

August 9, 2001

BY HAND

Ms. Katherine England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2001-49; Amendment to Expiration Date of Rules Relating to Bond
Mutual Fund Volatility Ratings

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-referenced rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Thomas M. Selman, Senior Vice President, Investment Companies/Corporate Financing, NASD Regulation, Inc., at (240) 386-4533, or Sarah J. Williams, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8083. The fax number for the Office of General Counsel is (202) 728-8264.

Very truly yours,

Patrice M. Gliniecki
Vice President and
Deputy General Counsel

Enclosures

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), NASD Regulation, Inc. ("NASD Regulation") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend Interpretive Material ("IM") 2210-5 to extend the expiration date of IM-2210-5 from August 31, 2001 to August 31, 2003, and to clarify that the filing requirements and review procedures applicable to sales literature that includes bond mutual fund volatility ratings, as set forth in NASD Rule 2210(c)(3), also will expire on August 31, 2001 absent further action by the NASD Regulation Board of Directors.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are bracketed.

IM-2210-5. Requirements for the Use of Bond Mutual Fund Volatility Ratings

(This rule and Rule 2210(c)(3) will expire on August 31, [2001] 2003, unless extended or permanently approved by the Association at or before such date.)

(a) No change.

(b) No change.

(c) No change.

2. Procedures of the Self-Regulatory Organization

(a) The NASD Regulation Board of Directors approved the proposed rule change at its meeting on July 25, 2001 and authorized the filing of the rule change with the SEC. The Nasdaq Stock Market, Inc. and NASD Dispute Resolution, Inc. were provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed

rule change at its meeting on July 26, 2001. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval. The NASD will announce the proposed rule change in a Notice to Members to be published no later than 30 days after the date of the filing.

(b) Questions regarding this rule filing may be directed to Thomas M. Selman, Senior Vice President, Investment Companies/Corporate Financing, at (240) 386-4533, or Sarah J. Williams, Assistant General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-8083.

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

(a) Purpose

Background and Description of the NASD's Rules on Bond Mutual Fund Volatility Ratings

On February 29, 2000, the SEC approved the adoption of NASD IM-2210-5, which permits members and their associated persons to include bond fund volatility ratings in supplemental sales literature (mutual fund sales material that is accompanied or preceded by a fund prospectus). The SEC also approved at that time, new NASD Rule 2210(c)(3), which sets forth the filing requirements and review procedures applicable to sales literature containing bond mutual fund volatility ratings. Previously, the NASD Regulation staff interpreted NASD rules to prohibit the use of bond fund volatility ratings in sales material.

IM-2210-5 permits the use of bond fund volatility ratings only in supplemental sales literature and only if certain conditions are met:

- The word "risk" may not be used to describe the rating.

- The rating must be the most recent available and be current to the most recent calendar quarter ended prior to use.
- The rating must be based exclusively on objective, quantifiable factors.
- The entity issuing the rating must provide detailed disclosure on its rating methodology to investors through a toll-free telephone number, a web site, or both.
- A disclosure statement containing all of the information required by the rule must accompany the rating. The statement must include such information as the name of the entity issuing the rating, the most current rating and the date it was issued, and a description of the rating in narrative form containing certain specified disclosures.

Rule 2210(c)(3) requires members to file bond mutual fund sales literature that includes or incorporates volatility ratings with the Advertising Regulation Department of NASD Regulation (“Department”) at least 10 days prior to use for Department approval. If the Department requests changes to the material, the material must be withheld from publication or circulation until the requested changes have been made or the material has been refiled and approved.

IM-2210-5 and the new Rule 2210(c)(3) were approved on an 18-month trial basis, which trial period expires on August 31, 2001, unless extended or permanently approved by NASD Regulation at or before that date.

Proposed Rule Change to Extend the Expiration Date of IM-2210-5 and to Clarify the Related Expiration Date of NASD Rule 2210(c)(3)

As indicated in the SEC’s order approving IM-2210-5 and Rule 2210(c)(3), NASD Regulation requested the 18-month trial period to provide an opportunity to assess whether the rule

change had facilitated the dissemination of useful, understandable information to investors, and whether it had prevented the dissemination of inappropriate and misleading information.¹

As of July 2001, the Department had received only six filings pursuant to these provisions. In general, these filings met the requirements of IM-2210-5. However, the staff does not believe that it has received a sufficient number of filings to adequately evaluate the provisions' effectiveness. While there may be a number of reasons for the low number of filings, it is possible that low investor demand for bond funds coupled with the strong promotion of equity mutual funds during much of the trial period has contributed to the low level of filings. The staff believes that additional experience with these provisions is necessary to evaluate adequately the effect on the delivery of accurate and useful information to investors concerning bond mutual fund volatility.

Accordingly, NASD Regulation is proposing to extend the expiration date of IM-2210-5 and Rule 2210(c)(3) for an additional two years, until August 31, 2003, to allow more filings to be made. Before this period expires, the staff will evaluate IM-2210-5 and Rule 2210(c)(3) and determine whether to recommend that they be eliminated, modified, or permanently approved as is. Further, NASD Regulation is proposing to amend IM-2210-5 to clarify that upon its expiration, Rule 2210(c)(3) will also expire.

(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 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. NASD Regulation

¹ See Securities Exchange Act Release No. 42476 (February 29, 2000), 65 FR 12305 at 12306.

believes that extending the expiration date of IM-2210-5 and Rule 2210(c)(3) will provide the additional experience necessary to fully analyze and evaluate the provisions.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder, in that the proposed rule change does not significantly affect the protection of investors or the public interest; and does not impose any significant burden on competition. In accordance with Rule 19b-4(f)(6)(iii), NASD Regulation submitted written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, prior to the date of filing. In that notice of intent, NASD Regulation also requested that the SEC waive the requirement that the rule change, by its terms, not become operative for 30 days after the date of the filing as set forth in Rule 19b-4(f)(6)(iii), as consistent with the protection of investors and the public interest. The SEC agreed to waive that requirement. Therefore, the proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

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

Not applicable.

9. Exhibits

Completed notice of proposed rule change for publication in the *Federal Register*.

Pursuant to the requirements of the Act, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: _____
Patrice M. Gliniecki
Vice President and Deputy General Counsel

Date: August 9, 2001

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2001-49)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. to Extend the Expiration Date of Rules Concerning Bond Mutual Fund Volatility Ratings

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on August __, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. NASD Regulation has designated the proposed rule change as constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 under the Act,² and the Commission has waived the requirement that the rule change, by its terms, does not become operative for 30 days after the date of the filing. Therefore, the rule is effective upon the Commission's receipt of this filing. 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 OF SUBSTANCE OF THE PROPOSED RULE CHANGE

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), NASD Regulation, Inc. ("NASD Regulation") is filing a proposed rule change to amend Interpretive Material ("IM") 2210-5 to extend the expiration date of IM-2210-5 from August 31, 2001 until August 31, 2003, and to clarify that the filing requirements and review procedures applicable to sales literature that

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR § 240.19b-4.

includes bond mutual fund volatility ratings, as set forth in NASD Rule 2210(c)(3), also will expire on August 31, 2001 absent further action by the NASD Regulation Board of Directors. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are bracketed.

IM-2210-5. Requirements for the Use of Bond Mutual Fund Volatility Ratings

(This rule and Rule 2210(c)(3) will expire on August 31, [2001] 2003, unless extended or permanently approved by the Association at or before such date.)

(a) No change.

(b) No change.

(c) No change.

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

In its filing with the Commission, NASD Regulation included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD Regulation has prepared summaries, set forth in Sections (A) - (C) below, of the most significant aspects of such statements.

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

(a) **Purpose**

Background and Description of the NASD's Rules on Bond Mutual Fund Volatility Ratings

On February 29, 2000, the SEC approved the adoption of NASD IM-2210-5, which permits members and their associated persons to include bond fund volatility ratings in supplemental sales literature (mutual fund sales material that is accompanied or preceded by a

fund prospectus). The SEC also approved at that time, new NASD Rule 2210(c)(3), which sets forth the filing requirements and review procedures applicable to sales literature containing bond mutual fund volatility ratings. Previously, the NASD Regulation staff interpreted NASD rules to prohibit the use of bond fund volatility ratings in sales material.

IM-2210-5 permits the use of bond fund volatility ratings only in supplemental sales literature and only if certain conditions are met:

- The word “risk” may not be used to describe the rating.
- The rating must be the most recent available and be current to the most recent calendar quarter ended prior to use.
- The rating must be based exclusively on objective, quantifiable factors.
- The entity issuing the rating must provide detailed disclosure on its rating methodology to investors through a toll-free telephone number, a web site, or both.
- A disclosure statement containing all of the information required by the rule must accompany the rating. The statement must include such information as the name of the entity issuing the rating, the most current rating and the date it was issued, and a description of the rating in narrative form containing certain specified disclosures.

Rule 2210(c)(3) requires members to file bond mutual fund sales literature that includes or incorporates volatility ratings with the Advertising Regulation Department of NASD Regulation (“Department”) at least 10 days prior to use for Department approval. If the Department requests changes to the material, the material must be withheld from publication or circulation until the requested changes have been made or the material has been refiled and approved.

IM-2210-5 and the new Rule 2210(c)(3) were approved on an 18-month trial basis, which trial period expires on August 31, 2001, unless extended or permanently approved by NASD Regulation at or before that date.

Proposed Rule Change to Extend the Expiration Date of IM-2210-5 and to Clarify the Related Expiration Date of NASD Rule 2210(c)(3)

As indicated in the SEC's order approving IM-2210-5 and Rule 2210(c)(3), NASD Regulation requested the 18-month trial period to provide an opportunity to assess whether the rule change had facilitated the dissemination of useful, understandable information to investors, and whether it had prevented the dissemination of inappropriate and misleading information.³

As of July 2001, the Department had received only six filings pursuant to these provisions. In general, these filings met the requirements of IM-2210-5. However, the staff does not believe that it has received a sufficient number of filings to adequately evaluate the provisions' effectiveness. While there may be a number of reasons for the low number of filings, the staff believes that low investor demand for bond funds coupled with the strong promotion of equity mutual funds during much of the trial period may have contributed to the low level of filings. The staff believes that additional experience with these provisions is necessary to evaluate the effect on the delivery of accurate and useful information to investors concerning bond mutual fund volatility.

Accordingly, NASD Regulation is proposing to extend the expiration date of IM 2210-5 and Rule 2210(c)(3) for an additional two years, until August 31, 2003, to allow more filings to be made. Before this period expires, the staff will evaluate IM-2210-5 and Rule 2210(c)(3) and determine whether to recommend that they be eliminated, modified, or permanently approved as is. Further,

³ See Securities Exchange Act Release No. 42476 (February 29, 2000), 65 FR 12305 at 12306.

NASD Regulation is proposing to amend IM-2210-5 to clarify that upon its expiration, Rule 2210(c)(3) will also expire.

(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 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. NASD Regulation believes that extending the expiration date of IM-2210-5 and Rule 2210(c)(3) will provide the additional experience necessary to fully analyze and evaluate the provisions.

(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

Written comments were neither solicited nor received.

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

The proposed rule change has been filed by the Association as a "non-controversial" rule change under Rule 19b-4(f)(6) under the Act.⁴ In accordance with Rule 19b-4(f)(6)(iii), prior to the filing date, NASD Regulation submitted written notice of its intent to file the proposed rule change along with a brief description and text of the proposed rule change. In that notice of its intent, NASD

⁴ 17 CFR § 240.19b-4(f)(6)

Regulation requested that the Commission waive the requirement that the rule change, by its terms, not become operative for 30 days after the date of filing, as consistent with the protection of investors and the public interest. The Commission agreed to waive that requirement. Accordingly, the proposed rule change will become effective upon filing pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of this publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17
CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary