For the Nuclear Regulatory Commission.

**L. Raghavan,**

*Chief, Section 1, Project Directorate III, Division of Licensing Project Management, Office of Nuclear Reactor Regulation.*

[FR Doc. 04–23790 Filed 10–22–04; 8:45 am]

**BILLING CODE 7590–01–P**

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–50552; File No. SR–Amex–2004–25]**

## Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendments No. 1 and No. 2 Thereto by the American Stock Exchange LLC Relating to Revisions to Amex Rule 111

October 15, 2004.

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 April 28, 2004, the American Stock Exchange LLC (''Amex'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change described in Items I, II, and III below, which Items have been prepared by the Exchange. On May 10, 2004, the Exchange submitted Amendment No. 1 to the proposed rule change.[3] On June 8, 2004, the Exchange submitted Amendment No. 2 to the proposed rule change.[4] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend Amex Rule 111. The text of the proposed rule change appears below. Proposed new language is in *italics.*

* * * * *

**Restrictions on Registered Traders**

Rule 111. (a) Registered Traders who wish to initiate purchases or sales while on the Floor for accounts in which they have an interest shall not:

(1) Congregate in a particular stock; or

(2) Individually or as a group, intentionally or unintentionally, dominate the market in a particular stock; or

(3) Effect such purchases or sales except in a reasonable and orderly manner; or

(4) Be conspicuous in the general market or in the market in a particular stock.

(b) No Registered Trader shall effect, on the Floor of the Exchange, for an account in which he has an interest, ''long'' purchases of stock above the previous day's closing price on ''plus'' or ''zero plus'' ticks, except for ''zero plus'' tick purchases on the bid.

(c) No Registered Trader shall effect, on the Floor of the Exchange, a transaction for an account in which he has an interest and execute as broker an off-Floor order in the same stock during the same trading session.

(d) No Registered Trader shall, in establishing or increasing a position for an account in which he has an interest, while on the Floor of the Exchange, retain priority over an off-Floor order.

(e) Registered Traders shall meet the following stabilization tests, to be computed on a monthly basis:

(1) 75 percent measured by the tick test on the acquisition side.

(2) 75 percent measured by the tick test on the liquidation side except where the liquidating transaction is at a loss of not less than the minimum price variation calculated on a ''first in, first out'' (FIFO) basis. Transactions, which are non-stabilizing, effected at such a loss, will not be counted in computing the stabilizing percentage.

(3) Under the tick test, purchases on ''minus'' and ''zero minus'' ticks and sales on ''plus'' and ''zero plus'' ticks are stabilizing.

(f) The provisions of the foregoing paragraphs of this Rule and of Rule 110 shall not apply to:

(1) Any transaction by a registered specialist in a security in which he is so registered; or

(2) Any transaction for the account of an odd-lot dealer in a security in which he is so registered; or

(3) Any stabilizing transaction effected in compliance with Rule 10b-7 under the Securities Exchange Act of 1934 to facilitate a distribution of a security in which a member is participating; or

(4) Any bona fide arbitrage transaction; or

(5) Any transaction, other than a transaction for an account in which a Registered Trader has an interest, made with the prior approval of a Floor Official to permit a member to contribute to the maintenance of a fair and orderly market in a security, or any purchase or sale to reverse any such transaction; or

(6) Any transaction to offset a transaction made in error.

(g) Members may initiate transactions in bonds while on the Floor, and the provisions of Rule 110 and of paragraphs (a) through (e) of this Rule shall not apply to such transactions.

(h) Specialists registered in rights may, while on the Floor, initiate transactions in a security which is the subject of the rights for the purpose of acquiring or liquidating a bona fide hedge position against the rights, and the provisions of Rule 110 and of paragraphs (a) through (e) of this Rule shall not apply to such transactions.

*(i) Subject to Rule 175, equity specialists may, while on the Floor, initiate transactions in any security overlying a security in which they are registered for the purpose of acquiring or liquidating a bona fide hedge position, and the provisions of Rules 110 and 111(a) through (e) (as made applicable to options by Rule 950(a) and (c)) and Rule 958 shall not apply to such transactions. Option specialists may, while on the Floor, initiate transactions in any security underlying a security in which they are registered for the purpose of acquiring or liquidating a bona fide hedge position, and the provisions of Rule 110 and of paragraphs (a) through (e) of this Rule shall not apply to such transactions. Registered Options Traders may, while on the Floor, initiate transactions in any security underlying a security in which they are acting as a market maker pursuant to Rule 958 for the purpose of acquiring or liquidating a bona fide hedge position, and the provisions of Rule 110 and of paragraphs (a) through (e) of this Rule shall not apply to such transactions. The term ''bona fide hedge'' shall have the meaning ascribed to it in Securities Exchange Act Rule 11a1–3(T) and pages 33–35 of Securities Exchange Act Release No. 15533 (January 29, 1979). Pages 33–35 of Securities Exchange Act Release No. 15533 are reprinted in Commentary .13 to this Rule.*

* * * Commentary

.01–.12—no change.

*.13 The following is a reprint of pages 33 through 35 of Securities Exchange Act Release No. 15533 (January 29, 1979):*

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

[2] 17 CFR 240.19b–4.

[3] *See* Letter from Bill Floyd-Jones, Counsel, Exchange, to Nancy Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated May 7, 2004 (''Amendment No. 1''). In Amendment No. 1, the Exchange clarified the proposed rule language, and provided additional explanation in the purpose section of the proposed rule change.

[4] *See* Letter from Bill Floyd-Jones, Counsel, Exchange, to Nancy Sanow, Assistant Director, Division, Commission, dated June 7, 2004 (''Amendment No. 2''). In Amendment No. 2, the Exchange added a definition of ''bona fide hedge'' to the text of the proposed rule change. In Amendment No. 2, the Exchange also reprinted pages 33–35 of Securities Exchange Act Release No. 15533 (January 29, 1979) as proposed Commentary .13 to the text of the proposed rule change.

*3. Hedge Transactions.*

*Section 11(a)(1)(D) also provides an exemption for ''any bona fide hedge transaction involving a long or short position in an equity security and a long or short position in a security entitling the holder to acquire or sell such equity security * * *.'' The Act does not otherwise specify what type of transaction will result in a ''bona fide hedge.'' While the application of that term is largely a matter of custom and practice, the Commission believes that it implies that an appreciable offset of risk, for all or part of the position being hedged, must be involved.*[58]

*A bona fide hedge may be established either by contemporaneous transactions in two securities where each position acquired reduces the risk of the other,*[59] *or by a single transaction in which a position acquired in one security reduces the risk of a previously established position in another security.*[60] *To the extent, however, that a position does more than offset the risk of the position or positions on the other side, the excess position is not part of a ''bona fide hedge'' for purposes of Section 11(a)(1)(D. [sic] Where a bona fide hedge has been established, the exemption under Section 11(a)(1)(D) also aplies [sic] to the transaction or transactions that liquidate the hedge.*[61]

* * * * *

## 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 Amex 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 IV below. The Exchange 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*

1. Purpose

Congress gave the Commission authority to regulate ''floor trading'' [5] in 1934.[6] The Commission did not exercise this authority until 1964, when it adopted SEC Rule 11a–1—''Regulation of Floor Trading.'' [7] Shortly after the adoption of SEC Rule 11a–1, the Commission published the Exchange's proposed floor trading plan (''Plan'') for public comment.[8] The Plan proposed the adoption of Amex Rules 110, 111, and 112 which (1) created a registered equity trader program, and (2) exempted trading pursuant to the first six exceptions in SEC Rule 11a–1 from both the prohibitions in SEC Rule 11a–1 and the Exchange's proposed Plan. On July 23, 1964, the Commission approved the Exchange's Plan [9] together with revisions to the Plan that exempted from the prohibitions contained in SEC Rule 11a–1 and the Plan: (1) Transactions in bonds, (2) hedging transactions by rights specialists in the underlying security, and (3) certain block transactions.[10] In approving the proposed exemption for hedging transactions by rights specialists, the Commission stated:

The second proposed exemption is of a technical nature and involves transactions by specialists in rights. The scope of the

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[58] *For example, while the risk of a short stock position might theoretically be reduced by a ''deep-out-of-the-money'' long call position, there generally would not be any realistic expectation that the call would offset any appreciable amount of the risk assumed in the short stock position. In such a case the two positions would not involve a bona fide hedge for purposes of Section 11(a)(1)(D). At the same time, a transaction establishing an ''in-the-money'' or ''near-the-money'' long call position covering 100 underlying shares of stock could be a hedge transaction for purposes of Section 11(a)(1)(D) for part of a preexisting short stock position of much greater size.*

*The question whether particular combinations of stock positions and options positions result in risk reduction in each of the positions involves subjective judgments as to the volatility and risk characteristics of those positions. For example, ''ratio'' hedges are frequently used when the risk involved in a stock position is offset by the writing of options. In such ratio hedges, the number of underlying shares deliverable upon exercise of the options exceeds the number of shares in the stock position that is being hedged. The hedge ratio reflects a calculation of the relative degree of risk involved in each position. In establishing a suitable ratio, some industry participants use the ''delta factor'' derived from the Black-Scholes pricing formula; the delta factor predicts price movements in an option as a function of movements in the underlying stock. Other industry participants have developed their own models. The Commission recognizes that the calculation of volatility and risk can only be approximate, and believes that, for purposes of Section 11(a)(1)(D), the determination of what constitutes an offset may be made by the use of any responsible method of calculating the risk of stock and options positions.*

[59] *For example, a bona fide hedge may involve essentially contemporaneous transactions in a stock and in one or more options to buy or sell that stock where the stock and option positions so acquired reduce the risks of each other. Where a bona fide hedge position is established by contemporaneous transactions, each such transaction qualifies for the hedge exemption.*

*In addition, the Commission recognizes that the ''legging in'' technique discussed above is used also in establishing hedges and that a similar ''legging out'' technique is used in liquidating some hedges. The Commission believes that, where either technique is used, the hedging exemption should apply on the same basis as is discussed above in connection with bona fide arbitrage. See text accompanying nn. 51–53, supra.*

[60] *A transaction to hedge a previously established position does not retroactively confer a hedge exemption on the transaction that established the original position. For example, a short stock position that had been established on February 1 could be hedged by a long call transaction on March 1. In that example, only the March 1 long call transaction could qualify as a bona fide hedge transaction. The February 1 short stock transaction would not, even though it later became involved in a hedge; if the transaction establishing the February 1 position had violated Section 11(a), the violation would not be cured by the March 1 transaction.*

[61] *When a hedge is liquidated, the hedge exemption applies to the transaction or transactions that eliminate the hedge, regardless of whether the transaction that originally established the position being liquidated was an exempt bona fide hedge transaction. If a hedge is eliminated by liquidating all the positions at the same time, or by legging them out, each liquidating transaction qualifies for the hedge exemption. For example, where a short stock position established on February 1 was hedged contemporaneously by a long call position, or was hedged at a later time (e.g., on March 1) by such a position, both positions could be liquidated, or ''legged out,'' under the hedge exemptions. If, on the other hand, a hedge is eliminated by liquidating only one of the positions that constitute the hedge, only that liquidating transaction qualifies for the hedge exemption; transactions liquidating the remaining positions that had formerly been, but were no longer, part of an existing hedge would not qualify for the hedge exemption (unless a hedge had been reestablished involving those positions). For example, where the hedge referred to above was eliminated by the liquidation of only the February 1 short stock position, that transaction would qualify for the hedge exemption, but the later liquidation of the March 1 long call position would not qualify under the hedge exemption (unless a hedge had been reestablished by acquiring a third position—e.g., another short stock position).*

[5] The Commission has defined ''floor trading'' as trading by members of national securities exchanges for their own account while personally present on the trading floor of an exchange. *See* Securities Exchange Act Release No. 7290 (April 9, 1964), 29 FR 5168 (April 15, 1964).

[6] As originally adopted, Section 11(a) of the Act provided:

''The Commission shall prescribe such rules and regulations as it deems necessary or appropriate in the public interest or for the protection of investors, (1) to regulate or prevent floor trading by members of national securities exchanges, directly or indirectly for their own account or for discretionary accounts, and (2) to prevent such excessive trading on the exchange but off the floor by members, directly or indirectly for their own account, as the Commission may deem detrimental to the maintenance of a fair and orderly market. It shall be unlawful for a member to effect any transaction in a security in contravention of such rules and regulations, but such rules and regulations may make such exemptions for arbitrage transactions, for transactions in exempted securities, and within the limitations of subsection (b) of this section, for transactions by odd-lot dealers and specialist, as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.''

[7] *See* Securities Exchange Act Release No. 7330 (June 2, 1964), 29 FR 7380 (June 6, 1964).

[8] Securities Exchange Act Release No. 7359 (June 30, 1964), 29 FR 9344 (July 8, 1964).

[9] Securities Exchange Act Release No. 7374 (July 23, 1964), 29 FR 10632 (July 30, 1964).

[10] Securities Exchange Act Release No. 7375 (July 23, 1964), 29 FR 10632 (July 30, 1964).

exemption is limited to a transaction in which a rights specialist having sold rights desires to effect a bona fide hedge of his position by purchasing the underlying security. This practice is analogous to arbitrage for which there is an existing exemption from Rule 11a–1. The transactions excepted by this amendment do not involve the problems of floor trading discussed in Release No. 7290.[11]

In 1975, Congress substantially amended Section 11(a) of the Act.[12] Congress extended the general prohibition on member floor trading embodied in SEC Rule 11a–1[13] to off-floor member trading.[14] Congress also established various statutory exemptions to the general prohibition on member trading, including exemptions for bona fide arbitrage and bona fide hedge transactions on the grounds that these types of trading were beneficial to the market and thus, should not be prohibited. The Exchange is now proposing to amend Amex Rule 111 to conform it to the 1975 amendments to Section 11(a) of the Act by allowing members registered as options specialists and options traders to initiate while on the Floor bona fide hedging transactions for their accounts in Amex listed securities and to allow members registered as equity specialists to initiate while on the Floor bona fide hedging transactions for their accounts in options traded on Amex.

The Exchange believes that bona fide hedging transactions do not create the member trading issues that Section 11(a)(1) of the Act was intended to prevent. Congress and the Commission have both recognized that bona fide hedging transactions are beneficial to the market and are not of a kind that should be prohibited by Section 11(a)(1) of the Act. Congress specifically exempted bona fide hedging transactions from the prohibition of Section 11(a)(1) of the Act.[15] The Commission also has issued extensive interpretive guidance as to the transactions that would qualify for the bona fide hedge exemption under Section 11(a)(1)(D) of the Act[16] and has defined bona fide hedge to include, among other things, options to options hedging.[17]

Under the Exchange's proposed rule change, options specialists and registered options traders could give an order for their account directly to an Amex broker on the Floor for a security underlying an option in which they are registered for the purpose of acquiring or liquidating a bona fide hedge position through a trade on the Exchange.[18] Similarly, Amex proposes to permit equity specialists (subject to Amex Rule 175 which regulates option transactions by equity specialists) to give an order for their account directly to an Amex broker on the Floor for a security overlying an equity in which they are registered for the purpose of acquiring or liquidating a bona fide hedge position through a trade on the Exchange.[19] The proposed rule would exempt bona fide hedge transactions by option specialists and registered options traders from the requirements of Amex Rule 110, and paragraphs (a) through (e) of Amex Rule 111 because options specialists and registered option traders would not be acting as registered traders in the underlying security when they trade the security to acquire or liquidate a hedge position.[20] Likewise, equity specialists would be exempted from the requirements of Amex Rule 958 (which regulates the transactions of registered options traders) when they acquire or liquidate hedge positions in the related options since they would not be acting as a registered option trader in effecting these trades.[21] The Exchange also proposes under Amex Rule 111(i) to add a definition of ''bona fide hedge'' which shall have the meaning found in SEC Rule 11a1–3(T) and in pages 33–35 of the Securities Exchange Act Release No. 15533 (January 29, 1979). The Exchange further proposes to provide a reprint of pages 33–35 of the Securities Exchange Act Release No. 15533 in proposed Commentary .13 of Amex Rule 111.[22]

Brokers who receive orders from options specialists, equity specialists or registered options traders would be required to prepare a record of any hedging order given to them,[23] and specialists and registered options traders who give out hedging orders would have to prepare and submit to the Exchange a record of all hedging orders and transactions effected for an account in which they have an interest.[24]

The Exchange believes that the proposed rule change may make the execution of hedging transactions in stocks underlying Amex listed options more efficient, particularly in the context of stock/option combination orders (*e.g.*, a buy-write transaction), by eliminating the need for off-floor transmission of the stock order followed by the re-transmission of the stock order to the Floor. Under the Exchange's proposed rule change, the stock component of the combination order could be sent directly to the location on the Floor where the stock trades without first transmitting it off the Floor. This will eliminate an intermediate step and may speed order execution to the benefit of investors. The Exchange, likewise, believes that the proposed rule change will facilitate the execution of hedging transactions by equity specialists in the overlying option by eliminating the need for off-floor transmission of the option order.[25]

2. Statutory Basis

As described above, the Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act[26] in general, and furthers the objectives of Section 6(b)(5) in particular,[27] in that it is 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 a national market system, and, in

[11] *Id.*

[12] *See* 15 U.S.C. 78k(a).

[13] 17 CFR 240.11a–1.

[14] ''The advanced communication systems of today enable exchange members to trade from off the floor with many of the same advantages over individual public investors that were enjoyed by floor traders in times passed. In its 1967 Report on Trading on the New York Stock Exchange by Off-Floor Members, the SEC found that the off-floor trader has may informational and market proximity advantages similar to those of the floor trader. He is apparently more quickly aware of developing market trends since he has a direct wire to the floor to keep him posted. Once having made an investment decision, the off-floor trader is able to execute the decision faster than a public investor.'' Report on H.R. 5050, at 49–50. A similar analysis is presented in the Report of S. 470, at 16.

[15] 15 U.S.C. 78k(a)(1)(D).

[16] *See* Securities Exchange Act Release No. 15533 (January 29, 1979). In its interpretive guidance, the Commission defined ''bona fide hedge'' as follows:

''While the application of that term [bona fide hedge] is largely a matter of custom and practice, the Commission believes that it implies that an appreciable offset of risk, for all or part of the position being hedged, must be involved.''

''A bona fide hedge may be established either by contemporaneous transactions in two securities where each position acquired reduces the risk of the other, or by a single transaction in which a position acquired in one security reduces the risk of a previously established position in another security. To the extent, however, that a position does more than offset the risk of the position or positions on the other side, the excess position is not part of a 'bona fide hedge' for purposes of Section 11(a)(1)(D). Where a bona fide hedge has been established, the exemption under Section 11(a)(1)(D) also applies to the transaction or transactions that liquidate the hedge.'' (Footnotes omitted.) (Pages 33–34.)

[17] *See* 17 CFR 240.11a1–3(T).

[18] *See* Amendment No. 1, *supra* note 2.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *See* Amendment No. 2, *supra* note 3.

[23] *See* Amex Rule 153.

[24] *See* Amex Rules 957 and 175, Guidelines for Specialists' Specialty Option Transactions Pursuant to Rule 175, paragraph (j).

[25] *See* Amendment No. 1, *supra* note 2.

[26] 15 U.S.C. 78f(b).

[27] 15 U.S.C. 78f(b)(5).

general, to protect investors and the public interest.

*B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

*C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

No written comments were solicited or received with respect to the proposed rule change.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, as amended, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

*Electronic Comments*

• Use the Commission's Internet comment form *http://www.sec.gov/rules/sro.shtml*; or

• Send an e-mail to *rule-comments@sec.gov*. Please include File No. SR–Amex–2004–25 on the subject line.

*Paper Comments*

• Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609.

All submissions should refer to File Number SR–Amex–2004–25. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Amex. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–Amex–2004–25 and should be submitted on or before November 15, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[28]

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. E4–2819 Filed 10–22–04; 8:45 am]

**BILLING CODE 8010–01–P**

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–50557; File No. SR–MSRB–2004–04]**

## Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Approving Proposed Rule Change and Amendment No. 1 Thereto Relating to Proposed Amendments To Eliminate Exemptions From the Continuing Education Regulatory Element Requirements

October 18, 2004.

On August 5, 2004, the Municipal Securities Rulemaking Board (''MSRB'' or ''Board'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') 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] to eliminate all currently effective exemptions from the requirement to complete the Regulatory Element of the Continuing Education (''CE'') Program. On August 27, 2004, the MSRB filed Amendment No. 1 to the proposed rule change.[3] The proposed rule change, as amended, was published for comment in the **Federal Register** on September 14, 2004.[4] The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

MSRB Rule G–3(h) currently provides, in part, that no member shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person, unless such person has complied with the Regulatory Element of the CE requirement set forth in this Rule.[5] The Regulatory Element component of MSRB Rule G–3(h)(i)(1) requires each registered person to complete a standardized, computer-based, interactive CE program within 120 days of their second registration anniversary date and every three years thereafter, or as otherwise prescribed by the Board. Registered persons who fail to complete the Regulatory Element are deemed inactive and may not perform in any capacity or be compensated in any way requiring registration.

Currently, two classes of persons are exempt from Regulatory Element requirements under MSRB G–3(h). The first class of persons come within the ''grandfathered'' exemption which applies to persons who were continuously registered, without serious disciplinary action,[6] for more than ten years as of the Rule's effective date (*i.e.*, July 1, 1995). The second class of persons come within the ''graduated'' exemption, which, although discontinued as of July 1998, continues to apply to registered persons who were ''graduated'' prior to the discontinuation of the exemption.[7]

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[28] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19b–4.

[3] *See* letter from Ronald W. Smith, Senior Legal Associate, MSRB, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated August 26, 2004. Amendment No. 1 replaced the original rule filing in its entirety.

[4] *See* Securities Exchange Act Release No. 50328 (September 7, 2004), 69 FR 55482 (September 14, 2004).

[5] *See* MSRB Rule G–3(h).

[6] For purposes of MSRB Rule G–3(h), a significant disciplinary action generally means a statutory disqualification as defined in Section 3(a)(39) of the Act; a suspension or imposition of a fine of $5,000 or more; or being subject to an order from a securities regulator to re-enter the Regulatory Element. *See* MSRB Rule G–3(h)(i)(C).

[7] When MSRB Rule G–3(h) was first adopted in 1995, the Regulatory Element schedule required registered persons to satisfy the Regulatory Element on the second, fifth, and tenth anniversary of their initial securities registration. After satisfying the tenth anniversary requirement, a person was ''graduated'' from the Regulatory Element. A graduated principal re-entered the Regulatory Element if he or she incurred a significant

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