

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50926; File No. SR-NASD-2004-110)

December 23, 2004

Self-Regulatory Organizations; Order Approving a Proposed Rule Change, and
Amendment Nos. 1, 2 and 3 Thereto, by National Association of Securities Dealers, Inc.
Relating to Divestiture of Its Interest in the American Stock Exchange LLC

I. Introduction

On July 16, 2004 the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “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 reflect NASD’s pending divestiture of its ownership interest in the American Stock Exchange LLC (“Amex”) pursuant to a Transaction Agreement between Amex and NASD wherein the The Amex Membership Corporation will become the sole owner of Amex (the “Transaction”).³ NASD amended the proposal on August 10, 2004,⁴ August 25, 2004,⁵ and September 3, 2004.⁶ The

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 50057 (July 22, 2004); 69 FR 45091, July 28, 2004) (SR-AMEX-2004-50) for a detailed description of the Transaction.

⁴ See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation (“Division”), Commission, dated August 10, 2004 (“Amendment No. 1”). Amendment No. 1 replaced NASD’s original filing in its entirety.

⁵ See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated August 25, 2004 (“Amendment No. 2”). Amendment No. 2 replaced NASD’s earlier amended filing in its entirety.

⁶ See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division,

proposed rule change was published for comment in the Federal Register on September 23, 2004.⁷ A correction to the proposed rule change was published in the Federal Register on October 5, 2004.⁸ No comments were received on the proposal. This order approves the proposal, as amended.

II. Description of the Proposal

The proposed rule change amends provisions of NASD's By-Laws to reflect NASD's pending divestiture of its ownership of Amex as a result of the Transaction; make parallel amendments to the definitional and conflict-of-interest provisions of the By-Laws of NASD Regulation, Inc. ("NASD Regulation") and NASD Dispute Resolution, Inc. ("Dispute Resolution"); terminate certain undertakings NASD assumed when it acquired Amex in 1998 (the "1998 Undertakings"); and make certain other clarifying amendments. A brief description of the proposed changes is set forth below.

NASD By-Law Article I (Definitions)

The proposed amendments eliminate references to Amex and/or Nasdaq from the definitions of "Industry Director" and "Industry Governor," "Non-Industry Director" and "Non-Industry Governor," and "Public Director" and "Public Governor." NASD proposes to replace references to Amex and/or Nasdaq in each of those definitions with

Commission, dated September 2, 2004 ("Amendment No. 3"). Amendment No. 3 modified Exhibit 1 and made certain technical corrections to the proposal. Amendment No. 3 replaced NASD's earlier amended filing in its entirety.

⁷ See Securities Exchange Act Release No. 50403 (September 16, 2004), 69 FR 57119.

⁸ See Securities Exchange Act Release No. 50403A (September 29, 2004), 69 FR 59630.

the phrase “a market for which NASD provides regulation.” Other references to Amex’s “Floor Governor,” “Amex,” “Amex Board” and “Chief Executive Officer of Amex” also have been eliminated. NASD also proposes further clarifying amendments to the definition of “Non-Industry Director” and “Non-Industry Governor” to include an officer or employee of an issuer of unlisted securities that are traded in the over-the-counter market. NASD represents that this particular change reflects NASD’s historical interpretation of the “Non-Industry Director” and “Non-Industry Governor” definitions. Parallel changes also have been proposed for the definitional provisions of the NASD Regulation and Dispute Resolution By-Laws. NASD also proposes to eliminate other definitions relating to Amex and Amex-related entities in the NASD Regulation and Dispute Resolution By-Laws.

NASD By-Law Article VII (Board of Governors)

In Section 4 of Article VII, NASD proposes to eliminate two seats on the NASD Board that have been reserved for the Chief Executive of Amex and an Amex Floor Governor. The proposal reduces the total number of Governors on the NASD Board from a range of 17-27 to a range of 15-25. NASD also proposes to eliminate the term provisions in Section 5 of Article VII that pertains to Amex’s Chief Executive Officer, and that sets the maximum permissible term of the Amex Floor Governor.

NASD By-Law Article IX (Committees)

NASD proposes to eliminate the requirements that at least one Governor of Amex be included on the NASD Executive Committee and that at least two members of the NASD Executive Committee be members of neither Amex nor NASD Regulation

Boards. Thus, with the changes, the NASD Executive Committee would be composed of no fewer than five and no more than eight Governors, including the Chief Executive Officer of the NASD and at least one Director of NASD Regulation.

NASD Bylaw Article XV (Limitation of Powers)

Section 4 of Article XV of the NASD Bylaws governs participation of NASD in transactions in which Amex Governors have an interest. Section 4(b) of Article XV provides that a contract or transaction in which an Amex Governor has an interest may be permitted if certain disclosures are made and the contract or transaction is approved by an affirmative vote of a majority of a quorum of disinterested Governors. Currently, an Amex-affiliated Governor could be counted as a disinterested Governor for purposes of determining the presence of a quorum. NASD proposes to eliminate Amex from the quorum provision and as a result, NASD represents that an Amex-affiliated Governor will no longer be counted as disinterested for purposes of determining the presence of a quorum at the portion of the meeting of the NASD Board that authorizes a contract or transaction with Amex. Parallel changes are proposed for the conflict-of-interest provisions of the NASD Regulation and Dispute Resolution By-Laws.

1998 Undertakings

Amex proposes to withdraw the principles that it adopted in 1998 that would guide the NASD in fulfilling its responsibilities as parent company of Amex with ultimate responsibility for Amex's compliance with its statutory responsibilities as a self-regulatory organization. In the 1998 Undertakings, among other things, NASD represented that it would exercise its powers and its managerial influence to ensure that

Amex fulfilled its self-regulatory obligations by directing Amex to take action necessary to effectuate its purposes and functions as a national securities exchange operating pursuant to the Act, and ensuring that Amex had, and appropriately allocated, such financial, technological, technical, and personnel resources as may be necessary or appropriate to meet its obligations under the Act. NASD also committed to refraining from taking any action with respect to Amex that would impede efforts by Amex to carry out its self-regulatory obligations.⁹

III. Commission Findings

The Commission finds the proposed rule change, as amended, is consistent with Section 15A of the Act¹⁰ and the rules and regulations thereunder applicable to a national securities association. In particular, the Commission find the proposed rule change is consistent with Section 15A(b)(6) of the Act,¹¹ which requires that NASD'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.¹²

The Commission finds that it is appropriate for NASD to delete any mandatory representation of Amex on the NASD Board or NASD Executive Committee. Following

⁹ See Exchange Act Release No. 40443 (September 16, 1998), 63 FR 51108 (September 24, 1998) (File No. SR-NASD-98-67 – Policies Regarding Authority Over American Stock Exchange LLC and Composition of Board of Governors of American Stock Exchange LLC); See also Exchange Act Release No. 40622 (October 30, 1998), 63 FR 59819 (November 5, 1998) (order approving proposed rule change and implementing NASD's undertakings regarding Amex).

¹⁰ 15 U.S.C. 78o-3.

¹¹ 15 U.S.C. 78o-3(b)(6).

¹² In approving this rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

the elimination of Amex representatives on the NASD's Board, the Board will continue to be a majority independent because the NASD By-Laws require that the number of Non-Industry Governors shall exceed the number of Industry Governors.¹³ Given the NASD's pending divestiture of its ownership interest and control over the Amex, the Commission finds that it is appropriate for the NASD to withdraw the 1998 Undertakings. Upon the closing of the Transaction, NASD will no longer maintain any ownership in or control over Amex. Therefore the 1998 Undertakings, which imposed upon NASD certain obligations as the owner of Amex, will no longer be applicable.

The Commission finds that the changes proposed by NASD that delete references to Amex and replace those references with broader provisions are appropriate. For example, NASD proposes to amend the definitions of "Industry Director" and "Industry Governor," "Non-Industry Director" and "Non-Industry Governor," and "Public Director" and "Public Governor" by deleting references to Amex and/or Nasdaq with "a market regulated by the NASD." The Commission believes that this change is appropriate because it takes into account NASD's current – and anticipated – contractual relationship with other market centers, and more importantly, clarifies how an individual's affiliation with such a market center might affect his/her qualification for that particular classification. The same rationale makes corresponding changes to the same definitions in the NASD Regulation and Dispute Resolution By-Laws appropriate.

The Commission also finds that the clarifying amendments that NASD proposes are appropriate. For example, NASD's definition of Non-Industry Director and Non-

¹³ The Commission also notes that the NASD's By-Laws continue to require that a certain number of Public Governors be on the NASD Board, depending on the exact number of NASD Governors in total.

Industry Governor previously included an officer or director of “securities traded in the over-the-counter market.” As noted above, NASD is clarifying this prong of that definition to include an officer or employee of an issuer of unlisted securities. The NASD proposes this change to align the rule text with NASD’s current practice of how it applies this prong of the definition of Non-Industry Director and Non-Industry Governor. NASD stated that this is not a substantive change.¹⁴ In addition, the Commission believes that deletion of Amex from the quorum requirements of NASD, NASD Regulation and Dispute Resolution’s By-Laws governing participation in transactions in which Amex Governors have a conflict of interest is appropriate because it clarifies that an Amex-affiliated Governor cannot be counted as disinterested for quorum purposes in a meeting of the NASD Board that authorizes a contract or transaction with Amex. Finally, the Commission finds that it is appropriate to eliminate the requirement that at least two members of the Executive Committee be members of neither the Amex nor NASD Regulation Boards because the original concern that prompted this requirement – that market interests might dominate the NASD Board – no longer poses any regulatory or governance concern.

¹⁴ Specifically, an officer or employee of a listed issuer could still qualify as a Industry Director or Industry Governor or Public Director or Public Governor if the officer or employee met the requirements for those categories, and could still qualify as a Non-Industry Director or Non-Industry Governor under the prong of that definition that states that a Non-Industry Director or Non-Industry Governor is “any other individual who would not be an Industry Director.” Thus, before and after this change, an officer or employee of a listed issuer could qualify in any of these three categories.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change, NASD 2004-110, as amended, be, and hereby is approved.

The proposed rule change shall be effective upon the closing of the Transaction.

By the Commission.

Margaret H. McFarland
Deputy Secretary

¹⁵ 15 U.S.C. 78s(b)(2).