

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 CBOE. All submissions should refer to File No. SR-CBOE-01-03 and should be submitted by March 27, 2001.

V. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of Section 6 of the Act. Among other provisions, section 6(b)(5) of the Act requires that the rules of an exchange be designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating securities transactions; remove impediments to and perfect the mechanism of a free and open market and a national securities system; and protect investors and the public interest.¹²

Pursuant to section 19(b)(2)¹³ of the Act, the Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice thereof in the **Federal Register**.¹⁴ The Commission believes that granting accelerated approval will provide the CBOE will flexibility to compete for order flow with other exchanges immediately.¹⁵

While increasing the maximum order size limit from seventy-five to one hundred contracts for automatic execution eligibility by itself does not raise concerns under the Act, the Commission believes that this increase raises collateral issues that the CBOE

will need to monitor and address. Increasing the maximum order size for particular option classes will make a larger number of option orders eligible for RAES. These orders may benefit from greater speed of execution, but at the same time create greater risks for market maker participants. Market makers signed onto RAES will be exposed to the financial risks associated with larger-sized orders being routed through the system for automatic execution at the displayed price. When the market for the underlying security changes rapidly, it may take a few moments for the related option's price to reflect that change. In the interim, customers may submit orders that try to capture the price differential between the underlying security and the option. The larger the orders accepted through RAES, the greater the risk market makers must be willing to accept. The Commission does not believe that, because the CBOE's appropriate FPC determines to approve orders as large as one hundred as eligible for RAES, the FPC or any other CBOE committee or officials should disengage RAES more frequently by, for example, declaring a "fast" market. Disengaging RAES can negatively affect investors by making it slower and less efficient to execute their option orders. It is the Commission's view that the CBOE, when increasing the maximum size of orders that can be sent through their respective automatic execution systems, should not disadvantage all customers—the vast majority of whom enter orders for less than one hundred contracts—by making their automatic execution systems less reliable.

It Is Therefore Ordered, pursuant to section 19(b)(2) of the Act,¹⁶ that the proposed change (SR-CBOE-01-03) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44004; File No. SR-NASD-01-06]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Amending the NASD By-Laws

February 26, 2001.

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 December 17, 1999, 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 the NASD. The NASD submitted Amendment No. 1 on February 5, 2001,³ and Amendment No. 2 on February 26, 2001.⁴ The Commission is publishing this notice, as amended, 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

The NASD is proposing to amend its By-Laws to address several corporate governance issues, including the treatment of staff Governors for purposes of Industry/Non-Industry balancing on the NASD's Board of Governors (the "Board"); the role of the National Nominating Committee ("NNC") in contested elections; the petition process by which individuals and slates can be included in the election process; the industry classifications that must be represented on the Board; and other clarifying amendments, including the addition of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Letter from T. Grant Callery, Senior Vice President and General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated February 2, 2001 ("Amendment No. 1"). In Amendment No. 1 the NASD provided the final ballot summary of the membership vote regarding the proposed amendments to the NASD By-Laws, indicating that the NASD membership approved the proposed amendments.

⁴ Letter from T. Grant Callery, Senior Vice President and General Counsel, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated February 23, 2001 ("Amendment No. 2"). In Amendment No. 2 the NASD amended proposed Article VII, Section 10(a)(ii) of the By-Laws to state "(ii) in the case of petitions in support of more than one person, petitions in support of the nominations of such persons duly executed by ten percent of the members."

¹² 15 U.S.C. 78f(b)(5).

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁵ See *supra* note 11.

¹⁶ 15 U.S.C. 78s(b)(2).

¹⁷ 17 CFR 200.30-3(a)(12).

certain definitions. Additionally, the amendments reflect the new NASD corporate structure, including the impending separation of The Nasdaq Stock Market, Inc. ("Nasdaq") and NASD and the creation of NASD Dispute Resolution, Inc., a wholly owned subsidiary of the NASD.

Below is the text of the proposed rule change, as amended. Proposed new language is in italics; proposed deletions are in brackets.

By-Laws of the National Association of Securities Dealers, Inc.

Article I—Definitions

(n) "Industry Director" means a Director of the NASD Regulation Board or [Nasdaq] *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), 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 [and Chief Operating Officer of the NASD, the Presidents of NASD Regulation and Nasdaq, and the Chief Executive Officer of Amex]) *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) 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 has had any such relationship or provided any such services at any time within the prior three years;

(v) "*NASD Dispute Resolution*" means *NASD Dispute Resolution, Inc.*;

(w) "Nasdaq" means The Nasdaq Stock Market, Inc.;

[(w) "Nasdaq Board" means the Board of Directors of Nasdaq;

(x) "Nasdaq Listing and Hearing Review Council" means a body

appointed pursuant to Article V of the Nasdaq By-Laws;

[(y)] (x) "NASD Regulation" means NASD Regulation, Inc.;

[(z)] (y) "NASD Regulation Board" means the Board of Directors of NASD Regulation;

[(aa)] (z) "National Adjudicatory Council" means a body appointed pursuant to Article V of the NASD Regulation By-Laws;

[(bb)] (aa) "National Nominating Committee" means the National Nominating Committee appointed pursuant to Article VII, Section 9 of these By-Laws;

[(cc)] (bb) "Non-Industry Director" means a Director of the NASD Regulation Board or [Nasdaq] *NASD Dispute Resolution* Board (excluding the Presidents of NASD Regulation and [Nasdaq]) *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 traded in the over-the-counter market; or (3) any other individual who would not be an Industry Director;

[(dd)] (cc) "Non-Industry Governor" or "Non-Industry committee member" means a Governor (excluding the Chief Executive Officer and [Chief Operating Officer] *any other officer* of the NASD [and], the [Presidents] *President* of NASD Regulation [and Nasdaq], 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 traded in the over-the-counter market; or (3) any other individual who would not be an Industry Governor or committee member;

[(ee)] (dd) "person associated with a member" or "associated person of a member" means: (1) a natural person who is registered or has applied for registration under the Rules of the Association; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other 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; and (3) for purposes of Rule 8210, any other person listed in Schedule A of Form BD of a member;

[(ff)] (ee) "Public Director" means a Director of the NASD Regulation Board or [Nasdaq Board] *NASD Dispute*

Resolution who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, *NASD Dispute Resolution*, or Nasdaq; [(gg)] (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;

[(hh)] (gg) "registered broker, dealer, municipal securities broker or dealer, or government securities broker or dealer" means any broker, dealer, municipal securities broker or dealer, or government securities broker or dealer which is registered with the Commission under the Act; [and

[(ii)] (hh) "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 Board pursuant to these By-Laws, as hereafter amended or supplemented[.];

[(jj)] (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;

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

[(ll)] (ii) "Amex" means American Stock Exchange LLC; and

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

Article IV—Membership

Application for Membership

Sec. 1. (a) Application for membership in the NASD, properly signed by the applicant, shall be made to the NASD via electronic process or such other process as the NASD may prescribe, on the form to be prescribed by the NASD, and shall contain:

(1) an agreement to comply with the federal securities laws, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board and the Treasury Department, the By-Laws of the NASD, NASD Regulations, and [Nasdaq] *NASD Dispute Resolution*, the Rules of the Association, and all rulings, orders, directions, and decisions issued and sanctions imposed under the Rules of the Association;

Article V—Registered Representatives and Associated Persons

Application for Registration

Sec. 2. (a) Application by any person for registration with the NASD, properly signed by the applicant, shall be made to the NASD via electronic process or such other process as the NASD may prescribe, on the form to be prescribed by the NASD and shall contain:

(1) an agreement to comply with the federal securities laws, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board and the Treasury Department, By-Laws of the NASD, NASD Regulation, and [Nasdaq] *NASD Dispute Resolution*, the Rules of the Association, and all rulings, orders, directions, and decisions issued and sanctions imposed under the Rules of the Association; and

Article VI—Dues, Assessments, and Other Charges

Power of the NASD to Fix and Levy Assessments

Sec. 1. The NASD shall prepare an estimate of the funds necessary to defray reasonable expenses of administration in carrying on the work of the NASD each fiscal year, and on the basis of such estimate, shall fix and levy the amount of admission fees, dues, assessments, and other charges to be paid by members of the NASD and issuers and any other persons using any facility or system which the NASD, NASD Regulation[, or Nasdaq] or *NASD Dispute Resolution* operates or controls. Fees, dues, assessments, and other charges shall be called and payable as determined by the NASD from time to time; provided, however, that such admission fees, dues, assessments, and other charges shall be equitably allocated among members and issuers and any other persons using any facility or system which the NASD operates or controls. The NASD may from time to time make such changes or adjustments in such fees, dues, assessments, and other charges as it deems necessary or appropriate to assure equitable allocation of due among members. In the event of termination of membership or the extension of any membership to a successor organization during any fiscal year for which an assessment has been levied and become payable, the NASD may make such adjustment in the fees, dues, assessments, or other charges payable by any such member or successor organization or organizations during such fiscal years as it deems fair and appropriate in the circumstances.

Article VII—Board of Governors

Powers and Authority of Board

Sec. 1. (a) The Board shall be the governing body of the NASD and, except as otherwise provided by applicable law, the Restated Certificate of Incorporation, or these By-Laws, shall be vested with all powers necessary for the management and administration of the affairs of the NASD and the promotion of the NASD's welfare, objects, and purposes. In the exercise of

such powers, the Board shall have the authority to:

(c) To the fullest extent permitted by applicable law, the Restated Certificate of Incorporation, and these By-Laws, the NASD may delegate any power of the NASD or the Board to a committee appointed pursuant to Article IX, Section 1, the NASD Regulation Board, the [Nasdaq] *NASD Dispute Resolution* Board, or NASD staff in a manner not inconsistent with the Delegation Plan.

Authority to Take Action Under Emergency or Extraordinary Market Conditions

Sec. 3. The Board, or such person or persons as may be designated by the Board, in the event of an emergency or extraordinary market conditions, shall have the authority to take any action regarding:

(a) the trading in or operation of the over-the-counter securities market, the operation of any automated system owned or operated by the NASD[, or NASD Regulation, [or Nasdaq,] and the participation in any such system of any or all persons or the trading therein of any or all securities; and

Composition and Qualifications of the Board

Sec. 4. (a) The Board shall consist of *no fewer than 17 nor more than 27 Governors, comprising (i) the Chief Executive [Officer and the Chief Operating] Officer of the NASD, [the Presidents of NASD Regulation and Nasdaq,] (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 [of Amex] and one Floor Governor of Amex, and (vi) no fewer than [16] 12 and no more than [28] 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, [and a Nasdaq issuer] 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. [A majority of the] *The number of Non-Industry Governors shall [be Non-] exceed the number of Industry Governors. If the**

[Board consists of 23 Governors, at least five shall be] *number of Industry and Non-Industry Governors is 15 to 17, the Board shall include at least four Public Governors. If the [Board consists of 24 to 27 Governors, at least six shall be] number of Industry and Non-Industry Governors is 18 to 19, the Board shall include at least five Public Governors. If the [Board consists of 28 to 31 Governors, at least seven shall be Public Governors. If the Board consists of 32 to 35 Governors, at least eight shall be] number of Industry and Non-Industry Governors is 20–25, the Board shall include at least six Public Governors.*

Term of Office of Governors

Sec. 5. (a) The Chief Executive Officer and [the Chief Operating Officer], *if appointed, the second officer of the NASD, the [Presidents] President of NASD Regulation [and Nasdaq], 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).*

(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.

Filling of Vacancies

Sec. 7. If [a] *an elected* Governor position becomes vacant, whether because of death, disability, disqualification, removal, or resignation, the National Nominating Committee shall nominate, and the Board shall elect by majority vote of the remaining Governors then in office, a person satisfying the classification (Industry, Non-Industry, or Public Governor) for

the governorship as provided in Section 4 to fill such vacancy, except that if the remaining term of office for the vacant Governor position is not more than six months, no replacement shall be required. If the remaining term of office for the vacant Governor position is more than one year, the Governor elected by the Board to fill such position shall stand for election in the next annual election pursuant to this Article.

The National Nominating Committee

Sec. 9. (a) The National Nominating Committee shall nominate *and, in the event of a contested election, may, as described in Section 11(b), support:* Industry, Non-Industry, and Public Governors for each vacant or new Governor position on the NASD Board for election by the membership; Industry, Non-Industry, and Public Directors for each vacant or new position on the NASD Regulation Board and the [Nasdaq] *NASD Dispute Resolution* Board for election by the [Board;] *stockholder; and* Industry, Non-Industry, and Public members for each vacant or new position on the National Adjudicatory Council for appointment by the NASD Regulation Board [; and Industry and Non-Industry members for each vacant or new position on the Nasdaq Listing and Hearing Review Council for appointment by the Nasdaq Board].

(d) Members of the National Nominating Committee shall be appointed annually by the Board and may be removed only by majority vote of the whole Board, after appropriate notice, for refusal, failure, neglect, or inability to discharge such member's duties. [The NASD Regulation Board and the Nasdaq Board each shall propose two candidates to the NASD Board for appointment to the National Nominating Committee.]

Procedure for Nomination of Governors

Sec. 10. Prior to a meeting of members pursuant to Article XXI for the election of Governors, the NASD shall notify the members of the names of each nominee selected by the National Nominating Committee for each governorship up for election, the classification of governorship (Industry, Non-Industry, or Public Governor) for which the nominee is nominated, the qualifications of each nominee, and such other information regarding each nominee as the National Nominating Committee deems pertinent. A person who has not been so nominated may be included on the ballot for the election of Governors if: (a) within [30] 45 days after the date of such notice [in 1997, or within 45 days after the date of such

notice in 1998 and thereafter], such person presents to the Secretary of the NASD *(i) in the case of petitions solely in support of such person, petitions in support of his or her nomination duly executed by three percent of the members, and no member shall endorse more than one such nominee, or (ii) in the case of petitions in support of one or more persons, petitions in support of the nominations of such persons duly executed by ten percent of the members;* and (b) the Secretary certifies that (i) the petitions are duly executed by the Executive Representatives of the requisite number of members[;], and (ii) the person satisfies the classification (Industry, Non-Industry, or Public Governor) of the governorship to be filled, based on such information provided by the person as is reasonably necessary to make the certification. The Secretary shall not unreasonably withhold or delay the certification. Upon certification, the election shall be deemed a contested election. After the certification of a contested election or the expiration of time for contesting an election under this Section, the Secretary shall deliver notice of a meeting of members pursuant to Article XXI, Section 3(a).

Communication of Views

Sec. 11. (a) The NASD, the Board, [the National Nominating Committee,] a committee appointed pursuant to Article IX, Section 1, and NASD staff shall not take any position publicly or with a member or person associated with or employed by a member with respect to any candidate in a contested election or nomination held pursuant to these By-Laws or the NASD Regulation By-Laws. A Governor or a member of *any committee (other than the National Nominating Committee [or any other committee])* may communicate his or her views with respect to any candidate if such Governor or committee member acts solely in his or her individual capacity and disclaims any intention to communicate in any official capacity on behalf of the NASD, the NASD Board, *or any committee (other than the National Nominating Committee [, or any other committee]).* Except as provided herein, any candidate and his or her representatives may communicate support for the candidate to a member or person associated with or employed by a member.

(b) *In a contested election, the National Nominating Committee may support its nominees under this Article by sending to NASD members eligible to vote up to two mailings of materials, in the manner set forth in Article VII, Section 12, in support of its nominees.*

In addition to such two mailings, in the event of mailings and or other communications to the NASD members by or on behalf of a candidate by petition in a contested election, the National Nominating Committee may respond in-kind, but shall not take a position unresponsive, to the contesting candidate's communications.

Election of Governors

Sec. 13. Governors *that are to be elected by the members* shall be elected by a plurality of the votes of the members of the NASD present in person or represented by proxy at the annual meeting of the NASD and entitled to vote thereat. The annual meeting of the NASD shall be on such date and at such place as the Board shall designate pursuant to Article XXI. Any Governor so elected must be nominated by the National Nominating Committee or certified by the Secretary pursuant to Section 10.

Maintenance of Compositional Requirements of the Board

Sec. 14. Each *elected* Governor shall update the information submitted under Section 9(e) regarding his or her classification as an Industry, Non-Industry, or Public Governor at least annually and upon request of the Secretary of the NASD, and shall report immediately to the Secretary any change in such classification.

Article VIII—Officers, Agents, and Employees

Resignation and Removal of Officers

Sec. 6. (b) Any officer of the NASD may be removed, with or without cause, by resolution adopted by a majority of the Governors then in office at any regular or special meeting of the Board or by a [written] consent [signed] *adopted* by all of the Governors then in office *in accordance with applicable law*. Such removal shall be without prejudice to the contractual rights of the affected officer, if any, with the NASD.

Article IX—Committees

Appointment

Sec. 1. Subject to Article VII, Section 1(c), the Board may appoint such committees or subcommittees as it deems necessary or desirable, and it shall fix their powers, duties, and terms of office. Any such committee or subcommittee consisting solely of one or more Governors, to the extent provided by these By-Laws or by resolution of the Board, shall have and may exercise all powers and authority of the Board in the management of the business and affairs of the NASD. *Any*

committee having the authority to exercise the powers and authority of the Board shall have a percentage of Non-Industry committee members at least as great as the percentage of Non-Industry Governors on the Board and a percentage of Public committee members at least as great as the percentage of Public Governors on the Board.

Executive Committee

Sec. 4. (b) The Executive Committee shall consist of no fewer than six and no more than nine Governors. The Executive Committee shall include the Chief Executive Officer of the NASD, at least one Director of NASD Regulation, [at least one Director of Nasdaq,] at least one Governor of Amex, and at least two Governors who are not members of either the NASD Regulation Board[, the Nasdaq Board, or the Amex Board. The number of Directors of the NASD Regulation Board and the number of Directors of the Nasdaq Board serving on the Executive Committee shall be equal at all times.] *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.

Article X—Compensation of Board and Committee Members

Sec. 1. The Board may provide for reasonable compensation of the Chair of the Board, the Governors, and the members of any committee. The Board may also provide for reimbursement of reasonable expenses incurred by such persons in connection with the business of the NASD, *including those expenses incurred in connection with the support of a candidate or candidates by the National Nominating Committee in contested elections in accordance with the By-Laws.*

Article XIII—Powers of Board To Impose Sanctions

Sec. 1. The Board is hereby authorized to impose appropriate sanctions applicable to members, including censure, fine, suspension, or expulsion from membership, suspension or bar from being associated with all members, limitation of activities, functions, and operations of a member, or any other fitting sanction, and to impose appropriate sanctions applicable to persons associated with members, including censure, fine, suspension or barring a person associated with a member from being

associated with all members, limitation of activities, functions, and operations of a person associated with a member, or any other fitting sanction, for:

(b) violation by a member or a person associated with a member of any of the terms, conditions, covenants, and provisions of the By-Laws of the NASD, NASD Regulation, or [Nasdaq] *NASD Dispute Resolution*, the Rules of the Association, or the federal securities laws, including the rules and regulations adopted thereunder, the rules of the Municipal Securities Rulemaking Board, and the rules of the Treasury Department;

Article XV—Limitation of Powers

Conflicts of Interest

Sec. 4. (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-Amex, Nasdaq] *NASD Dispute Resolution*, 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, the 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. The 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

According to the NASD, the proposed rule change has several significant purposes. First, the NASD Board of Governors has both Industry and Non-Industry members and is required by the By-Laws to have a majority of Non-Industry Governors. In 1998, the NASD affected a substantial corporate restructuring which included the acquisition of the American Stock Exchange LLC ("Amex"). As part of this restructuring, the NASD moved to an overlapping Board structure whereby all members of the NASD Regulation, Inc. ("NASDR") and Nasdaq Boards became members of the NASD Board. As a result of the 1998 restructuring, the number of Governors serving on the Board by virtue of their status as staff increased to five (the NASD Chief Executive Officer, the NASD Chief Operating Officer, the Presidents of NASDR and Nasdaq and the Chairman of Amex). In accordance with current NASD By-Laws, these five Governors have counted as Industry Governors for balancing purposes. With this current composition and classification of staff Governors, the only realistic manner for NASD to satisfy its obligation to ensure fair representation of all relevant constituencies has been to increase the number of Industry seats on the Boards, and, in order to maintain the required absolute majority of Non-Industry/Public seats on the Board, increase in the number of Non-Industry seats as well. These increases have made it extremely difficult for the NASD Board to be small enough to function with optimum efficiency while still satisfying NASD's obligation to ensure fair representation of the relevant constituencies.

To improve the efficiency of the Board while maintaining fair representation of the relevant constituents, the Association has determined to reclassify the NASD CEO and president of NASDR Governor positions as "neutral" Governors; that is, neither Industry nor Non-Industry Governors. The reclassification of these Governor positions as "neutral" is consistent with the neutrality

classification other Self-Regulatory Organizations assign to their Board staff members and allows the two Industry seats the staff occupy to now be available to Industry candidates elected by the NASD membership.

Second, the proposed By-Law amendments allow limited National Nominating Committee participation in contested elections. Under the current By-Laws, the NASD, NASD staff, the NNC and other corporate committees are prohibited from taking a position in contested elections. As a result of this prohibition, in contested elections the NNC has been unable to explain the reasons a NNC nominated candidate is worthy of support, and has been unable to respond to statements made by other candidates or parties about the NNC nominees. The NNC's current inability to support its candidates in contested elections is a deterrent to qualified individuals accepting nominations. To remedy this, the NASD is proposing to allow the NNC to provide limited support to NNC nominated candidates. Specifically, the NASD will allow the NNC to distribute two mailings to NASD voting members in support of its candidates. The NASD will also allow the NNC to respond in-kind to vote solicitations and additional mailings by other candidates. By limiting NNC's additional support to "responsiveness", the NASD will allow the NNC to support its candidates but not allow the NNC to unilaterally wage an electoral campaign on behalf of those candidates.

Next, the NASD elected to revise the NASD By-Laws with regard to inclusion on the ballot by petition. Under the current ballot by petition process, Industry candidates seeking nomination by petition can "coattail" other Industry and/or Non-Industry candidates in the same petition-gathering process. This process essentially allows the creation of a "slate" through the use of a single set of petitions signed by three percent of the membership. The NASD determined to continue to allow the nomination by petition of an individual signed by three percent of NASD's voting members and to permit each member to endorse only one such nominee. Under the revised amendments, the NASD specifically recognizes the validity of slate petitions, but requires that the slate be endorsed by ten percent of NASD's voting members. The NASD's adoption of separate thresholds for petition candidates and slate petitions is reasonable given the size and diversity of NASD's membership.

Fourth, to more accurately represent the full range of relevant industry constituents, the NASD proposes

representation by three additional industry segments: a national retail firm, a regional retail or independent financial planning member firm and a clearing firm. These segments are in addition to required representation by an investment company, an insurance affiliate and a small firm. The Board will periodically adopt resolutions establishing the criteria for national and regional firm representatives in accordance with changes in the industry structure and demographics.

Finally, to set forth the new NASD corporate structure and the change in the NASD-Nasdaq relationship, the NASD determined to make several technical changes to the By-Laws reflecting the current corporate structure. The changes primarily consist of adding references to the newly formed NASD Dispute Resolutions subsidiary and deleting references to Nasdaq.

Summary of Amendments

By-Laws of the NASD

Article I. Definitions

New definitions have been added, and the terms Industry, Non-Industry and Public "Director" "Governor" and "committee member" have been amended, to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Article IV. Membership

Application for Membership

Section 1 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Article V. Registered Representatives and Associated Persons

Application for Registration

Section 2 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Article VI. Dues, Assessments, and Other Charges

Power of the NASD to Fix and Levy Assessments

Section 1 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

*Article VII. Board of Governors***Powers and Authority of Board**

Section 1 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Authority to Take Action Under Emergency or Extraordinary Market Conditions

Section 3 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Composition and Qualifications of the Board

Section 4 has been amended to adjust the overall Board composition to no fewer than 17 nor more than 27 Governors, including no more than four staff Governors. This section has also been amended to require representation by three additional industry segments: a national retail firm, a regional retail or independent financial planning member firm and a clearing services firm. Finally, this section has been amended to allow the Board, by resolution, to specify the criteria for representatives of national retail and regional retail or independent financial planning firms.

Term of Office of Governors

Section 5 has been amended to reflect the changed NASD-Nasdaq relationship and to recognize the Board's discretion in limiting the term of a second NASD officer serving as a Governor.

Filing of Vacancies

Section 7 has been amended by clarifying that the provision applies to elected Governor positions.

The National Nominating Committee

Section 9 has been amended to specify that the NNC may support Governors in contested elections. This section has also been amended to reflect the new corporate structure and to eliminate the requirement that NASDR and Nasdaq propose two candidates each to the NASD Board for appointment to the NNC.

Procedure for Nomination of Governors

Section 10 has been amended to allow nomination by petition for individual ballots by three percent of NASD voting membership, to limit voting members from endorsing more than one individual nominee, and to allow nomination by petition for slates by ten percent of the NASD voting membership.

Communication of Views

Section 11 has been amended to detail the NNC's limited support of NNC nominees.

Election of Governors

Section 13 has been amended by clarifying that the provision applies to elected Governor positions.

Maintenance of Compositional Requirements of the Board

Section 14 has been amended by clarifying that the provision applies to elected Governor positions.

*Article VIII. Officers, Agents, and Employees***Resignation and Removal of Officers**

Section 6 has been amended to allow the Board to remove an officer of the NASD by a resolution adopting by a majority of Governors or a consent adopted by all Governors.

*Article IX. Committees***Appointment**

Section 1 has been amended to ensure that the Industry/Non-Industry balance of any committee given powers of the Board reflects the same balance of the Board.

Executive Committee

Section 4 has been amended to ensure balanced committee representation and to reflect the changed NASD-Nasdaq relationship.

Article X. Compensation of Board and Committee Members

Section 1 of this Article has been amended to allow member reimbursement of expenditures related to the limited NNC nominee support in contested elections.

Article XIII. Powers of Board to Impose Sanctions

Section 1 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

2. Statutory Basis

The NASD believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A(b)(4) of the Act,⁵ which requires, among other things, that the Association's rules must be designed to assure a fair representation of its members in the administration of its affairs. The NASD believes that the proposed rule change, as amended, enhances the Association's

ability to assure fair representation on the NASD Board of its members.

(i) *Proposed Changes to NASD Board Composition.* NASD believes that the reservation of Board seats for three additional specific industry segments, a national retail firm, a regional retail firm or independent financial planning member and a clearing firm, assures the ongoing participation in the governance of the NASD by these important segments of NASD membership. The reclassification of two staff Governor positions as neutral allows for a smaller, more efficient Board without compromising either the fair representation of NASD members or an appropriate balance of Industry and Non-Industry members.

(ii) *Proposed Changes to NASD Board Elections.* The NASD believes that the proposed changes, as amended, to the election procedures will foster a fair and vigorous NASD Board election process. The proposed changes reflect two enhancements. First, the amendments set clear and fair thresholds for petitions by ballot for individuals and slates. Second, the NNC will be able to respond in-kind in support of NNC nominated candidates and, as a result, NASD members will be better informed about the candidates and issues arising in contested elections.

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

The NASD 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.

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 the proposed rule change, as amended, or

B. Institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

⁵ 15 U.S.C. 78o(b)(4).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-01-06 and should be submitted by March 27, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 01-5329 Filed 3-5-01; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44009; File Nos. SR-NYSE-99-47 and SR-NASD-00-03]

Self-Regulatory Organizations; New York Stock Exchange, Inc., and National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Changes Relating to Margin Requirements for Day Trading; Notice of Filing and Order Granting Accelerated Approval of Amendments No. 1 to Each Proposed Rule Change

February 27, 2001.

I. Introduction

On December 13, 1999, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposal to amend NYSE

Rule 431, *Margin Requirements*. The proposed rule change would establish margin requirements for day trading in customer accounts of the Exchange's member organizations. On January 25, 2000, the NYSE rule proposal was published for public comment in the **Federal Register**.³

On January 13, 2000, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Regulation, Inc., also filed a proposed rule change to establish day trading margin requirements by amending NASD Rule 2520, *Margin Requirements*. On February 18, 2000, the NASD proposal was published for comment in the **Federal Register**.⁴

³ Securities Exchange Act Release No. 42343 (January 14, 2000), 65 FR 4005.

⁴ Securities Exchange Act Release No. 42418 (February 11, 2000), 65 FR 8461.

⁵ The NYSE and NASD rule proposals were the result of deliberations by the 431 Committee, which convenes regularly on margin issues. The Committee is generally comprised of NYSE and NASD staff, attorneys from the NYSE's outside counsel, the Board of Governors of the Federal Reserve System, and representatives from several clearing firms and broker-dealers. See letter from Alden Adkins, Senior Vice President and General Counsel, NASD, to Katherine England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated October 3, 2000 ("NASD Response to Comments").

⁶ See letter from James Buck, Senior Vice President, NYSE, to Nancy Sanow, Assistant Director, Division, Commission, dated September 8, 2000 ("Amendment No. 1 to the NYSE Proposal"). The amendment clarified that the proposed "knows or has a reasonable basis to believe" standard not only applies in the situation where a customer seeks to open an account, but also in the case where he or she seeks to resume day trading in an existing account. For further discussion of the "knows or has a reasonable basis to believe" standard, see *infra*, Section II, "Description of the Proposed Rule Changes."

⁷ See letter from Alden Adkins, Senior Vice President and General Counsel, NASD, to Katherine England, Assistant Director, Division, Commission, dated October 3, 2000 ("Amendment No. 1 to the NASD Proposal"). The amendment: (1) Deleted a provision relating to a 90-day period in which a day trader could be designated as a Pattern Day Trader; (2) clarified that the proposed "knows or has a reasonable basis to believe" standard would apply not only where a customer seeks to open an account, but also where a customer seeks to resume day trading in an existing account; (3) clarified that a two-day funds deposit requirement would apply only to customers who have been designated Pattern Day Traders; and (4) extended from 30 days to six months the proposed period for implementing the proposed rule change.

⁸ Some commenters sent letters in response to both the NYSE and NASD rule proposals. The public files for the NYSE and NASD rule proposals, including all comment letters received on the proposals and a List of Commenters that was prepared by Commission staff, are located at the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549-0609. See *infra*, footnote 28.

⁹ See letter from James Buck, Senior Vice President and Secretary, NYSE, to Nancy Sanow, Assistant Director, Division, Commission, dated September 20, 2000 ("NYSE Response to Comments").

Although the NYSE and NASD rule proposals were substantially similar, they diverged on certain issues.⁵ To reconcile the differences between, and provide for uniform application of, the two proposals, the NYSE and NASD each filed amendments to their respective proposals. The NYSE filed its amendment on September 8, 2000.⁶ The NASD filed its amendment on October 3, 2000.⁷ The Commission received 49 letters regarding the NASD proposal and 214 letters regarding the NYSE proposal.⁸ The NYSE provided a response to comments on September 20, 2000.⁹ The NASD filed its response to comments on October 3, 2000.¹⁰ This order approves the NYSE and NASD rule change proposals, as amended.

II. Description of the Proposed Rule Changes

A. Margin Trading and Regulation

Trading securities on margin involves the use of credit to finance securities purchases. A margin transaction takes place where a customer purchases a security in reliance on an extension of credit (*i.e.*, a loan) from his or her broker-dealer. Use of a margin loan increases both the customer's potential return on investment and his or her financial risk.¹¹

Section 7(a) of the Act grants authority to the Board of Governors of the Federal Reserve System ("Federal Reserve") to regulate the use of margin credit in order to prevent the excessive use of credit for the purchase or carrying of securities.¹² Pursuant to this authority, the Federal Reserve promulgated Regulation T¹³ to govern extensions of credit by brokers and dealers. Regulation T contains "initial" margin requirements, which limit the amount of credit that can be extended by a broker-dealer on certain securities transactions. Briefly, Regulation T generally allows broker-dealers to

¹⁰ NASD Response to Comments.

¹¹ Since trading securities on margin permits a customer to purchase securities valued at an amount greater than the equity available to his or her account, an increase in the value of those securities yields a higher return on equity than is possible if the size of the customer's purchases is limited to his or her available equity. On the other hand, trading securities on margin also makes it possible for a customer to generate losses that exceed his or her available equity.

¹² 15 U.S.C. 78g(a).

¹³ 12 CFR 220 *et seq.* Regulation T "imposes, among other things, obligations, initial margin requirements, and payment rules on securities transactions." 12 CFR 220.1(a).

¹⁴ The definition of "margin equity security" includes any equity security (as defined in Section 3(a)(11) of the Act) which is registered or has unlisted trading privileges on a national securities exchange or the Nasdaq Market. 12 CFR 220.2.

¹⁵ 12 CFR 220.12(a).

⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.