

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43507; File No. SR-NASD-98-11]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 by the National Association of Securities Dealers, Inc. Concerning Related Performance Information

November 2, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ Rule 19b-4 thereunder,² notice is hereby given that on February 12, 1998, 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. On August 10, 1998, NASD Regulation filed an amendment that completely replaced and superseded the original proposed rule change.³ On October 17, 2000, NASD Regulation again amended the proposal.⁴ On October 30, 2000, NASD

Regulation filed an amendment that made minor, technical changes to the proposed rule language.⁵ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

NASD Regulation is proposing a new Interpretive Material 2210-5 and conforming amendments to existing Rule 2210 and IM-2210-2 of the NASD. Below is the text of the proposed rule change, as amended. Proposed new language is in italics. Proposed deletions are in brackets.

2200. Communications with Customers and the Public

2210. Communications With the Public

(a) and (b) No change.

(c) Filing Requirements and Review Procedures.

(1) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts and unit investment trusts) not included within the requirements of paragraph (c)(2), and public direct participation programs (as defined in Rule 2810), and advertisements concerning governments securities (as defined in Section 3(a)(42) of the Act) shall be filed with the Association's Advertising/Investment Companies Regulation Department (Department) within 10 days of first use or publication by any member. The member must provide with each filing the actual or anticipated date of first use. Filing in advance of use is recommended. Members are not required to file advertising and sales literature which have previously been filed and which are used without change. Any member filing any investment company advertisement or sales literature pursuant to this paragraph (c) that includes or incorporates rankings or comparisons of the investment company with other investment companies shall include a copy of the ranking or comparison used in the advertisement or sales literature. *Any member filing a mutual fund or*

variable contract advertisement or sales literature that presents Comparison Portfolio Performance (as defined by IM 2210-5) shall include a copy of the proof of independent verification required by IM 2210-5(c)(1)(B).

(c)(2) through (f) No change.

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

(a) No change.

(b) Specific Considerations

(1) Fund Performance Predating Inclusion in the Variable Product

In order to show how an existing fund would have performed had it been an investment option within a variable life insurance policy or variable annuity, communications may contain the fund's historical performance that predates its including in the policy or annuity. Such performance may only be used provided that no significant changes occurred to the fund at the time or after it became part of the variable product. However, communications may not include the performance of an existing fund for the purposes of promoting investment in a similar, but new Investment option (i.e., clone fund or model fund) available in a variable contract. The presentation of historical performance must conform to applicable Association and SEC standards. Particular attention must be given to including all elements of return and deducting applicable charges and expenses.

(b)(2) through (5) No change.

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

Any advertisement or sales literature concerning an open-end management investment company (the "Advertised Mutual Fund") may present the following types of performance information (collectively, "Related Performance Information").

(a) "Clone" Performance

The total return of all registered open-end management investment companies, calculated in accordance with Item 21 of SEC Form N-1A, that have the same investment policies, investment objectives, investment strategies, investment adviser and sub-investment adviser as an Advertised Mutual Fund, provided that the presentation of this Related Performance Information complies with the general standards in paragraph (d).

(b) "Predecessor" Performance

The total return of an Advertised Mutual Fund, calculated in accordance with Item 21 of SEC Form N-1A, that includes the performance of an insurance company separate account,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See August 7, 1998 letter from Joan C. Conley, Secretary, NASD Regulation, and attachments to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), SEC ("Amendment No. 1")

⁴ See October 16, 2000 letter ("October 16 Letter" and attachments from Alden S. Adkins, General Counsel and Senior Vice President, NASD Regulation, and attachments, to Katherine A. England, Assistant Director, Division, SEC ("Amendment No. 2"). In Amendment No. 2, NASD Regulation proposes that (i) members presenting clone performance present total return information for all related clone funds; (ii) the predecessor and the advertised mutual fund share sub-investment advisers as well as investment advisers, and substantially all of the predecessor portfolio's assets must have been transferred to the advertised mutual fund, upon conversion the predecessor portfolio would have to cease to exist as a separate entity, to present predecessor performance; (iii) comparison portfolio performance reflect the total return of other investment companies as well as other portfolios managed by the investment adviser or sub-investment adviser; (iv) several changes be made to the general standards set forth in paragraph (d) of proposed IM-2210-5; (v) no material difference may exist between the portfolio to which the related performance information refers and the advertised mutual fund, except that the portfolio may not have been registered under the Investment Company Act of 1940, and material difference may exist between the fees and expenses of a clone fund and the advertised mutual fund; and (vi) any member filing sales material that presents related performance information to maintain books and records that demonstrate the basis for and calculation of the related performance information.

The draft notice in Amendment No. 2 includes all of the changes implemented in Amendment Nos.

1 and 2. See October 19, 2000 telephone conversation between Sarah Williams, Assistant General Counsel, NASD Regulation and Joseph P. Morra, Special Counsel, Division of Market Regulation, SEC.

⁵ See October 30, 2000 letter from Alden S. Adkins, Senior Vice President and General Counsel, NASD Regulation to Katherine A. England, Assistant Director, Division, SEC ("Amendment No. 3").

common trust fund or private investment company that had been converted into, and had the same investment adviser and sub-investment adviser as, the Advertised Mutual Fund; that had investment policies, investment objectives and investment strategies that were in all material respects equivalent to those of the Advertised Mutual Fund; and that was not created in order to establish a performance record, provided that:

(1) in the conversion, substantially all of the assets of the predecessor portfolio were transferred to the Advertised Mutual Fund and upon conversion the predecessor portfolio ceased to exist as a separate entity;

(2) the performance of the predecessor portfolio is adjusted as of the conversion date only, to reflect all current fees and expenses of the Advertised Mutual Fund, as disclosed in the fee table in the Advertised Mutual Fund's current prospectus, but not reflecting any fee waiver or expense reimbursement for the Advertised Mutual Fund; and

(3) the presentation of this Related Performance Information complies with the general standards in paragraph (d).

(c) "Comparison Portfolio" Performance

(1) The total return of a composite of other portfolios, including other investment companies, managed by the investment adviser (or, as appropriate, the sub-investment adviser) of an Advertised Mutual Fund, provided that:

(A) The composite:

(i) Consists of all actual fee-paying, discretionary portfolios managed by the investment adviser (or sub-investment adviser) with substantially similar investment policies, investment objectives, and investment strategies to the Advertised Mutual fund, including the Advertised Mutual Fund itself;

(ii) Excludes terminated portfolios after the last full performance measurement period the portfolios were under management, but includes terminated portfolios or all periods prior termination;

(iii) Does not reflect any portfolio that has been switched into the composite or exclude any portfolio that had been switched into the composite or exclude any portfolio that had been switched from the composite, unless documented changes in guidelines communicated by the client made the switching appropriate; and

(iv) Adjusts the gross performance information of any portfolio to reflect all current fees and expenses of the Advertised Mutual Fund, as disclosed in the fee table in the Advertised Mutual Fund's current prospectus;

(B) The investment adviser (or sub-investment adviser) has obtained verification from an independent third party that the creation and maintenance of the composite complies with paragraph (1)(A) and proof of this independent verification, current as of the investment adviser's (or sub-investment adviser's) most recently ended fiscal year, has been filed with the Advertising/Investment Companies Regulation Department; and

(C) The presentation of this Related Performance Information complies with the general standards in paragraph (d).

(2) No member may imply that the Association or any of its affiliates endorses or approves of any composite or the manner in which it was created or maintained.

(d) General Standards

(1) No material difference may exist between the portfolio to which the Related Performance Information refers and the Advertised Mutual Fund, except;

(A) The portfolio may not have been registered under the Investment Company Act of 1940 and therefore may not be subject to the restrictions that the Investment Company Act and the Internal Revenue Code impose; and

(B) Material differences may exist between the fees and expenses of an investment company reflected in Clone Performance and the Advertised Mutual Fund.

(2) Any Related Performance Information presented in an advertisement or sales literature:

(A) Must be, at a minimum, current to the most recent calendar quarter ended prior to submission for publication (in the case of an advertisement) or prior to use (in the case of sales literature); and

(B) Must be accompanied by Related Performance Information for one, five and ten years periods, provided that if the Related Performance Information is available for less than one, five or ten years, the time period during which the Related Performance Information is available must be substituted for the period otherwise prescribed.

(3) Any advertisement or sales literature that presents Related Performance Information:

(A) Must identify the length of, and the date of the last day in, the period used to compute the Related Performance Information:

(B) Must present, in a more prominent manner than the Related Performance Information, the total return of the Advertised Mutual Fund (excluding the performance of any predecessor portfolio) calculated and presented in accordance with the applicable SEC

rules, provided that the registration statement for the Advertised Mutual Fund has been effective for at least one year;

(C) When applicable, must prominently disclose that the Advertised Mutual Fund has been in operation for less than one year;

(D) Must disclose;

(i) Any material difference between the fees and expenses of an investment company reflected in Clone Performance and the Advertised Mutual Fund;

(ii) In the case of all Related Performance Information:

a. That the Related Performance Information is not the performance of the Advertised Mutual Fund and should not be considered indicative of or a substitute for that performance and;

b. When applicable, that some or all of the portfolios reflected in the Related Performance Information (including any predecessor portfolios) are not registered under the Investment Company Act of 1940 and therefore were not subject to certain investment restrictions that the Investment Company Act and the Internal Revenue Code impose, and that the performance of those portfolios may have been adversely affected had they been registered under the Investment Company Act; and

(iii) Any other information that may be necessary to ensure that the Related Performance Information is not presented in a misleading manner;

(E) May not refer to the Related Performance Information in any headline or other prominent statement;

(F) May not contain any ranking based on the Related Performance Information; and

(G) Must accompany any graph or illustration concerning Related Performance Information with a more prominent graph or illustration concerning the total return of the Advertised Mutual Fund, calculated and presented in accordance with applicable SEC rules, provided that the registration statement for the Advertised Fund has been effective for at least one year.

(4) No advertisement or sales literature for a money market fund may present Related Performance Information.

(5) Any member filing an advertisement or sales literature presenting Related Performance with the Department must maintain books and records that demonstrate the basis for and calculation of the Related Performance Information. Retention by the member of copies of all such records maintained by any investment advisers under Rule 204-2(16) of the Investment Advisers Act of 1940 would satisfy this requirement. Such records must be maintained for three years following the last distribution or publication of the advertisement or sales literature.

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

In its filing with the Commission, NASD Regulation included statements

concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD Regulation has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

Rule 2210 requires the filing of various forms of advertisement and sales literature with the Advertising/Investment Companies Regulation Department of NASD Regulation. NASD Regulation staff reviews these filings to determine whether they meet applicable standards in the NASD Conduct Rules, which are generally designed to ensure that sales material is fair, balanced and not misleading.

The SEC's Division of Investment Management recently issued a series of "no-action letters" that essentially permit mutual funds to present a range of performance information in their sales material and prospectuses, subject to specific factual circumstances and regulatory conditions. These letters generally permit the presentation of the performance of (i) a mutual fund from which the offered fund has been "cloned"; (ii) a non-investment company account that had been converted into the advertised mutual fund; (iii) private, investment company or institutional accounts that are managed by the mutual fund's adviser; and (iv) a mutual fund that was previously managed by the offered fund's portfolio manager ("manager performance"). (Together, these types of performance information will be referred to as "Related Performance Information.")

The SEC's no-action letters note that the NASD Conduct Rules impose standards on mutual fund and variable product sales material separate from the Commission rules, and the Commission staff reached no conclusion concerning whether the presentation of Related Performance Information under the conditions imposed by the no-action letters would comply with the NASD Conduct Rules.

Historically, the NASD has prohibited the presentation of any Related Performance Information, except predecessor performance, in mutual fund and variable product sales material. In light of the Commission

staff's recent no-action letters and apparent public interest in the potential benefits and concerns with the presentation of Related Performance Information in mutual fund and variable product sales material, NASD Regulation requested comment in August 1997 on whether the NASD should permit Related Performance Information to be included in advertisements or sale literature (*Notice to Members* 97-47).

NASD Regulation received 55 comment letters from investors, Chartered Financial Analysts, mutual funds, money managers, and trade associations. Forty-four commenters supported the presentation of some type of Related Performance Information, while 11 opposed the presentation of any Related Performance Information. Commenters disagreed about the types of Related Performance Information that NASD Regulation should permit. The highest level of opposition was raised to the presentation of manager performance information. Indeed, even some of those who otherwise supported the presentation of Related Performance Information opposed the presentation of portfolio manager performance. Of the 44 commenters who generally supported the presentation of Related Performance Information, 11 specifically discussed the presentation of manager performance. Of these 11, six opposed any presentation of manager performance information.

The proposed rule change would permit the presentation of Related Performance Information (other than manager performance information) in mutual fund and variable product sales material, subject to certain conditions designed to make the presentation fair, balanced and not misleading. The proposed rule change would generally permit, subject to certain conditions, the presentation of the performance of (i) a mutual fund from which the offered fund had been "cloned"; (ii) a non-investment company account that had been converted into the advertised mutual fund; and (iii) private, investment company or institutional accounts that are managed by the mutual fund's adviser. The proposed rule change thus represents a significant liberalization of the types of performance information that members may present in mutual fund and variable product sales material, subject to conditions designed to protect investors.

At the same time, the NASD Board of Directors reaffirmed the NASD's longstanding policy of prohibiting the presentation of manager performance in mutual fund advertisements and sales

literature. The NASD believes that the presentation of manager performance could mislead or confuse investors about the contributions of other personnel of the investment adviser to the mutual fund's performance, such as research analysts who recommend securities to the portfolio manager and traders who obtain best execution. The efforts of these personnel and the resources of the investment adviser are, in most cases, critical to the mutual fund's performance. Moreover, a relatively long time period may elapse between the departure of a portfolio manager from the previous mutual fund and the advertisement of the new mutual fund's performance, thus rendering the manager performance information stale.⁶

2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁷ in that the proposed rule change is designed to prevent fraudulent acts and practices, and to promote just and equitable principles of trade. In particular, NASD Regulation believes the proposal would establish conditions designed to ensure that the presentation of Related Performance Information is fair, balanced, and not misleading.

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

See discussion of comment letters in Item II(A)(1) above.

⁶ The position of the Commission's staff continues to be that manager performance information in a mutual fund's prospectus, advertisements or sales literature is not *per se* misleading under the federal securities laws, provided that the performance is not presented in a misleading manner and is not presented as a substitute for the advertised mutual fund's performance. See *Bramwell Growth Fund* (pub. avail. August 7, 1996); *ITT Hartford Mutual Funds* (pub. avail. February 7, 1997). The Commission's staff believes that whether manager performance information is misleading depends on the totality of the circumstances, including the manner in which it is presented. *Id.*

⁷ 15 U.S.C. 78o-3(b)(6).

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 NASD Regulation 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.

NASD Regulation has requested that the Commission provide the public with at least 45 days in which to comment on the proposed rule change.⁸ The Commission agrees to allow a 45-day comment period on the proposed rule change.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Additionally, as previously noted, the Commission's staff disagrees with the NASD's decision to *per se* exclude manager performance information from the rule. Interested persons are specifically invited to comment on this issue.

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, DC 20549-0609. 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 file number

SR-NASD-98-11 and should be submitted by December 26, 2000.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43488; File No. SR-NYSE-00-41]

Self-Regulatory Organization's; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by New York Stock Exchange, Inc., Relating to Approval Procedures for Exchange Employee Securities Accounts

October 27, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder² notice is hereby given that on October 6, 2000, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") 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 the Exchange. 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

The Exchange proposes to amend NYSE Rule 407.10 to make the Exchange's Ethics Officer the party to whom employees of the Exchange or any of its affiliates must apply for permission to open a securities or commodities account. The Exchange also proposes to clarify that the Rule's provisions are not applicable to any affiliated company (as that term is defined by the Rule) which administers a corporate employee securities account disclosure program.

The text of the proposed rule change is available at the NYSE and at the Commission.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

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

1. Purpose

NYSE Rule 407.10 directs Exchange employees, and employees of Exchange affiliates, who wish to open a securities or commodities account to apply to the Secretary of the Exchange for permission. The purpose of the proposed rule change is to require those employees to submit those applications for approval to the Exchange's Ethics Officer rather than the Exchange's Secretary.

The Exchange's ethics functions are performed by the office of the Exchange's senior Human Resources officer, who is also the Exchange's Ethics Officer. The Human Resources Division, as part of its traditional function and as part of its ethics function, maintains a database on Exchange employees. The Exchange Secretary also maintains a database on Exchange employees for the purpose of authorizing securities and commodities accounts.

The Exchange believes that shifting the account-approval function to the Ethics Officer will eliminate duplicative record-keeping and will place the function with the officer most appropriate for making account-approval decisions.

The Exchange also proposes to amend NYSE Rule 407.10 to clarify that the Rule's provisions are not applicable to any affiliated company (as that term is defined by the Rule) which administers a corporate employee securities account disclosure program. This will avoid duplicative approval processes.³

³ Currently, the Securities Industry Automation Corporation ("SIAC") is the only NYSE affiliated company that administers its own corporate employee disclosure program. In this regard, SIAC has a rule similar to NYSE Rule 407.10 requiring SIAC employees to apply to SIAC for permission to open a securities or commodities account. SIAC

⁸ See October 16, 2000 Letter at page 1. NASD Regulation also consents to an extension of the time period for Commission action to 30 days after the expiration of the 45-day comment period. The Commission notes that a further extension of the time period for Commission action may be needed to allow for Commission analysis of comment letters, and to allow NASD Regulation to provide a response to comment letters.

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.