

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41025; File No. SR-MSRB-97-12]

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Approving Proposed Rule Change Relating to Political Contributions and Prohibitions on Municipal Securities Business

February 8, 1999.

I. Introduction

On December 18, 1997, the Municipal Securities Rulemaking Board ("Board" or "MSRB") submitted to 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. The proposed rule change consists of amendments to Rule G-37, on political contributions and prohibitions on municipal securities business, Rule G-8, on recordkeeping, Rule G-9, on preservation of records, and G-38, on consultants. In addition, the MSRB submitted new proposed Form G-37x. On December 3, 1998, the Board filed Amendment No. 1 which superseded the original proposal.³ The proposed rule change, as amended, was published for comment in the **Federal Register** on January 5, 1999.⁴ The Commission received one comment on the proposal.⁵ This order approves the proposal, as amended.

II. Description of the Proposal

Rule G-37 prohibits a broker, dealer, or municipal securities dealer ("dealer") that effects transactions in municipal securities from engaging in municipal securities business⁶ with an issuer

within two years after certain contributions (other than certain *de minimis* contributions) to an official of an issuer made by the dealer, any municipal finance professional ("MFP") associated with such dealer or any political action committee ("PAC") controlled by the dealer or any MFP. In addition, Rules G-37 and G-38 require dealers to make disclosures of certain contributions to issuer officials payments to state and local political parties, consultant arrangements and municipal securities business on Form G-37/G-38. Rule G-8 requires dealers to create records of contributions, payments, consultants, and issuers with which the dealer has engaged in municipal securities business and Rule G-9 requires dealers to preserve these records for a period of at least six years.

Currently, every dealer is obligated to comply with the reporting requirements of Rule G-37 by submitting Form G-37/G-38 to the Board on a quarterly basis and to undertake the related recordkeeping obligations under Rule G-8, even if a dealer does not engage in municipal securities business.⁷

Upon review of the first four years of operation on Rule G-37, the Board believes that requiring dealers that do not engage in municipal securities business to comply with these disclosure and recordkeeping obligations does not substantially further Rule G-37's stated purpose of exposing to public scrutiny contributions and payments that may be linked to the awarding of municipal securities business. The Board believes that Rule G-37 has been successful in reducing the number of political contributions used to gain awards of municipal securities business. The Board stated that it continues to be vigilant in prohibiting improper political contributions from affecting the awarding of municipal securities business.

connection with primary offerings of municipal securities, such as acting as an underwriter in a negotiated sale, as a placement agent, or as a financial advisor, consultant or remarketing agent to an issuer in which the dealer was chosen on a negotiated basis.

⁷The range of activities encompassed by the term municipal securities business is significantly narrower than the types of activities that can cause a dealer to be subject to the obligation to comply with Board Rules. For example, a dealer that effects municipal securities transactions that are limited to secondary market trades for its customers or underwriting of new issues solely through competitive sales is not, by effecting such transactions, engaging in municipal securities business within the meaning of Rule G-37. However, the dealer is still required to undertake the disclosure and recordkeeping obligations under current Rules G-37 and G-8 with respect to contributions and payments.

Therefore, the Board has proposed certain amendments to Rules G-37 and G-8 to exempt dealers that do not engage in municipal securities business from reporting and recordkeeping obligations.⁸ Dealers invoking this new exemption (hereinafter referred to as the "No Business Exemption") will be required to meet two preconditions and will be subject to a third requirement if they later begin engaging in municipal securities business. To invoke the No Business Exemption, a dealer must: (1) not have engaged in municipal securities business for a period of at least two years; and (2) submit to the Board the new Form G-37x. If the dealer thereafter begins to engage in municipal securities business, it would become subject to a disclosure and recordkeeping look back requirement (hereinafter referred to as the "Look Back Requirement") that will obligate the dealer to create records of, and to disclose on Form G-37/G-38, certain contributions made to issuer officials and payments to state and local political parties made during the preceding two year period.

The Board has also proposed an amendment to Rule G-37 which codifies a previously recognized exemption to the Form G-37/G-38 submission requirement for any quarter in which a dealer has no information to report (hereinafter referred to as the "No Information Exemption"). The Board also proposed certain technical amendments to consolidate the provisions currently found separately in Rules G-37 and G-38 relating to the submission of Form G-37/G-38, to clarify Rule G-37 by eliminating certain cross-referencing to Rule G-8, and to provide for the maintenance and preservation under Rules G-8 and G-9 of any Forms G-37x submitted to the Board.

a. No Business Exemption for Dealers Not Engaged in Municipal Securities Business

A dealer that qualifies for the No Business Exemption under amended Rule G-37(e)(ii)(A)(2) will not be required to report information to the Board on Form G-37/G-38 regarding contributions to issuer officials and payments to state and local political parties and will not be required to create records of these contributions and payments pursuant to new clause (K) of

⁸This exemption would not extend to the reporting requirements under Rule G-38. Therefore, as amended, the rule would continue to require submission of information on Form G-37/G-38 concerning the use of consultants pursuant to Rule G-38.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The original proposal did not require Rule G-37 disclosures by dealers who have not engaged in municipal securities transactions for 2 years. In addition, the original proposal would not have required dealers subject to reporting requirements to make any filing in the event they had nothing to disclose. After discussions between the Commission and the MSRB, the MSRB filed Amendment No. 1. While the revised proposal maintains the exemptions to the disclosure requirements, it includes a dealer certification as a precondition to the effectiveness of the exemptions created in the original proposal.

⁴ Securities Exchange Act Release No. 40845 (December 28, 1998), 64 FR 539.

⁵ See letter from Sarah M. Starkweather, Vice President and Associate General Counsel, The Bond Market Association, to Mr. Jonathan G. Katz, Secretary, SEC, dated January 26, 1999. The comment letter supported the proposed rule change.

⁶ Municipal securities business is defined in Rule G-37 to encompass certain activities of dealers in

Rule G-8(a)(xvi).⁹ If a dealer engages in municipal securities business after invoking the No Business Exemption, the dealer will become subject to the Look Back Requirement under new paragraph (iii) of Rule G-37(e).

i. No Municipal Securities Business for at Least Two Years

The first proposed condition for invoking the No Business Exemption in any calendar quarter, as set forth in amended Rule G-37(e)(ii)(A)(2)(a), is that the dealer must not have engaged in municipal securities business during the calendar quarter and during the seven consecutive calendar quarters immediately preceding the calendar quarter. Any dealer that has previously engaged in municipal securities business may qualify for the No Business Exemption if it has ceased business for the requisite period of time. In addition, any dealer that has never engaged in municipal securities business may also qualify for the No Business Exemption, regardless of how long the dealer has been in existence.¹⁰

ii. Submission of Form G-37x

The second proposed condition for invoking the No Business Exemption, as set forth in amended Rule G-37(e)(ii)(A)(2)(b), is that the dealer must have sent, by certified or registered mail or some other equally prompt means that provides a record of sending, two copies of new Form G-37x to the Board. Form G-37x would include a certification that the dealer did not engage in municipal securities business during the eight consecutive calendar quarters immediately preceding the date of the certification. A Form G-37x submitted to the Board would remain in effect for so long as the dealer continues to refrain from engaging in municipal securities business.¹¹ Notwithstanding

⁹Dealers will still be required to maintain copies of any Forms G-37/G-38 submitted to the Board during the period of exemption (e.g., in connection with information relating to the use of consultants) and of any Forms G-37x submitted to the Board to invoke the No Business Exemption. In addition, the recordkeeping exemption would not entitle a dealer to discontinue preservation of any records previously created under Rule G-8(a)(xvi) unless the period for preserving the records under Rule G-9(a)(viii) has lapsed.

¹⁰For this purpose, the Board will deem that a dealer that has been subject to the rules of the Board for a period of less than two years (for example, because it came into existence during such period or because it previously effected only non-municipal securities transactions) and has not engaged in any municipal securities business since becoming subject to Board rules would automatically satisfy the two-year requirement of the No Business Exemption.

¹¹Thus, the Board explained, if after submitting Form G-37x, the dealer undertakes any municipal securities business (thereby subjecting itself to the

the submission of Form G-37x, a dealer will remain responsible for determining whether it continues to qualify for an exemption from the Form G-37/G-38 submission for each calendar quarter.¹²

The Board will make available to the public all Forms G-37x that are submitted to the Board in the same manner currently used for G-37/G-38. They will be available for review and photocopying at the Board's Public Access Facility in Alexandria, Virginia and will be posted on the Board's Internet Web site (<http://www.msrb.org>). The forms will also be available in CD-ROM format on a quarterly basis.¹³

ii. Look Back Requirement Upon Engaging in Municipal Securities Business

The Board stated that a dealer that has invoked the No Business Exemption but later begins engaging in municipal securities business will become subject to a two-part Look Back Requirement under proposed paragraph (iii) of Rule G-37(e). First, the proposed Look Back Requirement provides that the dealer must create records of political contributions and payments to state and local political parties under Rule G-8(a)(xvi) for the current calendar year and the two preceding calendar years and must continue to create such records thereafter unless the dealer again qualifies for, and invokes, the No Business Exemption.¹⁴ The dealer will

Look Back Requirement) and thereafter again seeks to invoke the No Business Exemption after a new two-year period of not engaging in municipal securities business, the dealer would be required to submit a new Form G-37x. The Commission believes that dealers should carefully consider the advisability of alternating between periods of undertaking municipal securities business and periods of invoking the No Business Exemption, particularly in view of the potential difficulties of complying with the strict Look Back Requirement.

¹²The Board explained that a dealer must continually determine whether it has met the requirement for the No Business Exemption or the No Information Exemption for each quarter. Moreover, a dealer will still be required to submit Form G-37/G-38 for any calendar quarter in which it has information to report regarding consultants under Rule G-38 even if it continues to qualify for the No Business Exemption.

¹³CD-ROMS are currently priced at \$10.00 (plus delivery or postage charges and any applicable sales tax) for each CD-ROM containing copies of Form G-37/G-38 and at \$11.50 (plus delivery or postage charges and any applicable sales tax) for each CD-ROM that is bundled with the software necessary to access and read the forms on a computer. See Securities Exchange Act Rel. No. 39488 (December 23, 1997), 63 FR 280 (January 5, 1998). The Board anticipates that Forms G-37x will be included on these CD-ROMs at no additional cost.

¹⁴The Board explained that a dealer that is creating records under the Look Back Requirement must re-create the records that it would have made during the current calendar year and the two preceding calendar years but for the No Business Exemption. This includes the political

be responsible for reviewing the newly created records to ensure that it has not been banned from business with an issuer as a result of a contribution to an official of the issuer during the No Business Exemption period, before the dealer engages in municipal securities business with the issuer.

Moreover, the Board stated that a dealer that engages in municipal securities business after invoking the No Business Exemption must disclose all reportable contributions to issuer officials and payments to state and local political parties made during the preceding two years by the dealer, any MFP, and non-MFP executive officer or any dealer-controlled or MFP controlled PAC, not reported previously because of the No Business Exemption.¹⁵ These disclosures must be made on Form G-37/G-38 for the calendar quarter during which the dealer first engages in municipal securities business. The dealer will also be required to send Form G-37/G-38 to the Board for each calendar quarter thereafter unless the dealer qualifies for the No Information Exemption or again qualifies for, and invokes, the No Business Exemption.

The Board explained that the Look Back requirement is intended to prevent circumvention of the rule and to promote public scrutiny of all contributions to issuer officials and payments to state and local political parties (other than qualifying *de minimis* contributions and payments) that may influence the awarding of municipal securities business to any dealer that is newly engaging in, or is again becoming engaged in, municipal securities business.

The Board stated that the No Business Exemption is best suited to dealers that do not intend to engage in municipal securities business in the foreseeable future. Thus, the Board asserted that dealers that qualify for the No Business Exemption but plan to engage in municipal securities business at a later time should carefully consider whether

contributions and payments to state and local political parties made by an individual who was an MFP or a non-MFP executive officer during this look back period. The dealer must also create records of the contributions and payments of individuals who become MFPs or non-MFP executive officers during the look back period. Rule G-37 does not require a dealer to create records of contributions or payments made prior to the look back period.

¹⁵When reporting prior contributions and payments on the calendar quarter's Form G-37/G-38, a dealer will be required to include the year and calendar quarter in which each such prior contribution or payment was made. A dealer, however, will not be required to include contributions or payments made more than two years prior to such quarter, even if not previously reported to comply with Rule G-37.

the burden of having to comply with the Look Back Requirement outweighs the short term benefit of not having to create and maintain these records and not having to submit Form G-37/G-38 on a current basis. The Look Back Requirement may cause great burden to dealers that must recreate at least two full years of records under Rule G-8(a)(xvi). Dealers also run the risk of unknowingly becoming banned from municipal securities business as a result of a contribution made to an issuer official during the exemption period. Any dealer that engages in municipal securities business after invoking the No Business Exemption should be prepared to produce evidence that it has created records and disclosed information required under the Look Back Requirement.

iv. No effect on Disclosure and Recordkeeping Obligations Relating to Consultants

The use of consultants in attempting to obtain municipal securities business is required to be disclosed to the Board pursuant to Rule G-38. The proposed rule change amends Rule G-37(e)(ii)(B) to require this disclosure to be reported on Form G-37/G-38 even during periods when a dealer qualifies for the No Business Exemption. This amendment requires that dealers report to the Board their use of consultants to obtain municipal securities business during the no business period. The submission of Form G-37/G-38 in any quarter will not cause the No Business Exemption or the related Form G-37x submission to lapse unless the dealer engages in municipal securities business. The Board suggested that any dealer that has retained a consultant to obtain municipal securities business carefully consider the advisability of invoking (or continuing to invoke) the No Business Exemption. If business is obtained as a result of a consultant's efforts, then, the dealer will need to comply with the Look Back Requirement, and in particular, confirm that it is not banned from undertaking municipal securities business with that issuer.

v. No Effect on Two-Year Ban on Municipal Securities Business or Prohibition of Certain Solicitation and Coordination Under Rule G-37(b) and (c)

The proposed rule change and the new No Business Exemption do not provide exemptions from the operation of sections (b) and (c) of Rule G-37.¹⁶

¹⁶ Section (b) provides that no dealer shall engage in municipal securities business with an issuer

Therefore, a political contribution (other than an MFP's *de minimis* contribution) to an official of an issuer that was not disclosed on Form G-37/G-38 and not recorded under Rule G-8(a)(xvi) by virtue of the No Business Exemption could cause a ban on municipal securities business with such issuer under section (b). Moreover, solicitation or coordination of contributions to an official of an issuer with which the dealer is seeking to engage in municipal securities business continues to be prohibited under section (c) even if the No Business Exemption is in effect. Dealers that qualify for the No Business Exemption but are considering future municipal securities business are directed to be aware of the continuing applicability of section (b) and (c) of Rule G-37.

b. No Information Exemption for Dealers With No Information to Report in a Quarter

The proposed rule change amends Rule G-37(e)(ii)(A)(1) to codify a previously recognized No Information Exemption to the quarterly Form G-37/G-38 submission requirement.¹⁷ The proposed amendment provides that a dealer would not be required to send Form G-37/G-38 to the Board for any calendar quarter in which *all* of the following apply: (1) the dealer has not engaged in municipal securities business; (2) the dealer has no reportable political contributions to issuer officials or payments to state and local political parties; and (3) the dealer has no reportable use of consultants. This No Information Exemption will continue to obviate the need for a dealer to submit a Form G-37/G-38 that does not reflect reportable activity under any category. However, a dealer is required to send Form G-37/G-38 to the Board in any subsequent calendar quarter in which it does not qualify for the No Information Exemption, unless the dealer qualifies for, and invokes, the No Business Exemption.¹⁸

within two years after any contribution to an official of such issuer made by the dealer, an MFP or a PAC controlled by the dealer or MFP. Section (c) provides that no dealer or MFP shall solicit any person or PAC to make any contribution, or shall coordinate any contributions, to an official of an issuer with which the dealer is engaging or seeking to engage in municipal securities business.

¹⁷ See Securities Exchange Act Release No. 34161 (June 6, 1994), 59 FR 30379 (June 14, 1994), Question and Answer No. 34, See also, *MSRB Reports*, Vol. 14, No. 3 (June 1994) at 15-16, and "Instructions for Completing and Filing Form G-37/G-38," reprinted in *MSRB Reports*, Vol. 16, No. 1 (January 1996) at 11.

¹⁸ A dealer that qualifies for the No Business Exemptions may, however, be required to submit G-37/G-38 if such dealer has engaged consultants to obtain municipal securities business, pursuant to Rule G-38.

c. Technical Amendments

Amend Rule G-37(e)(i) consolidates the Form G-37/G-38 submission procedures that are currently found separately in paragraphs (i) and (ii) of Rule G-37(e) and in Rule G-38(d). The proposal also contains certain related amendments to Rule G-38(d).

In addition, the existing exemption from reporting requirements under Rule G-37 for *de minimis* contributions made by MFPs and non-MFP executive officials of issuers¹⁹ and to state and local political parties²⁰ is effected by a cross-reference to the recordkeeping requirements of Rule G-8(a)(xvi). To clarify the nature of such *de minimis* exemptions, amended Rule G-37(e)(i)(A) incorporates into the language of Rule G-37, but does not change, the specific requirements of the *de minimis* exemption.

d. Amendments Relating to Records of Form G-37x

The proposed rule change amends section H of Rule G-8(a)(xvi) to require that dealers maintain copies of Form G-37x submitted to the Board along with the corresponding records of sending. Under amended Rule G-9(a)(viii), dealers will be required to keep copies of Form G-37x during the period of effectiveness and for at least six years following the end of effectiveness.

III. Discussion

The Commission believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder.²¹ In particular, the Commission finds that the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act.²² Section 15B(b)(2)(C) of the Act, requires,

¹⁹ A *de minimis* contribution to an official of an issuer not requiring disclosure consists of a contribution made by an MFP or non-MFP executive officer to an official of an issuer for whom the person is entitled to vote if all contributions by the person to such official, in total, do not exceed \$250 per election.

²⁰ A *de minimis* payment to a political party of a state or political subdivision not requiring disclosure consists of a payment made by an MFP or a non-MFP executive officer to a political party of a state or political subdivision in which the person is entitled to vote if all payments by the person to the political party, in total, do not exceed \$250 per year.

²¹ In reviewing this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. The proposed rule change should improve efficiency because it reduces the filing and recordkeeping burden of municipal securities dealers who do not engage in municipal securities business. In addition, the proposed rule change should maintain fair competition because all municipal securities dealers continue to be prohibited from improper business solicitations. 15 U.S.C. 78f(b)(7).

²² 15 U.S.C. 78o-4(b)(2)(C).

among other things, that the rules of the Board be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest.

a. The No Business Exemption

The Commission finds that the No Business Exemption is consistent with the requirements of Section 15B(b)(2)(C) of the Act because it removes impediments to and perfects the mechanism of a free and open market in municipal securities. After these rules have been implemented, dealers that have been engaged in municipal securities business for at least two years will not be required to report information to the Board regarding contributions to issuer officials or payments to state and local political parties. Furthermore, dealers will not be required to create contribution and payment records.²³ By eliminating these requirements, those dealers who are not engaged in municipal securities business will be relieved of reporting and recordkeeping burdens, which according to the MSRB do not substantially further the stated purpose of Rule G-37. By imposing a ban on dealers that make financial contributions to issuers, the rule ensures that municipal securities business is awarded based upon the business judgment of the issuer and not improper financial incentives. Thus the Commission agrees that the reporting requirements, amended by this proposal, imposed on dealers that do not engage in municipal securities business do not further this purpose and removing these reporting burdens should allow dealers to concentrate on their other municipal securities.

Once a dealer qualifies for the No Business Exemption, the dealer will be required to submit new Form G-37x. The requirement of submitting the new Form G-37x is also consistent with the requirements of Section 15B(b)(2)(C) of the Act because it provides for the protection of investors and the public interest. The public will be able to access and review all Form G-37x's that are filed and the Board providing notice of the status of dealers. Filing Form G-

37x is an affirmative representation by the dealer certifying that it has not engaged in municipal securities business for a least two years.

If a dealer begins or reenters the municipal securities business, it will be subject to the Look Back Requirement. The Look Back Requirement is consistent with the requirements of Section 15B(b)(2)(C) because it ensures that dealers that begin or reenter the municipal securities business are able to engage in such business with issuers in compliance with Rule G-37. The Look Back Requirement requires dealers to recreate and file records of political contributions and payments to state and local political parties for the current calendar year and the preceding two calendar years. These dealers will then be obligated to review these recreated records to ensure that they are in fact eligible to engage in municipal securities business with certain issuers. The Look Back Requirement should protect investors and the public interest because it should ensure that dealers only engage in municipal securities business with issuers to which they have not made contributions. It also allows public scrutiny of contributions to issuer officials and payments to state and local political parties that may improperly influence the award of municipal securities business.

Under the proposed rule change, dealers must continue to report the use of consultants to obtain municipal securities business. The proposed rule change affirmatively states in proposed Rule G-37(e)(ii)(B) that dealers will continue to be obligated to submit Form G-37/G-38 regarding the use of consultants to obtain municipal securities business even during periods when the dealer qualifies for the No Business Exemption. This is consistent with the Act because the public will be able to monitor the dealers that engage consultants to determine if the dealer is considering entering or reentering the municipal securities business, which should help protect investors.

The proposed rule change is also consistent with the requirements of Section 15B(b)(2)(C) of the Act because it removes impediments to and perfects the mechanisms of a free and open market in municipal securities. The proposed rule change should allow those dealers not engaging in municipal securities business to concentrate their business efforts on other municipal securities transactions that are pertinent to these dealers' businesses. It releases these dealers from the recordkeeping and reporting requirements of the MSRB rules and should provide them with flexibility to engage in business

ventures not defined as municipal securities business.

Finally, the Commission is satisfied that the proposed rule change should continue to further the purposes of Rule G-37. The proposed rule change does not provide exemptions from the two-year ban under Rule G-37(b) for dealers that have made contributions to officials of issuers or from the restrictions under Rule G-37(c) which prohibit dealers from soliciting others to make contributions to officials of issuers with which the dealer is engaging or seeking to engage in municipal securities business. The proposed rule change should continue to ensure that municipal securities business is not awarded based on improper financial incentives, which should prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest, consistent with the requirements of Section 15B(b)(2)(c).

b. The No Information Exemption

The Commission finds the No Information Exemption consistent with the requirements of Section 15B(b)(2)(C) of the Act because it removes impediments to and perfects the mechanisms of a free and open market in municipal securities. Dealers who are not engaged in municipal securities business, have not made any reportable contributions or payments, and have not engaged consultants to obtain municipal securities business, will no longer be required to file a Form G-37/G-38 with the Board. This proposed rule change also relieves the reporting burdens of dealers that are not engaged in municipal securities business allowing them to concentrate on other municipal securities activities. Moreover, the No Information Exemption should not harm investors and the public interest because the proposed rule change only obviates the need to report that the dealer does not have any information to report. However, once a dealer engages in municipal securities business or uses consultants to obtain municipal securities business, its reporting obligations again become mandatory.

c. Technical Amendments

The proposed rule change contains technical amendments which provide cross references and consolidations to the proposed rule changes. These technical amendments are consistent with Section 15B(b)(2)(C) of the Act because they promote just and equitable principles of trade by providing clarity to the rules of the Board which govern the actions of dealers of municipal securities.

²³ As noted above, dealers will continue to be required to create contribution and payment records if they are engaged in municipal securities business. If a dealer reenters the municipal securities business, it will be subject to the Look Back Requirement. The Commission stresses that the amendments to the reporting and filing requirements approved today are not to be used as a means of avoiding disclosure of financial payments to issuers and political parties.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2)²⁴ of the Act, that the proposed rule change, as amended, (SR-MSRB-97-12) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41026; File No. SR-NASD-99-10]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to an Amendment to the Composition of Boards of NASD Regulation, Inc. and the Nasdaq Stock Market, Inc.

February 8, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 3, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval to the proposed rule change.

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

The NASD is proposing to amend the By-Laws of the NASD Regulation, Inc. ("NASD Regulation") and The Nasdaq Stock Market, Inc. ("Nasdaq") to increase the possible size of the Board of Directors of those corporations. Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletion are in brackets.

Proposed Revisions to the NASD Regulation, Inc. By-Laws

ARTICLE IV

Number of Directors

Sec. 4.2 The Board shall consist of no fewer than five and no more than [eight] *ten* Directors, the exact number to be determined by resolution adopted by the Stockholder of NASD Regulation from time to time. Notwithstanding the preceding sentence, the number of Directors shall equal the number of Directors on the Nasdaq Board. Any new Director position created as a result of an increase in the size of the Board shall be filled *pursuant to* [as part of the annual election conducted under] Section 4.4.

Qualifications

Sec. 4.3 (a) Directors need not be stockholders of NASD Regulation. Only Governors of the NASD Board shall be eligible for election to the Board. The number of Non-Industry Directors shall equal or exceed the number of Industry Directors plus the President. The Board shall include the President and the National Adjudicatory Council Chair, representatives of an issuer of investment company shares or an affiliate of such an issuer, and an insurance company or an affiliated NASD member. *If t*[T]he Board *consist of five to seven Directors, it shall include at least one Public Director.*], unless the Board consists of eight Directors. In such case] *If the Board consists of eight Directors, at least two Directors shall be Public Directors and if the Board consists of ten Directors at least three shall be Public Directors.* The Chief Executive Officer of the NASD shall be an ex-officio non-voting member of the Board.

(b) No change.

Proposed Revisions to The Nasdaq Stock Market, Inc. By-Laws

ARTICLE IV

Definitions

Number of Directors

Sec. 4.2 The Board shall consist of no fewer than five and no more than [eight] *ten* Directors, the exact number to be determined by resolution adopted by the stockholder of Nasdaq from time to time. Notwithstanding the preceding sentence, the number of Directors shall equal the number of Directors on the NASD Regulation Board. Any new Director position created as a result of an increase in the size of the Board shall be filled *pursuant to* [as part of the annual election conducted under] Section 4.4.

Qualifications

Sec. 4.3 Directors need not be stockholders of Nasdaq. Only Governors of the NASD Board shall be eligible for election to the Board. The President of Nasdaq shall be a Director. The number of Non-Industry Directors, including at least one Public Director and at least one issuer representative, shall equal or exceed the number of Industry Directors plus the President[.]. *unless the Board consists of ten Directors. In such case at least two Directors shall be issuer representatives.* The Chief Executive Officer of NASD shall be an ex-officio non-voting member of the Board.

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

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

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

The purpose of the proposed rule change is to provide the NASD with more flexibility in determining the size of the boards of directors of its subsidiaries, NASD Regulation and Nasdaq, while maintaining the balance between non-industry and industry members contained in the current By-Laws of those subsidiaries. The proposed rule change will allow the NASD and its subsidiaries to accommodate additional constituencies and the larger number of NASD Board members that resulted from the recent reconfiguration of the NASD Board to accommodate the structure resulting from the NASD's recent merger with the American Stock Exchange. In addition to increasing the permissible size of the subsidiary boards, the proposed rule change will provide for additional public representation on the NASD Regulation Board and additional issuer representation on the Nasdaq Board should the size of the boards be increased to ten.

2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.