

change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2002-35 and should be submitted by May 6, 2002.

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

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45709; File No. SR-NASD-2001-46]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to Electronic Filings With the Corporate Financing Department

April 9, 2002.

#### I. Introduction

On August 6, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("Commission" or "SEC"), 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> a proposed rule change amending NASD Conduct Rule 2710 to require electronic filings. The proposed rule change was published for comment in the **Federal**

**Register** on August 24, 2001.<sup>3</sup> NASD Regulation filed Amendment No. 1 to the proposed rule change on March 4, 2002.<sup>4</sup> The Commission received three comments on the proposal. This order approves the proposal and issues notice of, and grants accelerated approval to, Amendment No. 1.

#### II. Description of the Proposal

NASD Regulation is proposing to amend NASD Rule 2710(b)(6) to require members to file information required by subparagraph (b)(6) with the NASD Regulation's Corporate Financing Department ("Department") through its electronic filing system, the Corporate Offerings Business Regulatory Analysis System ("COBRA").<sup>5</sup> The obligation to file information electronically would apply to all offerings subject to the rule's filing requirements, regardless of whether the offering is exempt from registration with the SEC or is submitted confidentially to the SEC for review.

NASD Regulation also is proposing to adopt new subparagraph (b)(5)(B) of Rule 2710 to provide that all documents that are filed with the SEC through the EDGAR system will be treated as filed with the Association. Members that do not file documents with the SEC through EDGAR would remain obligated to continue to submit multiple copies of any required documents in paper format. However, NASD Regulation is proposing to amend NASD Rule 2710(b)(5)(A)(ii) and (iii) to reduce the number of required copies of these documents from five to three.

NASD Regulation has hosted several training sessions to provide opportunities for members and their counsel to learn how to file offerings using COBRA. In addition, NASD Regulation has stated that certain Department staff members are dedicated to assisting filers when they access and navigate the system. According to NASD Regulation, before and following Commission approval of the proposed rule change, the Department will provide additional training sessions and provide continuing support and

assistance to members and their counsel who have questions and are unfamiliar with the system.

NASD Regulation has stated that the NASD will publish a Notice To Members within 30 days of Commission approval announcing the proposed rule change and providing an effective date within 60 days of Commission approval.

#### III. Summary of Comments and NASD Regulation's Response

The Commission received three comment letters on the proposed rule change.<sup>6</sup> The commenters concerns with the proposal, and NASD Regulation's response to these concerns, are summarized below.

##### *Increased Costs and Less Efficiency*

The Commenters were concerned that the mandatory use of COBRA generally would be more costly and less efficient than the current process of manual filings. NASD Regulation does not believe that these concerns are justified.

NASD Regulation believes that mandatory COBRA filing will reduce overall costs and enhance the efficiency of the Department's operations in several important ways. Electronic filing eliminates the need for the Department to handle and process thousands of packages that otherwise would be sent through the U.S. Postal Service or other couriers. Additionally, direct electronic filing into COBRA eliminates the need for analysts to input data from paper filings into COBRA. Electronic filing also mitigates against the possibility that paper records will be lost, such as in the event of a catastrophe. Further, COBRA eliminates the need for members to file registration statements with the Department if they have been filed with the SEC using EDGAR. Filers simply need to provide the Department with the EDGAR accession number in the COBRA Basic Information. This feature reduces members' printing and delivery expenses. For these reasons, NASD Regulation believes that members can expect to receive a speedier review of their electronic filings under COBRA.

The NASD states that the Department has worked with the legal community and NASD members for over four years to ensure that COBRA is as user-friendly and efficient as possible. NASD has three staff members available to train

<sup>3</sup> See Securities Exchange Act Release No. 44720 (August 17, 2001), 66 FR 44657.

<sup>4</sup> Letter from Patrice M. Gliniecki, Vice President and Acting General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated March 1, 2002 ("Amendment No. 1"). Amendment No. 1 responds to the concerns of commenters and makes a minor clarification to proposed Rule 2710(b)(6)(A)(vii).

<sup>5</sup> On April 30, 2001, the Department deployed a web-based application of COBRA, which consists of an internal software application used by the Department and "Web COBRADesk," a user interface that permits members and their counsel to file offerings of direct participation program securities.

<sup>6</sup> Letter from Edward M. Alterman, Fried, Frank, Harris, Shriver & Jacobson ("Fried") to Jonathan G. Katz, Secretary, Commission, dated September 24, 2001; Letter from Mark T. Lab, Simpson Thacher & Bartlett ("Simpson") to Jonathan G. Katz, Secretary, Commission, dated October 1, 2001; and Letter from Martin R. Miller, Willkie Farr & Gallagher ("Willkie") to Jonathan G. Katz, Secretary, Commission, dated October 4, 2001 (collectively, the "Commenters").

<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.

members and their counsel on using the system and assist filers who are unfamiliar with the system with navigation and information reporting requirements. NASD Regulation upgraded the system to make it even more user-friendly and efficient. Most notably is the development of COBRADesk as a "web-based" interface. NASD Regulation is currently installing additional system upgrades that respond to users' comments on ways to improve the system. The Department and its vendor, Dealogic,<sup>7</sup> are committed to making system improvements that are necessary to address filer comments and technological advances.

Willkie stated that there would be no need to make COBRA mandatory if it really saved costs. According to NASD Regulation, Willkie is presumably implying that filers would voluntarily use COBRA if it were less costly than the current system. NASD Regulation, however, does not agree with this assertion. Paper filings slow the review process for all filers because the Department must maintain and dedicate resources to redundant and inefficient paper filing procedures. Consequently, many of the benefits of the electronic system will not be realized unless all filers use it.

Fried stated that the Commission's goal in requiring electronic filings with EDGAR is to make the filings publicly available more rapidly. By contrast, filings with the Department are confidential. Fried argued therefore, that there is no basis for the NASD to require electronic filings with the Department. NASD Regulation does not believe that electronic filings should only be mandated when the goal of the system is public dissemination. As noted in the notice of proposed rule change, there are many efficiencies in having all filings made with the Department electronically.

#### *Information Required by the Electronic Filing System*

All of the Commenters objected to proposed NASD Rule 2710(b)(6)(A)(vii), which would require a person filing information through COBRA to file "any other information required by the Association's electronic filing system." NASD Regulation intended the provision to require all information required under NASD Rule 2710 to be filed exclusively through COBRA. NASD Regulation recognizes that, as drafted, the provision could be

construed to allow the NASD to change the substance of what is required by Rule 2710 simply by making a program change to COBRA. To address this concern, NASD Regulation amended proposed Rule 2710 (b)(6)(A)(vii) to state "any other information required to be filed under this Rule," to make clear that the electronic filing requirements are based upon the Rule and not the electronic filing interface.

#### *Yes/No Boxes*

The Commenters expressed concern with the feature in COBRA that they believe requires filers to answer "yes" or "no" to questions requiring compliance with various provisions of NASD Rules 2710, 2720, or 2810. For instance, Fried and Simpson noted that certain questions may not apply to the types of offerings that are filed with the Department (e.g., a question about compliance with Rule 2810 when the offering does not involve direct participation program securities).

NASD Regulation states that the questions serve as reminders to filers as they complete a submission. The COBRA system does not require that these buttons be checked; they are merely intended to be useful reminders of various regulatory requirements for members. Similarly, questions that do not apply to offerings of the type being filed are included so that members can navigate to proper screens on the Web site. NASD Regulation has not received similar complaints from other firms that routinely make electronic filings and believes the yes/no boxes serve as useful reminders to many filers.

#### *Security*

The Commenters raised concerns regarding the security of information filed through COBRA. Fried and Simpson argued that no web-based system is entirely safe from unauthorized access and is at least as vulnerable as the United States Government's highest level of security. Willkie noted that it is nearly impossible to guarantee the security of information transmitted on the Internet.

NASD Regulation states that the COBRADesk system was designed by Dealogic and is internally maintained by Electronic Data Systems Corporation ("EDS"). The COBRADesk system is one of many web-based systems designed and built by Dealogic that routinely are used by the financial services industry.

Web COBRADesk security features include: (i) Multiple Web server and standby database server to provide scalability and redundancy; (ii) servers housed at a secure data center run by EDS; (iii) multiple layers of security

including multiple firewalls; (iv) integrated industry-standard Kerberos security; (v) users and firms authenticated at Web and database level; and (vi) all sessions between users and Web server protected by 128-bit encryption. EDS applies patches, runs systems through multiple testing stages, and does penetration testing.

Further, while NASD Regulation recognizes that the security of information sent over the Internet is of critical importance, it notes that the information filed through COBRADesk tends to be less confidential and proprietary than other information members routinely send over the Internet, using systems that are designed by Dealogic. Moreover, over 200 members currently are sending or have sent information using COBRADesk,<sup>8</sup> and the security of that information has not raised any concerns, before the comment letters received in response to the proposed rule change.

#### *Required Information*

The Commenters also raised concerns regarding the provision that the system will not accept filings without certain specified information being provided, some of which typically is not known at the time of the initial filing with the SEC.<sup>9</sup> For instance, Fried stated that the system will not accept a filing for an equity offering without the actual number of shares and price per share, numbers that are rarely known at the time of the initial SEC filing. Fried and Willkie argued that filers will be forced to insert incomplete or unreliable information merely to make a filing within the time required. Fried argued that the practitioner submitting the filing is forced to invent numbers and qualify them with general language disclaiming the accuracy of that information. Willkie added that filers would be forced to include a disclaimer on COBRA that the information was merely a "best guess" to be able to comply with the timing requirements of Rule 2710. Fried stated that COBRA demands the stock symbol, the information on affiliations and associations between the issuer and the underwriters and related persons, the SEC accession number, and a detailed analysis of the terms of the underwriting documents. Fried argued that the only viable alternative to providing the required information would be to provide unreliable or estimated

<sup>8</sup> Thirty percent of the filings the Department received in 2001 were filed electronically.

<sup>9</sup> Pursuant to NASD Rule 2710(b)(4), the filing must be submitted to the Department no later than one business day after the filing of any such document with the SEC.

<sup>7</sup> Dealogic (formerly CommScan, L.L.C.) is the third-party vendor that designed and developed COBRADesk in June 1999 as a client application and as a Web application.

information and provide a disclaimer in the appropriate drop down box.

NASD Regulation received the same or similar comments in connection with the proposed amendments to NASD Rule 2710 that are pending at the SEC<sup>10</sup> and during other meetings with members and their counsel to discuss process improvements and opportunities to improve efficiency and fairness in the filing system. The proposed amendments to Rule 2710 include provisions that are intended to decrease the amount of information required to be filed with the NASD, where appropriate, particularly with regard to NASD association and affiliation. NASD Regulation notes, however, that electronic filing does not require any more or less information to be filed initially than the Department requires in connection with paper filings.

Specifically, COBRA will accept filings without certain information being provided. There are five required fields in the system: (i) The filer's e-mail address;<sup>11</sup> (ii) distribution method;<sup>12</sup> (iii) accession number;<sup>13</sup> (iv) compensation information;<sup>14</sup> and (v) the number and value of the securities proposed to be offered.<sup>15</sup> The stock symbol, the information regarding affiliation and association between the issuer and the underwriters and related persons, and a detailed analysis of the terms and arrangements of the underwriting agreements are not required fields.

NASD Regulation notes that even in paper-based filings, members are required to submit a good faith estimate of the number of shares and the price per share if they do not have definitive information. NASD Regulation recognizes that this information may change while an offering is marketed.

#### Browser

Fried stated that COBRA will not work when the filer uses Netscape Navigator, thereby forcing filers to use Internet Explorer. Simpson indicated that it had problems accessing the tutorial using Netscape, and it is concerned that only the most recent version of Internet Explorer works with COBRA.

According to NASD Regulation, the browser standards for accessing COBRA are Netscape Navigator 4.6 or greater and Microsoft Internet Explorer 5.0 or greater. Browser upgrades are available free of charge at their respective Web sites. An application designed for the Web must be supported by the current browsers to ensure maximum performance, reliability, flexibility, privacy, and security. COBRA's layout, screens, dialog boxes, scroll bars, list boxes, grids, and links conform to the latest browser versions. It is virtually impossible to develop a system for the Web using the latest Web technology that interfaces with all older browser versions.

NASD Regulation acknowledges that there are minor problems that complicate—but, in NASD's view, do not prevent—the use of Netscape Navigator when accessing the tutorial or Help screens. These areas will be corrected in the next maintenance release. The Department does not believe that these minimal technical requirements are costly or burdensome.

#### Corporate Financing Rule Amendments

Fried and Simpson questioned the practicability and legality of requiring a practitioner to certify compliance with proposed NASD rules that are pending at the SEC. Willkie recommended that this proposed rule change be postponed until such time as the SEC approves other proposed amendments relating to Rule 2710 (File No. SR-NASD-00-04).

Due to programming requirements and the time it would take to implement programming changes once the proposed amendments are adopted, when NASD Regulation ported COBRADesk to the Web in April 2001, NASD Regulation included data screens that can accept information regarding transactions that would meet one of the five exceptions proposed in the Rule amendments. COBRA, however, does not require certification of compliance with the proposed amendments, and it is within a filer's discretion whether to include information in the screens designed to capture information regarding transactions that meet the proposed exceptions.

#### IV. Discussion

The Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities association. In particular, the Commission finds that the proposed rule change is consistent with section 15A(b)(6) of the Act,<sup>16</sup> which requires that an Association's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest.<sup>17</sup>

Specifically, the Commission believes that the proposed rule change will greatly facilitate NASD Regulation's review of filings required by NASD Rule 2710. Moreover, the Commission does not believe that the proposal will place an undue burden on NASD members. The Commission notes that NASD Regulation has represented that three members of its staff will be available to train members and their counsel on using the system and assist filers who are unfamiliar with the system with navigation and information reporting requirements, which the Commission believes will minimize any burdens of the proposed rule change on NASD members. The Commission also notes that the provision of the proposal that eliminates the requirement to file paper copies of registration statements that have already been filed with the Commission through EDGAR should significantly reduce members' printing and delivery expenses related to corporate financing review by the Department. Finally, the Commission believes that NASD Regulation has adequately responded to the concerns of commenters.

The Commission finds good cause for accelerating approval of Amendment No. 1 to the proposed rule change prior to the thirtieth day after publication in the **Federal Register**. The Commission notes that Amendment No. 1 responds to concerns of commenters and raises no new substantive issues. Accordingly, the Commission finds that good cause exists, consistent with sections 15A(b)(6) of the Act,<sup>18</sup> and 19(b)(2) of the Act<sup>19</sup> to accelerate approval of Amendment No. 1 to the proposed rule change.

<sup>16</sup> 15 U.S.C. 78o-3.

<sup>17</sup> In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>18</sup> 15 U.S.C. 78o-3.

<sup>19</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> See Securities Exchange Act Release No. 42619 (April 4, 2000), 65 FR 19409 (April 11, 2000) (SR-NASD-00-04).

<sup>11</sup> The filer's e-mail address allows the Department to communicate with the filer.

<sup>12</sup> The information on distribution method is used to determine the amount of risk to be assumed by the participating members. The Department processes that information to calculate the maximum allowable compensation that a member may receive.

<sup>13</sup> The SEC accession number allows the staff a direct link to the documents through EDGAR.

<sup>14</sup> The Department reviews the amount of compensation paid to members in underwriting to ensure that the underwriting terms and arrangements in public offerings in which NASD members participate are fair and reasonable. To comply with this requirement, the Department must calculate the maximum allowable compensation a member may receive in connection with a public offering.

<sup>15</sup> Data on the price per share and the number of shares are needed to determine the offering proceeds, which are used to calculate the filing fee and compensation limits.

## V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether the amendment is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the 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-2001-46 and should be submitted by May 6, 2002.

## VI. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>20</sup> that the proposed rule change (SR-NASD-2001-46) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>21</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45706; File No. SR-NYSE-2002-08]

### Self Regulatory Organizations; New York Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Changes to Audit Trail Account Identification Codes

April 8, 2002.

On January 23, 2002, the New York Stock Exchange, Inc. ("NYSE") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule

change to introduce a new identification code/audit trail account type, "Q," to indicate a proprietary trade by a member to cover the member's own error pursuant to Exchange Rule 134.

The proposed rule change was published for comment in the **Federal Register** on February 28, 2002.<sup>3</sup> The Commission received no comments on the proposal.

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<sup>4</sup> and, in particular, the requirements of section 6 of the Act<sup>5</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with section 6(b)(5) of the Act,<sup>6</sup> which requires, among other things, that an exchange have rules that are designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. The Commission believes the addition of the identifier "Q" for proprietary trades to cover the member's own error should protect investors by identifying error transactions and enhancing the Exchange's ability to conduct automated surveillance of NYSE members' error trading.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>7</sup> that the proposed rule change (File No. SR-NYSE-2002-08) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>3</sup> Securities Exchange Act Release No. 45462 (February 20, 2002), 67 FR 9341 (February 28, 2002).

<sup>4</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>5</sup> 15 U.S.C. 78f.

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>7</sup> 15 U.S.C. 78s(b)(2).

<sup>8</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45712; File No. SR-PCX-2001-13]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. Relating to Its Auto-Ex System

April 9, 2002.

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 January 30, 2002, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. PCX submitted Amendment No. 1 to the proposed rule change on April 9, 2002.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes rule changes that describe circumstances and Exchange procedures for disengaging the Exchange's Automatic Execution System for Options ("Auto-Ex") and increasing or decreasing Auto-Ex order size. The proposed changes include a procedure for documenting circumstances in which Auto-Ex is disengaged or the eligible order size is increased or decreased. The proposed rule changes also establish circumstances and procedures for declaring away markets unreliable. The

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

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

<sup>3</sup> In Amendment No. 1, the Exchange proposed the following: (1) To add rule text and a purpose statement discussion specifying the circumstances necessary for declaring away markets unreliable and the procedures to be followed in making such declarations; (2) to delete language from the rule text and purpose statement that defines unusual market conditions as including "other situations that create unusual trading conditions;" (3) amend the definition of large influx of orders to include an extraordinarily large options order on the PCX in place of the prior language that referred to an extraordinarily large order on an options exchange; and (4) to delete language from the rule text and purpose statement that describes the underlying quote feed as unreliable when there is no response to orders to buy or sell the underlying stock, or when Market Makers are unable to manually update their quotes. See letter from Cindy Sink, Senior Attorney, Regulatory Policy, PCX, to Deborah L. Flynn, Assistant Director, Division of Market Regulation, Commission, dated April 8, 2002 ("Amendment No. 1").

<sup>20</sup> 15 U.S.C. 78s(b)(2).

<sup>21</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.