

to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.

The MSRB represents that the proposed rule change is intended to provide relief to underwriters that face violation of Rule G-36(c)(i) caused by a delay in delivery by issuers for whom no concomitant obligations exists to deliver an official statement by any particular date. The Commission believes that because underwriters and other dealers are still required to adhere to their continuing obligation under Rule G-32 to deliver official statements for new issue municipal securities to customers by settlement, the MSRB proposal will foster cooperation among persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, without adversely affecting the protection of investors and the public interest.

In general, underwriters may be exposed to a potential violation of Rule G-36 when an issuer fails to provide the official statement. The Commission notes that pursuant to Rule 15c2-12(b)(3), underwriters are required to contract to obtain official statements and thus have an enforceable mechanism to obtain the official statements. The Commission also appreciates the situation of underwriters who, because an issuer does not provide a final official statement and is not required to do so under a 15c2-12 contract, finds themselves in violation of Rule G-36(c)(i). However, the Commission expects that an underwriter that receives an official statement will provide the official statement to the Board without delay.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (SR-MSRB-99-11) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42965; File No. SR-NASD-99-74]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change as Amended by the National Association of Securities Dealers, Inc. Relating To an Exemption From NASD Conduct Rule 2710 for Closed-End Management Companies That Make Periodic Repurchases of Their Securities Under Rule 23c-3(b) of the Investment Company Act of 1940

June 20, 2000.

#### I. Introduction

On December 20, 1999, the National Association of Securities Dealers, Inc. ("NAD" or "Association"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change regarding an exemption from NASD Conduct Rule 2710 ("Corporate Financing Rule") for closed-end management companies that make periodic repurchases of their securities under Rule 23c-3(b)<sup>1</sup> of the Investment Company Act of 1940 ("1940 Act")<sup>2</sup> NASD Regulation filed an amendment to the proposed rule change on February 29, 2000, which amendment entirely replaced and superseded the initial proposal.<sup>3</sup> On March 20, 2000, NASD Regulation again amended the proposal.<sup>4</sup> The Proposed rule change, as amended, was published for comment in the **Federal Register** on April 7, 2000.<sup>5</sup> The Commission received one comment letter on the proposal.<sup>6</sup> This order grants approval to the proposed rule change, as amended.

<sup>1</sup> 17 CFR 270.23c-3(b).

<sup>2</sup> 15 U.S.C. 80a-1, *et seq.*

<sup>3</sup> See February 28, 2000 letter and attachments from Joan C. Conley, Secretary, NASD Regulation to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), SEC ("Amendment No. 1"). In Amendment No. 1, NASD Regulation made changes to the language of the proposed new rule. Exhibits 2 through 4 that were attached to the original filing are incorporated by reference in Amendment No. 1.

<sup>4</sup> See March 17, 2000 letter from Suzanne E. Rothwell, Chief Counsel, Corporate Financing, NASD Regulation to Katherine A. England, Assistant Director, Division, SEC ("Amendment No. 2"). In Amendment No. 2, NASD Regulation made minor, technical changes to the proposed new rule.

<sup>5</sup> See Securities Exchange Act Release No. 42601 (March 30, 2000), 65 FR 18405 (SR-NASD-99-74).

<sup>6</sup> See April 27, 2000 letter from Kathy D. Ireland, Associate Counsel, Investment Company Institute ("ICI"), to Jonathan G. Katz, Secretary, SEC ("ICI Letter").

#### II. Description of the Proposal

NASD Regulation proposes to amend the Corporate Financing Rule and NASD Conduct Rule 2830 to exempt public offerings by closed-end investment management companies that make periodic tender offers for their securities in compliance with Rule 23c-3(b)<sup>7</sup> of the 1940 Act<sup>8</sup> from the filing requirements and limitations on underwriting compensation of the Corporate Financing Rule and, instead, subject such offerings to the sales charge limitations of NASD Conduct Rule 2830.

The Corporate Financing Rule regulates the underwriting terms and other arrangements of public offerings of securities. Subparagraph (b)(8)(C) of the Corporate Financing Rule provides that securities of investment companies registered under the 1940 Act<sup>9</sup> are exempt from filing and compliance with the Corporate Financing Rule, unless the offerings is of securities of a management company defined as a "closed-end" company in Section 5(a)(2) of the 1940 Act<sup>10</sup> ("closed-end funds").<sup>11</sup> Thus, closed-end funds are subject to the filing requirements, filing fees, and regulations of the Corporate Financing Rule. Open-end investment companies ("open-end funds") are exempt from filing with NASD Regulation under the Corporate Financing Rule. Instead, open-end funds' sales charges are regulated under NASD Conduct Rule 2830.

Closed-end funds are subject to the core provisions of the 1940 Act<sup>12</sup> that also apply to open-end funds, including prohibitions on affiliated transactions, obligations requiring shareholder approval of advisory contracts, anti-pyramiding restrictions, and board composition requirements. However, such funds are not subject to other 1940 Act<sup>13</sup> restrictions applicable to open-end funds, including certain limitations on leverage and certain obligations pertaining to the liquidity of investments.

The NASD has applied the Corporate Financing Rule and its predecessor rule to members' sales of the securities of closed-end funds on the basis that

<sup>7</sup> 17 CFR 270.23c-3(b).

<sup>8</sup> 15 U.S.C. 80a-1, *et seq.*

<sup>9</sup> *Id.*

<sup>10</sup> 15 U.S.C. 80a-5(a)(2).

<sup>11</sup> Section 5(a)(1) of the 1940 Act defines "open-end company" as "a management company which is offering for sale or has outstanding any redeemable security for which it is the issuer." Section 5(a)(2) of the 1940 Act defines "closed-end company" as "any management company other than an open-end company."<sup>15</sup> U.S.C. 80a-5(a)(1) and (2).

<sup>12</sup> 15 U.S.C. 80a-1, *et seq.*

<sup>13</sup> *Id.*

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

closed-end fund offerings are structured and marketed in a manner that is more similar to and competitive with corporate securities offerings than to open-end funds. At the time the Corporate Financing Rule was adopted, closed-end funds conducted offerings of a fixed number of common shares at specified times; priced their shares periodically; limited sales compensation of broker/dealers to a discount from a fixed offering price; generally did not repurchase their securities directly from shareholders; and generally listed their securities on a securities market.

Certain closed-end funds, commonly known as "interval funds," however, engage in continuous offerings of their securities under Rule 415(a)(1)(xi)<sup>14</sup> under the Securities Act of 1933;<sup>15</sup> price their shares daily; pay broker/dealers initial and continuing compensation that meets the sales charge limitations of NASD Conduct Rule 2830; do not list their securities on a securities market; and conduct periodic repurchases in compliance with Rule 23c-3(b)<sup>16</sup> of the 1940 Act.<sup>17</sup> Rule 23c-3(b)(2)(i)<sup>18</sup> requires that the interval fund establish as a fundamental policy, changeable only by a majority vote of the outstanding voting securities of the company, that it will make periodic repurchase offers. Because the shares of interval funds are not redeemable on a daily basis, they are classified as "closed-end" under the 1940 Act.<sup>19</sup>

In *Notice to Members 98-81* (October, 1998), NASD Regulation requested public comment on whether any of the NASD's rules are obsolete. One commenter, the ICI, proposed exempting interval funds from regulation by the Corporate Financing Rule. In addition, the Corporate Financing Department has received a rulemaking petition requesting an exemption from the Corporate Financing Rule for interval funds. NASD Regulation believes that the distribution of interval fund shares is conducted and financed in a manner more similar to that used by open-end funds than the method used by traditional closed-end funds. Therefore, the calculation of members' compensation for the distribution of interval fund shares is more properly regulated by provision (d) of NASD Conduct Rule 2830 (provision (d) hereinafter, the "Sales Charge Rule"),

rather than by the limitations on underwriting compensation in the Corporate Financing Rule.

Consequently, NASD Regulation proposes to amend the Corporate Financing Rule and NASD Conduct Rule 2830 to exempt interval funds from the filing requirements, filing fees, and regulations of the Corporate Financing Rule and, instead, to subject them to NASD Conduct Rule 2830, which regulates the distribution and sales charges of open-end funds.<sup>20</sup> The proposed amendment to the Corporate Financing Rule would amend subparagraph (b)(8)(C) to provide that closed-end fund offerings are exempt if the fund makes periodic repurchase offers pursuant to Rule 23c-3(b)<sup>21</sup> and it offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi)<sup>22</sup> under the Securities Act of 1993.<sup>23</sup> Closed-end funds that do not meet these requirements will continue to be subject to the Corporate Financing Rule. The proposed amendment to NASD Conduct Rule 2830 would amend paragraph (d) and (j) to provide that interval funds are subject to the provisions regulating sales charges and the repurchases of fund securities.<sup>24</sup>

### III. Summary of Comments

The Commission received one comment letter on the proposal from the ICI.<sup>25</sup> While the ICI is generally supportive of the proposal, the ICI believes that the proposal does not go

far enough in two respects. First, the ICI recommends that the exemption from Corporate Financing Rule be expanded to include funds that make periodic self-tenders in compliance with Rule 13e-4<sup>26</sup> and Schedule 13E-4<sup>27</sup> under the Exchange Act.<sup>28</sup> The ICI believes that tender offer funds are substantially similar to the interval funds that fall within the scope of the proposal, in that funds making repurchases of shares outside of Rule 23c-3<sup>29</sup> also need to replenish their assets through sales of additional shares to offset the effects of repurchases, and therefore may wish to compensate broker-dealers in the same manner as interval funds relying on Rule 23c-3.<sup>30</sup> The ICI believes, therefore, it is irrelevant whether funds are required to have a fundamental policy to conduct self-tender offers, and that the proposal should be expanded to include tender offer funds.<sup>31</sup>

Second, the ICI notes that the proposal, as written, applies only to interval funds that offer their shares on a continuous basis pursuant to SEC Rule 415(a)(1)(xi).<sup>32</sup> The ICI states, however, that SEC Rule 415(a)(1)(xi)<sup>33</sup> permits interval funds to offer shares under the "shelf registration" provisions of the Act on either a continuous or delayed basis. To ensure consistency with SEC Rule 415(a)(1)(xi),<sup>34</sup> the ICI believes the proposal should be modified to include interval funds that offer their shares on a delayed basis. The ICI maintains that interval funds that make offerings on a delayed basis are also more similar to open-end funds than closed-end funds, and therefore should be treated as open-end funds.<sup>35</sup>

In responding to the ICI's comments, NASD Regulation stated that its proposed requirement that the exemption be made available only for those closed-end funds that issue securities on a continuous basis specifically excluding those interval funds that offer their shares on a delayed or periodic basis, was intended to ensure that the fund's manner of financing the distribution of shares

<sup>20</sup> Interval funds are distinguished from other hybrid closed-end funds that make periodic self-tenders in compliance with Rule 13e-4 and Schedule 13E-4 under the Securities Exchange Act of 1934 ("tender offer funds") ("Exchange Act"). See 17 CFR 240.13e-4 and 17 CFR 240.13e-101, *et seq.*, 15 U.S.C. 78a, *et seq.* Such tender offer funds are not required to establish as a fundamental policy that they will make periodic repurchases, as required by Rule 23c-3(b)(2)(i) under the 1940 Act. 17 CFR 270.23c-3(b)(2)(i), 15 U.S.C. 80a-1, *et seq.* The rule change proposed herein would not exempt tender offer funds from the Corporate Financing Rule. However, NASD Regulation will consider individual requests for exemption under the NASD Rule 9600 series from the requirements of the Corporate Financing Rule for such tender offer funds. See Exemption granted October 29, 1999 under "Corporate Financing Rule—Rule 2710" at [www.nasd.com](http://www.nasd.com).

<sup>21</sup> 17 CFR 270.23c-3(b).

<sup>22</sup> 17 CFR 270.415(a)(1)(xi).

<sup>23</sup> 15 U.S.C. 77a, *et seq.*

<sup>24</sup> An interval fund that has received a "no objections" opinion from the Corporate Financing Department based upon representations that underwriting compensation will not exceed a certain amount will become subject to the Sales Charge Rule upon effectiveness of the proposed amendments, provided that the compensation limit has not already been met or exceeded. Any interval fund that has reached the applicable compensation limit under the Corporate Financing Rule shall remain subject to the requirements of the Rule until the fund files a post-effective amendment with the Commission registering additional securities.

<sup>25</sup> See footnote, 4, *supra*.

<sup>26</sup> 17 CFR 240.13e-4.

<sup>27</sup> 17 CFR 240.13e-101. Although the ICI refers to Schedule 13E-4 in its comment letter, the Commission notes that Schedule 13E-4 was removed and reserved, effective January 24, 2000. See Securities Act Release No. 7760 (October 22, 1999), 64 FR 61408 (November 10, 1999). The information is now contained in new Schedule TO, 17 CFR 240.14d-100.

<sup>28</sup> 15 U.S.C. 78a, *et seq.*

<sup>29</sup> 17 CFR 270.23c-3

<sup>30</sup> *Id.*

<sup>31</sup> See ICI Letter at page 2.

<sup>32</sup> 17 CFR 230.415(a)(1)(xi).

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> See ICI Letter on page 2.

<sup>14</sup> 17 CFR 230.415(a)(1)(xi).

<sup>15</sup> 15 U.S.C. 77a, *et seq.*

<sup>16</sup> 17 CFR 270.23c-3(b).

<sup>17</sup> 15 U.S.C. 80a-1, *et seq.*

<sup>18</sup> 17 CFR 270.23c-3(b)(2)(i).

<sup>19</sup> 15 U.S.C. 80a-1, *et seq.*

would be more similar to the manner of financing the distribution of shares of mutual funds that offer shares on a continuous basis.<sup>36</sup> Additionally, NASD Regulation noted that closed-end funds that offer their shares on a periodic basis may decide to finance the distribution in a manner more similar to corporate offerings than the broker/dealer compensation methods used by mutual funds.<sup>37</sup> For these reasons, NASD Regulation does not believe that the ICI's suggested expansion of the scope of the proposal is warranted.

Additionally, NASD Regulation noted that, although some tender offer funds offer their shares continuously and periodically self-tender, these funds do not, as a matter of fundamental policy, establish that they will make periodic repurchases.<sup>38</sup> NASD Regulation explained that the discretion whether to make periodic repurchases allows a tender offer fund the flexibility to determine if it needs to continuously offer shares to replenish fund assets. Were a tender offer fund to decide to offer shares periodically, however, NASD Regulation notes that such a fund could compensate broker/dealers in the same manner as corporate issuers.<sup>39</sup> For these reasons, NASD Regulation does not propose to amend the proposal to extend the exemption to tender offer funds.

#### IV. Discussion

The Commission has reviewed carefully the NASD's proposed rule change and finds, for the reasons set forth below, the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a registered securities association, and in particular, with the requirements of Section 15A(b)(6) of the Exchange Act.<sup>40</sup>

Section 15A(b)(6) of the Exchange Act<sup>41</sup> requires that rules of a registered securities association be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and, in general, protect investors and the public interest. The proposal would require that certain closed-end funds known as "interval funds" be regulated by NASD Conduct Rule 2830(d), rather than by the limitations on underwriting

compensation in the Corporate Financing Rule. The Commission agrees that interval funds, because their manner of financing the distribution of shares are more similar to that of open-end funds, are more properly regulated by NASD Conduct Rule 2830, which regulates the distribution and sales charges of open-end funds. The proposal is narrowly construed, in that the amendment to subparagraph (b)(8)(C) of the Corporate Financing Rule would restricted to closed-end funds that make periodic repurchase offers pursuant to Rule 23c-3(b)<sup>42</sup> and offer shares on a continuous basis pursuant to Rule 415(a)(1)(xi)<sup>43</sup> under the Securities Act of 1933.<sup>44</sup> Closed-end funds that do not meet these requirements will continue to be subject to the Corporate Financing Rule. The Commission finds that allowing the requested exemption for funds that meet these limited criteria is consistent with the public interest and beneficial to investors because the distribution of interval fund shares is conducted and financed in a manner more similar to that used by open-end management investment companies, which are regulated by NASD Conduct Rule 2830(d).

The Commission has considered carefully the comments raised by the ICI, and is not persuaded that the scope of the proposal should be expanded to include interval funds that offer their shares on a periodic basis, nor that the proposed exemption should be made available to closed-end funds that operate as tender offer funds. The Commission finds that the proposal is reasonably designed to ensure that the exemption applies only to funds whose manner of financing the distribution of shares is more similar to that of mutual funds that offer shares on a continuous basis. The Commission is concerned that tender offer funds and interval funds that offer their shares periodically are marketed, and their distribution financed, in a manner more akin to corporate issuers that are subject to the Corporate Financing Rule. The Commission therefore believes that the exemption should not be expanded at this time to exempt these funds from the requirements of this rule. The Commission notes, however, that NASD Regulation stated that it prefers to gain experience regarding the financing structures of tender offer funds through the exemptive process under the Rule 9600 series, and therefore it will consider individual requests for

exemption from the requirements of the Corporate Financing Rule for these types of funds.<sup>45</sup>

#### V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>46</sup> that the proposed rule change (SR-NASD-99-74), as amended, is hereby approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>47</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42970; File No. SR-NASD-00-31]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. to Apply Nasdaq's Recently Amended Independent Director and Audit Committee Listing Requirements to Limited Partnerships

June 21, 2000.

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 May 26, 2000, the National Association of Securities Dealers, Inc. ("NASD" or "Association") through its wholly owned subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), 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 Nasdaq. 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

Nasdaq has filed with the Commission a proposed rule change to apply its recently amended independent director and audit committee listing requirements to limited partnerships. Below is the text of the proposed rule change. Proposed new language is *italicized* and proposed deletions are in [brackets].

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<sup>36</sup> See May 15, 2000 letter from Suzanne E. Rothwell, Chief Counsel, Corporate Financing, NASD Regulation to Katherine A. England, Assistant Director, Division, SEC ("NASD Regulation Letter").

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> 15 U.S.C. 78o-3(b)(6).

<sup>41</sup> *Id.*

<sup>42</sup> 17 CFR 270.23c-3(b).

<sup>43</sup> 17 CFR 230.415(a)(1)(xi).

<sup>44</sup> 15 U.S.C. 77a *et seq.*

<sup>45</sup> See NASD Regulation Letter at page 2.

<sup>46</sup> 15 U.S.C. 78s(b)(2).

<sup>47</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.