since the date the shareholders initially purchased the shares of the Acquired Fund.

4. The Boards, including all of the Independent Directors, determined that the Reorganization is in the best interests of each Fund and its shareholders and that the interests of shareholders would not be diluted as a result of the Reorganization. In determining whether to approve the Reorganization, the Boards considered various factors, including: (a) The terms and conditions of the Reorganization; (b) the comparative investment performance of the Funds; (c) the possible advantages to the Acquired Fund's shareholders of investing in a larger asset pool with a higher quality of securities; (d) the federal income tax consequences to the Acquired Fund's shareholders; (e) the possible benefits of a larger asset base to portfolio management of the Acquiring Fund; (f) the compatibility of investment objectives and policies of the Funds and any changes to the objectives and policies of the Acquired Fund that will result from the Reorganization; and (g) the tax-free nature of the Reorganization.

5. Applicants also state that the Boards determined that the investment objectives, restrictions and policies of the Funds, though not identical, are similar and the range of credit qualities in which the Acquiring Fund invests should offer the Acquired Fund's shareholders some degree of continuity in investment exposure to high yield bonds as well as potential for reduced risk. Although there is overlap in the range of securities in which the Funds may invest, Applicants state, however, that the Acquired Fund's assets that are not eligible investment for the Acquiring Fund will be liquidated prior to the Closing and the Acquired Fund and its shareholders will be responsible for any brokerage expenses and tax consequences resulting from this liquidation. The Adviser will bear all of the other costs associated with the Reorganization.

6. The Reorganization is subject to a number of conditions precedent, including that: (a) The Acquired Fund's shareholders will have approved the Reorganization; (b) the Funds will have received opinions of counsel that the Reorganization will be tax-free for the Funds and their shareholders; (c) applicants will have received from the Commission the exemptive relief requested by the application; (d) an N–14 registration statement relating to the Reorganization will have become effective with the Commission; and (e) the Acquired Fund will declare to shareholders of record on or prior to the Closing Date a dividend, which together with all previous dividends will have the effect of distributing to shareholders all of its income and all net realized capital gains, if any, as of the Closing. The Plan may be terminated by mutual consent of each Board at any time prior to the Closing Date. No material changes will be made to the Plan without prior approval of the Commission.

7. A registration statement on Form N–14 relating to the Reorganization, containing a proxy statement/prospectus, was filed with the Commission and declared effective and was mailed to the Acquired Fund's shareholders on May 20, 2002. A special meeting of the Acquired Fund's shareholders was held on June 26, 2002, and the Reorganization was approved.

Applicants' Legal Analysis

1. Section 17(a) of the Act prohibits any affiliated person of a registered investment company, or any affiliated person of that person, acting as principal, from selling to or purchasing from the registered investment company any security or other property. Section 2(a)(3) of the Act defines an ''affiliated person'' of another person to include: (a) Any person directly or indirectly owning, controlling, or holding with power to vote 5% or more of the outstanding voting securities of the other person; (b) any person 5% or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote by the other person; (c) any person directly or indirectly controlling, controlled by, or under common control with the other person; and (d) if the other person is an investment company, any investment adviser of that company.

2. Rule 17a–8 under the Act exempts certain mergers, consolidations, and sales of substantially all of the assets of registered investment companies that are affiliated persons, or affiliated persons of an affiliated person, solely by reason of having a common investment adviser, common directors, and/or common officers, provided, that certain conditions are satisfied.

3. Applicants state that they may not rely on rule 17a-8 because the Funds may be deemed to be affiliated persons for reasons other than those set forth in the rule. Applicants state that Principal Financial and the Adviser may be deemed to control the Funds. Also, Principal Life owns more than 5% of the total outstanding voting securities of the Acquired Fund. The Acquired Fund, pursuant to section 2(a)(3)(B) of the Act, is an affiliated person of Principal Life and Principal Financial because Principal Life has the power to vote more than 5% of the outstanding voting securities of the Acquired Fund. The Acquired Fund therefore may be an affiliated person of an affiliated person of the Acquiring Fund.

4. Section 17(b) of the Act provides, in relevant part, that the Commission may exempt a transaction from the provisions of section 17(a) if evidence establishes that the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned, and the proposed transaction is consistent with the policy of each registered investment company concerned and the general purposes of the Act.

5. Applicants request an order under section 17(b) of the Act exempting them from section 17(a) to the extent necessary to effect the Reorganization. Applicants submit that the Reorganization satisfies the conditions of section 17(b) of the Act. Applicants also state that the Boards, including all of the Independent Directors, have determined that the participation of the Funds in the Reorganization is in the best interests of each Fund and that such participation will not dilute the interests of existing shareholders of each Fund. Applicants also state that the Reorganization will be effected on the basis of relative net asset value.

For the Commission, by the Division of Investment Management, under delegated authority.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–17678 Filed 7–12–02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–46166; File No. SR–DTC–2001–14]

Self-Regulatory Organizations; the Depository Trust Company; Order Approving a Proposed Rule Change Relating to the Closing of the Mortgage-Backed Securities Division of the Depository Trust Company

July 3, 2002.

On July 24, 2001, The Depository Trust Company (''DTC'') filed with the Securities and Exchange Commission (''Commission'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''). Notice of the proposal was published in the **Federal Register** on

December 17, 2001.[1] Three comment letters were received.[2] For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

The rule change enables DTC to close its Mortgage Backed Securities Division (''MBS Division''). Among other things, the MBS Division provided the facilities for the issuance, immobilization, clearance, and settlement of mortgage-backed securities guaranteed by the Government National Mortgage Association (''GNMA''). However, in May 2000 GNMA publicly announced its decision to utilize the Fedwire system [3] of the Board of Governors of the Federal Reserve System (''Fed'') for the clearance and settlement of these mortgage-backed securities.[4] On March 23, 2002, the conversion of GNMA securities from the MBS Division to the Federal Reserve Banks was completed.

Prior to GNMA's announcement of its decision to move its securities from the MBS Division to the Federal Reserve Banks, the Ginnie Mae Settlement Task Force was organized by The Bond Market Association (''TBMA'') to assess the feasibility of the transfer. That task force consisted of representatives from broker-dealers, custodial banks, clearing banks, GNMA, the Federal Reserve Banks, the Mortgage Bankers Association, DTC, and TBMA. Followiing GNMA's announcement, the task force formed the Ginnie Mae Conversion Subcommittee to develop a conversion plan setting forth conversion details and an implementation schedule. The conversion subcommittee was comprised of representatives from broker-dealers, GNMA, the Federal Reserve Banks, DTC, clearing banks, and custodial banks. In February 2001, the subcommittee issued its Conversion Plan.[5]

The conversion took place in phases over a series of weekends beginning October 6, 2001, and ending March 23, 2002. During the conversion, different classes of GNMA securities were moved electronically from the MBS Division to the Federal Reserve Banks in accordance with delivery instructions provided to the MBS Division by the MBS Division's participants. Other securities issued through and settled at the MBS Division, namely securities guaranteed by the Department of Veterans Affairs and a limited number of FNMA and FHLMC securities that are collateralized by GNMA securities, were also moved to Federal Reserve Banks during the conversion.

Shortly after the completion of the payment of principal and interest with respect to securities last converted, DTC closed the transaction processing system of the MBS Division and returned the MBS Division participant fund deposits to the MBS Division's participants. DTC will now delete from its rules the rules that applied to the MBS Division.

Although DTC will close its MBS Division, GNMA securities remain eligible for processing at DTC and can be processed at DTC in the same manner as are other Fedwire-eligible securities. Fedwire-eligible securities processed at DTC are deposited and withdrawn free of payment to and from DTC's Fedwire account. Once deposited into DTC's Fedwire account, Fedwire-eligible securities are processed at DTC among DTC participants subject to DTC's rules and procedures applicable to other DTC-eligible fixed income securities.

In connection with the conversion of GNMA securities to the Federal Reserve Banks, DTC considered expanding its processing to permit GNMA securities to be delivered against payment into and from DTC's Fedwire account. DTC solicited comments from its participants, but fewer than a dozen participants expressed an interest in using such a service. In light of the development costs involved and the limited interest expressed by its participants, DTC's Board of Directors concluded that DTC's resources would be better applied to projects that serve a wider participant base.

II. Comments

The Commission received three comment letters. One commenter, Daniel L. Goelzer on behalf of State Street Bank and Trust Company, stated that the transfer of settlement responsibility for GNMA mortgage-backed securities from DTC to the Fedwire system would foster unfair discrimination among participants because securities settled in the Fedwire system are subject to a practice known as ''dealer time'' [6] that does not exist in DTC's MBS Division's settlement environment.[7] The commenter requested that the Commission institute proceedings under Section 19(b)(2)(B) to determine if DTC's proposed rule change should be disapproved.

Another comment letter submitted by TBMA in response to the State Street letter strongly supported the transfer of GNMA settlement to the Federal Reserve Banks and the subsequent closure of DTC's MBS Division. TBMA argued, among other things, that the proposed rule filing ''will promote the effective clearance and settlement of those securities on a basis comparable to mortgage-backed securities of other U.S. government-sponsored enterprises.'' [8] TBMA also stated that the dealer time guidelines are recommended, voluntary industry practices and are not relevant to the merits of the proposed rule change.

III. Discussion

The Commission finds that the proposed rule change is consistent with the Act's requirements and the rules and regulations thereunder and particularly with the requirements of Section 17A(b)(3)(F) of the Act.[9] Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions. Given the decision by GNMA to move its securities to the Federal Reserve Banks and use Fedwire for clearing its mortgage-backed securities, there is no reason for DTC to

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[1] Securities Exchange Act Release No. 45146 (Dec. 10, 2001), 66 FR 65014.

[2] Letters from Daniel L. Goelzer, Baker & McKenzie on behalf of State Street Bank and Trust Company (Dec. 14, 2001); Paul Saltzman, Executive Vice President and General Counsel, The Bond Market Association (Jan. 7, 2001); and Daniel L. Goelzer, Baker & McKenzie on behalf of State Street (Mar. 13, 2002).

[3] The Fedwire system is currently used for, among other things, the issuance and settlement of U.S. Treasury securities and mortgage-backed securities guaranteed by the Federal Home Loan Mortgage Corporation (''FHLMC'') and the Federal National Mortgage Association (''FNMA'').

[4] *See* 66 FR 44258 (Aug. 22, 2001) (issuance of final rule by GNMA governing payments of book-entry securities).

[5] The Conversion Plan is available online at <*www.frbservices.org*> and at <*www.bondmarkets.com/regulatory*>. A copy of the Conversion Plan is also attached as Exhibit 2 of DTC's filing [DTC Important Notice No. 1483 (Feb. 15, 2001)], which is available through the Commission's Public Reference Section or through DTC.

[6] ''Dealer time is a 15-minute window at the end of the Fed's book-entry security processing day during which dealers may make deliveries of securities to customers, but customers may not make deliveries to dealers. As a result of dealer time, institutional clients are unable to make deliveries during the last 15 minutes of the delivery day and are therefore forced to hold positions overnight and to incur significant financing costs. In contrast, dealer participants in the Fedwire system can effect delivery to non-dealers during this 15 minute period, while simultaneously enjoying protection from having to accept delivery. Just as dealer time imposes overnight financing costs on non-dealers, it afford dealers a privileged opportunity to avoid these costs by protecting dealers from receiving positions for which payment would have to be made.'' State Street letter (Dec. 14, 2000) at page 2.

[7] [7]: The purpose of the second State Street letter was to submit a letter dated March 1, 2002, from the New York Clearing House Association, the Boston Clearing House Association, and the Bank Depository Users Group to the TBMA, requesting that TBMA rescind its dealer-to-customer good delivery (*i.e.* dealer time) guidelines.

[8] TBMA letter at page 1.

[9] 15 U.S.C. 78q–1(b)(3)(F).

keep its MBS Division open. Accordingly, the proposed rule change should enable DTC to eliminate unproductive expenditures and use its resources in a more efficient manner to promote the prompt and accurate clearance and settlement of securities transactions.

The concern raised in the State Street letter regarding dealer time concerns an industry practice relating to the settlement of Fedwire-eligible securities and is not the subject of this proposed rule change.[10] Furthermore, the Fed addressed this issue in a 1995 release adopting new closing times for the Fedwire securities transfer system.[11] Responding to State Street's suggestion that the Fed also review the need for a dealer turnaround deadline, the Fed stated that ''[d]ealer-turnaround time was established by the PSA [the previous name of the BMA] as an industry guideline to promote the smooth functioning of the government securities market'' and that ''[t]he dealer-turnaround deadline had been reflected in the Federal Reserve Banks'' operating circulars; however, the Reserve Banks do not police participant activity with respect to this time.'' The Fed concluded that their action (*i.e.,* adopting new closing times) did ''not preclude the continuation of an industry standard for a dealer-turnaround time if the industry believes it is needed.'' Therefore, because GNMA securities will now be cleared and settled through the Fedwire system, commenters should direct their concerns regarding Fedwire rules to the Fed.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR–DTC–2001–14) be, and hereby is, approved.

[10] The first State Street letter acknowledged this by recognizing ''that disapproval of the DTC rule proposal * * * might not necessarily prevent the transfer of GNMA securities to the Fedwire system or compel the abolition of dealer time.'' Goelzer letter (Dec. 14, 2000) at page 7, fn 10.

[11] 60 FR 42410 (Aug. 15, 1995).

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[12]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–17679 Filed 7–12–02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–46165; File No. SR–NASD–2002–87]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to Establishing Effective Dates for NASD Rule 2711, Research Analysts and Research Reports

July 3, 2002.

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 July 1, 2002, the National Association of Securities Dealers, Inc. (''NASD'') submitted to 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 NASD. On July 3, 2002, the NASD filed Amendment No. 1 to the proposed rules change.[3] The NASD has designated the proposed rule change as constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule series under paragraph (f)(1) of Rule 19b–4 under the Act,[4] which renders the proposal effective upon filing Amendment No. 1 with the Commission. 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

Pursuant to the provisions of Section 19(b)(1) of the Act,[5] the NASD is filing with the Commission a proposed rule change to establish November 6, 2002 as the effective date for certain provisions of NASD Rule 2711. First, the proposed rule change would establish November 6, 2002 as the effective date for Rules 2711(b) and (c) for members that over the previous three years, on average, have participated in 10 or fewer investment banking transactions on underwritings as manager or co-manager and generated $5 million or less in gross investment banking revenues from those transactions. Rules 2711(b) and (c), when effective, will prohibit a research analyst from being subject to the supervision or control of any employee of a member's investment banking department, and will further require legal or compliance personnel to intermediate certain communications between the research department and either the investment banking department or the company that is the subject of a research report or recommendation (''subject company'').

Second, the proposed rule change would also establish November 6, 2002 as the effective date for Rule 2711(h)(2) as applied to the receipt of compensation by a member's foreign affiliates from a subject company. Rule 2711(h)(2), when effective, will require a member to disclose in research reports all compensation received by it or its affiliates from a subject company for investment banking services in the past 12 months, or expected to be received in the next 3 months.[6]

Third, the proposed rule change would establish November 6, 2002, subject to certain conditions, as the effective date for Rule 2711(g)(3) for those research analysts who must divest holdings to comply with their firm's more restrictive policy that prohibits analyst ownership of securities they cover. Rule 2711(g)(3), when effective, will prohibit a ''research analyst account'' from purchasing or selling a security or option or derivative of that security, in a manner contrary to the analyst's most recent published recommendation reflected in the member's research report.

[12] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] In Amendment No. 1, NASD established a further condition for delaying the implementation of Rules 2711(b) and (c) until November 6, 2002 for members that over the previous three years, on average, have participated in 10 or fewer investment banking transactions on underwritings as manager or co-manager and generated $5 million or less in gross investment banking revenues from those transactions. Amendment No. 1 requires that those firms that meet the eligibility requirements outlined above must maintain records of communications that would otherwise be subject to the gatekeeper provisions of Rules 2711(b) and (c). In Amendment No. 1, NASD also corrected several technical errors that appeared in its original filing. *See* letter from Marc Menchel, Senior Vice President and General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated July 2, 2002 (''Amendment No. 1'').

[4] 17 CFR 240.19b–4(f)(1).

[5] 15 U.S.C. 78s(b)(1).

[6] *See* Amendment No. 1, *supra* note 3.