

\$5.00, \$5.05, \$5.10, \$5.15, and \$5.20; in aggregate these orders represent 50 contracts. The specialist has determined to buy all 50 contracts at \$5.20. The contracts would be allocated by QT to the specialist and registered traders in accordance with the ratios set forth above.

#### Auto-Match

The Auto-Match feature currently in AODB, which automatically matches and executes market and marketable limit orders that have by-passed the Exchange's automatic execution system ("Auto-Ex") with limit orders on the AODB, would be modified to include registered trader participation when an imbalance exists.<sup>6</sup> Imbalances would be distributed among the specialist and registered traders according to the above allocation ratio. For example, the best bid is represented by a limit order to buy 10 contracts in an option class whose Auto-Ex eligible size is 20 contracts. A market order of 20 contracts to sell by-passes Auto-Ex and is routed to the AODB; 10 contracts are matched and executed with the limit order. The remaining 10 contracts would be allocated through QT to the specialists and registered traders.

#### Sweep of the Book

The Sweep of the Book function allows a specialist to simultaneously execute orders in multiple series at the quoted market. Following implementation of Quick Trade, contracts executed through the Sweep of the Book function would be automatically allocated by QT on a per series basis to the specialist and registered traders in accordance with the above allocation ratio.<sup>7</sup>

The Exchange believes that implementation of Quick Trade would increase the Exchange's competitiveness while furthering the efficient processing of customer option orders. Further, the Exchange believes that Quick Trade would enhance the fair and orderly allocation of orders executed on the Exchange especially during times of high trading volume by automating the allocation process.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>8</sup> in general and furthers the objectives of Section 6(b)(5)

of the Act<sup>9</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

#### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition.

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

No written comments were solicited or received with respect to the proposed rule change.

#### 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 Exchange 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, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 the filing will also be available for inspection and copying at the principal offices of the Amex. All submissions should refer to File No. SR-Amex-2001-65 and should be submitted by January 22, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 01-32084 Filed 12-28-01; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45181; File No. SR-NASD-00-12]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto by the National Association of Securities Dealers, Inc. Concerning Amendments to Rules Governing Member Communications with the Public

December 20, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 9, 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.<sup>3</sup> On August 8, 2001, NASD Regulation filed Amendment No. 1 to the proposed rule change.<sup>4</sup> On December 12, 2001, NASD Regulation filed Amendment No. 2 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

NASD Regulation is proposing to amend Rule 2210 and the Interpretive Materials thereunder, promulgate new Rule 2211, and renumber existing Rule 2211, of the National Association of Securities Dealers, Inc. ("NASD" or "Association"). Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletions are in brackets.

<sup>6</sup> See Securities Exchange Act Release No. 42652 (April 7, 2000) 65 FR 20235 (April 14, 2000).

<sup>7</sup> QT would allocate the order(s) for each series separately. Telephone conversation between Claire P. McGrath, Amex, and Ira L. Brandriss, Division, Commission, on December 5, 2001.

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 17 CFR 200.30-3(a)(12).

**2200. Communications With Customers and The Public****2210. Communications with the Public**

(a) Definitions [Communications with the public shall include] For purposes of this Rule and any interpretation thereof, "communications with the public" consist of:

(1) "Advertisement." [For purposes of this Rule and any interpretation thereof, "advertisement" means material] 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, [a] newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, or telephone directories (other than routine listings), [electronic or other public media].

(2) "Sales Literature." [For purposes of this Rule and any interpretation thereof, "sales literature" means any] Any written or electronic communication, other than an advertisement, independently prepared reprint, institutional sales material and correspondence, that is generally distributed or made generally available to customers or the public, [which communication does not meet the foregoing definition of "advertisement." Sales literature includes, but is not limited to], including circulars, research reports, market letters, performance reports or summaries, form letters, telemarketing scripts, seminar texts, [and] reprints (that are not independently prepared reprints) or excerpts of any other advertisement, sales literature or published article, and press releases concerning a member's products or services.

(3) "Correspondence" [For purposes of this Rule and any interpretation thereof, "correspondence" means any written or electronic communication prepared for delivery to a single current or prospective customer, and not for dissemination to multiple customers or the general public.] as defined in Rule 2211(a)(1).

(4) "Institutional Sales Material" as defined in Rule 2211(a)(2).

(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;

(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) Each item of advertising and sales literature shall be approved by signature or initial, prior to use or filing with the Association, by a registered principal of the member. This requirement may be met, only with respect to corporate 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, by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock Exchange.]

[(2) A separate file of all advertisements and sales literature, including the name(s) of the person(s)

who prepared them and/or approved their use, shall be maintained for a period of three years from the date of each use.]

**(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 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 separate 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.

**(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 government 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.]

*(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).*

*[(2) Advertisements concerning collateralized mortgage obligations, and advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts and unit investment trusts) that include or incorporate rankings or comparisons of the investment company with other investment companies where 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, shall be filed with the Department for review at least 10 days prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changed by the Association, shall be withheld from publication or circulation until any changes specified by the Association have been made or, if expressly disapproved, until the advertisement has been refiled for, and*

*has received, Association approval. The member must provide with each filing the actual or anticipated date of first use. Any member filing any investment company advertisement or sales literature pursuant to this paragraph shall include a copy of the data, ranking or comparison on which the ranking or comparison is based.]*

*(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) dvertisements concerning collateralized mortgage obligations.*

*[(3)] 4 Requirement for Certain Members to File Material Prior to Use*

*(A) Each member [of the Association] that [which] has not previously filed advertisements with the [Association] Department (or with a registered securities exchange having standards comparable to those contained in this Rule) [shall] must file its initial advertisement with the Department at least [ten] 10 business days prior to use and shall continue to file its advertisements at least [ten] 10 business days prior to use for a period of one year. [The member must provide with each filing the actual or anticipated date of first use.]*

*[(B) Except for advertisements related to exempted securities (as defined in Section 3(a)(12) of the Act), municipal securities, direct participation programs or investment company securities, members subject to the requirements of paragraph (c)(3)(A) of this Rule may, in lieu of filing with the Association, file advertisements on the same basis, and for the same time periods specified in that subparagraph, with any registered securities exchange having standards*

*comparable to those contained in this Rule.]*

*[(4) (A)] (B) Notwithstanding the foregoing provisions, the Department, upon review of a member's advertising and/or sales literature, and after determining that the member has departed [and there is a reasonable likelihood that the member will again depart] from the standards of this Rule, may require that such member file all advertising and/or sales literature, or the portion of such member's material that [which] is related to any specific types or classes of securities or services, with the Department, at least [ten] 10 business days prior to use. [The member must provide with each filing the actual or anticipated date of first use.] [(B)] The Department [shall] 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. [The requirement shall not exceed one year, however, and shall not take effect until 30 days after the member receives the written notice, during which time the member may request a hearing under Rule 9514, and any such hearing shall be held in reasonable conformity with the hearing and appeal procedures of the Rule 9510 Series.] 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 9510 Series.*

*(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 also must file the final filmed version within 10 business days of first use or broadcast.*

*[(5) In addition to the foregoing requirements, every member's advertisements and sales literature shall be subject to a routine spot-check procedure. Upon written request from the Department, each member shall promptly submit the material requested. Members will not be required to submit material under this procedure which has been previously submitted pursuant to one of the foregoing requirements and, except for material related to exempted securities (as defined in Section 3(a)(12) of the Act), municipal securities, direct participation programs or investment company securities, the procedure will not be applied to members who have been, within the Association's current examination cycle subjected to a spot-check by a registered*

securities exchange or other self-regulatory organization using procedures comparable to those used by the Association.]

**(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.*

**[(6)] (7) Exclusions from Filing Requirements**

The following types of material are excluded from the [foregoing] filing requirements and [except for [research reports under] *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.*

*[(A)] (B) Advertisements [or] and sales literature solely related to recruitment or changes in a member's name, personnel, [location,] 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[;].*

*[(B)] (C) Advertisements [or] and sales literature [which] that do no more than identify the Nasdaq or a national securities exchange symbol of the member [and/or of a security in] or identify a security for which the member is a Nasdaq registered market maker[;].*

*[(C)] (D) Advertisements [or] and sales literature that [which] do no more than identify the member [and/or offer a specific security at a stated price[;].*

*[(D)] Material sent to branch offices or other internal material that is not distributed to the public[;]*

*(E) Prospectuses, preliminary prospectuses, fund profiles, offering circulars and similar documents [used in connection with an offering of securities which has been registered or] that have been filed with the Securities and Exchange Commission (the "SEC") or any state, or [which] that is exempt from such registration, except that an investment company prospectus published pursuant to SEC Rule 482 under the Securities Act of 1933 [shall] 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 [such] the advertisements are related to direct participation programs or securities issued by registered investment companies.*

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

*[(i)] the report is prepared by an entity 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.]*

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

*(H) Independently prepared reprints.*

*(I) Correspondence.*

*(J) Institutional sales material.*

*Although [research reports meeting the above requirements are] the material described in paragraphs (c)(7)(G) through (J) is excluded from the foregoing filing requirements, [they] investment company communications described in those paragraphs shall be deemed filed with the Association for purposes of Section 24(b) of the Investment Company Act of 1940 and Rule 24b-3 [of the Securities and Exchange Commission] thereunder.*

*[(7)] (8) Material [which] that refers to investment company securities, [or] direct participation programs, or exempted securities (as defined in Section 3(a)(12) of the Act) solely as part of a listing of products [and/or services*

*offered by the member, is excluded from the requirements of [sub]paragraphs [(1) and (2)] (c)(2) and (c)(3).*

*[(8) Exemptions.] (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 [Applicable to Communications With the Public]**

**(1) [General] Standards Applicable to All Communications With the Public**

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

*(B) [Exaggerated, unwarranted or misleading statements or claims are prohibited in all public communications of members. In preparing such communications, members must bear in mind that inherent in investment are the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield, and no] No member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public. No member [shall, directly or indirectly,] may publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.*

*[(C)] When sponsoring or participating in a seminar, forum, radio or television interview, or when otherwise engaged in public appearances or speaking activities which may not constitute advertisements, members and persons associated with members shall nevertheless follow the standards of paragraphs (d) and (f) of this Rule.]*

*[(D)] In judging whether a communication or a particular element of a communication may be misleading, several factors should be considered, including but not limited to:]*

*[(i)] the overall context in which the statement or statements 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 balance of treatment of risks and potential benefits.]*

[(ii) the audience to which the communication is directed. Different levels of explanation or detail may be necessary depending on the audience to which a communication is directed, and the ability of the member given the nature of the media used, to restrict the audience appropriately. If the statements made in a communication would be applicable only to a limited audience, or if additional information might be necessary for other audiences, it should be kept in mind that it is not always possible to restrict the readership of a particular communication.]

[(iii) the overall clarity of the communication. A statement or disclosure made in an unclear manner can result in a lack of understanding of the statement, or in a serious misunderstanding. A complex or overly technical explanation may be more confusing than too little information. Likewise material disclosure relegated to legends or footnotes may not enhance the reader's understanding of the communication.]

*(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.*

*(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) [Specific] Standards Applicable to Advertisements and Sales Literature

[In addition to the foregoing general standards, the following specific standards apply:]

[(A) Necessary Data. Advertisements and sales literature shall contain the name of the member, unless such advertisements and sales literature comply with paragraph (f). Sales literature shall contain the name of the person or firm preparing the material, if other than the member, and the date on which it is first published, circulated or distributed. If the information in the material is not current, this fact should be stated.]

[(B) Recommendations.]

[(i) 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:]

[a. 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;]

[b. 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;]

[c. that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years.]

[(ii) 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.]

[(iii) 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.]

[(iv) Also permitted is material which 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 (iii). 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.]

[(C) Claims and Opinions.

Communications with the public must not contain promises of specific results, exaggerated or unwarranted claims or unwarranted superlatives, opinions for which there is no reasonable basis, or forecasts of future events which are unwarranted, or which are not clearly labeled as forecasts.]

[(D) Testimonials. In testimonials concerning the quality of a firm's investment advice, the following points must be clearly stated in advertisements or sales literature:] *(A) Advertisements or sales literature providing any testimonial concerning the investment advice or investment performance of a member or its products must prominently disclose 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 [must be indicated].*

*(iv) If the testimonial concerns a technical aspect of investing, the person making the testimonial must have knowledge and experience to form a valid opinion.]*

[(E) Offers of Free Service. Any statement in communications with the public to the effect that any report, analysis, or other service will be furnished free or without any charge must not be made unless such report, analysis or other service actually is or will be furnished entirely free and without condition or obligation.]

[(F) Claims for Research Facilities. No claim or implication in communications with the public may be made for research or other facilities beyond those which the member actually possesses or has reasonable capacity to provide.]

[(G) Hedge Clauses. No cautionary statements or caveats, often called hedge clauses, may be used in communications with the public if they are misleading or are inconsistent with the content of the material.]

[(H) Recruiting Advertising. Advertisements in connection with the recruitment of sales personnel must not contain exaggerated or unwarranted claims or statements about opportunities in the investment banking or securities business and should not refer to specific earnings figures or ranges which are not reasonable under the circumstances.]

[(I) Periodic Investment Plans. Advertisements and sales literature should not discuss or portray any type

of continuous or periodic investment plan without disclosing that such a plan does not assure a profit and does not protect against loss in declining markets. In addition, if the material deals specifically with the principles of dollar-cost averaging, it should point out that since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low price levels.]

[(J) References to Regulatory Organizations. Communications with the public shall not make any reference to membership in the Association or to registration or regulation of the securities being offered, or of the underwriter, sponsor, or any member or associated person, which reference could imply endorsement or approval by the Association or any federal or state regulatory body. References to membership in the Association or Securities Investors Protection Corporation shall comply with all applicable By-Laws and Rules pertaining thereto.]

[(K) Identification of Sources. Statistical tables, charts, graphs or other illustrations used by members in advertising or sales literature should disclose the source of the information if not prepared by the member.]

[(L) Claims of Tax Free/Tax Exempt Returns. Income or investment returns may not be characterized in communications with the public as tax free or exempt from income tax where tax liability is merely postponed or deferred. If taxes are payable upon redemption, that fact must be disclosed in advertisements and sales literature. References in advertisements and sales literature to tax free/tax exempt current 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 may be subject to state or local income taxes, this should be stated, or the illustration should otherwise make it clear that income is free from federal income tax.]

[(M) Comparisons. In making a comparison in advertisements or sales literature, either directly or indirectly, the member must make certain that the purpose of the comparison is clear and must provide a fair and balanced presentation, including any material differences between the subjects of comparison. Such differences may include investment objectives, sales and management fees, liquidity, safety, guarantees or insurance, fluctuation of

principal and/or return, tax features, and any other factors necessary to make such comparisons fair and not misleading.]

[(N) Predictions and Projections. In communications with the public, investment results cannot be predicted or projected. Investment performance illustrations may not imply that gain or income realized in the past will be repeated in the future. However, for purposes of this Rule, hypothetical illustrations of mathematical principles are not considered projections of performance; e.g., illustrations designed to show the effects of dollar cost averaging, tax-free compounding, or the mechanics of variable annuity contracts or variable life policies.]

*(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) [Application] Violation of [SEC] Other Rules

[In addition to the provisions of paragraph (d) of this Rule, members' public communications shall conform to all applicable rules of the Commission, as in effect at the time the material is used.] *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 2210.*

[(f) Standards Applicable to the Use and Disclosure of the Association Member's Name]

[(1) In addition to the provisions of paragraph (d) of this Rule, members' public communications shall conform to the following provisions concerning the use and disclosure of member names. The term "communication" as used herein shall include any item defined as

either "advertising" or "sales literature" in paragraph (a). The term "communication" shall also include, among other things, business cards and letterhead.]

[(2) General Standards]

[(A) Any communication used in the promotion of a member's securities business must clearly and prominently set forth the name of the Association member. This requirement shall not apply to so-called "blind" advertisements used for recruiting personnel or to those communications meeting the provisions of paragraph (f)(3).]

[(B) If a non-member entity is named in a communication in addition to the member, the relationship, or lack of relationship, between the member and the entity shall be clear.]

[(C) If a non-member entity is named in a communication in addition to the member and products or services are identified, no confusion shall be created as to which entity is offering which products and services. Securities products and services shall be clearly identified as being offered by the member.]

[(D) If an individual is named in a communication containing the names of the member and a non-member entity, the nature of the affiliation or relationship of the individual with the member shall be clear.]

[(E) Communications that refer to individuals may not include, with respect to such individuals, references to nonexistent or self-conferred degrees or designations, nor may such communications make reference to bona fide degrees or designations in a misleading manner.]

[(F) If a communication identifies a single company, the communication shall not be used in a manner which implies the offering of a product or service not available from the company named.]

[(G) The positioning of disclosure can create confusion even if the disclosures or references are entirely accurate. To avoid confusion, a reference to an affiliation (e.g., registered representative) shall not be placed in proximity to the wrong entity.]

[(H) Any reference to membership (e.g., NASD, SIPC, etc.) shall be clearly identified as belonging to the entity that is the actual member of the organization.]

[(3) Specific Standards]

[The foregoing standards set forth in subparagraphs (1) and (2) shall apply to all communications unless at least one of the following special circumstances exists, in which case the standards set

forth herein would supersede the standards in subparagraphs (1) and (2).]

[(A) Doing Business As. An Association member may use a fictional name in communications provided that the following conditions are met:]

[(i) Non-Required Fictional Name. A member may voluntarily use a fictional name provided that the name has been filed with the Association and the Commission, all business is conducted under that name and it is the only name by which the firm is recognized.]

[(ii) Required Fictional Name. If a state or other regulatory authority requires a member to use a fictional name, the following conditions shall be met:]

[a. The fictional name shall be used to conduct business only within the state or jurisdiction requiring its use.]

[b. If more than one state or jurisdiction requires a firm to use a fictional name, the same name shall be used in each, wherever possible.]

[c. Any communication shall disclose the name of the member and the fact that the firm is doing business in that state or jurisdiction under the fictional name, unless the regulatory authority prohibits such disclosure.]

[(B) Generic Names. An Association member may use an "umbrella" designation to promote name recognition, provided that the following conditions are met:]

[(i) The name of the member shall be clearly and prominently disclosed;]

[(ii) The relationship between the generic name and the member shall be clear; and]

[(iii) There shall be no implication that the generic name is the name of a registered broker/dealer.]

[(C) Derivative Names. An Association member may use a derivative of the firm name to promote certain areas of the firm's business, provided that the name of the member is clearly and prominently disclosed. Absent such disclosure, the following conditions must be met:]

[(i) The name used to promote a specific area of the firm's business shall be a derivative of the member name; and]

[(ii) The derivative name shall not be misleading in the context in which it is being used.]

[(D) "Division of." An Association member firm may designate an aspect of its business as a division of the firm, provided that the following conditions are met:]

[(i) The designation shall only be used by a bona fide division of the member. This shall include:]

[a. a division resulting from a merger or acquisition that will continue the previous firm's business; or]

[b. a functional division that conducts or will conduct one specialized aspect of the firm's business.]

[(ii) The name of the member shall be clearly and prominently disclosed.]

[(iii) The division shall be clearly identified as a division of the member firm.]

[(E) "Service of/Securities Offered Through." An Association member firm may identify its brokerage service being offered through other institutions as a service of the member, provided that the following conditions are met:]

[(i) The name of the member shall be clearly and prominently disclosed.]

[(ii) The service shall be clearly identified as a service of the member firm.]

[(F) Telephone Directory Line Listings, Business Cards and Letterhead. All such listings, cards or letterhead shall conform to the provisions of Rule 3010(g)(2).]

[IM-2210-1. Communications With the Public About Collateralized Mortgage Obligations (CMOs)]

[(a) General Considerations]

[For purposes of the following guidelines, the term "collateralized mortgage obligation" (CMO) refers to a multiclass bond backed by a pool of mortgage pass-through securities or mortgage loans. CMOs are also known as "real estate mortgage investment conduits" (REMICs). As a result of the 1986 Tax Reform Act, most CMOs are issued in REMIC form to create certain tax advantages for the issuer. The term CMO and REMIC are now used interchangeably. In order to prevent advertisements and sales literature regarding CMOs from being false or misleading, there are certain factors to be considered, including, but not limited to, the following:]

[(1) Product Identification]

[In order to assure that investors understand exactly what security is being discussed, all communications concerning CMOs should clearly describe the product as a "collateralized mortgage obligation." Member firms should not use the proprietary names for CMOs as they do not adequately identify the product. To prevent confusion and the possibility of misleading the reader, communications should not contain comparisons between CMOs and any other investment vehicle, including Certificates of Deposit.]

[(2) Educational Material]

[In order to ensure that customers are adequately informed about CMOs members are required to offer to

customers educational material which covers the following matters:]

[(A) A discussion of CMO characteristics as investments and their attendant risks;]

[(B) An explanation of the structure of a CMO, including the various types of tranches;]

[(C) A discussion of mortgage loans and mortgage securities;]

[(D) Features of CMOs, including: credit quality, prepayment rates and average lives, interest rates (including effect on value and prepayment rates), tax considerations, minimum investments, transactions costs and liquidity;]

[(E) Questions an investor should ask before investing; and]

[(F) A glossary of terms that may be helpful to an investor considering an investment.]

[(3) Safety Claims]

[A communication should not overstate the relative safety offered by the CMO. Although CMOs generally offer low investment risk, they are subject to market risk like all investment securities and there should be no implication otherwise. Accordingly, references to liquidity should be balanced with disclosure that, upon resale, an investor may receive more or less than his original investment.]

[(4) Claims About Government Guarantees]

[(A) Communications should accurately depict the guarantees associated with CMO securities. For example, in most cases it would be misleading to state that CMOs are "government guaranteed" securities. A government agency issue could instead be characterized as government agency backed. Of course, private-issue CMO advertisements should not contain references to guarantees or backing, but may disclose the rating.]

[(B) If the CMO is offered at a premium, the communication should clearly indicate that the government agency backing applies only to the face value of the CMO, and not to any premium paid. Furthermore, communications should not imply that either the market value or the anticipated yield of the CMO is guaranteed.]

[(5) Simplicity Claims]

[CMOs are complex securities and require full, fair and clear disclosure in order to be understood by the investor. A communication should not imply that these are simple securities that may be suitable for any investor seeking high yields. All CMOs do not have the same



characteristics and it is misleading to indicate otherwise. Even though two CMOs may have the same underlying collateral, they may differ greatly in their prepayment speed and volatility.]

#### [(6) Claims About Predictability]

[A communication would be misleading if it indicated that the anticipated yield and average life of a CMO were assured. It should disclose that the yield and average life will fluctuate depending on the actual prepayment experience and changes in current interest rates.]

#### [(b) Print Advertising]

[(1) Educational advertising, discussing generally the features of CMOs, can be a very useful and informative tool in explaining these securities to the investing public. However, such "generic" advertising should not contain anticipated yield or coupon rates.]

[(2) Advertising relating to CMOs must be filed with the Association's Advertising/Investment Companies Regulation Department for review at least ten days prior to use, pursuant to requirements in Rule 2210.]

[(3) The Association has developed a standardized CMO advertisement that provides information deemed necessary to prevent the communication from being misleading. Members must file the standardized CMO advertisement, ten days prior to its first use, with the Association's Advertising/Investment Companies Regulation Department.]

[(4) Members are not required to use the standardized CMO advertisement. If firms do not elect to use the standardized CMO advertisement, they should ensure that their advertising contains the same information and meets the same conditions as the standardized CMO advertisement. Members using a non-standardized format must file the advertisement ten days prior to first use.]

[(5) After an advertisement has been filed prior to initial use, subsequent use of the identical advertisement, changed only to reflect the updated information for the security being advertised, does not require re-filing with the Association. Such advertisements must be approved by a principal (or designee) and maintained in the member firm's files as required by the Association's Rules.]

#### [(6) Standardized CMO Advertisement]

[(A) The standardized CMO advertisement contains four sections, each of which must be given an equal portion of space in the advertisement. The information in Sections 1 and 2 is

required to be included in advertising for CMOs. The information suggested for Section 3 is optional; therefore, the member may elect to include any, all or none of this information in the advertisement. The information in Section 4 may be tailored to the member's preferred signature. An example of the standardized CMO advertisement may be found at the end of these guidelines.]

[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)]

[Section 4 Company Information:

Name, Address, Telephone Number, Representative's Name, Memberships]

[(B) If this standardized CMO advertisement is used, the following conditions must also be met:]

[(i) All figures in Section 1 must be in equal type size.]

[(ii) The disclosure language in Section 2 may not be altered and must be given equal prominence with Section 1.]

[(iii) The prepayment assumption used to determine the advertised yield and average life must either be obtained from a nationally recognized service (e.g., Bloomberg, Telerate) 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 advertisement that is maintained in the firm's advertising files in order to verify that the prepayment scenario advertised is reasonable and to satisfy the conditions for waiving the pre-use filing requirement.]

[(iv) If a member intends to impose a sales charge, a reasonable sales charge should be reflected in the anticipated yield.]

[(v) The advertisement 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.]

[(vi) If the bond advertised is an accrual bond, the following language should be included in Section 1: "This is an accrual bond and may not currently pay principal and interest."]

[(vii) If the bond is being offered at par, the advertisement may include the yield to maturity in Section 1.]

[(C) No additional information may be included in the standardized advertisement.]

#### [(c) Radio/Television Advertising]

[(1) Radio and television advertising alternatives are too varied to attempt to provide standardized formats for either medium. Such advertisements must be filed with the Association at least ten days prior to first use. The storyboard or other description should accompany the filing of a television advertisement.]

[(2) If an advertisement is filed with the Association prior to its initial use, it is not necessary to subsequently refile the advertisement if the only changes are to update the information relating to the security being advertised. A copy of each advertisement should be approved by a principal (or designee) and should be maintained, along with a copy of the listing for the CMO or the firm's justification, in the member firm's files in accordance with Association Rules.]

[(3) The following guidelines should be followed when developing radio and television advertisements:]

[(A) The advertisements must be preceded by the following oral disclaimer: "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) The advertisements must disclose the information contained in Section 1 of the standardized CMO advertisement above:][Coupon Rate, Anticipated Yield, Average Life, Final Maturity Date, Initial Issue Tranche (Number and Class), and Underlying Collateral.]

[(C) The advertisements must contain the following oral disclosure statement:]

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

[(D) The advertisements must state that the CMO is "offered subject to prior sale and price change."]

[(E) If a member intends to impose a sales charge, a reasonable sales charge should be reflected in the anticipated yield.]



[(F) If the bond advertised is an accrual bond, the following language should be included:]

["This is an accrual bond and may not currently pay principal and interest."]

[(G) If the bond is being offered at par, the advertisement may include the yield to maturity.]

[Example of Standardized CMO Advertisement (See IM-2210-1.)]

[Collateralized Mortgage Obligations]

[8.50% Coupon]

[8.75% Anticipated Yield to 10-Year Average Life]

[FNMA 9532X, Final Maturity March 2010]

[Collateral 100% FNMA 8.50%]

[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.]

[\$5,000 Minimum]

[Income Paid Monthly]

[Implied Rating/Volatility Rating]

[U.S. Gov't Agency Backed]

[Generic Description (e.g., PAC, Companion, Sequential Pay Bonds)]

[Company Name]

[Contact Person]

[Address]

[City, State, ZIP Code]

[Phone Number]

[Offered subject to prior sale and price change.]

[Member SIPC]

#### **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) Also permitted is 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**

The standards governing communications with the public are set forth in Rule 2210. In addition to those standards, the following guidelines must be considered in preparing advertisements and sales literature about variable life insurance and variable annuities. The guidelines are applicable to advertisements and sales literature as defined in Rule 2210, as well as individualized communications such as personalized letters and computer generated illustrations,

whether printed or made available on-screen.

#### (a) General Considerations

##### (1) Product Identification

In order to assure that investors understand exactly what security is being discussed, all communications must clearly describe the product as either a variable life insurance policy or a variable annuity, as applicable. Member firms may use proprietary names in addition to this description. In cases where the proprietary name includes a description of the type of security being offered, there is no requirement to include a generalized description. For example, if the material includes a name such as the "XYZ Variable Life Insurance Policy," it is not necessary to include a statement indicating that the security is a variable life insurance policy. Considering the significant differences between mutual funds and variable products, the presentation must not represent or imply that the product being offered or its underlying account is a mutual fund.

##### (2) Liquidity

Considering that variable life insurance and variable annuities frequently involve substantial charges and/or tax penalties for early withdrawals, there must be no representation or implication that these are short-term, liquid investments. Presentations regarding liquidity or ease of access to investment values must be balanced by clear language describing the negative impact of early redemptions. Examples of this negative impact may be the payment of contingent deferred sales loads and tax penalties, and the fact that the investor may receive less than the original invested amount. With respect to variable life insurance, discussions of loans and withdrawals must explain their impact on cash values and death benefits.

##### (3) Claims About Guarantees

Insurance companies issuing variable life insurance and variable annuities provide a number of specific guarantees. For example, an insurance company may guarantee a minimum death benefit for a variable life insurance policy or the company may guarantee a schedule of payments to a variable annuity owner. Variable life insurance policies and variable annuities may also offer a fixed investment account which is guaranteed by the insurance company. The relative safety resulting from such a guarantee must not be overemphasized or exaggerated as it depends on the claims-paying ability of the issuing insurance

company. There must be no representation or implication that a guarantee applies to the investment return or principal value of the separate account. Similarly, it must not be represented or implied that an insurance company's financial ratings apply to the separate account.

##### (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 inclusion 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.

##### (2) Product Comparisons

A comparison of investment products may be used provided the comparison complies with applicable requirements set forth under Rule 2210. Particular attention must be paid to the specific standards regarding "comparisons" set forth in [Rule 2210(d)(2)(M)] *Rule 2210(d)(2)(B)*.

##### (3) Use of Rankings

A ranking which reflects the relative performance of the separate account or the underlying investment option may be included in advertisements and sales literature provided its use is consistent with the standards contained in IM-2210-3.

##### (4) Discussions Regarding Insurance and Investment Features of Variable Life Insurance

Communications on behalf of single premium variable life insurance may emphasize the investment features of the product provided an adequate explanation of the life insurance features is given. Sales material for other types of variable life insurance must provide a balanced discussion of these features.

##### (5) Hypothetical Illustrations of Rates of Return in Variable Life Insurance Sales Literature and Personalized Illustrations

(A) (i) Hypothetical illustrations using assumed rates of return may be used to demonstrate the way a variable life insurance policy operates. The illustrations show how the performance of the underlying investment accounts could affect the policy cash value and death benefit. These illustrations may not be used to project or predict investment results as such forecasts are strictly prohibited by the Rules. The methodology and format of hypothetical illustrations must be modeled after the required illustrations in the prospectus.

(ii) An illustration may use any combination of assumed investment returns up to and including a gross rate of 12%, provided that one of the returns is a 0% gross rate. Although the maximum assumed rate of 12% may be acceptable, members are urged to assure that the maximum rate illustrated is reasonable considering market conditions and the available investment options. The purpose of the required 0% rate of return is to demonstrate how a lack of growth in the underlying investment accounts may affect policy values and to reinforce the hypothetical nature of the illustration.

(iii) The illustrations must reflect the maximum (guaranteed) mortality and expense charges associated with the policy for each assumed rate of return. Current charges may be illustrated in addition to the maximum charges.

(iv) Preceding any illustration there must be a prominent explanation that the purpose of the illustration is to show how the performance of the underlying investment accounts could affect the policy cash value and death benefit. The explanation must also state that the illustration is hypothetical and may not be used to project or predict investment results.

(B) In sales literature which includes hypothetical illustrations, member firms may provide a personalized illustration which reflects factors relating to the individual customer's circumstances. A personalized illustration may not contain a rate of return greater than 12% and must follow all of the standards set forth in subparagraph (A), above.

(C) In general, it is inappropriate to compare a variable life insurance policy with another product based on hypothetical performance as this type of presentation goes beyond the singular purpose of illustrating how the performance of the underlying investment accounts could affect the policy cash value and death benefit. It is permissible, however, to use a

hypothetical illustration in order to compare a variable life insurance policy to a term policy with the difference in cost invested in a side product. The sole purpose of this type of illustration would be to demonstrate the concept of tax-deferred growth as a result of investing in the variable product. The following conditions must be met in order to make this type of comparison balanced and complete:

(i) the comparative illustration must be accompanied by an illustration which reflects the standards outlined in subparagraph (A), above;

(ii) the rate of return used in the comparative illustration must be no greater than 12%;

(iii) the rate of return assumed for the side product and the variable life policy must be the same;

(iv) the same fees deducted from the required prospectus illustration must be deducted from the comparative illustration;

(v) the side product must be illustrated using gross values which do not reflect the deduction of any fees; and,

(vi) the side product must not be identified or characterized as any specific investment or investment type.

#### IM-2210-3. Use of Rankings in Investment Companies 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 [shall] *may* not use [in] investment company *rankings in any advertisement[s,] or item of sales literature* [or general promotional material any investment company rankings] other than [those developed and produced by entities that meet the definition of "Ranking Entity," and which conform to the requirements of the guidelines herein] *(1) rankings created and published by Ranking Entities or (2) rankings created by an investment company or an investment company affiliate 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)] A headline or other prominent statement must 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.

[(B)] Prominent disclosure of the investment company's ranking, the total number of investment companies in the category, the name of the category, and the period on which the ranking is based (i.e., the length of the period and the ending date; or, the first day of the period and the ending date), must appear in close proximity to any headline or other prominent statement that refers to a ranking.]

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

All advertisements and sales literature containing an investment company ranking must disclose *prominently*[, with respect to the ranking]:

(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 [and the ending date,] (or[, the first day of the period] and [the] *its* ending date; and

(E) 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;*

[(F)] (B) for investment companies [which] *that* assess front-end sales loads, whether the ranking takes *those loads* into account [sales charges];

[(G)] (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; [and]

(D) the publisher of the ranking data (e.g., "ABC Magazine, June 1999 [1993]")]. The disclosure required by subparagraph (A) through (D) above, must be set forth prominently in the body of the advertisement or sales literature.]; *and*

[(3)] (E) [If] *if* the [investment company] ranking consists of a symbol

(e.g., a star system) rather than a number, [the advertisement or sales literature also must disclose] the meaning of the symbol (e.g., a four-star ranking indicates that the fund is in the top 30% of all investment companies).

[(4)] All advertisements and sales literature containing an investment company ranking must disclose that past performance is no guarantee of future results.]

##### (d) Time Periods

###### (1) Current Rankings

Any investment company ranking *included* [set forth] in an [advertisement or] *item of sales literature* must be, at a minimum, current to the most recent calendar quarter ended *prior to use*. *Any investment company ranking included in [, in the case of] an advertisement must be, at minimum, current to the most recent calendar quarter ended 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 [must not use any rankings other than rankings based on yield, based on a period of less than one year] *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 specified in paragraph (d)(2)(B).* [An investment company ranking based on the current SEC standardized yield 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.]

(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) [Subject to the standards below, an] 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) When the investment company ranking is based on a subcategory, the advertisement or sales literature must disclose the name of the full category and the investment company's ranking and the number of investment companies in the full category. This requirement does not apply if the subcategory is (A) based solely on the investment objectives of the investment companies included and (B) created by a Ranking Entity. This disclosure could be included in a footnote.]

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

[(5) If an advertisement uses a category created by the investment company or an investment company affiliate, including a "subcategory" of a category established by a Ranking Entity, the advertisement must prominently disclose:]

[(A) the fact that the investment company or its affiliate has created the ranking category;]

[(B) the number of investment companies in the category;]

[(C) the basis for selecting the category; and]

[(D) the Ranking Entity that developed the research on which the ranking is based.]

[(6) An advertisement or sales literature containing a headline or other prominent statement that proclaims an investment company ranking created by an investment company or its affiliate must indicate, in close proximity to the headline or statement, that the investment company ranking is based upon a category created by the investment company or its affiliate.]

(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 or series thereof 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

(a) Statements of Membership [Use of Association Name]

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

[(1) A member may indicate membership in the Association in recognized trade directories or other similar types of business listings.]

[(2) A member may indicate membership in the Association in the member's advertisements and sales literature if such use is:]

[(A) separate from the regular text of the advertisement or sales literature;

[(B) in a smaller type size and with less emphasis than that used for the member's name; and]

[(C) carries no direct or implied indication of Association approval of any security or service discussed in the advertisement or sales literature.]

*(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;*

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

[(4) A member may indicate membership in the Association on the door or entrance way of a member's principal office or a registered branch office in the following manner: "Member, National Association of Securities Dealers, Inc." or "Member of the National Association of Securities Dealers, Inc.".]

(b) Certification of Membership

Upon request to the Association, a member [shall] 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 shall remain the property of the Association and [shall] must be returned by the member upon request of the NASD Board or the Chief Executive Officer of the Association.

[(c) Fraudulent or Misleading Use Prohibited]

[A member or person associated with a member shall not use the name of the Association in a fraudulent or misleading manner in connection with the promotion or sale of any security or in connection with any other aspect of the member's business or imply orally, visually, or in writing that the Association endorses, indemnifies, or guarantees a member's business practices, selling methods, or class or type of securities offered.]

[(d) Violation of Rule 2110]

[An improper, fraudulent, or misleading use of the Association's

name by a member or person associated with a member shall be deemed conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of Rule 2110.]

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

(No changes to text.)

*IM-2210-6. Presentation of Mutual Fund Related Performance Information*

(Text to reflect final rule changes of SR-NASD-98-11 if approved by the Commission.)<sup>5</sup>

*IM-2210-7 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

<sup>5</sup> SR-NASD-98-11 was published for comment in the *Federal Register* on November 8, 2000. See Securities Exchange Act Release No. 43507 (November 2, 2000), 65 FR 67025.

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 any written letter or electronic mail message distributed by a member to:

(A) one or more of 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.

### (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 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 based on (A) a category or subcategory created and published by a Ranking Entity as defined in IM-2210-3(a) 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.

### (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.

[2211] 2212. Telemarketing

(No change to rule text.)

## 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

##### a. 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, provided that a member developed appropriate policies and procedures to supervise and review such communications. 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.<sup>6</sup>

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 on 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.

#### b. Description

##### 1. 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.

##### 2. Definition of "Public Appearance"

Existing Rule 2210(d)(1)(C) provides that members who engage 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 public 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.

##### 3. Institutional Sales Material

Currently, Rule 2210 does not distinguish between retail and institutional sales material. Moreover, the rule currently defines "sales literature" to include any "form letter," which NASD Regulation 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>7</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

<sup>7</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>6</sup> NASD member broker/dealers that are dually registered as investment advisers will remain subject to the advertising standards of the Investment Advisers Act of 1940 and Commission rules thereunder, to the extent that their sales material promotes advisory products or services.



person has an account with an Association member;<sup>8</sup>

(2) governmental entity or subdivision thereof;

(3) qualified plan, as defined in Section 3(a)(12)(C) of the Act, that has at least 100 beneficiaries;

(4) Association member or registered associated person of such a member,<sup>9</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 at least 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>10</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, as previously mentioned, 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.

#### 4. 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.

The proposed rule change would define "correspondence" to include 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"), as well as written and electronic communications prepared for delivery to a single retail customer. The proposed rule change would subject Group Correspondence to the strict supervisory procedures in Rule 3010(d), which governs the approval and review of correspondence, 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>11</sup>

NASD Regulation believes that Rule 3010(d) 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

<sup>8</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 amount 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>9</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>10</sup> See, e.g., ERISA § 103(a)(3)(A) (auditing requirements) and 104(a)(2)(A) (annual reporting).

<sup>11</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" an advertisement or item of 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.

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.

Notice to Members 98-11 provides guidance to members concerning Rule 3010(d). The Notice makes clear that, at a minimum, a member must develop procedures for the review of some of each registered representative's correspondence with the public relating to the member's investment banking or securities business, tailored to its structure and the nature and size of its business and customers.

The Notice provides that members must:

- Specify in writing the firm's policies and procedures for reviewing different types of correspondence;
- Identify what types of correspondence will be pre- or post-reviewed by a registered principal; and
- Periodically re-evaluate the effectiveness of the firm's procedures for reviewing public correspondence and consider any necessary revisions.

These procedures must be reasonably designed to ensure that a member's correspondence complies with the content standards of the applicable advertising rules.

In order to ensure that its review of Group Correspondence meets these standards, a member would be expected to review its procedures to ensure that they adequately address potential concerns with the distribution of Group Correspondence. Members should consider whether to adopt stricter procedures that require registered principal pre-use approval and filing with NASD Regulation of Group Correspondence that presents a higher risk to investors. This determination should be based upon such factors as the content, purpose and targeted audience of the Group Correspondence. Thus, for example, members may wish to consider adopting procedures requiring pre-use principal review and filing as appropriate with NASD Regulation of Group Correspondence that promotes a new investment product or strategy that is sent to existing retail customers. In addition, members should strongly consider requiring pre-use principal review of Group Correspondence sent by a registered representative that has been disciplined in the past for advertising or sales practice violations.

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 Rule 2211(d).

#### 5. 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.

An article reprint would qualify as an "independently prepared reprint" under Rule 2210(a)(6)(A) only if, among other things, its publisher is not an affiliate of the member using the reprint or any underwriter or issuer of the security mentioned in the reprint. For purposes of this provision, "affiliate" has the same meaning as that term is defined in NASD Rule 2720(b)(1)(A) and (B). The term "affiliate" as used in Rule 2210(a)(6)(B) (regarding investment company research reports) also has this meaning.

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.

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.

#### 6. 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>12</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.

#### 7. 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.

<sup>12</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 state 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.

#### 8. 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>13</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.

#### 9. Filing Requirements

The proposed rule change would retain 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.

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 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>14</sup> The proposed rule change would clarify that members need not

<sup>13</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>14</sup> See, e.g., NASD Regulatory and Compliance Alert (April 1995) at p. 9.

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 purposes 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 as other types of communications that need not be filed. 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 MDPF 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.

#### 10. 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.<sup>15</sup> 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.

#### 11. Legends and Footnotes

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.

#### 12. 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.

#### 13. 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.

#### 14. Recommendations

The NTM Version would have clarified certain aspects of the existing standards governing recommendations. Some commenters argued that the

<sup>15</sup> The current IM-2210-1 concerning collateralized mortgage obligations would be redesignated as IM-2210-7.

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 the SEC staff 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 separately, and recently issued NTM 01-45 seeking comment on this matter. Pending the separate resolution of this rulemaking initiative, the proposed rule change would make no amendment to the existing standards governing recommendations.

#### 15. 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>16</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.

#### 16. 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>17</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 rankings 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 Section 12(d)(1)(G) of 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 retain 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 retain 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.

#### 17. 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.

#### 18. 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-2210-7. 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.

#### 2. 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.<sup>18</sup> NASD Regulation 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.

<sup>16</sup> The requirement thus would not apply to institutional sales material.

<sup>17</sup> The application of this limitation to correspondence would appear in new Rule 2211(d)(3) rather than in IM-2210-3.

<sup>18</sup> 15 U.S.C. 78k-1(b)(6).

*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.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 30 days after the expiration of the comment period following 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, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 the file number in the caption above and should be submitted by February 14, 2002.<sup>19</sup>

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>20</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-45188; File No. SR-PCX-2001-33]**

**Self-Regulatory Organizations; Notice of filing of Proposed Rule Change and Amendment No. 1 by the Pacific Exchange, Inc. To Adopt Procedures for the Transfer of Options Positions**

December 21, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 10, 2001, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the PCS. The Exchange amended the proposed rule change on December 11, 2001.<sup>3</sup> 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**

The PCX proposes to establish procedures for the transfer of options positions. The text of the proposed rule change, as amended, is below. Proposed new language is italicized.

Rule 6.78 (a)-(c) No change.

**Transfer of Positions**

*(d) Transfer of Positions off the Floor. "Transfer of positions off the floor" is defined as moving a member's ownership interest in securities from its*

Commission action on this filing until 30 days after the end of the comment period. See Section III.

<sup>20</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter dated December 10, 2001 from Cindy Sink, Senior Attorney, Regulatory Policy, PCX, to Joe Morra, Special Counsel, Division of Market Regulation, Commission and attachments ("Amendment No. 1"). In Amendment No. 1, the PCX: (1) Clarified the intent of the rule that after the proper request has been completed, a transfer will be automatically permitted when the transfer satisfies one of the specified categories set forth in proposed Rule 6.78(d)(1); (2) revised Item 8 to state that the proposed rule change is based, in part, on Chicago Board Options Exchange Rule 6.49A; and (3) made technical changes to the rule text.

*account to an account of another member or person in a manner other than trading on the floor of a securities exchange.*

*(1) Transfers off the Floor. Notwithstanding the prohibition set forth in subsection (a), an Exchange member may transfer positions off the floor if the transfer involves one or more of the following events: (i) The dissolution of a joint account in which the remaining member assumes the positions of the joint account; (ii) the dissolution of a corporation or partnership in which a former nominee of that corporation or partnership assumes the positions; (iii) positions transferred as part of a member's capital contribution to a new joint account, partnership, or corporation; (iv) the donation of positions to a not-for-profit corporation; (v) the transfer of positions to a minor under the Uniform Gifts to Minors Act; (vi) a merger or acquisition resulting in a continuity of ownership or management; or (vii) consolidation of accounts within a member organization.*

*(2) Written Request. No member or member organization may effect a transfer of positions off the floor in any security listed on the Exchange without the prior submission of a completed written request to the Exchange. This requirement applies regardless of whether the transfer is permitted under subsection (d)(1) or (f).*

*(e) Transfer of Positions Offered on the Floor. "Transfer of positions offered on the floor" is defined as moving a member's ownership interest in securities from its account to an account of another member or person in circumstances other than those set forth in subsection (d)(1).*

*(1) Transfer Procedure for Positions Offered on the Floor. A member seeking a transfer must offer the positions on the floor in the following manner:*

*(A) A member or member organization seeking to transfer positions on the floor ("Transferor") must specify the securities positions to be transferred that are traded on the Exchange or at another securities exchange ("Transfer Positions"). In offering Transfer Positions to the floor, the Transferor must offer a set of options or other financial products being offered by the Transferor as a package ("Transfer Package"), to be bid upon at a net debit or credit for the entire Transfer Package. A single Transfer Package must include no more than one option issue listed on the Exchange, but may also include stock or other securities. A Transferor may offer multiple Transfer Packages on the floor at the same time or on the same day. These offers must be made in a form*

<sup>19</sup> The NASD requested a 45 day comment period and has consented to the extension of the time for