2) rankings created by an investment company or an investment company affiliated but based on the performance measurements of a Ranking Entity. Rankings in advertisements and sales literature also must conform to the following requirements.

#### **(c) Required Disclosures**

##### **(1) Headlines/Prominent Statements**

A headline or other prominent statement may not state or imply that an investment company or investment company family is the best performer in a category unless it is actually ranked first in the category.

##### **(2) Required Prominent Disclosure**

All advertisements and sales literature containing an investment company ranking must disclose prominently:

- (A) the name of the category (e.g., growth);
- (B) the number of investment companies or, if applicable, investment company families in the category;
- (C) the name of the Ranking Entity and, if applicable, the fact that the investment company or an affiliate created the category or subcategory;
- (D) the length of the period (or the first day of the period) and its ending date; and
- (E) the criteria on which the ranking is based (e.g., total return, risk-adjusted performance).

**(3) Other Required Disclosure**

All advertisements and sales literature containing an investment company ranking also must disclose:

(A) the fact that past performance is no guarantee of future results;

(B) for investment companies that assess front-end sales loads, whether the ranking takes those loads into account;

(C) if the ranking is based on total return or the current SEC standardized yield, and fees have been waived or expenses advanced during the period on which the ranking is based and the waiver or advancement had a material effect on the total return or yield for that period, a statement to that effect;

(D) the publisher of the ranking data (e.g., "ABC Magazine, June 1999");  
and

(E) if the ranking consists of a symbol (e.g., a star system) rather than a number, the meaning of the symbol (e.g., a four-star ranking indicates that the fund is in the top 30% of all investment companies).

**(d) Time Periods**

**(1) Current Rankings**

Any investment company ranking included in an advertisement or sales literature must be, at a minimum, current to the most recent calendar quarter ended, in the case of an advertisement, prior to the submission for publication, or, in the case of sales literature, prior to use. If no ranking that meets this requirement is available from the Ranking Entity, then a member may only use the most current ranking available from the Ranking Entity unless use of the most current ranking would be misleading, in which case no ranking from the Ranking Entity may be used.

**(2) Rankings Time Periods; Use of Yield Rankings**

Except for money market mutual funds:

(A) advertisements and sales literature may not present any ranking that covers a period of less than one year, unless the ranking is based on yield;

(B) an investment company ranking based on total return must be accompanied by rankings based on total return for a one year period for investment companies in existence for at least one year; one and five year periods for investment companies in

existence for at least five years, and one, five and ten year periods for investment companies in existence for at least ten years supplied by the same Ranking Entity, relating to the same investment category, and based on the same time period; provided that, if rankings for such one, five and ten year time periods are not published by the Ranking Entity, then rankings representing short, medium and long term performance must be provided in place of rankings for the required time periods; and

(C) an investment company ranking based on yield may be based only on the current SEC standardized yield and must be accompanied by total return rankings for the time periods in paragraph (d)(2)(B).

**(e) Categories**

(1) The choice of category (including a subcategory of a broader category) on which the investment company ranking is based must be one that provides a sound basis for evaluating the performance of the investment company.

(2) An investment company ranking must be based only on (A) a category or subcategory created and published by a Ranking Entity or (B) a category or subcategory created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.

(3) An advertisement or sales literature may not use any category or subcategory that is based upon the asset size of an investment company or investment company family, whether or not it has been created by a Ranking Entity.

**(f) Multiple Class/Two-Tier Funds**

Investment company rankings for more than one class of investment company with the same portfolio must be accompanied by prominent disclosure of the fact that the investment companies or classes have a common portfolio.

**(g) Investment Company Families**

Advertisements and sales literature may contain rankings of investment company families, provided that these rankings comply with the guidelines above, and further provided that no advertisement or sales literature for an individual investment company may provide a ranking of an investment company family unless it also prominently discloses the various rankings for the individual investment company supplied by the same Ranking Entity, as described in paragraph (d)(2)(B). For purposes of this IM-2210-3, the term “investment company family” means any two or more registered investment companies that hold themselves out to investors as related companies for purposes of investment and investor services.

#### **IM-2210-4. Limitations on Use of Association's Name in Communications With the Public**

##### **(a) Statements of Membership**

Members may indicate membership in the Association in conformity with Article XV, Section 2 of the NASD By-Laws in the following ways:

(1) in any communication with the public, provided that the communication complies with the applicable standards of Rule 2210 and neither states nor implies that the Association or any other regulatory organization endorses, indemnifies, or guarantees the member's business practices, selling methods, the class or type of securities offered, or any specific security;

(2) in a confirmation statement for an over-the-counter transaction that states: "This transaction has been executed in conformity with the Uniform Practice Code of the National Association of Securities Dealers, Inc."

##### **(b) Certification of Membership**

Upon request to the Association, a member will be entitled to receive an appropriate certification of membership, which may be displayed in the principal office or a registered branch office of the member. The certification will remain the property of the Association and must be returned by the member upon request of the NASD Board or the Chief Executive Officer of the Association.



**IM-2210-5. Presentation of Mutual Fund Related Performance Information**

**[RESERVED, AWAITING SEC DETERMINATION CONCERNING  
PREVIOUSLY FILED PROPOSAL]**

## **IM-2210-6 Communications with the Public About Collateralized Mortgage Obligations (CMOs)**

### **(a) Definition**

For purposes of the following guidelines, the term "collateralized mortgage obligation" (CMO) refers to a multiclass debt instrument backed by a pool of mortgage pass-through securities or mortgage loans, including real estate mortgage investment conduits (REMICs) as defined in the Tax Reform Act of 1986.

### **(b) Disclosure Standards and Required Educational Material**

#### **(1) Disclosure Standards**

All advertisements, sales literature and correspondence concerning CMOs:

(A) must include within the name of the product the term "Collateralized Mortgage Obligation;"

(B) may not compare CMOs to any other investment vehicle, including a bank certificate of deposit;

(C) must disclose, as applicable, that a government agency backing applies only to the face value of the CMO and not to any premium paid; and

(D) must disclose that a CMO's yield and average life will fluctuate depending on the actual rate at which mortgage holders prepay the mortgages underlying the CMO and changes in current interest rates.

#### **(2) Required Educational Material**

Before the sale of a CMO to any person other than an institutional investor, a member must offer to the customer educational material that includes the following:

(A) a discussion of:

(i) characteristics and risks of CMOs including credit quality, prepayment rates and average lives, interest rates (including their effect on value and prepayment rates), tax considerations, minimum investments, transaction costs and liquidity;

(ii) the structure of a CMO, including the various types of tranches that may be issued and the rights and risks pertaining to each (including the fact that

two CMOs with the same underlying collateral may be prepaid at different rates and may have different price volatility); and

(iii) the relationship between mortgage loans and mortgage securities;

(B) questions an investor should ask before investing; and

(C) a glossary of terms.

**(c) Promotion of Specific CMOs**

In addition to the standards set forth above, advertisements, sales literature and correspondence that promote a specific security or contain yield information must conform to the standards set forth below. An example of a compliant communication appears at the end of this section.

(1) The advertisement, sales literature or correspondence must present the following disclosure sections with equal prominence. The information in Sections 1 and 2 must be included. The information in Section 3 is optional; therefore, the member may elect to include any, all or none of this information. The information in Section 4 may be tailored to the member's preferred signature.

Section 1 Title - Collateralized Mortgage Obligations  
Coupon Rate  
Anticipated Yield/Average Life  
Specific Tranche - Number & Class  
Final Maturity Date  
Underlying Collateral

Section 2 Disclosure Statement:  
"The yield and average life shown above consider prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life. Please contact your representative for information on CMOs and how they react to different market conditions."

Section 3 Product Features (Optional):  
Minimum Denominations  
Rating Disclosure  
Agency/Government Backing  
Income Payment Structure  
Generic Description of Tranche (e.g., PAC, Companion)  
Yield to Maturity of CMOs Offered at Par

Section 4 Company Information:  
Name, Memberships

Address  
Telephone Number  
Representative's Name

**(2) Additional Conditions**

The following conditions must also be met:

(A) All figures in Section 1 must be in equal type size.

(B) The disclosure language in Section 2 may not be altered and must be given equal prominence with the information in Section 1.

(C) The prepayment assumption used to determine the yield and average life must either be obtained from a nationally recognized service or the member firm must be able to justify the assumption used. A copy of either the service's listing for the CMO or the firm's justification must be attached to the copy of the communication that is maintained in the firm's advertising files in order to verify that the prepayment scenario is reasonable.

(D) Any sales charge that the member intends to impose must be reflected in the anticipated yield.

(E) The communication must include language stating that the security is "offered subject to prior sale and price change." This language may be included in any one of the four sections.

(F) If the security is an accrual bond that does not currently distribute principal and interest payments, then Section 1 must include this information.

**(3) Radio/Television Advertisements**

(A) The following oral disclaimer must precede any radio or television advertisement in lieu of the Title information set forth in Section 1:

"The following is an advertisement for Collateralized Mortgage Obligations. Contact your representative for information on CMOs and how they react to different market conditions."

(B) Radio or television advertisements must contain the following oral disclosure statement in lieu of the legend set forth in Section 2:

"The yield and average life reflect prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life."

**(4) Standardized CMO Communication Example**

Collateralized Mortgage Obligations

7.50% Coupon  
7.75% Anticipated Yield to 22-Year Average Life  
FNMA 9532X, Final Maturity March 2023  
Collateral 100% FNMA 7.50%

The yield and average life shown above reflect prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life. Please contact your representative for information on CMOs and how they react to different market conditions.

\$5,000 Minimum  
Income Paid Monthly  
Implied Rating/Volatility Rating  
Principal and Interest Payments Backed by FNMA  
PAC Bond

Offered subject to prior sale and price change.

Call Mary Representative at (800)555-1234

Your Company Securities, Inc., Member SIPC  
123 Main Street  
Anytown, State 12121

## **2211 Institutional Sales Material and Correspondence**

### **(a) Definitions**

For purposes of Rule 2210, this Rule, and any interpretation thereof:

- (1) “Correspondence” consists of form letters and electronic mail messages distributed by a member only to:
  - (A) its existing retail customers; and
  - (B) fewer than 25 prospective retail customers within any 30 calendar-day period.
- (2) “Institutional Sales Material” consists of any communication that is distributed or made available only to institutional investors.
- (3) “Institutional Investor” means any:
  - (A) person described in Rule 3110(c)(4), regardless of whether that person has an account with an Association member;
  - (B) governmental entity or subdivision thereof;
  - (C) qualified plan, as defined in Section 3(a)(12)(C) of the Act, that has at least 100 beneficiaries;
  - (D) Association member or registered associated person of such a member; and
  - (E) person acting solely on behalf of any such institutional investor.

No member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any person other than an institutional investor.

- (4) “Existing Retail Customer” means any person for whom the member or a clearing broker or dealer on behalf of the member carries an account, or who has an account with any registered investment company for which the member serves as principal underwriter, and who is not an institutional investor. “Prospective Retail Customer” means any person who has not opened such an account and is not an institutional investor.

**(b) Approval and Recordkeeping**

**(1) Registered Principal Approval**

(A) Correspondence. Correspondence need not be approved by a registered principal prior to use, but is subject to the supervision and review requirements of Rule 3010(d).

(B) Institutional Sales Material. Each member shall establish written procedures that are appropriate to its business, size, structure, and customers for the review by a registered principal of institutional sales material used by the member and its registered representatives. Such procedures should be in writing and be designed to reasonably supervise each registered representative. Where such procedures do not require review of all institutional sales material prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing institutional sales material, documentation of such education and training, and surveillance and follow-up to ensure that such procedures are implemented and adhered to. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to the Association upon request.

**(2) Record-keeping**

(A) Members must maintain all institutional sales material in a file for a period of three years from the date of last use. The file must include the name of the person who prepared each item of institutional sales material.

(B) Members must maintain in a file information concerning the source of any statistical table, chart, graph or other illustration used by the member in communications with the public.

Cross Reference -- NASD Conduct Rule 3010 (Supervision) and Rule 3110 (Books and Records)

**(c) Spot-Check Procedures**

Each member's correspondence and institutional sales literature may be subject to a spot-check procedure under Rule 2210. Upon written request from the Advertising/Investment Companies Regulation Department (the "Department"), each member must submit the material requested in a spot-check procedure within the time frame specified by the Department.

**(d) Content Standards Applicable to Institutional Sales Material and Correspondence**

(1) All institutional sales material and correspondence are subject to the content standards of Rule 2210(d)(1) and the applicable Interpretive Materials under Rule 2210.

(2) All correspondence (which for purposes of this provision includes business cards and letterhead) must:

(A) prominently disclose the name of the member and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction;

(B) reflect any relationship between the member and any non-member or individual who is also named; and

(C) if it includes other names, reflect which products or services are being offered by the member.

(3) Members may not use investment company rankings in any correspondence other than rankings created and published by Ranking Entities as defined in IM-2210-3(a) or rankings created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.

**(e) Violation of Other Rules**

Any violation by a member of any rule of the SEC, the Securities Investor Protection Corporation or the Municipal Securities Rulemaking Board applicable to institutional sales material or correspondence will be deemed a violation of this Rule and Rule 2210.

Cross Reference - SEC Rules Concerning Investment Company Sales Literature and Advertising (SEC Rules and Regulation T Tab)

Cross Reference -- Conduct Rule 3010(g)(2) (Concerning branch office locations, telephone directory line listings, business cards and letterhead)



## **Rule 2211 (Telemarketing)**

Rule 2211 shall be renumbered as new Rule 2212.

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

#### ***(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change***

##### **Background**

The proposed rule change would modernize and clarify the rules governing member communications with the public. Among other provisions, the proposed rule change would exclude all communications to institutional investors from member pre-use approval and NASD Regulation filing requirements and from many of the content standards. Form letters and group e-mail to existing retail customers and fewer than 25 prospective retail customers also would be eligible for these exclusions. Additionally, the proposed rule change would exclude independently prepared reprints from the filing and many of the content standards, and would exclude certain press releases from the filing requirements. The proposed rule change would simplify the content standards applicable to member communications.

As discussed in greater detail below, the proposed rule change reflects many of the comments and suggestions received by NASD Regulation in response to Notice to Members 99-79 ("NTM 99-79"). In NTM 99-79, NASD Regulation requested comment from members and other interested parties to an earlier version of the proposed rule change ("NTM Version"). The comment period on NTM 99-79 closed on October 29, 1999. NASD Regulation received 72 comment letters in response to NTM 99-79. In developing the proposed rule change, NASD Regulation also consulted with five of its member committees, its district committees, and its National Adjudicatory Council, and considered comments received to Notice to Members 98-81, which requested comment generally on how the NASD rules and By-Laws could be modernized.

##### **Description**

###### *Reorganization of Rule 2210*

The proposed rule change would create new Rule 2211, which would apply to institutional sales material and correspondence. The creation of a separate rule for institutional sales material and correspondence should facilitate a reader's ability to determine how the advertising rules apply to those communications. In order to further simplify this process, the proposed rule change would provide cross-references between Rule 2210 and Rule 2211 in appropriate places. Existing Rule 2211, concerning telemarketing, would be renumbered as Rule 2212.

### *Definition of “Public Appearance”*

Existing Rule 2210(d)(1)(C) provides that members who engaged in public appearances or speaking activities must follow the content standards of Rule 2210(d) and (f). Consequently, public appearances already are subject to strict content requirements.

The proposed rule change would clarify the application of Rule 2210 to public appearances by defining “public appearance” as a type of communication with the public. Public appearances would include participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or speaking activity.

The proposed rule change also would provide members with more flexibility than they have today, by subjecting public appearances only to some, but not all of the content standards of Rule 2210. Several commenters to NTM 99-79 argued that none of the content standards should apply to public appearances. These commenters asserted that by subjecting public appearances to any of the content standards, the proposed rule change would impose impractical constraints on television and other public appearances by members.

NASD Regulation disagrees with the suggestion that statements made in public appearances should be excluded from all of the content standards. While some accommodation of the practical concerns raised by commenters may be necessary, leaving investors virtually unprotected from public statements that are misleading, unbalanced or unwarranted is not an acceptable solution. Therefore, the proposed rule change would subject public appearances to some of the content standards, while providing members with more flexibility than they have today to provide useful information in their public appearances.

In addition, by defining “public appearance” to include an interactive electronic forum, the proposed rule change would codify the NASD Regulation staff’s position that Internet chat rooms constitute public appearances rather than advertisements or sales literature for purposes of Rule 2210.

### *Institutional Sales Material*

Today Rule 2210 does not distinguish between retail and institutional sales material. Moreover, the rule currently defines “sales literature” to include any “form letter,” which the NASD has interpreted to mean written communications, including e-mail messages, sent to at least two persons. Consequently, any communication sent to two or more institutional investors is deemed “sales literature,” must comply with the content standards of Rule 2210, must be pre-approved by a registered principal, and may have to be filed with the Advertising/Investment Companies Regulation Department of NASD Regulation (the “Department”) if it concerns certain types of products, such as registered investment companies.

The proposed rule change would eliminate the pre-use approval and filing requirements applicable to communications that are distributed or made available only to institutional investors. Institutional sales material would be subject to new supervision and review requirements that are modeled on those in Rule 3010, which apply to correspondence.

Moreover, institutional sales material would continue to be subject to the record-keeping requirements and some, but not all, of the content standards in Rule 2210.<sup>12</sup>

Under the proposed rule change, no member could treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any person other than an institutional investor. For example, if a member had reason to believe that such a communication would be forwarded or made available to 401(k) plan participants or other beneficiaries of institutional accounts, it would be treated as retail sales material. NASD Regulation believes that plan participants and other beneficiaries of institutional accounts should receive the same protections under the advertising rules as other retail investors. Similarly, an advertisement in a publication designed for broker/dealers or other institutional investors may not be treated as institutional sales material if the member has reason to believe that the publication will be made available to any person other than an institutional investor.

The proposed rule change would define “institutional investor” as any:

- (1) person described in Rule 3110(c)(4), regardless of whether that person has an account with an Association member;<sup>13</sup>
  - (2) governmental entity or subdivision thereof;
  - (3) qualified plan, as defined in Section 3(a)(12)(C) of the Securities Exchange Act of 1934, that has at least 100 beneficiaries;
  - (4) Association member or registered associated person of such a member;<sup>14</sup>
- and

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<sup>12</sup> The proposed rule change would revise the content standards to specifically indicate which type of communication is subject to each standard. Therefore, standards that apply only to “advertisements” or “sales literature” would not apply to institutional sales material. For example, the ranking guidelines in proposed IM-2210-3 would apply only to advertisements and sales literature and therefore would not apply to institutional sales material.

<sup>13</sup> Rule 3110(c)(4) defines “institutional account” to mean the account of a bank, savings and loan, insurance company, registered investment company, or registered investment adviser. It also includes the account of any other entity or natural person with total assets of at least \$50 million. For purposes of Rule 2210 and Rule 2211, the term “institutional investor” would include trust companies organized under state law that come within the definition of “bank” in Article I(b) of the NASD By-Laws. In addition, the proposed rule change is not intended to require a member to verify that an investment adviser that is required to register with the SEC or a state has in fact done so, in order for the member to treat this investment adviser as an “institutional investor.”

<sup>14</sup> Some commenters expressed concern about the proposal to include broker/dealer-only material within the definition of institutional sales material. These commenters asserted that currently broker/dealer-only material is excluded from the content standards of Rule 2210, and that by treating it as institutional sales material and subjecting it to some of the content standards, the proposed rule change would reduce the flexibility that members now have to place various types of information in broker/dealer-only material.

This comment reflects an apparent misunderstanding about the current scope of the content standards. Today all content standards of Rule 2210 apply to advertisements and sales literature sent only to members or their  
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- (5) person acting solely on behalf of any such institutional investor.

Several elements of this definition were amended as a result of comments to NTM 99-79. First, the definition was amended to include governmental entities and their subdivisions. Second, the definition would apply to qualified plans with at least 100 beneficiaries. NASD Regulation believes that qualified plans with 100 beneficiaries generally have the level of sophistication and expertise to justify their treatment as institutional investors under the advertising rules. Various statutory provisions similarly distinguish these qualified plans from smaller ones.<sup>15</sup>

Third, the proposed rule change would define “institutional investor” to include any person acting solely on behalf of any institutional investor. Several commenters urged NASD Regulation to define “institutional investor” to include pension consultants and others acting on behalf of institutional investors. Rather than establishing a new category based upon a person’s occupation, NASD Regulation has determined to include any person acting on behalf of an institutional investor.

Fourth, in response to one commenter, NASD Regulation would clarify that the term “institutional investor” includes only associated persons who are registered with an NASD member. The “broker/dealer-only” exception, which would become a part of the institutional investor definition, recognizes the special expertise that NASD members have with respect to brokerage products and services. While registered persons should have this expertise, as demonstrated by their completion of the qualifications process, there can be no assurance that other associated persons would.

Fifth, the definition would clarify that no member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded *or made available to* any person other than an institutional investor. Thus, for example, if a member has reason to believe the employer sponsor of a retirement plan will make sales material available for inspection by the plan beneficiaries, then the member may not treat the sales material as having been distributed only to an institutional investor.

The definition of “institutional investor” would include persons described in Rule 3110(c)(4), which defines “institutional account” to include any entity with total assets of at least \$50 million. Several commenters asserted that this threshold level is too high in light of the purposes of the proposed rule change, and recommended that NASD Regulation reduce it to a level such as \$5 million, a level used in Regulation D under the Securities Act of 1933.

NASD Regulation has determined that the \$50 million threshold is appropriate, particularly in light of the significant effect that the definition of “institutional investor” would have on the filing, pre-approval and content requirements. Moreover, the amendment to include qualified plans with at

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registered persons. By including this material within the definition of institutional sales material, and subjecting it only to those standards applicable to institutional sales material, the proposed rule change would provide members with more flexibility to include various information in broker/dealer-only material.

<sup>15</sup> See, e.g., ERISA § 103(a)(3)(A) (auditing requirements) and 104(a)(2)(A) (annual reporting).

least 100 beneficiaries should address many of the concerns expressed by those who proposed a reduction in the asset size threshold.

### *Form Letters and Group Electronic Mail*

Rule 2210 currently treats any letter or e-mail sent to more than one person as “sales literature” subject to the panoply of content standards applicable to all other sales literature, and to the member pre-use approval and NASD Regulation filing requirements. The use of group electronic mail has become commonplace in many firms. For example, registered representatives may provide customers with information concerning their accounts, changes in market conditions, or current economic conditions. Given the volume of form letters and group e-mail that members and their associated persons may send, and the speed with which this material can be dispatched to customers, a pre-use approval requirement may be less practical than supervisory procedures that are more specifically tailored to these forms of communication.

NASD Regulation believes that Conduct Rule 3010(d), which governs the approval and review of correspondence, provides the most effective means of supervising form letters and group e-mail sent to existing and a limited number of prospective retail customers. Rule 3010(d) requires members to adopt written procedures for the review of correspondence by registered principals. Any member that does not pre-approve all correspondence must educate and train associated persons as to NASD rules governing communications with the public and the firm’s procedures must document this training and must monitor adherence to these procedures. Members must retain all correspondence of registered representatives related to the member’s investment banking or securities business.

The proposed rule change would define “correspondence” as form letters and group e-mail sent to existing retail customers and to fewer than 25 prospective retail customers within any 30 calendar-day period (“Group Correspondence”). The proposed rule change would subject Group Correspondence to the strict supervisory procedures in Rule 3010(d) and to those content standards that apply to correspondence. Form letters and group e-mail sent to 25 or more prospective retail customers within any 30 calendar-day period would be subject to the pre-use approval, filing, and record-keeping requirements of Rule 2210, and to all of the content standards applicable to sales literature.<sup>16</sup>

The NTM Version would have applied a 90-day rather than a 30-day period to the determination of whether form letters and group e-mail have been sent to fewer than 25 prospective retail customers. One commenter questioned the feasibility of monitoring the issuance of form letters and group e-mail to prospective customers over a rolling 90-day period. The proposed rule change would reduce this period to 30 calendar days, to make the monitoring responsibility more manageable.

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<sup>16</sup> The proposed rule change would permit members to treat form letters or group e-mail sent to a *combination* of existing customers and fewer than 25 prospective retail customers within any 30 calendar-day period as correspondence.

Of course members could not “sanitize” sales literature by enclosing it with Group Correspondence. For example, an item that a member has distributed as sales literature would remain sales literature for purposes of Rule 2210 when the member encloses it in Group Correspondence.

The term “existing retail customer” has been modified in response to comments to NTM 99-79. “Existing retail customer” would be defined as any person, other than an institutional investor, for whom the member or a clearing broker or dealer on behalf of the member carries an account, or who has an account with any registered investment company for which a member serves as principal underwriter. The new language would make clear that a person who has opened an account with an investment company or with a transfer agent for such an investment company could qualify as an existing retail customer. NASD Regulation also has amended the language to make it more consistent with existing Conduct Rule 2211(d).

### *Article Reprints*

Rule 2210 currently defines “sales literature” to include “reprints or excerpts of any . . . published article.” Article reprints thus may have to be filed with the Department, depending upon their content, such as whether they pertain to registered investment companies. For some time, NASD Regulation has received comments that third-party article reprints should not be subject to the filing requirements of Rule 2210. Some have argued that reprints often are available to the public through large-circulation periodicals published by firms that are not NASD members, and that it makes little sense to require members to file reprints, especially when they have no control over the content of these articles. In NTM 99-79, NASD Regulation therefore proposed to exclude article reprints from the filing requirements. Several commenters to NTM 99-79 argued that article reprints also should be exempt from most of the content standards of Rule 2210.

In response to these comments, the proposed rule change would define a new type of communication with the public, an “independently prepared reprint,” and exclude independently prepared reprints from the filing and most of the content standards. An independently prepared reprint would consist of any article reprint that meets certain standards that are designed to ensure that the reprint was issued by an independent publisher and was not materially altered by the member. In response to comments to NTM 99-79, the proposed rule change would provide that a member may alter the contents of an independently prepared reprint in a manner necessary to make it consistent with applicable regulatory standards or to correct factual errors.

Some, but not all, content standards would apply to independently prepared reprints. For example, Rule 2210(d)(1) would impose various content standards on all communications with the public, including independently prepared reprints. However, paragraph (d)(1)(D) (concerning predictions and projections of performance) would not apply to a statement in an independently prepared reprint that represents the author’s opinion about the prospects for a member’s business, products or services.<sup>17</sup>

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<sup>17</sup> Nevertheless, a statement made by a person other than the author, such as a mutual fund’s portfolio manager or an associated person of a member, and quoted in the independently prepared reprint, would be subject to paragraph (d)(1)(D).

The proposed rule change also would include certain investment company research reports within the definition of independently prepared reprints. Rule 2210 was recently amended to exclude these research reports from the filing requirements. Because these research reports present essentially the same issues as independently prepared reprints, the proposed rule change would subject these research reports to the same content and other requirements that apply to independently prepared reprints.

Independently prepared reprints would continue to be subject to the pre-use approval and record-keeping requirements of Rule 2210. Moreover, article reprints and research reports that do not meet the definition of “independently prepared reprint” would continue to constitute sales literature that would have to meet all of the requirements applicable to sales literature.

### *Press Releases*

Rule 2210 defines “sales literature” to include “any written or electronic communication distributed or made generally available to customers or the public,” which the Department has interpreted to include press releases. The proposed rule change would codify this interpretation by amending the definition of “sales literature” to include press releases concerning a member’s product or service. The proposed rule change would exclude from the filing requirements press releases that are made available only to members of the media.<sup>18</sup> This exclusion would recognize the time-sensitive nature of these press releases, and the fact that press releases generally do not raise significant concerns in the filing process.

Some commenters to NTM 99-79 recommended that NASD Regulation exclude press releases from most of the content standards, or even exclude press releases from Rule 2210 entirely. Some of these commenters asserted that press releases are not part of a member’s effort to market its products and services, and therefore need not be subject to Rule 2210. In fact, press releases often announce the availability of new products or services and members frequently circulate press releases to their customers with other marketing material. While NASD Regulation recognizes that the media may substantially edit a press release or even refrain from using the press release at all, we disagree with the assertion that press releases concerning a member’s products or services have little to do with its marketing efforts. Consequently, the proposed rule would exempt from the filing requirements those press releases that are made available only to members of the media, but would subject them to the content, pre-use approval and record-keeping requirements of Rule 2210.

### *Television and Video Advertisements*

The proposed rule change would require members that have filed a draft version or “story board” of a television or video advertisement pursuant to a filing requirement also to file the final

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<sup>18</sup> The proposed rule change, unlike the NTM Version, would exclude all press releases made available only to members of the media, without limiting the exclusion to press releases concerning investment companies. Some commenters to NTM 99-79 stated that the limitation might create confusion concerning whether other press releases that must be filed under existing Rule 2210, such as those concerning variable products, would be similarly excluded.

filmed version within ten business days of first use or broadcast. This rule change would codify an existing Department policy regarding television and video sales material. Rule 2210 would impose a filing fee only when the draft version or story board is filed. No additional fee would be assessed when the final filmed version is filed.

### *Approval and Record-keeping*

The proposed rule change would make three additional modifications to the pre-use approval and record-keeping requirements in response to comments to NTM 99-79. First, it would clarify that the pre-use approval requirement could be met with respect to a research report concerning any debt or equity security, including non-corporate securities, by signature or initial of a supervisory analyst under New York Stock Exchange Rule 344. Second, the proposed rule change would clarify that members must maintain a file with the name of the registered principal who approved any advertisement or sales literature. Members would not be required to maintain a file with the name of the person who prepared those items, however.<sup>19</sup> Third, the proposed rule change would clarify that members must maintain a file with information concerning the source, but not necessarily the data, of any statistical table, chart, graph or other illustration.

### *Filing Requirements*

The proposed rule change would reinstate the existing provision concerning the obligation of a member that has not filed an advertisement with the Department, to pre-file its advertisements for a one-year period. The NTM Version appeared to cause some confusion concerning this pre-filing obligation. The proposed rule change would modify the existing language slightly, to make it more clear and consistent with standards of plain English. The proposed rule change also has been modified from the NTM version to clarify that advertisements and sales literature for continuously offered closed-end funds must be filed with the Department. This clarification codifies a long standing position of the Department.<sup>20</sup>

Rule 2210 does not require members who are subject to this pre-filing requirement to await completion of the Department's review of its advertisements before using them. Nevertheless, NASD Regulation encourages these members to do so, in order to better ensure that their advertisements reflect the Department's comments and that these members do not incur the expense of revising advertisements already in use.

The proposed rule change would clarify that members need not file advertisements and sales literature that previously have been filed and that are to be used without material change. This provision would codify existing practice, which excludes from the filing requirement material that has been filed previously, but in which performance data is updated or there are other changes that are not

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<sup>19</sup> Proposed Rule 2211 would require members to maintain all institutional sales material in a file that includes the name of the person who prepared each item.

<sup>20</sup> See, e.g., NASD Regulatory and Compliance Alert (April 1995) at p. 9.



material for purpose of the filing requirement. Members are encouraged to file material that is particularly aged, to ensure that the material has not fallen out of compliance due to changes in rules or other circumstances.

In response to comments received on NTM 99-79, the proposed rule change would specifically list institutional sales material as one type of communication that need not be filed. The proposed rule change also would list correspondence, independently prepared reprints, and certain press releases. In addition, the proposed rule change would state that when these items concern investment companies, then they will be deemed filed with the Association for purposes of Section 24(b) of the Investment Companies Act of 1940 and Rule 24b-3 thereunder. Based on our conversations with the SEC staff, we understand that this provision would eliminate the need to file this material with the SEC.

The proposed rule change also would exclude from the filing requirement announcements as a matter of record that a member has participated in a private placement.

Several commenters to NTM 98-81 and NTM 99-79 argued that investment company annual and semi-annual reports should be excluded from the filing requirements. These commenters note that shareholder reports are already subject to specific content requirements under SEC rules and are filed with the SEC, and argue that these requirements should address any investor protection concerns.

Members are not required to file shareholder reports that only consist of statistical reporting information such as financial statements and portfolio holdings. However, members must file the management's discussion of fund performance (MDFP) portion of a report (as well as any supplemental sales material attached to or distributed with the report) with the Department. In the Department's experience, members frequently use the MDFP or other supplemental information as marketing material that goes far beyond the SEC regulatory requirements for shareholder reports. While NASD Regulation carefully considered the comments suggesting an exemption for shareholder reports, we have decided not to propose such an exclusion from the filing requirement.

Several commenters to NTM 98-81 and NTM 99-79 also requested that NASD Regulation eliminate the requirement that members file a copy of the ranking or comparison used in sales material that contains rankings. These comments appear to assume that the filing is pro forma because the ranking or comparison information is reflected in the sales material itself, or that the ranking or comparison information is readily available to the Department. In fact, it is not unusual for the Department to comment on sales material that presents a ranking or comparison in a manner inconsistent with the backup ranking information. Additionally, sales material often contains rankings or comparisons that are not readily available. Because the Department relies on the backup filings when reviewing sales material that contains rankings or comparisons, elimination of this requirement could significantly delay completion of the staff's review. Accordingly, while NASD Regulation carefully considered the comments suggesting an exclusion for backup material, the proposed rule change would not eliminate this filing requirement.

Several commenters to NTM 98-81 and 99-79 also recommended that NASD Regulation eliminate the requirement to file generic mutual fund advertisements that comply with Rule 135a under the Securities Act of 1933. Members rarely file generic advertisements. To the extent the

Department has received generic advertisements, however, it has found that members sometimes misunderstand the content requirements of Rule 135a, and sometimes misclassify advertising that falls under other rules as generic advertisements. We are concerned that an exclusion for generic advertisements could lead some members not to file investment company sales material that should be filed due to their misunderstanding of Rule 135a. Accordingly, NASD Regulation does not propose to exclude generic fund advertisements from the filing requirements.

### *Standards Applicable to Member Communications*

The proposed rule change would substantially shorten and simplify the standards applicable to communications with the public that are contained in Rule 2210(d). The proposed rule change would relocate certain standards from Rule 2210(d) to a new Interpretive Material 2210-1, Guidelines to Ensure that Communications Are Not Misleading. New proposed IM-2210-1 would make clear that members have the primary responsibility to ensure that their communications with the public are not misleading, and would rewrite many standards to make them more clear and consistent with the principles of plain English.

Proposed IM-2210-1 would not contain certain of the specific standards currently in Rule 2210. Partially in response to comments received to NTM 98-81, the proposed rule change would eliminate the specific standards regarding non-existent or self-conferred degrees or designations, offers of free service, claims for research facilities, hedge clauses, recruiting advertising, and periodic investment plans. To the extent that these provisions prohibit statements that are misleading, unbalanced, or inaccurate regarding particular types of communications, the rule already prohibits the use of such statements. Moreover, certain required disclosures, such as those currently applicable to statements concerning periodic investment plans, may not be necessary depending upon the context in which they are made.

Proposed IM-2210-1(4) in the NTM version has been turned into new paragraphs (4) and (5) to clarify which guidelines concerning references to tax free or tax exempt income apply to all communications with the public, and which guidelines apply only to advertisements or sales literature.

### *Legends, Footnotes, and Hyperlinks*

Rule 2210 cautions members concerning the placement of footnotes, and in the filing review process the Department has insisted that members adopt an appropriate use of footnotes. The NTM Version would have required that material information appear in the main text of a communication and not be relegated to footnotes. Commenters expressed concern that the NTM Version would eliminate much of the flexibility that members now have concerning the placement of footnotes in specific items of sales material. Moreover, commenters noted that a requirement to include all “material” information in the text might have unintended litigation consequences.

The proposed rule change would attempt to balance these concerns with the need to ensure that Rule 2210 provides clear direction to members concerning their responsibility to avoid inappropriate reliance on legends and footnotes. Consequently, the proposed rule change would provide that information may be placed in a legend or footnote only in the event that such placement would not

inhibit an investor's understanding of the communication. Thus, for example, footnotes in especially small type in an advertisement might be deemed to inhibit an investor's understanding of the advertisement. Similarly, an advertisement that presents bold claims that are supposedly "balanced" only with footnote disclosure might not comply with this content standard.

### *Hypothetical Illustrations*

The NTM Version would have deleted from Rule 2210 the statement that "a hypothetical illustration of mathematical principles is not considered a prediction or projection of performance." Commenters objected to this change, arguing that this provision has permitted members to provide educational information in their sales material, and that its elimination might interfere with presentations such as a mutual fund cost calculator.

In proposed Rule 2210(d)(1)(D), NASD Regulation would insert language similar to the existing language. Under the proposed rule change, a member could present a hypothetical illustration of mathematical principles, provided that the illustration does not predict or project the performance of an investment or investment strategy and is not used in such a manner. The proposed rule change thus would permit the use of mutual fund cost calculators and other hypothetical illustrations that are permitted by existing Rule 2210.

### *Testimonials*

The NTM Version would have applied specific standards to testimonials concerning "a member's products and services." Commenters indicated that this change would cause confusion about whether the testimonial standards would apply even when the testimonial concerns matters other than investment performance, such as the member's general services. In order to clarify this matter, the proposed rule change would apply the testimonial standards to advertisements or sales literature concerning the investment advice or investment performance of a member or its products.

### *Recommendations*

The NTM Version would have clarified certain aspects of the existing standards governing recommendations. Some commenters argued that the proposal went too far, and that it would inhibit legitimate discussion about the prospects for various investments. Nevertheless, NASD Regulation continues to share the concerns of SEC Chairman Levitt and others about the need to provide investors with adequate disclosure about the financial interests that research analysts, other associated persons, or their firms may have in securities that they recommend. NASD Regulation has determined to consider this issue further, and to work with the SEC staff on the possible development of more detailed disclosure requirements. In the meantime, the proposed rule change would make no amendment to the existing standards governing recommendations.

### *Use and Disclosure of a Member's Name*

The proposed rule change would dramatically simplify the provisions concerning disclosure of member names. In addition, the proposed rule change would make clear that the requirement to

disclose the member's name applies to advertisements, sales literature, and correspondence, which for purposes of this provision would include business cards and letterhead.<sup>21</sup> In response to comments to NTM 99-79, the provision would clarify that the advertisement, sales literature or correspondence must "reflect" (rather than disclose) any relationship between the member and the other named person and the products and services offered by the member. This change would help ensure that members do not mislead investors concerning these relationships and offerings, but would not mandate disclosure that may be unnecessary to achieve this objective.

### *Ranking Guidelines*

The proposed rule change would modify the ranking guidelines in several respects. First, the proposed rule change would make clear that no advertisement, item of sales literature or correspondence may present a ranking other than rankings (1) created and published by a Ranking Entity, which the ranking guidelines define to include certain independent entities, or (2) created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.<sup>22</sup> Second, the proposed rule change would make clear that the ranking guidelines in IM-2210-3 apply only to advertisements and sales literature.

Third, the proposed rule change would permit the use of investment company family ranking even in sales material that advertises only one investment company in the family. Several commenters to NTM 99-79 urged NASD Regulation to permit the use of investment company family rankings. These types of rankings are not currently permitted under the Rule 2210, due to concern that sales material that presents a family ranking might confuse investors about the true ranking of the advertised investment company. The proposed rule change attempts to strike a balance between the interest in presenting some form of family ranking, and the need to ensure that presentations of family rankings do not mislead investors about the ranking of an individual investment company. The proposed rule change thus would permit the presentation of investment company family rankings, provided that when a particular investment company is being advertised, the individual rankings for that investment company also must be presented. The definition of "investment company family" is substantially similar to the definition of "group of investment companies" in SEC Rule 11a-3 under the Investment Company Act of 1940. Of course, as with all performance rankings, use of an investment company family ranking would have to comply with the other applicable requirements of Rule 2210.

The proposed rule change would reinsert existing language concerning the required ranking periods. The NTM Version would have required rankings only for short, medium and long-term periods. Commenters to NTM 99-79 suggested that this provision would allow members to "cherry pick" ranking periods, to the detriment of investors. The proposed rule change would reinstate the existing language, but with some modifications to clarify the language and make it more consistent with principles of plain English.

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<sup>21</sup> The requirement thus would not apply to institutional sales material.

<sup>22</sup> The application of this limitation to correspondence would appear in new Rule 2210(d)(3) rather than in IM-2210-3.

The proposed rule change also would eliminate the requirement that certain disclosures appear in “close proximity” to any headline or other prominent statement that refers to a ranking. The subjective nature of this requirement has complicated the Department’s administration of the ranking guidelines without providing meaningful additional protection to investors. The proposed rule change would eliminate certain disclosure requirements applicable to investment company rankings that are based on subcategories of funds or categories created by an investment company or its affiliate.

#### *Limitations on Use of the Association’s Name*

The proposed rule change would simplify and shorten the requirements in IM-2210-4 concerning the use of the NASD’s name. The proposed rule change also would delete current Rule 2210(d)(2)(J) concerning references to regulatory organizations.

#### *Communications About Collateralized Mortgage Obligations*

The proposed rule change would rewrite existing IM-2210-1 (the CMO Guidelines), which governs communications about collateralized mortgage obligations and renumber it as IM-2210-6. The current CMO Guidelines may give the impression that different standards apply to educational material, advertisements and “communications.” The proposed rule change would simplify, shorten and reorganize the CMO Guidelines to provide a more straightforward and uniform list of disclosure requirements.

The proposed rule change would modify the NTM Version in several respects. First, the proposed rule change would eliminate prohibitions of certain statements concerning the safety, liquidity, potential guarantees, and simplicity of CMOs. The content standards of Rule 2210, in their current form and as they would be amended, already prohibit a member from making these statements in any communication with the public. Second, the proposed rule change would make clear that paragraphs (b)(1) and (c) apply only to advertisements, sales literature and correspondence. Third, the proposed rule change would clarify that paragraph (b)(2) does not apply to the sale of a CMO to an institutional investor.

#### **(b) Statutory Basis**

NASD Regulation 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 Association’s rules must 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. The NASD believes that the proposed rule change will more appropriately address the issues related to member communications with the public, will promote the safety and soundness of member firms, and will further investor protection.

**(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.

**(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

Notice to Members 99-79 solicited comments on the proposed rule change, which commenters generally supported. The comment period expired on October 29, 1999. Seventy-two comment letters were received in response to the notice. A copy of Notice to Members 99-79 is attached as Exhibit 2. A summary of comments received in response to NTM 99-79 is attached as Exhibit 3. NASD Regulation's responses to comments are addressed above in Section 3, the Statement of Purpose. Modifications made in response to comments are discussed above.

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

Within 35 days of the date of publication of this notice in the *Federal Register* or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

**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 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