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May 29, 2007

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **File No. SR-NASD-2007-023 – Response to Comments**

Dear Ms. Morris:

This letter responds to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) to the above-referenced filing, a proposed rule change to amend the By-Laws of NASD (“By-Laws” or “NASD By-Laws”) to implement governance and related changes to accommodate the planned consolidation of the member firm regulatory operations of NASD and NYSE Regulation, Inc. (“NYSE Regulation”) into NASD, operating under a new name (“New SRO”). The proposed rule change was published for comment in the Federal Register on March 26, 2007.¹

The Commission received 73 comment letters in response to the proposed rule change.² Commenters represented a broad spectrum of NASD membership, as well as various trade organizations, members of the public and one state securities regulator. Most of the commenters opposed the proposed rule change, addressing either the language of the proposed By-Laws or the procedures by which they were adopted. A broad cross-section of commenters supported the proposed rule change, among them several representatives of small firms, the nation’s second largest mutual fund firm, the Securities Industry and Financial Markets Association (“SIFMA”), the Financial Services Institute (“FSI”), the National Association of Independent Broker/Dealers (“NAIBD”) and the North American Securities Administrators Association (“NASAA”).

Comments directed specifically at the language of the proposed By-Laws addressed three primary issues.³ First, commenters focused most intently on whether the proposed By-Law

¹ Securities Exchange Act Release No. 55495 (March 20, 2007), 72 FR 14149 (March 26, 2007).

² See Exhibit 1. The Commission also posted to its Web site four additional letters it received prior to the filing of the proposed rule change and an NASD letter in response to the arbitration issues raised in those advance submissions. See Exhibit 2.

³ NASD and the New York Stock Exchange LLC (“NYSE”) expect to submit additional rule filings to the Commission in connection with the consolidation, including a filing by

asserted that the consolidation will result in less investor protection because it would “eliminate” a regulator. NASD takes issue with these comments and addresses them below.

Fair Representation

The proposed rule change sets forth in full detail the composition of the New SRO Board and the nomination, election and appointment processes to populate that Board and the nominating committee. For the purposes of this response to comments, the most relevant aspects of the proposed governance structure are summarized as follows:

The proposed rule change would create a New SRO Board structure that balances public and industry participation and designates certain Governor seats for firms of various sizes and with particular business models. For the first three years (the “Transitional Period”), the Board would be comprised of 23 governors: eleven “Public Governors,” ten “Industry Governors,” and the Chief Executive Officers (“CEOs”) of NASD and NYSE Regulation. The eleven Public Governors must have no material business relationship with a broker or dealer or an SRO registered under the Exchange Act. Of the ten Industry Governors: (1) three would be registered with a member that employs 500 or more registered persons (“Large Firm Governors”); (2) one would be registered with a member that employs at least 151 and no more than 499 registered persons (“Mid-Size Firm Governor”); (3) three would be registered with a member that employs at least one and no more than 150 registered persons (“Small Firm Governors”); (4) one would be associated with a floor member of the New York Stock Exchange (“Floor Member Governor”); (5) one would be associated with an independent dealer or insurance affiliate (“Independent Dealer/Insurance Affiliate Governor”); and (6) one would be associated with an investment company affiliate (“Investment Company Affiliate Governor”). After the Transitional Period, the seat for the CEO of NYSE Regulation would terminate and the authorized number of Governors would be reduced to 22. The Board could increase its size up to 25 Governors, provided that the number of Public Governors always must exceed the number of Industry Governors.⁴

Under the proposal, the Small, Mid-Size and Large Firm Governors initially would be nominated by one or both of the preexisting NASD Board of Governors (“NASD Board”) and the Board of Directors of NYSE Group (“NYSE Group Board”), depending on the category. Members of corresponding size could nominate additional candidates through a petition process and would elect the Governors in their respective category. The NASD Board and NYSE Group Board each would appoint five Public Governors; one Public Governor would be jointly appointed; the NYSE Group Board would appoint the Floor Member Governor; the NASD

⁴ The proposed By-Laws state that the Board size may be no fewer than 16 nor more than 25 Governors. However, as one commenter pointed out, as a practical matter the Board cannot have fewer than 22 Governors due to the number of designated Industry Governor seats and the requirement that Public Governors exceed the number of Industry Governors. Thus, absent the filing of a proposed rule change, there would be a minimum number of 10 Industry Governors, 11 Public Governors, plus the CEO of New SRO.

In context of the overall proposed governance structure, NASD believes the election and appointment process is consistent with the fair representation standard. It reserves for members the ability to nominate and elect a percentage of the Board – at least 28% – that alone would satisfy the fair representation standard for the reasons explained above. Yet the proposed rule change provides for three additional industry seats and the potential for member-elected Governors to serve on the committee to nominate those seats. In fact, the expectation is that at least 20% of the Nominating Committee will be comprised of Industry Governors. As a trade-off to the substantial industry participation on the Board and to maintain its overall independence, NASD believes it reasonable and sensible to ensure that public members are selected by a nominating committee and that the Board is not dominated by the industry. The Investment Company Affiliate, Independent Dealer/Insurance Affiliate and Floor Member Governors represent seats with distinct business models that are important in informing the deliberations of the Board. To that end, the governance structure reflects a process of vetting by the Nominating Committee and appointment by the Board for the purpose of ensuring that the Governors serving in those seats will be in the best position to provide that subject matter expertise.

Time Period for By-Law Changes

Some commenters contended that NASD failed to follow its existing By-Law procedures for adopting amendments to those By-Laws. Article XVI of the NASD By-Laws provides that an amendment to the By-Laws be approved by a majority of the members voting within 30 days after the date of submission to the membership. These commenters noted that the proposed amendments were submitted to members on December 14, 2006 and that the vote approving the By-Law changes occurred more than 30 days later, on January 19, 2007.

While Article XVI of the NASD By-Laws provides a procedure for obtaining member approval of amendments to the By-Laws, that procedure does not purport to be the exclusive means by which member approval of amendments to the By-Laws must be obtained. Article XXI of the NASD By-Laws permits special meetings of the membership. Members of a Delaware non-stock corporation, including NASD, may take action at an annual or special meeting held pursuant to 8 Del. C. § 211(a) or, unless otherwise restricted by such corporation's certificate of incorporation, by written consent pursuant to 8 Del. C. § 228. The Article XVI By-Law procedure did not eliminate the ability of NASD members under Article XXI and other applicable law to approve changes to the By-Laws at an otherwise validly convened meeting of the members of NASD.¹²

Independent Dealer/Insurance Affiliate and Investment Company Affiliate Governors

One commenter noted confusion in the proposed rule change with respect to the eligibility for the seats of Investment Company Affiliate Governor and the Independent Dealer/Insurance Affiliate Governor. By way of clarification, those two seats are intended to ensure representation on the New SRO Board for certain segments of the securities industry,

¹² See 8 Del. C. § 109(a).

39. Ronald Patterson, President, Southcoast Investment Group, Inc. (April 13, 2007)
40. Craig Biddick, President, Mission Securities Corporation (April 13, 2007)
41. Gary L. Haney, CEO, United Insurance Group, Inc. (April 14, 2007)
42. Mike Miller, CPA, President, Miller Financial Corp. (April 15, 2007)
43. Mike Miller, CPA, President, Miller Financial Corp. (April 15, 2007)
44. E. John Moloney, President and CEO, Moloney Securities Co., Inc. (April 15, 2007)
45. David Isolano, CEO, Max International Broker Dealer Corp. (April 16, 2007)
46. Mary M. Eitel (April 16, 2007)
47. Albert Kramer, President, Kramer Securities Corporation (April 16, 2007)
48. Johnny Q. Member (April 16, 2007)
49. Johnny Q. Member (April 16, 2007)
50. Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association (SIFMA) (April 16, 2007)
51. David W. Stringer, President, Prospera Financial Services, Inc. (April 16, 2007)
52. Bonnie K. Wachtel (April 16, 2007)
53. Deborah Castiglioni, CEO, Cutter & Company, Inc. (April 16, 2007)
54. Lisa Roth, Chairman, National Association of Independent Broker-Dealers (NAIBD) (April 16, 2007)
55. Donald R. Penrod, President, Penrod and Company (April 16, 2007)
56. William C. Alsover, Chairman, Centennial Securities Company, LLC (April 16, 2007)
57. William A. Johnstone, President and CEO, D.A. Davidson & Co. (April 16, 2007)

58. Mark S. Casady, Chairman and CEO, Linsco/Private Ledger Corporation (April 16, 2007)
59. Dale E. Brown, CAE, Executive Director and CEO, Financial Services Institute (April 16, 2007)
60. Steven B. Caruso, President, Public Investors Arbitration Bar Association (April 16, 2007)
61. Charlie Cray, Director, Center for Corporate Policy (April 16, 2007)
62. Kathryn L. Lundgren (April 16, 2007)
63. Howard Spindel, Senior Managing Director, Integrated Management Solutions (April 16, 2007)
64. Walter S. Robertson, III, President and CEO, Scott & Stringfellow, Inc. (April 16, 2007)
65. M. LaRae Bakerink, CEO, WBB Securities, LLC (April 16, 2007)
66. William R. Pictor, Jr., President, Trubee, Collins & Co., Inc. (April 16, 2007)
67. I.P. Daily (April 16, 2007)
68. Ari Gabinet, Principal, The Vanguard Group, Inc. (April 17, 2007)
69. Joseph P. Borg, President and Director, North American Securities Administrators Association, Inc. (NASAA), Alabama Securities Commission (April 17, 2007)
70. William F. Galvin, Secretary of the Commonwealth, Massachusetts Securities Division, Commonwealth of Massachusetts (April 18, 2007)
71. Michael J. Mungenast, CEO and President, ProEquities, Inc. (April 23, 2007)
72. Joan Hinchman, Executive Director, President and CEO, National Society of Compliance Professionals (April 26, 2007)
73. Jonathan W. Cuneo, Esq. and Richard D. Greenfield, Esq., on behalf of Benchmark Financial Services, Inc. and Standard Investment Chartered, Inc. (May 4, 2007)

Comments Received Prior to the Submission of SR-NASD-2007-023

1. Franco Mortarotti, Zermatt Capital Management (December 11, 2006)
2. Samuel F. Lek, Lek Securities Corporation (December 15, 2006)
3. Mary S. Darcy, Managing Partner, The Darcy Group, LLC (December 21, 2006)
4. The Public Members of Securities Industry Conference on Arbitration (SICA) (January 12, 2007)
5. Linda Fienberg, President, Dispute Resolution, NASD (January 26, 2007)

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