SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40615; File No. SR–NASD–98–56]

Self-Regulatory Organizations; Order Granting Partial Approval to Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Small Firm Representative on NASD Board Portion of the Proposed Rule Change Relating to Amendment to Composition of NASD Board to Include Members of New Amex LLC and for Other Purposes

October 28, 1998.

On August 10, 1998, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder.[2] In its proposal, among other matters, the NASD proposed revision of its by-laws to reserve one Industry Governor position on the NASD Board of Governors (''Board'') for a representative of smaller NASD member firms. Notice of the proposal was published in the **Federal Register** on August 26, 1998 (''Notice'').[3] The Commission received one comment letter on the filing.

I. Introduction and Description of the Proposal

In 1997, the NASD reorganized its corporate governance structure in connection with a revision of its disciplinary process following issuance of the Commission's Report Pursuant to Section 21(a) of the Act and related order and undertakings.[4] The changes streamlined the NASD's decisionmaking process, improved communication among members of the Board and Association staff and enabled the Association to act quickly and decisively when appropriate.[5] After the reorganization, the NASD established the Small Firm Advisory Board [6] to address concerns raised by a number of smaller member firms about their representation within the new NASD corporate structure.

The Notice indicated that the NASD's experience under the new corporate structure suggested that further participation by the small member firm community in matters affecting their business and their customers would be desirable. To provide this, the NASD filed the proposed rule change, seeking amendment of its by-laws to include one representative of member firms with 150 or fewer registered representatives among the Industry positions on the Board of Governors.[7]

II. Summary of Comments

The Commission received one comment letter from the Independent Broker-Dealer Association (''IBDA'').[8] The NASD responded to this letter.[9]

The comment letter expresses numerous concerns about the representation of small firms within the NASD.[10] Primarily, the comment letter questions whether the proposed ''small firm Board position,'' combined with the current Small Firm Advisory Board, adequately represent the IBDA members within the NASD. The letter stresses the need for enhanced representation of small firms and asserts that IBDA members have been hurt by the lack of adequate representation. The comment letter suggests that IBDA members would be better represented if they were able to elect the members of the Small Firm Advisory Board and the small firm Board representative directly. The comment letter also suggests that the maximum number of registered representatives allowed by the proposed definition of a small firm should be reduced, to more adequately represent the majority of smaller firms.

Responding to the IBDA's concerns, the NASD points out that the Commission approved its 1997 corporate structure and in doing so, found the restructuring to be consistent with the requirements of Section 15A of the Act, including the provisions requiring fair representation of members in the governance of the NASD.[11] In particular, the Association responds that the Commission assessed the 1997 corporate structure changes in terms of the fair representation requirement before reservation of a small firm Board position. Additionally, the NASD asserts that the Small Firm Advisory Board was voluntarily established by the Board of Governors to provide a more effective voice for the small firm member community, notwithstanding the minimum requirements of the Act. Moreover, the NASD points out that, regardless of the proposed definition, the current nominee for the small firm Governor position is associated with a member firm of eight registered representatives,[12] and that eight of the twelve members of the Small Firm

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 40399 (August 19, 1998), 63 FR 22839 (File No. SR–NASD–98–56).

[4] Report and Appendix to Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and The Nasdaq Stock Market (August 8, 1996) and Securities Exchange Act Release No. 37538 (August 8, 1996) (SEC Order Instituting Public Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, In the Matter of National Association of Securities Dealers, Inc. Administrative Proceeding File No. 3–9056), respectively. The undertakings were included in the SEC Order.

[5] *See* Securities Exchange Act Release No. 39326 (November 14, 1997), 62 FR 62385 (November 21, 1997) (File Nos. NASD–97–71, 96–29 and 96–20).

[6] Press Release, National Association of Securities Dealers, NASD Creates Small Firm Advisory Board (Feb. 17, 1998).

[7] To qualify for this position, a proposed nominee must be associated with a member firm of 150 or fewer registered representatives. The definition of an Industry Governor is set forth in Article I of the NASD By-laws.

[8] *See* Letter from Bill T. Singer, Singer Fumiento LLP to The Secretary, Securities and Exchange Commission, dated September 11, 1998. The comment letter is composed of a cover letter from Mr. Singer, counsel to the IBDA and a report to Alan Davidson, President of the IBDA from Mr. Singer, addressing the small firm representative and other issues, dated September 10, 1998.

[9] *See* Letter from T. Grant Callery, General Counsel, NASD to Katherine England, Assistant Director, Division of Market Regulation, Commission, dated October 22, 1998.

[10] The comment letter also questioned: (a) certain aspects of the proposed NASD/Amex combination; (b) inclusion of the small firm representative vote in the same filing as the combination; and (c) the effects of the post 21(a) Report enhancement of the NASD disciplinary process on OBDA members. That portion of SR–NASD–98–56 regarding the NASD/Amex combination, and any comment letters received thereto, will be separately addressed by the Commission at a later date, in connection with review of all filings addressing the combination. *See, e.g.,* Securities Exchange Act Release No. 40426 (September 10, 1998) (*Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the American Stock Exchange, Inc. Relating to Changes to the Combination of the American Stock Exchange, Inc. and the National Association of Securities Dealers, Inc.* File No. SR–AMEX–98–32) and Securities Exchange Act Release No. 40443 (September 16, 1998.) (*Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to Policies Regarding Authority Over American Stock Exchange LLC and Composition of Board of Governors of American Stock Exchange LLC,* File No. SR–NASD–98–67).

The Association has indicated to the Commission that the small firm representative Board member vote was included in the same ballot as the NASD/Amex combination issues as a cost-savings mechanism, to avoid incurring the expense of separate mailings to the NASD membership on each issue. Conversation between Philip Rosen, Associate General Counsel, Office of General Counsel, NASD and Mandy S. Cohen, Special Counsel, Division of Market Regulation, Commission, on October 26, 1998.

The comments on the post 21(a) Report disciplinary process enhancements do not relate to the subject of SR–NASD–98–56, the proposal currently under consideration. The Commission notes, however, that enhancement of the disciplinary process is a favorable outcome of the 21(a) Report and SEC Order.

[11] *See* 15 U.S.C. 78*o*(b)(4).

[12] *See, e.g.,* Notice To Members 98–80 (Sept. 29, 1998); *supra* note 9.

Advisory Board are from member firms with fewer than twenty registered representatives. Finally, the NASD notes that its by-laws allow for the nomination of dissident candidates for specific positions, such as the small firm representative, through the by-laws' contested election procedures.[13]

III. Discussion

As discussed below, the Commission has determined to approve the Association's proposal incorporating a small firm Board representative. The standard by which the Commission must evaluate a proposed rule change is set forth in Section 19(b) of the Act. The Commission must approve a proposed NASD rule change if it finds that the proposal is consistent with the requirements of Section 15A of the Act[14] and the rules and regulations thereunder that govern the NASD.[15] In evaluating a given proposal, the Commission examines the record before it and all relevant factors and necessary information. In addition, Section 15A of the Act establishes specific standards for NASD rules against which the Commission must measure the proposal.[16]

The Commission believes the creation of a small firm representative is consistent with that portion of Section 15A requiring fair member representation in the governance of the NASD.[17] As discussed above, the Association made substantial changes to its corporate governance structure in 1997, many of which responded to the Commission's 21(a) Report and related documents. After these changes, the NASD created the Small Firm Advisory Board to address concerns raised by small firms about their ability to participate in the new NASD corporate structure. Today, the Commission approves the reservation of a Governor position to represent member firms with 150 or fewer registered representatives. The Commission agrees with the NASD that the changes, as proposed, will enhance the representation of small firms within the NASD corporate governance structure by inserting a small firm representative into the center of the decisionmaking process, the NASD Board of Governors. As a member of the Board of Governors, the small firm representative, unlike a member of the Small Firm Advisory Board, will have an opportunity to actively participate in the governance of the NASD and keep abreast of the Association's new initiatives.

Additionally, the Commission believes that the NASD acted within its discretion by defining a small member firm as one having 150 or fewer registered representatives. Approval of the exercise of this discretion is supported by the fact that the NASD by-laws include contested election provisions approved in connection with the 1997 restructuring. These provision will allow organizations such as the IBDA to present candidates for the NASD Board of Governors to the NASD membership during the regular election process, if they do not like those nominated by the NASD Nominating Committee. The existence of these contested election procedures further supports the finding that the amendments approved today satisfy the fair representation requirements of the Act discussed above, since these provisions permit presentation of an alternative nominee for the small firm representative Board position.

IV. Conclusion

The Commission believes that the proposed rule change is consistent with the Act, and, particularly, with Section 15A thereof.[18] In approving the proposal, the Commission has considered its impact on efficiency, competition, and capital formation.[19]

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[20] that the portion of the proposed rule change (SR–NASD–98–56) relating to reservation of a small firm representative on the NASD Board of Governors, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[21]

Margaret H. McFarland,

Deputy Secretary.

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[13] *See* Article VII, Section 10 to the NASD by-laws. In this context, dissident candidates are those not nominated by the NASD Nominating Committee.

[14] 15 U.S.C. 78*o*–3.

[15] 15 U.S.C. 78s(b).

[16] 15 U.S.C. 78*o*–3.

[17] 15 U.S.C. 78*o*(b)(4).

[18] 15 U.S.C. 78*o*–3.

[19] 15 U.S.C. 78(c)f.

[20] 15 U.S.C. 78s(b)(2).

[21] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40614; File No. SR–NSCC–98–09]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Mutual Fund Profile Service

October 28, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on July 22, 1998, the National Securities Clearing Corporation (''NSCC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which items have been prepared by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The purpose of the proposed rule change is to increase the information available through NSCC's Mutual Fund Profile Service.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments its received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.[2]

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Currently, MFPS provides NSCC's members with an automated method of transmitting and receiving information pertaining to mutual funds through a centralized and standardized facility.[3]

[1] 15 U.S.C. 78s(b)(1).

[2] The Commission has modified the text of the summaries prepared by the NSCC.

[3] For a complete description of MFPS, refer to Securities Exchange Act Release No. 37171 (May 14, 1996), 61 FR 24343 [File No. SR–NSCC–96–04] (order approving the proposed rule change establishing the daily price and rate file phase of MFPS).