

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50122; File No. SR-Amex-2004-32)

July 29, 2004

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change by the American Stock Exchange LLC to Amend Article II, Section 3 of the Exchange Constitution

I. Introduction

On May 12, 2004, the American Stock Exchange LLC (“Amex” 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 proposed rule change to amend Article II, Section 3 of the Exchange Constitution to provide the Amex the ability to contract with another self-regulatory organization for regulatory services. The proposed rule change was published for comment in the Federal Register on June 3, 2004.³ The Commission received no comments on the proposed rule change. On June 24, 2004, Amex filed Amendment No. 1 to the proposal.⁴ This order approves the proposed rule change.

II. Description of Proposal

The Exchange proposes to amend Article II, Section 3 of the Exchange Constitution to create a mechanism to allow the Exchange to contract with another self-regulatory organization

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 49775 (May 26, 2004), 69 FR 31437.

⁴ See letter from William Floyd-Jones, Jr., Associate General Counsel, Amex, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, (“Division”), Commission, dated June 23, 2004 (“Amendment No. 1”). In Amendment No. 1 the Exchange advised that on June 22, 2004, the proposed rule change was approved by New NASD Holdings, Inc., the holder of the Class B interest in the Exchange, and as a result, the Exchange’s internal procedures with respect to the proposed rule change were complete. Amendment No. 1 is a technical amendment, and, therefore, not subject to notice and comment.

for the performance of certain of Amex's regulatory functions. The amendment would authorize an officer of the Exchange, on behalf of the Exchange, subject to approval by the Amex Board, to enter into one or more agreements with another self-regulatory organization to provide regulatory services to the Exchange to assist the Exchange in discharging its obligations under Section 6 and Section 19(g) of the Act.⁵ Under the proposal, any action taken by another self-regulatory organization, or its employees or authorized agents, acting on behalf of Amex pursuant to a regulatory services agreement will be deemed to be an action taken by the Exchange. However, the amended Constitution states that nothing in Article II, Section 3 shall affect the oversight of such other self-regulatory organization by the Commission. The amended Constitution also provides that Amex will retain ultimate legal responsibility for, and control of, its self-regulatory responsibilities, and that any such regulatory services agreement shall so provide.

In the proposal, the Exchange noted that this rule change would have immediate applicability with respect to a Regulatory Services Agreement ("RSA") dated as of April 30, 2004, between the National Association of Securities Dealers, Inc. ("NASD") and the Amex.⁶ Amex determined that, to best discharge its self-regulatory responsibilities, it would contract with the NASD, which is subject to Commission oversight pursuant Sections 15A and 19 of the Act,⁷ to provide certain regulatory services to the Amex. Under the RSA, NASD, through its wholly owned subsidiaries NASD Regulation, Inc. ("NASDR") and NASD Dispute Resolution,

⁵ 15 U.S.C. 78f and 15 U.S.C. 78s(g).

⁶ Pursuant to applicable provisions of the Freedom of Information Act, 18 U.S.C. 1905, and Commission regulations thereunder, 17 CFR 200.83, Amex has requested confidential treatment for the RSA.

⁷ 15 U.S.C. 78q-3 and 15 U.S.C. 78s.

Inc. (“NASDDR”), performs certain regulatory functions as an agent on behalf of Amex. The RSA provides a framework for oversight of Amex members and enforcement of Amex rules and federal securities laws, and describes the services that NASD will perform so as to ensure a regulatory program that will satisfy applicable statutory requirements. Specifically, pursuant to the RSA, NASDR and NASDDR will provide market and trade practice surveillance and analysis; financial and operational regulation; options sales practice regulation; disciplinary and enforcement functions; and dispute resolution services.

The Amex stated that in performing services under the RSA, the NASD will be operating pursuant to the statutory self-regulatory responsibilities of the Amex under Section 6 and Section 19 of the Act⁸ and will apply Amex’s rules. The Exchange also stated that any action taken by NASD or its employees or authorized agents pursuant to the RSA (or any other SRO with which the Exchange contracts) will be deemed an action taken by the Amex (without, however, affecting the Commission’s oversight of such other self-regulatory organization). The Amex noted, however, that it retains ultimate responsibility for performance of its self-regulatory duties under the RSA.

III. Discussion

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.⁹ Specifically, the Commission finds that the proposed rule change is consistent with and furthers the objectives of Sections 6(b)(1),¹⁰

⁸ 15 U.S.C. 78f and 15 U.S.C. 78s.

⁹ 15 U.S.C. 78f.

¹⁰ 15 U.S.C. 78f(b)(1).

6(b)(6),¹¹ and 6(b)(7)¹² of the Act, which require that the Exchange enforce compliance by its members and persons associated with its members with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange; that the rules of the Exchange provide that its members and persons associated with its members shall be appropriately disciplined for violations of the Act, the rules and regulations thereunder, and the rules of the Exchange; and that the rules of the Exchange provide a fair procedure for the disciplining of members and persons associated with members.

The Commission has previously stated and continues to believe that contractual regulatory agreements between self-regulatory organizations may be permissible in instances where it is consistent with the public interest.¹³ The Commission believes that it is reasonable and consistent with the public interest to allow a self-regulatory organization to contract with another self-regulatory organization to perform disciplinary and enforcement functions.¹⁴ The Commission also believes NASD has the expertise and experience to perform these functions, and thus will be able to assist Amex in fulfilling its self-regulatory responsibilities as set forth under the Act.

¹¹ 15 U.S.C. 78f(b)(6).

¹² 15 U.S.C. 78f(b)(7).

¹³ See Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) at Section III(D)(2) (“ISE Approval Order”) (approving the application for registration of the International Securities Exchange, Inc., including authority to contract with another self-regulatory organization to perform regulatory functions).

¹⁴ Id. In the ISE Approval Order, the Commission also stated that “[d]iscipline and enforcement are fundamental elements to a regulatory program, and constitute core self-regulatory functions. It is essential to the public interest and the protection of investors that these functions are carried out in an exemplary manner, and the Commission believes that NASD Regulation has the expertise and experience to perform these functions.”

The Commission continues to believe, however, that it is important, and required by the Act, for ultimate responsibility and primary liability for self-regulatory failures to rest with the Exchange itself rather than the contracted self-regulatory organization.¹⁵ Consistent with this approach, Amex will bear ultimate legal responsibility for the performance of its self-regulatory functions, despite the fact that NASD's subsidiaries will be carrying out the regulation of Amex's market pursuant to the RSA. Nevertheless, the Commission has stated and again reiterates that the self-regulatory organization providing regulatory services may bear liability for causing, or, in appropriate circumstances, aiding and abetting, regulatory failures by the Exchange.¹⁶ Thus, NASD may bear secondary liability if the Commission finds that the contracted regulatory functions are being performed so inadequately as to cause a violation of the federal securities laws by Amex.

The Commission also notes that Amex has represented that any NASD employee acting pursuant to the RSA will be deemed to be an Amex employee for purposes of Amex's rules. In particular, Amex represents that for purposes of any rule that requires an employee or personnel of Amex to perform a specific regulatory oversight, disciplinary or enforcement function, any NASD employee that is performing such function pursuant to the RSA will be deemed to be an Amex employee for purposes of Amex's rules as a result of this rule change. Thus, no changes to Amex's rules are required as a result of this filing.¹⁷

¹⁵ See ISE Approval Order at Section III(D)(2), and Sections 6(b), 19(g) and 19(h) of the Act. 15 U.S.C. 78f(b), 78s(g) and 78s(h).

¹⁶ See ISE Approval Order at footnote 68 and accompanying text.

¹⁷ Telephone call between William Floyd-Jones, Jr., Associate General Counsel, Amex, and Heather Seidel, Attorney-Fellow, Division, Commission, on July 29, 2004.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (SR-Amex-2004-32) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

Margaret H. McFarland
Deputy Secretary

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ 17 CFR 200.30-3(a)(12).