

association not be designed to permit unfair discrimination between customers, issuers, brokers or dealers, and would constitute a constructive denial of access to ECNs, which would constitute, in turn, an unnecessary or inappropriate burden on competition in violation of Section 15A(b)(8) of the Act.<sup>9</sup>

In its response letter, Nasdaq acknowledged the White Cap Letter and spoke to the comments raised in the Bloomberg Letter. Nasdaq stated that Bloomberg's business decision to execute orders internally within Bloomberg's book rather than offering automatic execution on SuperMontage should not impede Nasdaq from proceeding with a market enhancement. Nasdaq suggested that there are multiple options that Bloomberg could pursue to satisfy its customers' interest in participating fully in the Nasdaq Opening Cross, such as (1) by participating in the Opening Cross on an automatic execution basis; (2) by routing standing limit orders through another participant that participates on an automatic execution basis, or (3) by discussing with Nasdaq the possibility of establishing a second market participant identifier for the entry of orders eligible to participate in the Nasdaq Opening Cross. Moreover, Nasdaq stated that the Opening Cross is inherently a "match"—matching interest of buyers and sellers at a single instant in time—and is not conducive to an iterative order delivery process, which would create substantial technical difficulties for Nasdaq and unwarranted risk for other market participants. Nasdaq pointed out that participation in the Nasdaq Opening Cross is completely voluntary and that Bloomberg is effectively excluding itself from the process.

Nasdaq stated that Bloomberg misunderstood the proposed rule change with respect to the pre-opening process, saying that Nasdaq is modifying the pre-opening process in order to improve and emphasize the official open at 9:30 a.m., and that the 9:25 a.m. opening of quotes would dramatically improve the 9:30 a.m. open, not replace it. Nasdaq also pointed out that, with respect to Nasdaq's "buried secret rules," Nasdaq has a practice of making its technical specifications publicly available far in advance of its proposed launch dates and has a natural interest in having the document widely scrutinized and used by market participants.<sup>10</sup>

Nasdaq stated that the Closing Cross has performed as it was designed and, overall has improved the Nasdaq closing process. Thus, Nasdaq believes that the Nasdaq Opening Cross will provide similar benefits to the opening process.

#### IV. Discussion and Commission's Findings

After careful consideration of the proposed rule change, the comment letters, and Nasdaq's response to the comment letters, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.<sup>11</sup> The Commission believes that the proposed rule change is consistent with Section 15A(b) of the Act,<sup>12</sup> in general, and furthers the objectives of Section 15A(b)(6),<sup>13</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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.

The Commission believes that Nasdaq has adequately addressed the comments raised in the comment letters. The Commission also believes that the proposed rule change, as amended, should provide useful information to market participants and increase transparency and order interaction at the open. In addition, the Commission believes that the proposed rule change, as amended, should result in the public dissemination of information that more accurately reflects the trading in a particular security at the open.

#### V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder applicable to a national securities association, and, in particular, Section 15A(b) of the Act.<sup>14</sup>

<sup>11</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>12</sup> 15 U.S.C. 78o-3(b).

<sup>13</sup> 15 U.S.C. 78o-3(b)(6).

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

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>15</sup> that the proposed rule change (SR-NASD-2004-071), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

Margaret H. McFarland,

*Deputy Secretary.*

[FR Doc. E4-2349 Filed 9-22-04; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50403; File No. SR-NASD-2004-110]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Divestiture of American Stock Exchange

September 16, 2004.

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 July 16, 2004, 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, II, and III below, which items have been prepared by NASD. On August 10, 2004, NASD amended the proposal.<sup>3</sup> NASD further amended the proposal on August 25, 2004,<sup>4</sup> and on September 3, 2004.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

<sup>16</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> See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated August 10, 2004 ("Amendment No. 1"). Amendment No. 1 replaced NASD's original filing in its entirety.

<sup>4</sup> See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated August 25, 2004 ("Amendment No. 2"). Amendment No. 2 replaced NASD's earlier amended filing in its entirety.

<sup>5</sup> See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated September 2, 2004 ("Amendment No. 3"). Amendment No. 3 modified Exhibit 1 and made certain technical corrections to the proposal. Amendment No. 3 replaced NASD's earlier amended filing in its entirety.

<sup>9</sup> 15 U.S.C. 78o-3(b)(8).

<sup>10</sup> Nasdaq published the technical specifications on June 17, 2004.

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

NASD is proposing to amend provisions of its By-Laws to reflect NASD's pending divestiture of its ownership interest in the American Stock Exchange LLC ("Amex"). NASD is also proposing to make parallel changes to the definitional and conflict-of-interest provisions of the By-Laws of NASD Regulation, Inc. ("NASD Regulation") and NASD Dispute Resolution, Inc. ("Dispute Resolution"), to terminate certain undertakings NASD assumed when it acquired Amex in 1998, and to make certain other clarifying amendments. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

\* \* \* \* \*

**Proposed Revisions to By-Laws of National Association of Securities Dealers, Inc.**

*Article I*

*Definitions*

\* \* \* \* \*

(n) "Industry Director" means a Director of the NASD Regulation Board or NASD Dispute Resolution Board (excluding the Presidents) who: (1) Is or has served in the prior three years as an officer, director, or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (2) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (3) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (4) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Director or 20 percent or more of the gross revenues received by the Director's firm or partnership; (5) provides professional services to a director, officer, or employee of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's, officer's, or employee's professional capacity and constitute 20

percent or more of the professional revenues received by the Director or 20 percent or more of the gross revenues received by the Director's firm or partnership; or (6) has a consulting or employment relationship with or provides professional services to the NASD, NASD Regulation, NASD Dispute Resolution, [Nasdaq,] or [Amex (and any predecessor)] *a market for which NASD provides regulation*, or has had any such relationship or provided any such services at any time within the prior three years;

(o) "Industry Governor" or "Industry committee member" means a Governor (excluding the Chief Executive Officer of the NASD and the President of NASD Regulation) or committee member who: (1) Is or has served in the prior three years as an officer, director or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (2) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (3) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (4) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Governor or committee member or 20 percent or more of the gross revenues received by the Governor's or committee member's firm or partnership; (5) provides professional services to a director, officer, or employee of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's, officer's, or employee's professional capacity and constitute 20 percent or more of the professional revenues received by the Governor or committee member or 20 percent or more of the gross revenues received by the Governor's or committee member's firm or partnership; [(6) is a Floor Governor,] or [(7)]6 has a consulting or employment relationship with or provides professional services to the NASD, NASD Regulation, NASD Dispute Resolution, [Nasdaq or Amex (and any predecessor)] *or a market for which NASD provides regulation*, or has had any such relationship or provided

any such services at any time within the prior three years;

\* \* \* \* \*

(bb) "Non-Industry Director" means a Director of the NASD Regulation Board or NASD Dispute Resolution Board (excluding the Presidents of NASD Regulation and NASD Dispute Resolution) who is: (1) a Public Director; (2) an officer or employee of an issuer of securities listed on [Nasdaq or Amex, or] *a market for which NASD provides regulation*; (3) *an officer or employee of an issuer of unlisted securities that are traded in the over-the-counter market*; or [(3)]4 any other individual who would not be an Industry Director;

(cc) "Non-Industry Governor" or "Non-Industry committee member" means a Governor (excluding the Chief Executive Officer and any other officer of the NASD, the President of NASD Regulation)[, any Floor Governor, and the Chief Executive Officer of Amex] or committee member who is: (1) A Public Governor or committee member; (2) an officer or employee of an issuer of securities listed on [Nasdaq or Amex, or] *a market regulated by NASD*; (3) *an officer or employee of an issuer of unlisted securities that are traded in the over-the-counter market*; or [(3)]4 any other individual who would not be an Industry Governor or committee member;

\* \* \* \* \*

(ee) "Public Director" means a Director of the NASD Regulation Board or NASD Dispute Resolution Board who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, NASD Dispute Resolution, or [Nasdaq] *a market for which NASD provides regulation*;

(ff) "Public Governor" or "Public committee member" means a Governor or committee member who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, NASD Dispute Resolution, or [Nasdaq] *a market for which NASD provides regulation*;

\* \* \* \* \*

[(ii) "Floor Governor" or "Amex Floor Governor" means a Floor Governor of Amex elected pursuant to Article II, Section .01(a) of the Amex By-Laws;

(jj) "Amex" means American Stock Exchange LLC; and

(kk) "Amex Board" means the Board of Governors of Amex.]

\* \* \* \* \*

*Article VII*

*Board of Governors*

\* \* \* \* \*

Composition and Qualifications of the Board

Sec. 4. (a) The Board shall consist of no fewer than [17] 15 nor more than [27] 25 Governors, comprising (i) the Chief Executive Officer of the NASD, (ii) if the Board of Governors determines, from time to time, in its sole discretion, that the appointment of a second officer of the NASD to the Board of Governors is advisable, a second officer of the NASD, (iii) the President of NASD Regulation, (iv) the Chair of the National Adjudicatory Council, [(v) the Chief Executive Officer and one Floor Governor of Amex,] and [(vi)] (v) no fewer than 12 and no more than 22 Governors elected by the members of the NASD. The Governors elected by the members of the NASD shall include a representative of an issuer of investment company shares or an affiliate of such an issuer, a representative of an insurance company, a representative of a national retail firm, a representative of a regional retail or independent financial planning member firm, a representative of a firm that provides clearing services to other NASD members, and a representative of an NASD member having not more than 150 registered persons. The number of Non-Industry Governors shall exceed the number of Industry Governors. If the number of Industry and Non-Industry Governors is [15 to 17] 13 to 15, the Board shall include at least four Public Governors. If the number of Industry and Non-Industry Governors is [18 to 19] 16-17, the Board shall include at least five Public Governors. If the number of Industry and Non-Industry Governors is [20-25] 18-23, the Board shall include at least six Public Governors.

\* \* \* \* \*

Term of Office of Governors

Sec. 5. (a) The Chief Executive Officer and, if appointed, the second officer of the NASD, and the President of NASD Regulation[, and the Chief Executive Officer of Amex] shall serve as Governors until a successor is elected, or until death, resignation, or removal (or, in addition, in the case of a second officer of the NASD, until the Board of Governors, in its sole discretion, determines that such appointment is no longer advisable).

(b) The Chair of the National Adjudicatory Council shall serve as a Governor for a term of one year, or until a successor is duly elected and qualified, or until death, resignation, disqualification, or removal. A Chair of the National Adjudicatory Council may not serve more than two consecutive

one-year terms as a Governor, unless a Chair of the National Adjudicatory Council is appointed to fill a term of less than one year for such office. In such case, the Chair of the National Adjudicatory Council may serve an initial term as a Governor and up to two consecutive one-year terms as a Governor following the expiration of such initial term. After serving as a Chair of the National Adjudicatory Council, an individual may serve as a Governor elected by the members of the NASD.

[(c) The Amex Floor Governor shall serve as a Governor for a term of two years, or until a successor is duly elected and qualified, or until death, resignation, disqualification, or removal. An Amex Floor Governor may not serve more than three consecutive two-year terms as a Governor, unless such Amex Floor Governor is appointed to fill a term of less than one year for such office. In such case, the Amex Floor Governor may serve that initial term as a Governor and up to three consecutive two-year terms as a Governor following the expiration of the initial term.]

(c [d]) The Governors elected by the members of the NASD shall be divided into three classes and hold office for a term of no more than three years, such term to be fixed by the Board at the time of the nomination or certification of each such Governor, or until a successor is duly elected and qualified, or until death, resignation, disqualification, or removal. A Governor elected by the members of the NASD may not serve more than two consecutive terms. If a Governor is elected by the Board to fill a term of less than one year, the Governor may serve up to two consecutive terms following the expiration of the Governor's initial term. The term of office of Governors of the first class shall expire at the January 1999 Board meeting, of the second class one year thereafter, and of the third class two years thereafter. At each annual election, commencing January 1999, Governors shall be elected for a term of three years to replace those whose terms expire.

\* \* \* \* \*

Article IX

Committees

\* \* \* \* \*

Executive Committee

Sec. 4. (a) The Board may appoint an Executive Committee, which shall, to the fullest extent permitted by the General Corporation Law of the State of Delaware and other applicable law, have and be permitted to exercise all the

powers and authority of the Board in the management of the business and affairs of the NASD between meetings of the Board, and which may authorize the seal of the NASD to be affixed to all papers that may require it.

(b) The Executive Committee shall consist of no fewer than [six]five and no more than [nine]eight Governors. The Executive Committee shall include the Chief Executive Officer of the NASD, and at least one Director of NASD Regulation. [, at least one Governor of Amex, and at least two Governors who are not members of either the NASD Regulation Board, or the Amex Board.] The Executive Committee shall have a percentage of Non-Industry committee members at least as great as the percentage of Non-Industry Governors on the whole Board and a percentage of Public committee members at least as great as the percentage of Public Governors on the whole Board.

(c) An Executive Committee member shall hold office for a term of one year.

(d) At all meetings of the Executive Committee, a quorum for the transaction of business shall consist of a majority of the Executive Committee, including not less than 50 percent of the Non-Industry committee members. In the absence of a quorum, a majority of the committee members present may adjourn the meeting until a quorum is present.

\* \* \* \* \*

Article XV

Limitation of Powers

\* \* \* \* \*

Conflicts of Interest

Sec. 4. (a) A Governor or a member of a committee shall not directly or indirectly participate in any adjudication of the interests of any party if such Governor or committee member has a conflict of interest or bias, or if circumstances otherwise exist where his or her fairness might reasonably be questioned. In any such case, the Governor or committee member shall recuse himself or herself or shall be disqualified in accordance with the Rules of the Association.

(b) No contract or transaction between the NASD and one or more of its Governors or officers, or between the NASD and any other corporation, partnership, association, or other organization in which one or more of its Governors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason if: (i) The material facts pertaining to such Governor's or officer's relationship or interest and the contract or transaction are disclosed or

are known to the Board or the committee, and the Board or committee in good faith authorizes the contract or transaction by the affirmative vote of a majority of the disinterested Governors, even though the disinterested governors be less than a quorum; or (ii) the material facts are disclosed or become known to the Board or committee after the contract or transaction is entered into, and the Board or committee in good faith ratifies the contract or transaction by the affirmative vote of a majority of the disinterested Governors even though the disinterested governors be less than a quorum. Only disinterested Governors may be counted in determining the presence of a quorum at the portion of a meeting of the Board or of a committee that authorizes the contract or transaction. This subsection shall not apply to any contract or transaction between the NASD and NASD Regulation, Nasdaq, or NASD Dispute Resolution[, or Amex].

\* \* \* \* \*

**Proposed Revisions to By-Laws of NASD Regulation, Inc.**

*Article I*

*Definitions*

\* \* \* \* \*

(q) "Industry Director" or "Industry member" means a Director (excluding the President of NASD Regulation and the Chief Executive Officer of NASD) or a National Adjudicatory Council or committee member who (1) is or has served in the prior three years as an officer, director, or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (2) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (3) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (4) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership; (5) provides professional services to a director, officer, or

employee of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's, officer's, or employee's professional capacity and constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership; or (6) has a consulting or employment relationship with or provides professional services to the NASD, NASD Regulation, [Nasdaq,] NASD Dispute Resolution, or [Amex (and any Predecessor),] *a market for which NASD provides regulation*, or has had any such relationship or provided any such services at any time within the prior three years;

\* \* \* \* \*

(y) "Non-Industry Director" or "Non-Industry member" means a Director (excluding the President of NASD Regulation and the Chief Executive Officer of NASD) or a National Adjudicatory Council or committee member who is (1) a Public Director or Public member; (2) an officer or employee of an issuer of securities listed on [Nasdaq or Amex,] *a market for which NASD provides regulation*; (3) *an officer or employee of an issuer of unlisted securities that are traded in the over-the-counter market*; or [(3)](4) any other individual who would not be an Industry Director or Industry member;

\* \* \* \* \*

(aa) "Public Director" or "Public member" means a Director or National Adjudicatory Council or committee member who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, or [Nasdaq,] *a market for which NASD provides regulation*;

\* \* \* \* \*

[(dd) "Floor Governor" or "Amex Floor Governor" means a Floor Governor of Amex elected pursuant to Article I, Section 01(a) of the Amex By-Laws;

(ee) "Nasdaq-Amex" means Nasdaq-Amex Market Group, Inc.;

(ff) "Amex" means American Stock Exchange LLC;

(gg) "Amex Board" means the Board of Governors of Amex.];

\* \* \* \* \*

*Article IV*

*Board of Directors*

\* \* \* \* \*

Sec. 4.14 (a) Conflicts of Interest; Contracts and Transactions Involving Directors

Sec. 4.14 (a) A Director or a National Adjudicatory Council or committee member shall not directly or indirectly participate in any adjudication of the interests of any party if that Director or National Adjudicatory Council or committee member has a conflict of interest or bias, or if circumstances otherwise exist where his or her fairness might reasonably be questioned. In any such case, the Director or National Adjudicatory Council or committee member shall recuse himself or herself or shall be disqualified in accordance with the Rules of the Association.

(b) No contract or transaction between NASD Regulation and one or more of its Directors or officers, or between NASD Regulation and any other corporation, partnership, association, or other organization in which one or more of its Directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason if: (i) the material facts pertaining to such Director's or officer's relationship or interest and the contract or transaction are disclosed or are known to the Board or the committee, and the Board or committee in good faith authorizes the contract or transaction by the affirmative vote of a majority of the disinterested Directors; (ii) the material facts are disclosed or become known to the Board or committee after the contract or transaction is entered into, and the Board or committee in good faith ratifies the contract or transaction by the affirmative vote of a majority of the disinterested Directors; or (iii) the material facts pertaining to the Director's or officer's relationship or interest and the contract or transaction are disclosed or are known to the stockholder entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholder. Only disinterested Directors may be counted in determining the presence of a quorum at the portion of a meeting of the Board or of a committee that authorizes the contract or transaction. This subsection shall not apply to a contract or transaction between NASD Regulation and[:] the NASD, *NASD Dispute Resolution*, or Nasdaq[, Nasdaq-Amex, or Amex].

\* \* \* \* \*

## Proposed Amendments to By-Laws of NASD Dispute Resolution, Inc.

### Article I

#### Definitions

When used in these By-Laws, unless the context otherwise requires, the term:

(a) "Act" means the Securities Exchange Act of 1934, as amended;

[(b) "Amex" means American Stock Exchange LLC;]

(b) [(c)] "Board" means the Board of Directors of NASD Dispute Resolution;

(c) [(d)] "broker" shall have the same meaning as in Section 3(a)(4) of the Act;

(d) [(e)] "Commission" means the Securities and Exchange Commission;

(e) [(f)] "day" means calendar day;

(f) [(g)] "dealer" shall have the same meaning as in Section 3(a)(5) of the Act;

(g) [(h)] "Delaware law" means the General Corporation Law of the State of Delaware;

(h) [(i)] "Delegation Plan" means the "Plan of Allocation and Delegation of Functions by NASD to Subsidiaries" as approved by the Commission, and as amended from time to time;

(i) [(j)] "Director" means a member of the Board, excluding the Chief Executive Officer of the NASD;

(j) [(k)] "Executive Representative" means the executive representative of an NASD member appointed pursuant to Article IV, Section 3 of the NASD By-Laws;

(k) [(l)] "Industry Director" or "Industry member" means a Director (excluding the President) or a committee member who (1) is or has served in the prior three years as an officer, director, or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (2) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (3) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (4) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership; (5) provides professional

services to a director, officer, or employee of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's, officer's, or employee's professional capacity and constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership; or (6) has a consulting or employment relationship with or provides professional services to the NASD, NASD Regulation, [Nasdaq,] NASD Dispute Resolution, or [Amex (and any predecessor),] *a market for which NASD provides regulation*, or has had any such relationship or provided any such services at any time within the prior three years;

(l) [(m)] "NASD" means the National Association of Securities Dealers, Inc.;

(m) [(n)] "NASD Board" means the NASD Board of Governors;

(n) [(o)] "NASD Dispute Resolution" means NASD Dispute Resolution, Inc.;

(o) [(p)] "NASD member" means any broker or dealer admitted to membership in the NASD;

(p) [(q)] "NASD Regulation" means NASD Regulation, Inc.;

(q) [(r)] "Nasdaq" means The Nasdaq Stock Market, Inc.;

[(s) "Nasdaq-Amex" means Nasdaq-Amex Market Group, Inc.;

(r) [(t)] "National Nominating Committee" means the National Nominating Committee appointed pursuant to Article VII, Section 9 of the NASD By-Laws;

(s) [(u)] "Non-Industry Director" or "Non-Industry member" means a Director (excluding the President) or committee member who is (1) a Public Director or Public member; (2) an officer or employee of an issuer of securities listed on [Nasdaq or Amex, or] *a market for which NASD provides regulation*; (3) *an officer or employee of an issuer of unlisted securities that are traded in the over-the-counter market*; or [(3)](4) any other individual who would not be an Industry Director or Industry member;

(t) [(v)] "person associated with a member" or "associated person of a member" means: (1) A natural person registered under the Rules of the Association; or (2) a sole proprietor, partner, officer, director, or branch manager of a member, or a natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is

registered or exempt from registration with the NASD under these By-Laws or the Rules of the Association;

(u) [(w)] "Public Director" or "Public member" means a Director or committee member who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, [Nasdaq,] *a market for which NASD provides regulation*, or NASD Dispute Resolution;

(v) [(x)] "Rules of the Association" or "Rules" means the numbered rules set forth in the NASD Manual beginning with the Rule 0100 Series, as adopted by the NASD Board pursuant to the NASD By-Laws, as hereafter amended or supplemented.

\* \* \* \* \*

### Article IV

#### Board of Directors

\* \* \* \* \*

#### Conflicts of Interest; Contracts and Transactions Involving Directors

Sec. 4.14(a) A Director or a committee member shall not directly or indirectly participate in any determinations regarding the interests of any party if that Director or committee member has a conflict of interest or bias, or if circumstances otherwise exist where his or her fairness might reasonably be questioned. In any such case, the Director or committee member shall recuse himself or herself or shall be disqualified in accordance with the Rules of the Association.

(b) No contract or transaction between NASD Dispute Resolution and one or more of its Directors or officers, or between NASD Dispute Resolution and any other corporation, partnership, association, or other organization in which one or more of its Directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason if: (i) The material facts pertaining to such Director's or officer's relationship or interest and the contract or transaction are disclosed or are known to the Board or the committee, and the Board or committee in good faith authorizes the contract or transaction by the affirmative vote of a majority of the disinterested Directors; (ii) the material facts are disclosed or become known to the Board or committee after the contract or transaction is entered into, and the Board or committee in good faith ratifies the contract or transaction by the affirmative vote of a majority of the disinterested Directors; or (iii) the material facts pertaining to the Director's or officer's relationship or interest and the contract or transaction are disclosed or are known to the

stockholder entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholder. Only disinterested Directors may be counted in determining the presence of a quorum at the portion of a meeting of the Board or of a committee that authorizes the contract or transaction. This subsection shall not apply to a contract or transaction between NASD Dispute Resolution and the NASD, NASD Regulation, or Nasdaq[, Nasdaq-Amex, or Amex].

\* \* \* \* \*

## 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 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. 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

The proposed rule change will reverse a number of changes that NASD made to the By-Laws of NASD, NASD Regulation, and Dispute Resolution in 1998, when NASD acquired Amex. In addition, NASD proposes to withdraw certain representations it made in 1998 regarding its relationship with Amex following the Amex acquisition. Finally, NASD proposes to make certain other clarifying changes.

#### Proposed NASD By-Law Revisions

The proposed NASD By-Law changes are discussed briefly below. Where noted, parallel changes will be made to the By-Laws of NASD Regulation and Dispute Resolution.

#### Article I (Definitions)

The amendments will eliminate references to both Amex and Nasdaq from the definitions of "Industry Director" and "Industry Governor," "Non-Industry Director" and "Non-Industry Governor," "Public Director" and "Public Governor." The current references to Nasdaq and Amex will be replaced with references to "a market for which NASD provides regulation." For example, the definition of "Industry

Governor" currently includes persons with a consulting or employment relationship with NASD, NASD Regulation, NASD Dispute Resolution, Nasdaq, or Amex. Under the proposed amendments, the "Industry Governor" definition will include persons with a consulting or employment relationship with "a market regulated by NASD," a term that embraces markets with which NASD has entered a contract to provide regulatory services, but in which NASD does not necessarily have an ownership interest. Because NASD has entered into a regulatory services agreement with Amex, and continues to provide regulatory services to Nasdaq, for example, the amended definition of "Industry Governor" will continue to encompass individuals who have a consulting or employment relationship with Amex or Nasdaq. NASD believes that, given the difficulty and expense involved in amending the NASD By-Laws when regulatory clients are added or deleted, substituting "a market regulated by NASD" is preferable to identifying such clients by name in the By-Laws.

In addition, clarifying amendments are proposed for the definitions of "Non-Industry Director" and "Non-Industry Governor," which currently include an officer or employee of an issuer of securities "traded in the over-the-counter market." Historically, NASD has interpreted this provision as applying only to officers and employees of unlisted securities traded in the over-the-counter market; NASD has never applied the provision to include officers and employees of listed securities that were traded off-exchange. However, since both listed and unlisted securities may be traded in the over-the-counter market, Article I, Sections (bb) and (cc) have been amended to reflect NASD's historical interpretation of the definitions. The proposed amendments make no substantive change to the definitions; rather, the amendments simply seek to clarify that (renumbered) Subsections 3 of the "Non-Industry Director" and "Non-Industry Governor" definitions include an officer or employee of only an issuer of unlisted securities that are traded exclusively in the over-the-counter market.

Finally, the definitions of and references to "Floor Governor," "Amex," and "Amex Board" have been eliminated.

Parallel changes are proposed for the definitional provisions of the NASD Regulation and Dispute Resolution By-Laws.

#### Article VII (Board of Governors)

The proposed amendments will eliminate two seats on the NASD Board that have been reserved for the Chief Executive of Amex and an Amex Floor Governor. The elimination of these seats will permit NASD to reduce the overall size of the Board. The current authorized size of the Board is between 17 and 27 members. With the elimination of the Amex seats, the authorized size of the Board will be reduced to between 15 and 25.

The proposed amendments will leave unchanged the existing requirement that the NASD Board include a minimum of four to six Public Governors. However, the numeric thresholds for these minimums will be adjusted downward to reflect the smaller overall Board size. For example, the By-Laws currently require a minimum of four Public Governors when the combined number of Industry and Non-Industry Governors is 15 to 17; under the proposed amendments, a minimum of four Public Governors will be required when the combined number of Industry and Non-Industry Governors is 13 to 15.

No change is proposed to the existing requirement that the number of Non-Industry Governors exceed the number of Industry Governors.

Under Delaware law, the NASD Board determines how many of the authorized seats should be filled. Because smaller boards tend to function more efficiently than larger boards, NASD has repeatedly stated a preference to avoid filling all authorized seats if the compositional requirements set forth in the By-Laws can be met without the maximum permissible number of Governors.

In addition, the proposed amendments will eliminate from Section 5 of Article VII the provision that sets the maximum permissible term of the Amex Floor Governor.

#### Article IX (Committees)

Article IX establishes the NASD Executive Committee, which is authorized to act on behalf of the NASD Board between meetings of the NASD Board. Currently, the committee must include six to nine members, at least one of whom must be an Amex representative, but at least two of whom may not be members of the boards of either NASD Regulation or the Amex.

The proposed amendments will reduce the authorized size range of the committee by one, and eliminate the requirement that an Amex representative be included on the committee. The proposed amendments also will eliminate the current requirement that at least two members

of the committee be members of neither the Amex nor NASD Regulation boards. NASD notes that requiring at least two NASD-only members of the Executive Committee appears to have responded to concerns that arose when there were multiple subsidiaries (at various times Nasdaq, Amex, and/or NASD Regulation) that were entitled to representation on both the NASD Board and the Executive Committee.<sup>6</sup>

NASD notes that avoiding possible domination of NASD affairs by market interests, and a corresponding diminution of NASD's performance of its regulatory responsibilities, has represented a primary consideration in NASD corporate governance since the Select Committee Report was issued in 1995.<sup>7</sup> With the elimination of "status" seats reserved for Nasdaq and Amex representatives, however, NASD believes concerns that these markets could dominate NASD decision-making also are eliminated.

The elimination of mandatory market representation on the Executive Committee will leave NASD Regulation as the sole remaining subsidiary entitled to be represented on the committee. Under the proposed rule change, NASD Regulation will continue to be entitled to at least one representative on the Executive Committee. However, because NASD believes the possibility that regulatory interests could improperly dominate NASD decision making would not raise the same concerns as the possibility of market-interest domination, the proposed amendments do not specify any minimum number of NASD-only Governors who must be included on the Executive Committee. NASD believes that the proposed changes to the Executive Committee

composition are consistent with the Select Committee Report and the Section 21(a) Report.

#### *Article XV (Limitation of Powers)*

Subsection 4(b) of Article XV governs participation in transactions in which Governors have a conflict of interest. The subsection currently does not apply to contracts or transactions between NASD and NASD Regulation, Nasdaq, NASD Dispute Resolution, or Amex. The proposed amendments will eliminate Amex from this exemptive provision. As a result of this change, an Amex-affiliated Governor could no longer be counted as disinterested for purposes of determining the presence of a quorum at the portion of a meeting of the Board that authorizes a contract or transaction with Amex.

Parallel changes are proposed for the conflict-of-interest provisions of the NASD Regulation and Dispute Resolution By-Laws.

#### *1998 Undertakings Regarding NASD-Amex Relationship*

In 1998, NASD articulated certain principles that would guide the organization in fulfilling its responsibilities as parent company of Amex with ultimate responsibility for Amex's compliance with its statutory responsibilities as a self-regulatory organization ("SRO").<sup>8</sup> Upon completion of NASD's divestiture of its ownership interest in Amex, these principles will no longer be applicable. Instead, the NASD-Amex relationship will be governed by the regulatory services agreement into which the organizations have entered. Because the Commission approved the 1998 undertakings as NASD rules,<sup>9</sup> NASD now seeks the Commission's approval of the withdrawal of the undertakings.

<sup>8</sup> Among other things, NASD represented that it would exercise its powers and its managerial influence to ensure that Amex fulfilled its self-regulatory obligations by directing Amex to take action necessary to effectuate its purposes and functions as a national securities exchange operating pursuant to the Act, and ensuring that Amex had and appropriately allocated such financial, technological, technical, and personnel resources as may be necessary or appropriate to meet its obligations under the Act. NASD also committed to refraining from taking any action with respect to Amex that would impede efforts by Amex to carry out its SRO obligations. See Exchange Act Release No. 40443 (September 16, 1998), 63 FR 51108 (September 24, 1998) (File No. SR-NASD-98-67—Policies Regarding Authority Over American Stock Exchange LLC and Composition of Board of Governors of American Stock Exchange LLC).

<sup>9</sup> See Exchange Act Release No. 40622 (October 30, 1998), 63 FR 59819 (November 5, 1998) (describing NASD's undertakings regarding Amex).

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of section 15A(b)(4) of the Act<sup>10</sup> which requires, among other things, that NASD's rules assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of NASD, broker or dealer. NASD also believes the proposed rule change is consistent with section 15A(b)(6) of the Act,<sup>11</sup> which requires that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and protect investors and the public interest.

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

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

#### *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

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. Comments may be submitted by any of the following methods:

<sup>10</sup> 15 U.S.C. 78o-3(b)(4).

<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

<sup>6</sup> In 1997, NASD made extensive modifications to its corporate documents in response to the Report of the Select Committee on Structure and Governance to the NASD Board of Governors ("Select Committee Report") and the Commission's 1996 Report Pursuant to Section 21(a) of the Act ("Section 21(a) Report"). Among other things, Article IX, Section 4 was amended to authorize the appointment of the Executive Committee. The 1997 amendments included requirements that: (i) Nasdaq and NASD Regulation be represented on the committee; and (ii) at least two of the committee members not be affiliated with those subsidiaries. See Exchange Act Release No. 39326 (November 14, 1997), 62 FR 62385 (November 21, 1997). Following the acquisition of Amex in 1998, Amex was added to the entities entitled to representation on the committee. See Exchange Act Release No. 40622 (October 30, 1998), 63 FR 59819 (November 5, 1998). Nasdaq's right to representation on the committee was terminated in 2001. See Exchange Act Release No. 44280 (May 8, 2001), 66 FR 26892 (May 15, 2001).

<sup>7</sup> Telephone conversation between Anne H. Wright, Associate Vice President and Associate General Counsel, NASD and Rebekah C. Liu, Special Counsel, Division, Commission, on September 13, 2004.

*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](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2004-110 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-110. 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the 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 File Number SR-NASD-2004-110 and should be submitted on or before October 14, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. E4-2354 Filed 9-22-04; 8:45 am]

**BILLING CODE 8010-01-P**

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-50404; File No. SR-NYSE-2004-33]

**Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto To Amend Exchange Rule 345A ("Continuing Education for Registered Persons")**

September 16, 2004.

On June 28, 2004, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change, 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> to rescind all currently effective exemptions from required participation in the Regulatory Element programs. On August 4, 2004, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change, as amended, was published for comment in the **Federal Register** on August 17, 2004.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

NYSE Rule 345A currently provides, in part, that no member or member organization shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person, unless such person has complied with the Regulatory Element of the continuing education requirement set forth in this Rule.<sup>5</sup> The Regulatory Element component of NYSE Rule 345A requires each registered person to complete a standardized, computer-based, interactive continuing education program within 120 days of their second registration anniversary date and every three years thereafter, or as otherwise prescribed by the Exchange. Persons who fail to complete the Regulatory Element are deemed inactive and may not perform in any capacity or be compensated in any way requiring registration.

Currently, registered persons who were continuously registered, without a

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Darla Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated August 3, 2004 ("Amendment No. 1"). In Amendment No. 1, the NYSE made technical corrections and clarifications to the filing.

<sup>4</sup> See Securities Exchange Act Release No. 50177 (August 10, 2004), 69 FR 51134 (August 17, 2004).

<sup>5</sup> See NYSE Rule 345A(a).

serious disciplinary action,<sup>6</sup> for more than ten years as of the Rule's effective date (*i.e.*, July 1, 1995) were initially, and continue to be, exempt from Regulatory Element requirements under NYSE Rule 345A. The "graduated" exemption, although discontinued as of July 1998,<sup>7</sup> continues to apply to registered persons who were "graduated"<sup>8</sup> prior to the discontinuation of the exemption.

However, in response to recommendations made by the Securities Industry/Regulatory Council on Continuing Education (the "Council"), the NYSE submitted a proposed rule change to rescind all currently effective exemptions from required participation in Regulatory Element programs.<sup>9</sup> The Council believes that there is great value in exposing all registered industry participants to the full benefit of Regulatory Element programs.

Proposed amendments are expected to become effective on April 4, 2005, due to changes that would have to be made to the CRD System. Should the necessary CRD System changes be delayed, the effective date would be within 30 days of the implementation of such changes. NYSE membership will be notified via an Information Memo.

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of section 6 of the Act,<sup>10</sup> and the rules and regulations thereunder applicable to a national securities exchange.<sup>11</sup> In particular, the Commission finds that the proposed rule change is consistent

<sup>6</sup> For purposes of NYSE Rule 345A, a "disciplinary action" includes statutory disqualification as defined in Section 3(a)(39) of the Act; suspension or imposition of a fine of \$5,000 or more; or being subject to an order from a securities regulator to re-enter the Regulatory Element program. See Rule 345A(a)(3)(i)-(iii).

<sup>7</sup> See Securities Exchange Act Release No. 39712 (March 3, 1998), 63 FR 11939 (March 11, 1998) (SR-NYSE-97-33).

<sup>8</sup> Once the tenth anniversary program requirement was satisfied, the registered person became exempt from Regulatory Element requirements going forward (absent a serious disciplinary event).

<sup>9</sup> The Council recommended at its December 2003 meeting that SRO Rules (*e.g.*, NYSE Rule 345A) be amended to eliminate existing exemptions from the Regulatory Element and to require all "grandfathered" and "graduated" persons to fully participate in future standardized continuing education programs, according to the Rule's prescribed schedule. See proposed NYSE Rule 345A(a)(1). Note that the proposed amendments renumber existing paragraphs of the Rule; the Rule's prescribed schedule is currently found in NYSE Rule 345A(a).

<sup>10</sup> 15 U.S.C. 78f(6).

<sup>11</sup> In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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