

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

No written comments were either solicited or received.

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

The proposed rule change has become effective upon filing pursuant to Section 19(b)(3)(A) of the Act and subparagraph (e) of Rule 19b-4 thereunder, in that the proposal establishes or changes a due, fee, or other charge. At any time within 60 days of the filing of such 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-97-82 and should be submitted by December 29, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

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

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-39356; File No. SR-NASD-97-57]

**Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers Inc. Relating to the Electronic Delivery of Information Between Members and Their Customers**

November 25, 1997.

**I. Introduction**

On July 30, 1997,<sup>1</sup> the National Association of Securities Dealers, Inc. ("NASD" or "Association") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> a proposed rule change setting forth the policy of NASD Regulation, Inc. ("NASD Regulation" or "NASDR") regarding electronic delivery of information between members and their customers. A notice of the proposed rule change appeared in the **Federal Register** on September 11, 1997.<sup>4</sup> The Commission received one comment letter addressing the proposed rule change.<sup>5</sup> This order approves the proposed rule change.

**II. Description of Proposal**

The Association filed with the Commission a Notice of Members ("NTM") which establishes the NASDR's policy regarding electronic delivery of information between members and their customers. The NASDR policy will allow members to use electronic media to electronically transmit documents that they are required or permitted to furnish to customers under Association rules and to receive electronic communications from customers. The NTM states that use of electronic media is permitted provided members comply with certain guidelines outlined in Commission

Release Nos. 34-37182<sup>6</sup> and 33-7233.<sup>7</sup> In these releases, the Commission addresses the procedural aspects of how broker-dealers and others may satisfy their delivery obligations under federal securities laws by using electronic media as an alternative to paper-based media provided that they comply with certain prescribed requirements.

The NTM summarizes the Commission procedures, which address, among other things, content, notice, access, evidence to show delivery, and communication of personal financial information, and consent. The NTM also lists current Association rules that require or permit communications between members and their customers for which electronic delivery may be used in accordance with the standards contained in the Commission releases. The policy established in the NTM will also apply to a new rule or an amendment to an existing rule that requires or permits communications between members and their customers unless NASDR specifies otherwise at the time of adoption of the rule or amendment.

**III. Summary of Comments**

The Commission received one comment letter addressing this proposal.<sup>8</sup> While the ICI Letter generally supports the NASDR's NTM, it recommends certain additions to the list of NASD rules contained in the NTM,<sup>9</sup> and responds to a request for comment issued in the notice.<sup>10</sup>

The additional rules that ICI believes should be added to the list of NASD rules contained in the NTM are: Rule 2210 (d) and (f); IM-2210-3; Rule 2830(d); Rule 2830(k)(7); Rule 2830(l)(1)(C); and Rule 3010(g)(2).<sup>11</sup> ICI believes that Rules 2210(d), 2210(f) and IM-2210-3, which outline standards for when members communicate with the public, should be included to confirm that their disclosure and other requirements may be satisfied using electronic media where the communication itself is made through

<sup>6</sup> See, Securities Exchange Act Release No. 37182, May 9, 1996; 61 FR 24644, May 15, 1996, (Commission's interpretation concerning the delivery of information through electronic media in satisfaction of broker-dealer and transfer agent requirements to deliver information under the Act and the rules thereunder).

<sup>7</sup> See, Securities Act Release No. 7233, Oct. 6, 1995; 60 FR 53458, Oct. 13, 1995, (Commission's interpretation concerning the use of electronic media as a means of delivering information required to be disseminated pursuant to the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940).

<sup>8</sup> See *supra* note 5.

<sup>9</sup> ICI Letter at pp. 2-3.

<sup>10</sup> See *supra* note 4, at p. 47859, n.6.

<sup>11</sup> ICI Letter, p. 3.

<sup>1</sup> On August 27, 1997, the NASD amended the exhibit attached to the rule filing. See letter from Mary N. Revell, Associate General Counsel, NASD Regulation, Inc., to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated August 26, 1997.

<sup>2</sup> 15 U.S.C. 78s(b)(1).

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> Securities Exchange Act Release No. 39025 (September 5, 1997); 62 FR 47858.

<sup>5</sup> Letter from Joseph P. Savage, Assistant Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, SEC, dated October 2, 1997 ("ICI Letter").

<sup>7</sup> 17 CFR 200.30-3(a)(12) (1989).

electronic media.<sup>12</sup> Rule 2830 applies to the activities of members in connection with investment company securities.<sup>13</sup> ICI notes that Rules 2830(d), 2830(k)(7), and 2830(l)(1)(C), which apply to sales charges, execution of investment company portfolio transactions, and dealer concessions, respectively, should be included in the NTM to confirm that electronic disclosure meets the requirements in these rules in the case of a prospectus that is delivered electronically.<sup>14</sup> Concerning Rule 3010(g)(2), which defines the term "branch office," ICI believes that the NTM should clarify the requirements of the rule may be satisfied through electronic delivery of sales material.<sup>15</sup>

In its response, the NASDR does not agree that these rules should be added to the NTM.<sup>16</sup> According to the NASDR, "the rules the ICI suggests adding to the NTM do not specifically address the delivery of information between broker/dealers and customers, but instead concern substantive obligations that arise under NASD rules regardless of whether information is submitted in electronic or non-electronic form."<sup>17</sup> Notwithstanding its decision to exclude the rules from the NTM, the NASDR agrees that the disclosure requirements of Rules 2210(d), 2210(f), IM-2210-3, and 3010(g)(2) may be satisfied using electronic media where the communication itself is made electronically.<sup>18</sup> The NASDR also agrees that the disclosure requirements of Rules 2830(d), 2830(d)(4), 2830(k)(7), and 2830(l)(1)(C) may be met if the prospectus is electronically delivered.<sup>19</sup>

In the notice, the Commission requested comment on what types of security measures broker-dealers employ or will employ to reasonably assure themselves that the responses they receive electronically from customers are authentic.<sup>20</sup> According to ICI, while no formal survey of its membership was conducted, one member has indicated that it requires each customer who wishes to communicate electronically regarding his or her securities account, provide his or her social security number, customer account number, and personal

identification number before electronic access to the account will be allowed.<sup>21</sup> For certain institutional clients, another member uses a security system which includes encryption technology and a password requirement.<sup>22</sup>

The Commission reiterates its concern that adequate security measures must be implemented by members to protect customers' personal financial information and to prevent unauthorized transactions when "receiving" or "obtaining" electronic responses from their customers. The Commission recognizes that the security measures instituted will vary depending on the computer's hardware and software capabilities, as well as, on the information being sent or received. However, an effort should be made to secure customers' information, as the two ICI members have done, by developing procedures and improving technology, when feasible.

#### IV. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations promulgated thereunder. Specifically, the Commission believes that approval of the proposed rule change is consistent with Section 15A(b)(6)<sup>23</sup> of the Act.<sup>24</sup> Pursuant to Section 15A(b)(6), the proposed rule change benefits the public, because it not only allows customers easy and efficient access to account information, but also requires an evaluation of systems and procedures by members to ensure that the privacy of personal information is maintained. In using the Commission's releases as a guide,<sup>25</sup> the Association has established a uniform policy concerning electronic delivery of information which should allow members and member organizations to satisfy their delivery obligations under the federal securities laws and the Association's rules. This uniform policy should simplify compliance by members and member organizations and aid the Association in monitoring the same.

For the above reasons, the Commission believes that the proposed rule change is consistent with the

provisions of the Act, and in particular with Section 15A(b)(6).

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>26</sup> that the proposed rule change (SR-NASD-97-57) be, and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>27</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39361; File No. SR-NASD-97-69]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Tape Recording of Conversations

November 26, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on September 12, 1997, as amended on November 17, 1997,<sup>2</sup> 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. 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 Regulation is proposing to amend National Association of Securities Dealers, Inc. ("NASD" or "Association") Rule 3010 to require tape recording of conversations where members hire more than a specified percentage of registered persons from certain firms that have been expelled or

<sup>26</sup> 15 U.S.C. 78s(b)(2).

<sup>27</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. § 78s(b)(1).

<sup>2</sup> On November 17, 1997, NASD Regulation filed Amendment No. 1 with the Commission. In Amendment No. 1, the NASD clarified that firms will be required to establish procedures required by the Rule when either information supplied by NASD Regulation or the firm's actual knowledge indicates that it is the subject of the Rule, and added a new provision defining the term, "registered person," and moving the definition of a "disciplined firm" to a different location in the Rule for ease of reference. See Letter from Mary N. Revell, Associate General Counsel, NASD, to Katherine A. England, Assistant Director, Office of Market Supervision, Division of Market Regulation (November 17, 1997).

<sup>12</sup> *Id.*

<sup>13</sup> See NASD Manual, Conduct Rules, Rule 2830, p. 4621.

<sup>14</sup> ICI Letter, p. 3.

<sup>15</sup> *Id.*

<sup>16</sup> Letter from Mary N. Revell, Associate General Counsel, NASD Regulation, Inc., to Katherine England, Assistant Director, SEC, dated November 13, 1997 ("NASDR Letter"), p. 2.

<sup>17</sup> *Id.* at p. 2.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at pp. 2-3.

<sup>20</sup> See *supra* note 10.

<sup>21</sup> ICI Letter at p. 2.

<sup>22</sup> *Id.*

<sup>23</sup> Section 15A(b)(6) requires the Commission to determine that an Association's rules are designed to prevent fraudulent acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

<sup>24</sup> Pursuant to Section 3(f) of the Act, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. § 78c(f).

<sup>25</sup> See *supra* notes 6 and 7.