

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>8</sup> which requires, among other things, the Exchange's rules to be designed to prevent fraudulent and manipulative acts and practices and, in general, to protect investors and the public interest. As noted above, the Exchange's proposed rule change is aimed at improving the effectiveness of audit committees of Exchange issuers, which is consistent with these goals. Accordingly, this proposal is properly within the discretion of the Exchange.

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

The Exchange believes the proposed rule change will impose no burden on competition.

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

The Exchange did not solicit or receive written comments on 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 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 Amex. All submissions should refer to the File No. SR-Amex-99-38 and should be submitted by November 3, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

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## SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-41974; File No. SR-NASD-99-52)

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to a Delay in Implementing Changes to Nasdaq Riskless Principal Trade Reporting Rules

October 4, 1999.

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 September 29, 1999, the National Association of Securities Dealers ("NASDA" or "Association"), through its wholly-owned subsidiary, Nasdaq Stock Market, Inc. ("Nasdaq"), 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 Nasdaq. Nasdaq has designated this proposal as one constituting a stated policy and interpretation with respect to the meaning of an existing rule under Section 19(b)(3)(A)(i) of the Act<sup>3</sup> and Rule 19b-4(f)(1)<sup>4</sup> thereunder, which renders the rule effective upon the Commission's receipt of this filing. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

<sup>9</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> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>4</sup> 17 CFR 240.19b-4(f)(1).

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

Nasdaq filed with the SEC a re-interpretation to NASD Rules 4632, 4642, 4652, and 6620, regarding Nasdaq riskless principal trade reporting. The purpose of this re-interpretation of NASD Rules 4632, 4642, 4652, and 6620, is to delay the effective date of the Nasdaq riskless principal trade reporting rule changes announced in SR-NASD-98-59<sup>5</sup> and the interpretation thereto file in SR-NASD-99-39.<sup>6</sup>

## II. Self-Regulatory Organization's Statement of the Purpose of and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq 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. Nasdaq 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*

On March 24, 1999, the Commission approved a proposal to amend the trade reporting rules relating to riskless principal transactions in Nasdaq National Market, Nasdaq Small Cap Market, Nasdaq convertible debt, and non-Nasdaq OTC equity securities ("Riskless Principal Rule Changes").<sup>7</sup> Under the proposed Riskless Principal Rule Changes, a "riskless" principal transaction is one where an NASD member, after having received an order to buy (sell) a security, purchases (sells) the security as principal at the same price to satisfy the order to buy (sell). The proposed rule changes provide that if a transaction is "riskless", the offsetting transaction/leg (*i.e.*, the transaction with the customer), does not need to be reported to the tape.

When the SEC approved the rule change, the Commission asked Nasdaq to submit an interpretation giving examples of how mark-ups, mark-downs, and other fees will be excluded for purposes of the amended riskless

<sup>5</sup> Securities Exchange Act Release No. 40382 (August 28, 1998), 63 FR 47337 (September 4, 1998).

<sup>6</sup> Securities Exchange Act Release No. 41731 (August 11, 1999), 64 FR 44983 (August 18, 1999).

<sup>7</sup> See Securities Exchange Act Release No. 41208 (March 24, 1999), 64 FR 15386 (March 31, 1999).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

principal rules.<sup>8</sup> As requested, on August 5, 1999, Nasdaq filed SR-NASD-99-39 with the Commission, attached to which was *Notice to Members 99-65*, which gave examples of how mark-ups and other fees will be excluded for purposes of the riskless principal trade reporting rules. SR-NASD-99-39 and *Notice to Members 99-65* were filed as an interpretation to existing NASD Rules 4632, 4642, and 6620.<sup>9</sup> In addition to giving examples of how mark-ups and other fees will be excluded for purposes of the riskless principal trade reporting rules, *Notice to Members 99-65* stated that the rule changes announced in SR-NASD-98-59 and the interpretations to those rules contained in the *Notice* would become effective on September 15, 1999.

Nasdaq is filing this proposal to delay implementation of the Nasdaq Riskless Principal Rule Changes until March 1, 2000, because a number of NASD members have represented that they are unable to prepare their systems for compliance with the changes by the September 30, 1999 deadline. The firms' inability to meet the September 30, 1999 deadline is due (in large part) to Year 2000 ("Y2K") remediation and testing requirements, as well as other code changes. In addition, the firms have represented that, due to a Y2K code freeze—which most firms will implement from September 30, 1999, until mid-January 2000—they will not be able to complete programming for the Riskless Principal Rule Changes until the end of the first quarter of 2000.

Specifically, Nasdaq received a letter dated September 3, 1999 ("September 3 Letter"),<sup>10</sup> and a letter dated August 27, 1999 ("August 27 Letter"),<sup>11</sup> in which the signatory NASD member firms requested a delay of the implementation

of the Riskless Principal Rule Changes. The August 27 Letter stated that the signatory NASD member firms ("Firms") were requesting a delay because they need additional time to implement the sophisticated software changes necessary to modify their trading systems. In addition, the August 27 Letter represented that most firms in the industry have taken the prudent step of imposing freezes on system changes beginning as early as September 15, 1999, to ensure a smooth Y2K transition. The letter further stated that meeting the September 30, 1999 implementation deadline, however, could have a significant impact on the Firms' Y2K efforts. The August 27 Letter represented that the Firms will work closely with the NASD and Nasdaq to ensure a smooth implementation of the new reporting requirement after the Firms have successfully met the challenges presented by the Y2K transition.<sup>12</sup>

The September 3 Letter stated that, given the complexity of programming changes required by the Riskless Principal Rule Changes in combination with Y2K approaching, it would be difficult for the 14 signatory firms to meet the September 30, 1999 implementation date. The letter represented that systems personnel at each of the 14 firms have indicated that the programming changes necessitated by the Riskless Principal Rule Changes are very complicated and would require significant programming and testing. The September 3 Letter stated that since the adoption of the Riskless Principal Rule Changes, the NASD has issued *Notice to Members 99-65* (August 1999), which raises several issues of application and interpretation, the resolution of which may require further programming changes. The September 3 Letter requested additional time to reasonably assure that programming changes are properly analyzed and implemented.

Nasdaq believes that a delay in the implementation of the Nasdaq Riskless Principal Rule Changes is reasonable in light of the Y2K remediation efforts, the code freeze that most NASD members will observe, and the programming changes required by the rule change. Nasdaq believes it would not be prudent or consistent with Section 15A of the Act<sup>13</sup> to require members to implement substantial system changes at a time when they are focusing significant resources and time to perform Y2K

testing to insure the integrity of their major market systems. Thus, Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)<sup>14</sup> in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

Nasdaq 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)(i)<sup>15</sup> of the Act and Rule 19b-4(f)(1) thereunder,<sup>16</sup> in that it constitutes a stated policy and interpretation with respect to the meaning of an existing rule.

At any 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. 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

<sup>8</sup> See *id.* at footnote 15.

<sup>9</sup> See Securities Exchange Act Release No. 41731 (August 11, 1999), 64 FR 44983 (August 18, 1999) (SR-NASD-99-39).

<sup>10</sup> The September 3 Letter was submitted to Robert E. Aber, Senior Vice President and General Counsel, The Nasdaq Stock Market, Inc., from Richard T. Sharp, Solomon, Zauder, Ellenhorn Frischer & Sharp, on behalf of the following NASD member firms: Banc of America Securities; Cantor Fitzgerald & Co.; Deutsche Bank Securities, Inc.; Fidelity Capital Markets; Herzog, Heine, Geduld, Inc.; J.P. Morgan Securities, Inc.; Knight Securities L.P.; Mayer & Schweitzer, Inc.; OLDE Discount Corporation; Paine Webber Incorporated; Sherwood Securities Corp.; Spear, Leeds & Leeds & Kellogg Capital Markets; Warburg Dillon Read LLC; and Weeden & Co.

<sup>11</sup> The August 27 letter was submitted to Robert E. Aber, Senior Vice President and General Counsel, The Nasdaq Stock Market, Inc., and was signed by the following NASD member firms: Merrill Lynch, Pierce, Fenner & Smith; Morgan Stanley Dean Witter; Salomon, Smith Barney; Credit Suisse First Boston Corporation; Donaldson, Luftkin & Jenrette Securities; Goldman, Sachs & Co.; and Lehman Brothers Inc.

<sup>12</sup> The letter also stated that the Firms support the rule change because it will reduce transaction fees, including SEC fees.

<sup>13</sup> 15 U.S.C. 78o-3.

<sup>14</sup> 15 U.S.C. 78o-3(b)(6).

<sup>15</sup> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>16</sup> 17 CFR 240.19b-4(f)(1).

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 File No. SR-NASD-99-52, and should be submitted by November 3, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41982; File No. SR-NASD-99-48]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Amending Nasdaq's Audit Committee Requirements

October 6, 1999.

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 September 20, 1999, 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 ("SEC" or "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 amending its definition of independence and its audit committee requirements. Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletions are in brackets.

#### Rule 4200. DEFINITIONS

(a) For purposes of the Rule 4000 Series, unless the context requires otherwise:

(1)-(14) No change

(15) "Independent director" means a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. *The following persons shall not be considered independent:*

(a) *a director who is employed by the corporation or any of its affiliates for the current year or any of the past three years;*

(b) *a director who accepts any compensation from the corporation or any of its affiliates in excess of \$60,000 during the previous fiscal year, other than compensation for board service, benefits under a tax-qualified retirement plan, or non-discretionary compensation;*

(c) *a director who is a member of the immediate family of an individual who is, or has been in any of the past three years, employed by the corporation or any of its affiliates as an executive officer. Immediate family includes a person's spouse, parents, children, siblings, mother-in-law, father-in-law, brother-in-law, sister-in-law, and anyone who resides in such person's home;*

(d) *a director who is a partner in, or a controlling shareholder or an executive officer of, any for-profit business organization to which the corporation made, or from which the corporation received, payments (other than those arising solely from investments in the corporation's securities) that exceed 5% of the corporation's or business organization's consolidated gross revenues for that year, or \$200,000, whichever is more, in any of the past three years;*

(e) *a director who is employed as an executive of another entity where any of the company's executives serve on that entity's compensation committee.*

(15)-(36) renumbered as (16)-(37)

(b) No change

#### Rule 4310. Qualification Requirements for Domestic and Canadian Securities

To qualify for inclusion in Nasdaq, a security of a domestic or Canadian issuer shall satisfy all applicable requirements contained in paragraphs (a) or (b), and (c) hereof.

(a)-(b) No change

(c) In addition to the requirements contained in paragraph (a) or (b) above,

and unless otherwise indicated, a security shall satisfy the following criteria for inclusion in Nasdaq:

(1)-(24) No change

(25) Corporate Governance

Requirements

\* \* \* \* \*

(A) No change

(B) Independent Directors

Each issuer shall maintain a [minimum of two] *sufficient number of independent directors on its board of directors to satisfy the audit committee requirement set forth in Rule 4310(c)(26)(B).*

[(C) Audit Committee

Each issuer shall establish and maintain an Audit Committee, a majority of the members of which shall be independent directors.]

(D)-(H) renumbered as (C)-(G)

(26) Audit Committee

(A) Audit Committee Charter

*Each Issuer must certify that it has adopted a formal written audit committee charter and that the Audit Committee has reviewed and reassessed the adequacy of the formal written charter on an annual basis. The charter must specify the following:*

(i) *the scope of the audit committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements;*

(ii) *the audit committee's responsibility for ensuring its receipt from the outside auditors of a formal written statement delineating all relationships between the auditor and the company, consistent with Independence Standards Board Standard 1, and the audit committee's responsibility for actively engaging in a dialogue with the auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor and for taking, or recommending that the full board take, appropriate action to ensure the independence of the outside auditor; and*

(iii) *the outside auditor's ultimate accountability to the board of directors and the audit committee, as representatives of shareholders, and these shareholder representatives' ultimate authority and responsibility to select, evaluate, and, where appropriate, replace the outside auditor (or to nominate the outside auditor to be proposed for shareholder approval in any proxy statement).*

(B) Audit Committee Composition

(i) *Each issuer must have, and certify that it has and will continue to have, an audit committee of at least three*

<sup>17</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.