

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52372; File No. SR-NASD-2005-104)

August 31, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Extend on a Pilot Basis Rules Concerning Bond Mutual Fund Volatility Ratings

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 29, 2005, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by NASD. NASD has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

NASD is proposing to extend on a pilot basis the provisions of NASD Rule 2210(c)(3) and Interpretive Material 2210-5 concerning bond mutual fund volatility ratings (collectively, the “Rules”) until December 29, 2005, unless the Rules are extended or approved on a permanent basis before that date. Below is the text of the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

change. Proposed new language is in italics; proposed deletions are in brackets.

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

(This rule and Rule 2210(c)(3) will expire on [August 31]December 29, 2005, unless extended or permanently approved by NASD at or before such date.)

(a) through (c) No change.

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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 included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD 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

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

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

⁵ See Securities Exchange Act Release No. 42476 (February 29, 2000); 65 FR 12305 (March 8, 2000) (SR-NASD-97-89).

NASD Rule 2210(c)(3), which sets forth the filing requirements and review procedures applicable to sales literature containing bond mutual fund volatility ratings. IM-2210-5 and Rule 2210(c)(3) initially were approved on an 18-month pilot basis that was scheduled to expire on August 31, 2001.⁶ On August 10, 2001, NASD filed with the Commission a proposed rule change that was effective upon filing that extended the effectiveness of IM-2210-5 and Rule 2210(c)(3) an additional two years until August 31, 2003.⁷ On August 7, 2003, NASD filed a similar proposed rule change with the Commission that was effective upon filing and that extended the effectiveness of IM-2210-5 and Rule 2210(c)(3) until August 31, 2005.⁸

Prior to the pilot, NASD staff interpreted NASD rules to prohibit the use of bond fund volatility ratings in sales material. Under the pilot, IM-2210-5 permits the use of bond fund volatility ratings only in supplemental sales literature and only if certain conditions are met, including that:

- The word “risk” may not be used to describe the rating.
- The rating must be the most recent available and be current to the most recent calendar quarter ended prior to use.
- The rating must be based exclusively on objective, quantifiable factors.
- The entity issuing the rating must provide detailed disclosure on its rating methodology to investors through a toll-free telephone number, a web site, or both.

⁶ Id.

⁷ See Securities Exchange Act Release No. 44737 (August 22, 2001); 66 FR 45350 (August 28, 2001) (SR-NASD-2001-49); NASD Notice to Members 01-58 (September 2001).

⁸ See Securities Exchange Act Release No. 48353 (August 15, 2003); 68 FR 50568 (August 21, 2003) (SR-NASD-2003-126); NASD Notice to Members 03-48 (August 2003).

- A disclosure statement containing all of the information required by the rule must accompany the rating. The statement must include such information as the name of the entity issuing the rating, the most current rating and the date it was issued, and a description of the rating in narrative form containing certain specified disclosures.

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

Proposed Rule Change to Extend IM-2110-5 and Rule 2210(c)(3) for 120 Days

NASD intends shortly to submit to the Commission a proposed rule change to make the Rules effective on a permanent basis. However, the process to obtain Commission approval, including publication of the proposal for comment in the Federal Register and responding to any comments received, will extend beyond the expiration of the current pilot on August 31, 2005. Therefore, to maintain operation of the pilot pending the approval process of the Rules on a permanent basis, NASD is proposing to extend the pilot for 120 days until December 29, 2005, unless the Rules are extended or approved on a permanent basis before that date.

The proposed rule change will become effective upon filing, will be implemented at the close of business, August 31, 2005, and will expire on December 29, 2005, unless the Rule are extended or approved on a permanent basis before that date.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁹ which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that extending the effectiveness of IM-2210-5 and Rule 2210(c)(3) for 120 days unless the Rules are extended or approved on a permanent basis before that date will allow members to publish sales material that contains bond fund volatility ratings during this interim period in a manner that will protect investors and serve the public interest.

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

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

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

Written comments were neither solicited nor received.

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

The proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁰ and Rule 19b-4(f)(6) thereunder¹¹ because the proposal: (i) does not

⁹ 15 U.S.C. 78q-3(b)(6).

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative prior to 30 days after the date of filing or such shorter time as the Commission may designate.¹²

NASD has requested that the Commission waive the requirement that the rule change not become operative for 30 days after the date of the filing so that NASD can begin implementation of this proposed rule change as of the close of business on August 31, 2005, in order to prevent the current pilot Rules from lapsing. The Commission believes that such waiver is consistent with the protection of investors and the public interest because the proposed rule change would prevent the current pilot Rules from lapsing while the permanent adoption of the Rules is under consideration.

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

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

¹² A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of the filing. However, pursuant to Rule 19b-4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest.

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2005-104 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-104. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available

publicly. All submissions should refer to the File Number SR-NASD-2005-104 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Jonathan G. Katz
Secretary

¹³ 17 CFR 200.30-3(a)(12).