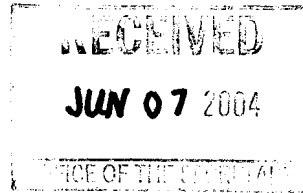


Elisse B. Walter
Executive Vice President
Regulatory Policy and Programs

5



June 7, 2004



Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth St., N.W.
Washington, D.C. 20549-0609

Re: File No. S7-18-04 – Notice of Proposed Rulemaking Concerning Proposed Rule
Changes of Self-Regulatory Organizations (“Proposing Release”)

Dear Mr. Katz:

The staff of the National Association of Securities Dealers (“NASD”) welcomes the opportunity to express its views on the proposed rulemaking by the Securities and Exchange Commission (“SEC” or “Commission”) concerning the electronic filing of proposed rule changes by self-regulatory organizations (“SROs”) and the posting on SRO websites of those proposed rule changes, as well as current and complete sets of their rules.¹

We strongly support the SEC’s efforts to streamline and expedite the SRO rule filing and approval process through the use of electronic web-based technology and the posting of SROs’ current and proposed rules on their websites. As described in more detail herein, we believe that the general objectives of the proposal – to modernize and make more transparent the SRO rule filing process – will have a favorable effect on the rulemaking process and will enhance the SROs’ abilities to provide members, investors, fellow regulators, and other interested parties with timely access to information relating to proposed and approved rule changes. This letter, however, sets forth our concerns with certain requirements described in the proposal, as well as certain SEC estimates of the costs and burdens associated with the SRO rulemaking process.

Overview

In general, the SEC’s proposal would: (1) amend Rule 19b-4 under the Securities Exchange Act of 1934 (“Exchange Act”) and Form 19b-4 to require that all Forms 19b-4 be submitted electronically to the SEC through a web-based system; (2) amend Rule 19b-4 to

¹ The comments provided in this letter are solely those of the staff of NASD; they have not been reviewed or endorsed by the Board of Governors of NASD or by the Board of Directors of NASD Regulation. For ease of reference, this letter may use “we,” “NASD” and “NASD staff” interchangeably, but with the exception of references to NASD systems, these terms refer only to NASD staff.

require each SRO to post all proposed rule changes on its public website no later than the next business day after filing with the SEC; and (3) amend Rule 19b-4 to require SROs to post and maintain a current and complete set of their rules on their websites.²

1. Electronic Filing of SRO Proposed Rule Changes and Amendments

According to the Proposing Release, individuals authorized by the SRO would use a secure website, accessed via unique user IDs and passwords, to file with the SEC the SRO's proposed rule changes, including any related amendments, withdrawals, or extensions of time. The authorized users would complete an electronic Form 19b-4 with the required information for the rule filing. The SRO would convert exhibits, such as comment letters, into an electronic format (*i.e.*, PDF format) and electronically attach them to the Form 19b-4.

As to signature requirements, the SRO would be required to file its proposed rule changes with an electronic signature. Each duly authorized signatory would be required to obtain a "digital ID" from a "Certificate Authority." The duly authorized signatory also would be required to manually sign a paper copy of the rule filing either before or at the time the rule filing is electronically submitted to further authenticate the electronic signature. The SRO would have to retain the manual signature page of each rule filing for not less than five years after the Form 19b-4 is filed with the SEC in accordance with SEC Rule 17a-1 and, upon request, furnish a copy of it to the Commission or its staff. A proposed rule change would be deemed filed with the SEC on the business day that it is submitted electronically, so long as the SEC receives it on or before 5:30 p.m., EST (or Eastern Daylight Savings Time, as the case may be), and it is filed in accordance with the requirements of Rule 19b-4 and Form 19b-4.

We strongly support an electronic web-based SRO rule filing process. The use of an electronic web-based filing system to submit SRO rule filings will help significantly to streamline the rulemaking process, making it more efficient and more transparent to all interested persons. The technology is already familiar to NASD, as we currently use web-based electronic filing technology in our new member application process and also convert all pre-filing comment letters we receive in response to NASD Notices to Members into an electronic format for publication on NASD's website.

However, as further detailed below, we have some concerns regarding certain aspects of this electronic filing requirement and, while not an impediment to our support for an electronic filing process, the SEC's estimates of related costs and burdens.

² We note that the SEC's proposal also would: (1) make a technical amendment to Regulation S-T to reflect that the Form 19b-4 will be filed electronically; (2) amend Rule 19b-4(e) to clarify that the term "new derivative securities products" does not include a single equity option or a securities future product; and (3) amend Rule 19b-4(f)(2) to more clearly reflect the SEC's stated position that a proposed fee change applicable to non-members and non-participants must be filed under Section 19(b)(2) of the Exchange Act for full notice and comment. We are not, however, commenting on these proposed changes in this letter.

A. Paper Filing Alternative

The proposed amendments would permit certain portions of a rule filing to be made in paper form under limited circumstances, such as certain documents that cannot be transmitted electronically or proprietary information that the SRO does not want to file electronically. We firmly agree with these provisions and appreciate the SEC's recognition of the need for SROs to be able to submit certain portions of a filing in paper form, including confidential and proprietary information or documents that are not readily convertible to electronic format. However, we recommend that the SEC also provide SROs with the option to use paper-based filing in certain additional emergency situations, such as when the electronic web-based system may be temporarily unavailable, or the SEC or SRO is otherwise experiencing systems problems due to internal or external factors. We suggest that, under such exceptional circumstances, the SEC make available to SROs the existing processes and procedures for paper-based filing of rule changes.

B. Signing and Retaining a Paper Signature Page of Form 19b-4

We do not believe that requiring the duly authorized signatory to sign, and the SRO to retain, a paper signature page is necessary. If the purpose of the manual signature page is to assure that the rule filing has been properly signed and filed, the digital ID accompanying the electronic signature should suffice.³ Also, the elimination of the proposed requirement to retain a manual signature page would permit SROs, in the case of many rule filings, to store all information electronically and therefore able to eliminate paper files for these rule filings. In the absence of compelling reasons to keep this paper-based recordkeeping burden on SROs, we recommend eliminating this requirement as inconsistent with the administrative efficiency and economy goals that are a large part of the motivation for this rule proposal.

C. SRO Notice of Receipt of Filing

The Proposing Release does not address whether the proposed electronic web-based system would provide an SRO with notice that the SEC has received the SRO's rule filing. If the electronic filing system does not provide such notice of receipt, we request that the SEC incorporate this feature. An electronic notice of receipt would inform the SRO, without manual intervention, that the SEC has received the rule filing. It also could serve as notice to the SRO of the need to post the rule filing on its website, as required by this proposal, within the specified time period.

The Proposing Release also discusses the SEC Division of Market Regulation's internal SRO Rule Tracking System ("SRTS"), which, in the event the SEC mandates electronic filing of SRO rule changes, will be able to monitor electronically the progress of SRO rule filings

³ In this regard, the Proposing Release states that the digital ID requirement will serve to provide "both the Commission and the SRO with assurances that the Form 19b-4 has been transmitted without external interference." SEC Proposing Release, 69 F.R. 17864, 17865 (April 5, 2004).

from initial receipt through final disposition. We encourage the SEC to consider providing the SROs with appropriately limited viewing capability to permit them to determine, by electronic means, the current status of their respective rule filings.

D. Rule Filings Deemed by the SEC as not Properly Filed

In the Proposing Release, the SEC suggests that an SRO should inform the public of a proposed rule change that the SEC has deemed incomplete or not properly filed because it does not comply with the requirements of proposed amended Rule 19b-4 and Form 19b-4. In these instances, the SEC staff will return the rule filing to the SRO.

As an initial comment, we have significant concerns with the SEC's stated practice of returning rule filings to an SRO that it deems not in compliance with Rule 19b-4 or Form 19b-4.⁴ In particular, we are concerned that, in those instances where the SEC returns a rule filing, the rule filing is not subjected to the procedural requirements applicable to the SRO rule filing process under the Exchange Act and, therefore, is not afforded the important safeguards provided by that process. As discussed in the Proposing Release generally, under Section 19(b)(1) of the Exchange Act, the SEC is required, upon the filing of any proposed rule change, to publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved.⁵ The SEC must then give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. The proposed rule change may not take effect unless the Commission approves it, or it is otherwise permitted to become effective under Section 19(b)(3)(A) of the Exchange Act. Under Section 19(b)(2)(B) of the Exchange Act, the Commission must approve a proposed rule change of an SRO if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the SRO. As an alternative to approving a rule change, the Commission may, under Section 19(b)(2)(B), institute proceedings to determine whether the proposed rule change should be disapproved.

To the extent a rule filing does not comply with the requirements of Rule 19b-4 and Form 19b-4, we appreciate that the SEC must have the ability to return such filings to the SRO as incomplete. If, however, the SEC has concerns with the substance or content of any particular filing, we believe it is critical that the SEC notice the filing for public comment, and, at the SEC's discretion, solicit specific public comment on any area of substantive concern.

⁴ In this regard, amended Form 19b-4 would specifically state, "[t]he proposed rule change shall be considered filed on the date on which the Commission receives the proposed rule change if the filing complies with all requirements of this form. Any filing that does not comply with the requirements of this form may be returned to the self-regulatory organization at any time before the issuance of the notice of filing. Any filing so returned shall for all purposes be deemed not to have been filed with the Commission. *See also* Rule 0-3 under the Act (17 CFR 240.0-3)." This proposed language is substantially similar to that appearing in the current Form 19b-4.

⁵ See also SEC Proposing Release, 69 F.R. at 17864 ("Once an SRO files a proposed rule change, the Commission must publish notice of it and provide an opportunity for public comment.").

Importantly, as noted above, in the event the SEC were to remain concerned that an SRO rule filing was inconsistent with the requirements of the Exchange Act, the SEC has the ability, under Section 19 of the Exchange Act, to institute a proceeding to determine whether a proposed rule change should be disapproved. In contrast, the SEC's initial review to determine whether a filing is in compliance with the requirements of Rule 19b-4 and Form 19b-4 should be unrelated to the substance of the proposal, and the practice of returning a filing should be limited to those SRO rule filings that are incomplete.

Assuming that the SEC were to return a filing to an SRO as incomplete, we do not object to informing the public of the status of the proposed rule change by means of a notation on the SRO's website indicating "Filing Returned." In such situations, NASD staff believes that the SRO should be permitted to decide whether to remove the filing itself from its website, provided that the SRO includes the notation that the rule filing has been returned.⁶ Such a notation would satisfy the SEC's concern that persons monitoring proposed rule changes have comprehensive information on the status of filings.

As a preferred alternative, however, NASD staff strongly suggests that the SEC implement a policy that would require SEC staff to review an SRO filing for completeness and to inform an SRO if its filing is deemed incomplete and thus not properly filed before the expiration of the time in which the SRO is required to post the filing on its website. In this regard, the SEC staff has, on at least one occasion, informed NASD several months after filing a proposed rule change that the rule filing was not considered complete and was being returned as not properly filed. Having a filing posted on an SRO website for such a significant period of time, only to have it returned by the SEC, heightens public confusion and regulatory uncertainty.

We note that we have previously expressed to the SEC our support for an earlier SEC proposal to, among other things, publish for comment an SRO's proposed rule changes within 10 business days of being filed with the Commission.⁷ While the Exchange Act does not specify the number of days in which the SEC must publish an SRO rule filing for public comment,⁸ we believe that a fair reading of the Exchange Act and the provisions applicable to the SRO rule filing process require the SEC to publish promptly for comment those SRO rule filings that meet the technical filing requirements of Rule 19b-4. In this regard, we view the current proposal as a departure from the previous proposal insofar as it does not provide procedural certainty and specific time parameters around the SEC's statutory obligation to

⁶ Cf. SEC Proposing Release, 69 F.R. at 17866 n.23 ("If the SRO withdrew the proposed rule change, the SRO could remove the proposed rule change from its website.").

⁷ See comment letter to Jonathan G. Katz, Secretary, SEC, from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD Regulation, Inc. and NASD Dispute Resolution, Inc. (May 3, 2001), regarding S7-03-01, Notice of Proposed Rulemaking Concerning Proposed Rule Changes of Self-Regulatory Organizations.

⁸ See supra note 5 and accompanying text.

publish rule filings for comment. We therefore request that the Commission revisit that aspect of the earlier proposal (i.e., to publish SRO rule filings within 10-business days of filing) in conjunction with its review of the comments submitted on the current proposal. A requirement that SROs file their proposed rule changes electronically combined with an SEC 10-business-day publication requirement would significantly expedite and improve the rulemaking process, thereby allowing all parties to promptly address important regulatory issues.

E. Withdrawn Rule Filings

The Proposing Release requests comment on whether an SRO should inform the public if a properly filed rule filing is subsequently withdrawn. In this regard, we currently note on our website if a rule filing has been withdrawn, and support incorporating such a requirement into the SRO rulemaking process. Informing members and the public of the formal withdrawal of such filings is appropriate and assists persons in monitoring the status of rule filings. Consistent with our comment in Section I.D. above regarding returned rule filings, an SRO should be permitted to decide whether to remove the filings from the website, provided that the SRO includes a notation that the rule filing has been withdrawn.⁹

F. SEC's Estimate of Time to Complete Average Rule Filing and Amendment and Estimated Cost of Digital IDs

The Proposing Release estimates that an SRO requires approximately 35 hours to complete an average rule filing, which assumes 25 hours of legal work and 10 hours of clerical work. The Proposing Release also estimates that an SRO requires four hours to complete an amendment to a proposed rule change, based on two hours of legal work and two hours of clerical work. While not material to our response to this proposal, we note that these figures significantly underestimate the time NASD requires to complete even an average rule filing or amendment, given the need for staff to, among other things, draft the filing, research related issues, coordinate comments within and between Departments, contact the SEC staff and other SROs as appropriate, proofread and cite-check the filing, and handle clerical matters, such as manually numbering rule filing pages that may include numerous pre-filing comment letters, photocopying, and otherwise preparing the filing package. Because the time spent in preparing any particular rule filing is very fact specific, we cannot readily provide estimates on the number of hours required to complete an average rule filing or amendment; however, we would be happy to provide additional data to the SEC staff if they would find such information useful to this proposal.

The SEC estimates that digital IDs will cost each SRO approximately \$30 annually (approximately \$15 for each digital ID) because each SRO will need to obtain two digital IDs. We note that NASD likely would seek 5-10 digital IDs to ensure that NASD can electronically

⁹ See supra note 6.

file its proposed rule changes, amendments, extensions, and withdrawals in a timely manner, under a duly authorized signature.

As noted earlier, notwithstanding these comments on the SEC's stated estimates, we strongly support an electronic web-based filing process for SRO rulemaking.

G. Web Posting of National Market System Plans

We agree with the SEC's suggestion that the plan administrators of the seven national market system plans¹⁰ be required to post on their websites or on a separate plan website a current version of the plans as well as proposed amendments to those plans. However, we suggest that the SEC also provide this information or a hyperlink to this information on its website. Having this information on the SEC's website would make it more accessible to investors, especially those individuals who may not be familiar with these national market system plans or their various plan administrators.

2. Web Posting by SROs of Their Proposed Rule Changes

Under the proposal, each SRO would be required to post all proposed rule changes and any related amendments on its public website no later than the next business day after filing with the SEC. We support the proposal that all SROs be required to post their filings on their websites. In this regard, we have posted virtually all of NASD's proposed rule changes and amendments on our website since 1998. Requiring all SROs to post this information would better inform SRO members, investors, other regulators, and other interested parties about current SRO rulemaking efforts. It also would enable persons to comment more promptly on proposed regulatory initiatives. We note, below, however, our concerns regarding certain aspects of the proposed web-posting requirement and the SEC's estimates of the related costs and burdens.

A. Next-Business Day Posting Period

The SEC proposes to require each SRO to post all proposed rule changes, and any amendments thereto, on its public website no later than the next business day after filing with the SEC. We believe that this period is too short for SROs to be able, on a routine basis, to

¹⁰ As noted in the Proposing Release, the national market system plans are: (1) the Intermarket Trading Systems ("ITS") Plan, (2) the Consolidated Tape Plan, (3) the Consolidated Quotation Plan, (4) the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis ("OTC/UTP Plan"), (5) the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information ("OPRA"), (6) the Plan for the Purpose of Creating and Operating an Options Intermarket Linkage ("Linkage Plan"), and (7) the Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options ("Options Listing Procedures Plan"). See SEC Proposing Release, 69 F.R. at 17868.

format copies of the proposed rule changes and post them on their websites. We suggest that the SEC expand the requisite period for posting a proposed rule change to five business days from the date of filing. We base this suggestion, in part, on information from NASD's Corporate Communications Department (Communications Department), which manages NASD's website as well as other communications projects and needs. We believe that requiring the Communications Department, in all cases, to post proposed rule changes within one business day after another department submits a rule filing or amendment would not allow sufficient time for the Communications Department to integrate these postings into its normal work flow.

In addition, as mentioned above in Section 1.D., the brevity of the one-business-day posting period increases the likelihood that an SRO would post a proposed rule change on its website that the SEC subsequently returns to the SRO as "not properly filed." Again, subject to the concerns noted in Section 1.D. regarding the return of rule filings, the SEC should consider a policy that would require SEC staff to inform an SRO if its rule filing is deemed not properly filed within a reasonable amount of time before the expiration of the time period in which the SRO is required to post the rule filing – which we suggest should be five business days from the date of filing.

B. SEC's Estimates Regarding Time Needed to Post Proposed Rule Changes and Related Costs

The SEC estimates that 30 minutes is sufficient time to post either a proposed rule change, or any amendments thereto, on a website. We believe that this estimate is too low. Before the Communications Department can post a proposed rule change on the website, it must convert it into a PDF file, copy it to a development server to be processed, and link it (but not yet activate the link) to NASD's Rule Filing web page. The Communication Department then returns it to the responsible NASD department for review to ensure that no rule filing language or proposed rule text has been inadvertently altered or omitted during the formatting process. After the review is complete, the Communications Department is notified and activates the link to allow individuals to access the PDF file on NASD's Rule Filing web page. This process takes approximately four hours per rule filing and/or amendment and could take considerably longer, depending on the size of the proposed rule filing and work schedules/demands.

In addition, the SEC's release estimates that an SRO would incur only nominal costs in posting filings on its website. Again, this estimate appears to overlook the staff resources required to format and review a proposed rule change, or amendment thereto, before it can be posted. Nonetheless, we believe that the benefits of requiring SROs to post their rule filings on their public websites far outweigh the related costs.

3. Web Posting of Current Rules and Approved Rule Changes – Online Manual

Under the proposed amendments to Rule 19b-4, SROs would be required to post and maintain a current and complete set of their rules on their websites. We interpret this to mean that the SEC would expect each SRO to maintain an online manual of their rules. Also, each

SRO would be required to update its website to reflect rule changes no later than the next business day after it has been notified of SEC approval of the rule change or SEC notice of an effective-upon-filing SRO rule. The SEC estimates that an SRO would require only two hours to perform this update. The Proposing Release states that the SEC will notify the SROs either electronically, via SRTS, or by faxing the SEC's approval order or the SEC's notice of an effective-upon-filing SRO rule to the SRO.

The proposed amendments further require that if a rule change is not effective for a certain period, the SRO must clearly indicate the effective date in the relevant rule text.¹¹ The SEC, however, requests specific comment on whether, in such situations, the SRO's website update should be delayed until the rule change's effective date.

We generally support these posting requirements and already post a current and complete version of NASD rules on our website. However, we do not believe that the one-business-day posting period and the two-hour estimate described above accurately reflect the amount of time necessary for an SRO to incorporate recently approved or effective-upon-filing rule changes into its online manual.

NASD currently contracts with an outside vendor to update its online manual, a practice recognized by the SEC in the Proposing Release. The process generally requires internal staff review and approval of the final rule text, as well as review and approval of the galleys prepared by the vendor. Depending on the size and complexity of the rule change, this process may require several iterations of review and corrections, and can take up to ten or more business days. Moreover, because effective dates of approved rules are often driven by the date on which NASD issues a Notice to Members announcing SEC approval of the change, it is not uncommon for an effective date to be undetermined for, for example, thirty days or more following SEC approval.

To account for the myriad issues raised by this process,¹² we suggest that, instead of the one-business-day deadline, the SEC grant SROs certain flexibility to determine when to update their websites to reflect approved, or effective-upon-filing, rule changes, provided that each SRO adheres to certain basic principles in the process: First, the SRO should be required to update its online manual to reflect a recently approved rule change by no later than the effective date of the rule change. Second, in the event the SRO elects to update its online manual prior to the effective date of the approved rule change, the SRO should be required both to clearly delineate on its website the text of the rules currently in effect versus the rule text to be effective

¹¹ If the SEC is proposing to require that all effective dates be set forth in the actual rule text (i.e., in final print form), we do not support such a requirement. Referencing the effective dates of every rule change in actual rule text would unnecessarily complicate the content of the rules, particularly given that rules often are amended in sections, with varying effective dates.

¹² Notwithstanding the practical constraints further discussed herein, we recognize NASD's ultimate responsibility to adhere to SEC requirements and will work with our vendors to incorporate any requirements reflected in any final rule in this area.

in the future, and to apply this approach consistently to all of its rules. For instance, if an SRO elects to update its online manual prior to the effective date of new amendments (with the proper notation and delineation of effective dates), then persons using the online manual should be able to assume that, in the absence of such a notation, there are no recently approved, but not yet effective, changes to any given rule. Lastly, in the case of effective-upon-filing rule changes, we suggest that the SROs be required to post the text in a designated section of the websites within five business days of receipt of the SEC's notice; this, e.g., would then provide NASD with sufficient time to coordinate with its vendors to update its actual online manual.

Within this framework, an SRO would be able to work diligently, either directly or with its vendor, to ensure that the online manual is updated as promptly as possible to reflect newly approved rule changes and also that it would be updated in a manner that would allow members and other persons to clearly distinguish between currently effective rule language and future rule text.

Alternatively, if the SEC believes it necessary to require SROs to adhere to uniform procedures and to post recently approved rule changes on their websites within a specified period of time, the SEC should provide the SROs with at least 15 business days in which to do so,¹³ or alternatively, the SEC should permit the SROs, in a designated section of their websites, simply to post the SEC's approval order (or the revised rule text) within five business days of notice of such approval. NASD currently includes hyperlinks on its website to the SEC's approval orders shortly following their publication in the Federal Register; however, the SEC's approval orders do not always set forth the final approved rule text. In this regard, we recommend that the SEC consider routinely including the final approved rule text in its approval orders to help facilitate electronic posting of the text.

A. Notification of Approval of Rule Change or Effective-Upon-Filing SRO Rule

The Proposing Release suggests that the SEC notify an SRO of an approved rule change or an effective-upon-filing SRO rule either electronically, via SRTS, or by facsimile. We believe that notification through facsimile alone would not be sufficiently reliable, and suggest that the SEC notify SROs by electronic communication and use facsimile notification only as a backup in situations where electronic communication systems are impaired or otherwise unavailable.

The Proposing Release does not identify the person(s) that the SEC will notify of the approved or effective-upon-filing rule changes. We assume that the SEC intends to notify the person listed on the Form 19b-4 as the contact person for the rule filing. However, we do not

¹³ Even with this 15-business day requirement, we ask that the SEC retain authority to grant an SRO a reasonable extension of such time period in extraordinary circumstances.

Mr. Jonathan G. Katz

June 7, 2004

Page 11

believe sending notification to one person alone provides an SRO with adequate notice of SEC action. On the day the notification arrives, the contact person for a rule filing could be out of the office, in extended meetings, or otherwise unavailable. To provide adequate notice, we suggest providing a contact information field that would allow an SRO to designate up to five persons that should receive notice of an approved or effective-upon-filing rule change. Given the import of such notice, we also suggest that the SEC consider incorporating a feature in the electronic web-based filing system to allow an SRO to confirm receipt of the SEC's notice, with the SEC staff promptly following up in the event the SRO does not respond.

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We appreciate the opportunity to express our views to the Commission on these important issues and looks forward to working with the Commission and its staff to streamline the rulemaking process.

Very truly yours,



Elisse B. Walter

Executive Vice President

NASD, Regulatory Policy and Programs