

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38469; International Series Release No. 1070; File No. SR-NASD-97-16]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Revision of the Listing Standards for The Nasdaq Stock Market, Inc.

April 2, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4² thereunder, notice is hereby given that on March 3, 1997,³ the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary The Nasdaq Stock Market, Inc. ("Nasdaq"), 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 the self-regulatory organization. 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

Nasdaq proposes to amend Rules 4200, 4300, 4310, 4320, 4400, 4420, 4450, 4460, 4470 and 4480 of the NASD to revise the listing standards for Nasdaq. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in *brackets*.

All references to "the Association" in Rules 4300 through 4480 inclusive should be replaced with "Nasdaq," except in Rule 4300, Rule 4310(c)(16), Rule 4320(e)(15), Rule 4400, Rule 4420(f) and Rule 4420(g) which are amended as indicated, below.

4200. Definitions.

For purposes of the Rule 4000 Series, unless the context requires otherwise:

- (a)—(f) No change.
- (g) "Capital and surplus" means total stockholders' equity as presented in

accordance with generally accepted accounting principles as reflected on the issuer's statement of financial condition or comparable statement.]

- (h)—(j) Renumbered as (g)—(i).
- (j) "*Independent director*" means a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

- (k)—(aa) No change.
- (bb) "*Round lot holder*" means a holder of a normal unit of trading.
- (bb)—(dd) Renumbered as (cc)—(ee).

4300. Qualification Requirements For Nasdaq Stock Market Securities

The Nasdaq Stock Market [The Association, as operator of The Nasdaq Stock Market,] is entrusted with the authority to preserve and strengthen the quality of and public confidence in its market. The Nasdaq Stock Market stands for integrity and ethical business practices in order to enhance investor confidence, thereby contributing to the financial health of the economy and supporting the capital formation process. Nasdaq issuers, from new public companies to companies of international stature, by being included in Nasdaq, are publicly recognized as sharing these important objectives of the Nasdaq Stock Market.

No further change.

4310. Qualification Requirements for Domestic and Canadian Securities

To qualify for inclusion in Nasdaq, a security of a domestic or Canadian issuer shall satisfy all applicable requirements contained in paragraphs (a) or (b), and (c) hereof.

- (a) No change.
- (b) No change.
- (c) In addition to the requirements contained in paragraph (a) or (b) above, and unless otherwise indicated, a security shall satisfy the following criteria for inclusion in Nasdaq:
 - [(1) For initial and continued inclusion, the issue shall have two registered and active market makers, one of which may be a market maker entering a stabilizing bid.]

(1) *For initial inclusion, the issue shall have three registered and active market makers, and for continued inclusion, the issue shall have two registered and active market makers, one of which may be a market maker entering a stabilizing bid.*

- [(2) For initial inclusion, the issuer shall have total assets of at least \$4

million. For continued inclusion, the issuer shall have total assets of at least \$2 million. An issuer's total assets will be determined on the basis of a balance sheet prepared in accordance with generally accepted accounting principles. Assets that are temporary or restricted in their use will be excluded from the determination of total assets.]

- [(3) For initial inclusion, the issuer shall have capital and surplus of at least \$2 million. For continued inclusion, the issuer shall have capital and surplus of at least \$1 million. Only issues of common and preferred stock will be included in capital and surplus. Debentures and redeemable securities with the redemption provision within the sole control of the holder will be excluded from the determination of capital and surplus.]

(2)(A) *For initial inclusion, the issuer shall have:*

- (i) *net tangible assets of \$4 million;*
- (ii) *market capitalization of \$50 million; or*
- (iii) *net income of \$750,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years.*

(B) *For continued inclusion, the issuer shall maintain:*

- (i) *net tangible assets of \$2 million;*
- (ii) *market capitalization of \$35 million; or*
- (iii) *net income of \$500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years.*

(3) *For initial inclusion, the issuer shall have an operating history of at least one year or market capitalization of \$50 million.*

(4) For initial inclusion, common or preferred stock shall have a minimum bid price of [3] \$4 per share. For continued inclusion the minimum bid price per share shall be \$1 [, provided however that an issuer shall not be required to maintain the \$1 per share minimum bid price if it maintains market value of public float of \$1 million and \$2 million in capital and surplus].

- (5) No change.

(6) In the case of common stock, there shall be at least 300 *round lot* holders of the security. An account of a member that is beneficially owned by a customer (as defined in Rule 0120) will be considered a holder of a security upon appropriate verification by the member.

(7) In the case of common stock, there shall be at least [100,000] *1,000,000* publicly held shares *for initial inclusion and 500,000 publicly held shares for continued inclusion.* For initial inclusion such shares shall have a market value of at least [5] \$5 million.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On March 27, 1997, Nasdaq filed Amendment No. 1 to the proposed rule change. On April 1, 1997, Nasdaq filed Amendment No. 2 to the proposed rule change. Amendment No. 1 and Amendment No. 2 make technical and conforming changes to the proposed rule filing. See letter from Robert E. Aber, Vice President and General Counsel, Nasdaq to Katherine England, Assistant Director, Commission, dated March 27, 1997 and letter from Robert E. Aber, Vice President and General Counsel, Nasdaq to Katherine England, Assistant Director, Commission, dated April 1, 1997.

For continued inclusion such shares shall have a market value of at least [\$200,000] \$1 million. Shares held directly or indirectly by any officer or director of the issuer and by any person who is the beneficial owner of more than 10 percent of the total shares outstanding are not considered to be publicly held.

(8)(A) No change.

(B) A failure to meet the continued inclusion requirements for minimum bid price and market value of public float shall be determined to exist only if the deficiency for the applicable criterion continues for a period of [10] 30 consecutive business days. Upon such failure, the issuer shall be notified promptly and shall have a period of 90 calendar days from such notification to achieve compliance with the applicable continued inclusion standard. *Compliance can be achieved by meeting the applicable standard for a minimum of 10 consecutive business days during the 90 day compliance period.*

(9)—(15) No change.

(16) Except in unusual circumstances, the issuer shall make prompt disclosure to the public through the news media of any material information that would reasonably be expected to affect the value of its securities or influence investors' decisions and shall, prior to the release of the information, provide notice of such disclosure to *Nasdaq's Market Watch Department* [the Association's Market Surveillance Department].*

*This notice shall be made to the *Market Watch* [Market Surveillance] Department at 9513 Key West Avenue, Rockville, Maryland 20850-3389. The telephone number is 1-800-537-3929, (301) 590-6411, or from 7 p.m. to 8 a.m. Eastern Time, (301) 590-6413. The fax number is (301) 590-6482.

(17)—(24) No change.

(25) *Corporate Governance Requirements*—*Nasdaq shall review the issuer's past corporate governance activities when the issuer's securities were traded on or after withdrawal from Nasdaq or a securities exchange which imposes corporate governance requirements. Based on such review, Nasdaq may take any appropriate action, including placing of restrictions on or additional requirements for listing, or the denial of listing of a security if Nasdaq determines that there have been violations or evasions of such corporate governance standards. Determinations under this subparagraph shall be made on a case-by-case basis as necessary to protect investors and the public interest.*

(A) *Distribution of Annual and Interim Reports*

(i) *Each issuer shall distribute to shareholders copies of an annual report containing audited financial statements of the company and its subsidiaries. The report shall be distributed to shareholders a reasonable period of time prior to the company's annual meeting of shareholders and shall be filed with Nasdaq at the time it is distributed to shareholders.*

(ii) *Each issuer which is subject to SEC Rule 13a-13 shall make available copies of quarterly reports including statements of operating results to shareholders either prior to or as soon as practicable following the company's filing of its Form 10-Q with the Commission. If the form of such quarterly report differs from the Form 10-Q, the issuer shall file one copy of the report with Nasdaq in addition to filing its Form 10-Q pursuant to Rule 4310(c)(14). The statement of operations contained in quarterly reports shall disclose, as a minimum, any substantial items of an unusual or nonrecurrent nature and net income before and after estimated federal income taxes or net income and the amount of estimated federal taxes.*

(iii) *Each issuer which is not subject to SEC Rule 13a-13 and which is required to file with the Commission, or another federal or state regulatory authority, interim reports relating primarily to operations and financial position, shall make available to shareholders reports which reflect the information contained in those interim reports. Such reports shall be made available to shareholders either before or as soon as practicable following filing with the appropriate regulatory authority. If the form of the interim report provided to shareholders differs from that filed with the regulatory authority, the issuer shall file one copy of the report to shareholders with Nasdaq in addition to the report to the regulatory authority that is filed with Nasdaq pursuant to Rule 4310(c)(14).*

(B) *Independent Directors*

Each issuer shall maintain a minimum of two independent directors on its board of directors.

(C) *Audit Committee*

Each issuer shall establish and maintain an Audit Committee, a majority of the members of which shall be independent directors.

(D) *Shareholder Meetings*

Each issuer shall hold an annual meeting of shareholders and shall

provide notice of such meeting to Nasdaq.

(E) *Quorum*

Each issuer shall provide for a quorum as specified in its by-laws for any meeting of the holders of common stock; provided, however, that in no case shall such quorum be less than 33 1/3 percent of the outstanding shares of the company's common voting stock.

(F) *Solicitation of Proxies*

Each issuer shall solicit proxies and provide proxy statements for all meetings of shareholders and shall provide copies of such proxy solicitation to Nasdaq.

(G) *Conflicts of Interest*

Each issuer shall conduct an appropriate review of all related party transactions on an ongoing basis and shall utilize the company's Audit Committee or a comparable body of the board of directors for the review of potential conflict of interest situations where appropriate.

(H) *Shareholder Approval*

(i) *Each issuer shall require shareholder approval of a plan or arrangement under subparagraph a. below or, prior to the issuance of designated securities under subparagraph b., c., or d. below:*

a. when a stock option or purchase plan is to be established or other arrangement made pursuant to which stock may be acquired by officers or directors, except for warrants or rights issued generally to security holders of the company or broadly based plans or arrangements including other employees (e.g. ESOPs). In a case where the shares are issued to a person not previously employed by the company, as an inducement essential to the individual's entering into an employment contract with the company, shareholder approval will generally not be required. The establishment of a plan or arrangement under which the amount of securities which may be issued does not exceed the lesser of 1% of the number of shares of common stock, 1% of the voting power outstanding, or 25,000 shares will not generally require shareholder approval;

b. when the issuance will result in a change of control of the issuer;

c. in connection with the acquisition of the stock or assets of another company if:

1. *any director, officer or substantial shareholder of the issuer has a 5% or greater interest (or such persons collectively have a 10% or greater interest), directly or indirectly, in the*

company or assets to be acquired or in the consideration to be paid in the transaction or series of related transactions and the present or potential issuance of common stock, or securities convertible into or exercisable for common stock, could result in an increase in outstanding common shares or voting power of 5% or more; or

2. where, due to the present or potential issuance of common stock, or securities convertible into or exercisable for common stock, other than a public offering for cash:

A. the common stock has or will have upon issuance voting power equal to or in excess of 20% of the voting power outstanding before the issuance of stock or securities convertible into or exercisable for common stock; or

B. the number of shares of common stock to be issued is or will be equal to or in excess of 20% of the number of shares or common stock outstanding before the issuance of the stock or securities; or

d. in connection with a transaction other than a public offering involving:

1. the sale or issuance by the issuer of common stock (or securities convertible into or exercisable for common stock) at a price less than the greater of book or market value which together with sales by officers, directors or substantial shareholders of the company equals 20% or more of common stock or 20% or more of the voting power outstanding before the issuance; or

2. the sale or issuance by the company of common stock (or securities convertible into or exercisable common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock.

(ii) Exceptions may be made upon application to Nasdaq when:

a. the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise; and

b. reliance by the company on this exception is expressly approved by the Audit Committee or a comparable body of the board of directors.

A company relying on this exception must mail to all shareholders not later than ten days before issuance of the securities a letter alerting them to its omission to seek the shareholder approval that would otherwise be required and indicating that the Audit Committee or a comparable body of the board of directors has expressly approved the exception.

(iii) Only shares actually issued and outstanding (excluding treasury shares or shares held by a subsidiary) are to be

used in making any calculation provided for in this subparagraph (25)(H)(i)d.1. Unissued shares reserved for issuance upon conversion of securities or upon exercise of options or warrants will not be regarded as outstanding.

(iv) Voting power outstanding as used in this Rule refers to the aggregate number of votes which may be cast by holders of those securities outstanding which entitle the holders thereof to vote generally on all matters submitted to the company's security holders for a vote.

(v) An interest consisting of less than either 5% of the number of shares of common stock or 5% of the voting power outstanding of an issuer or party shall not be considered a substantial interest or cause the holder of such an interest to be regarded as a substantial security holder.

(vi) Where shareholder approval is required, the minimum vote which will constitute shareholder approval shall be a majority of the total votes cast on the proposal in person or by proxy.

(26) Listing Agreement

Each issuer shall execute a Listing Agreement in the form designated by Nasdaq.

(27) Peer Review

(A) Each issuer must be audited by an independent public accountant that:

(i) has received an external quality control review by an independent public accountant ("peer review") that determines whether the auditor's system of quality control is in place and operating effectively and whether established policies and procedures and applicable auditing standards are being followed; or

(ii) is enrolled in a peer review program and within 18 months receives a peer review that meets acceptable guidelines.

(B) The following guidelines are acceptable for the purposes of subparagraph (c)(27):

(i) The peer review should be comparable to AICPA standards included in Standards for Performing on Peer Reviews, codified in the AICPA's SEC Practice Section Reference Manual;

(ii) The peer review program should be subject to oversight by an independent body comparable to the organizational structure of the Public Oversight Board as codified in the AICPA's SEC Practice Section Reference Manual; and

(iii) The administering entity and the independent oversight body of the peer review program must, as part of their rules of procedure, require the retention of the peer review working papers for 90

days after acceptance of the peer review report and allow Nasdaq access to those working papers.

(d) No change.

4320. Qualification Requirements for Non-Canadian Foreign Securities and American Depositary Receipts

To qualify for inclusion in Nasdaq, a security of a non-Canadian foreign issuer, an American Depositary Receipt (ADR) or similar security issued in respect of a security of a foreign issuer shall satisfy the requirements of paragraphs (a), (b) or (c), and (d) and (e) of this Rule.

(a)—(d) No change.

(e) In addition to the requirements contained in paragraphs (a), (b) or (c), and (d), the security shall satisfy the following criteria for inclusion in Nasdaq:

(1) [For initial and continued inclusion, the issue shall have two registered and active market makers.] For initial inclusion, the issue shall have three registered and active market makers, and for continued inclusion, the issue shall have two registered and active market makers. A failure to meet the continued inclusion requirement for number of market makers shall be determined to exist only if the deficiency continues for a period of 10 consecutive business days. Upon such failure the issuer shall be notified promptly and shall have a period of 30 calendar days from such notification to achieve compliance with the market maker requirements.

(2) [For initial inclusion, the issuer shall have total assets of at least U.S. \$4 million. For continued inclusion, the issuer shall have total assets of at least U.S. \$2 million.]

(A) For initial inclusion, the issuer shall have:

(i) net tangible assets of U.S. \$4 million;

(ii) market capitalization of U.S. \$50 million; or

(iii) net income of U.S. \$750,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years.

(B) For continued inclusion, the issuer shall maintain:

(i) net tangible assets of U.S. \$2 million;

(ii) market capitalization of U.S. \$35 million; or

(iii) net income of U.S. \$500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years.

(C) An issuer's [total] net tangible assets will be determined on the basis of a balance sheet prepared in accordance with U.S. generally accepted

accounting principles or those accompanied by detailed schedules quantifying the differences between U.S. generally accepted accounting principles and those of the issuer's country of domicile. [Assets that are temporary or restricted in their use will be excluded from the determination of total assets.]

[(3)] (3) For initial inclusion, the issuer shall have capital and surplus of at least U.S. \$2 million. For continued inclusion, the issuer shall have capital and surplus of at least U.S. \$1 million. Only issues of common, preferred or equivalent stock will be included in capital and surplus. Debentures and redeemable securities with the redemption provision within the sole control of the holder will be excluded from the determination of capital and surplus.]

[(4)] (3) In the case of a convertible debt security, for initial inclusion, there shall be a principal amount outstanding of at least U.S. \$10 million. For continued inclusion, there shall be a principal amount outstanding of at least U.S. \$5 million.

[(5)] (4) In the case of foreign shares, there shall be at least 300 round lot holders of the security. An account of a member that is beneficially owned by a customer (as defined in Rule 0120) will be considered a holder of a security upon appropriate verification by the member.

[(6)] (5) In the case of foreign shares, there shall be at least [100,000] 1,000,000 publicly held shares for initial inclusion and 500,000 publicly held shares for continued inclusion. Shares held directly or indirectly by any officer or director of the issuer and by any person who is the beneficial owner of more than 10 percent of the total shares outstanding are not considered to be publicly held.

(7)—(15) renumbered as subparagraphs (6)—(14)

(15)[16] Except in unusual circumstances, the issuer shall make prompt disclosure to the public in the United States through international wire services or similar disclosure media of any material information that would reasonably be expected to affect the value of its securities or influence investor's decisions and shall, prior to the release of the information, provide notice of such disclosure to Nasdaq [the Association].*

*This notice shall be made to the Market Watch [Market Surveillance] Department at 9513 Key West Avenue, Rockville, Maryland 20850-3389. The telephone number is 1-800-537-3929, (301) 590-6411, or from 7 p.m. to 8 a.m.

Eastern Time, (301) 590-6413. The fax number is (301) 590-6482.

(17)—(21) renumbered as subparagraphs (16)—(20)

(21) *Corporate Governance Requirements*—No provisions of this subparagraph shall be construed to require any foreign issuer to do any act that is contrary to a law, rule or regulation of any public authority exercising jurisdiction over such issuer or that is contrary to generally accepted business practices in the issuer's country of domicile. Nasdaq shall have the ability to provide exemptions from the applicability of these provisions as may be necessary or appropriate to carry out this intent.

Nasdaq shall review the issuer's past corporate governance activities when the issuer's securities were traded on or after withdrawal from Nasdaq or a securities exchange which imposes corporate governance requirements. Based on such review, Nasdaq may take any appropriate action, including placing of restrictions on or additional requirements for listing, or the denial of listing of a security if Nasdaq determines that there have been violations or evasions of such corporate governance standards. Determinations under this subparagraph shall be made on a case-by-case basis as necessary to protect investors and the public interest

(A) *Distribution of Annual and Interim Reports*

(i) Each issuer shall distribute to shareholders copies of an annual report containing audited financial statements of the company and its subsidiaries. The report shall be distributed to shareholders a reasonable period of time prior to the company's annual meeting of shareholders and shall be filed with Nasdaq at the time it is distributed to shareholders.

(ii) Each issuer which is subject to SEC Rule 13a-13 shall make available copies of quarterly reports including statements of operating results to shareholders either prior to or as soon as practicable following the company's filing of its Form 10-Q with the Commission. If the form of such quarterly report differs from the Form 10-Q, the issuer shall file one copy of the report with Nasdaq in addition to filing its Form 10-Q pursuant to Rule 4310(c)(14). The statement of operations contained in quarterly reports shall disclose, as a minimum, any substantial items of an unusual or nonrecurrent nature and net income before and after estimated federal income taxes or net income and the amount of estimated federal taxes.

(iii) Each issuer which is not subject to SEC Rule 13a-13 and which is required to file with the Commission, or another federal or state regulatory authority, interim reports relating primarily to operations and financial position, shall make available to shareholders reports which reflect the information contained in those interim reports. Such reports shall be made available to shareholders either before or as soon as practicable following filing with the appropriate regulatory authority. If the form of the interim report provided to shareholders differs from that filed with the regulatory authority, the issuer shall file one copy of the report to shareholders with Nasdaq in addition to the report to the regulatory authority that is filed with Nasdaq pursuant to Rule 4310(c)(14).

(B) *Independent Directors*

Each issuer shall maintain a minimum of two independent directors on the board of directors.

(C) *Audit Committee*

Each issuer shall establish and maintain an Audit Committee, a majority of the members of which shall be independent directors.

(D) *Shareholder Meetings*

Each issuer shall hold an annual meeting of shareholders and shall provide notice of such meeting to Nasdaq.

(E) *Quorum*

Each issuer shall provide for a quorum as specified in its by-laws for any meeting of the holders of common stock; provided, however, that in no case shall such quorum be less than 33 1/3 percent of the outstanding shares of the company's common voting stock.

(F) *Solicitation of Proxies*

Each issuer shall solicit proxies and provide proxy statements for all meetings of shareholders and shall provide copies of such proxy solicitation to Nasdaq.

(G) *Conflicts of Interest*

Each issuer shall conduct an appropriate review of all related party transactions on an ongoing basis and shall utilize the company's Audit Committee or a comparable body of the board of directors for the review of potential conflict of interest situations where appropriate.

(H) *Shareholder Approval*

(i) Each issuer shall require shareholder approval of a plan or arrangement under subparagraph a.

below or, prior to the issuance of designated securities under subparagraph b., c., or d. below: a. when a stock option or purchase plan is to be established or other arrangement made pursuant to which stock may be acquired by officers or directors, except for warrants or rights issued generally to security holders of the company or broadly based plans or arrangements including other employees (e.g. ESOPs). In a case where the shares are issued to a person not previously employed by the company, as an inducement essential to the individual's entering into an employment contract with the company, shareholder approval will generally not be required. The establishment of a plan or arrangement under which the amount of securities which may be issued does not exceed the lesser of 1% of the number of shares of common stock, 1% of the voting power outstanding, or 25,000 shares will not generally require shareholder approval;

b. when the issuance will result in a change of control of the issuer;

c. in connection with the acquisition of the stock or assets of another company if:

1. any director, officer or substantial shareholder of the issuer has a 5% or greater interest (or such persons collectively have a 10% or greater interest), directly or indirectly, in the company or assets to be acquired or in the consideration to be paid in the transaction or series of related transactions and the present or potential issuance of common stock, or securities convertible into or exercisable for common stock, could result in an increase in outstanding common shares or voting power of 5% or more; or

2. where, due to the present or potential issuance of common stock, or securities convertible into or exercisable for common stock, other than a public offering for cash:

A. the common stock has or will have upon issuance voting power equal to or in excess of 20% of the voting power outstanding before the issuance of stock or securities convertible into or exercisable for common stock; or

B. the number of shares of common stock to be issued is or will be equal to or in excess of 20% of the number of shares or common stock outstanding before the issuance of the stock or securities; or

d. in connection with a transaction other than a public offering involving:

1. the sale or issuance by the issuer of common stock (or securities convertible into or exercisable for common stock) at a price less than the greater of book or market value which together with sales by officers, directors

or substantial shareholders of the company equals 20% or more of common stock or 20% or more of the voting power outstanding before the issuance; or

2. the sale or issuance by the company of common stock (or securities convertible into or exercisable common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock.

(ii) Exceptions may be made upon application to Nasdaq when:

a. the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise; and

b. reliance by the company on this exception is expressly approved by the Audit Committee or a comparable body of the board of directors.

A company relying on this exception must mail to all shareholders not later than ten days before issuance of the securities a letter alerting them to its omission to seek the shareholder approval that would otherwise be required and indicating that the Audit Committee or a comparable body of the board of directors has expressly approved the exception.

(iii) Only shares actually issued and outstanding (excluding treasury shares or shares held by a subsidiary) are to be used in making any calculation provided for in this subparagraph (21)(H)(i)d.1. Unissued shares reserved for issuance upon conversion of securities or upon exercise of options or warrants will not be regarded as outstanding.

(iv) Voting power outstanding as used in this Rule refers to the aggregate number of votes which may be cast by holders of those securities outstanding which entitle the holders thereof to vote generally on all matters submitted to the company's security holders for a vote.

(v) An interest consisting of less than either 5% of the number of shares of common stock or 5% of the voting power outstanding of an issuer or party shall not be considered a substantial interest or cause the holder of such an interest to be regarded as a substantial security holder.

(vi) Where shareholder approval is required, the minimum vote which will constitute shareholder approval shall be a majority of the total votes cast on the proposal in person or by proxy.

(22) Listing Agreement

Each issuer shall execute a Listing Agreement in the form designated by Nasdaq.

(23) Peer Review

(A) Each issuer must be audited by an independent public accountant that:

(i) has received an external quality control review by an independent public accountant ("peer review") that determines whether the auditor's system of quality control is in place and operating effectively and whether established policies and procedures and applicable auditing standards are being followed; or

(ii) is enrolled in a peer review program and within 18 months receives a peer review that meets acceptable guidelines.

(B) The following guidelines are acceptable for purposes of subparagraph (e)(23):

(i) The peer review should be comparable to AICPA standards included in Standards for Performing on Peer Reviews, codified in the AICPA's SEC Practice Section Reference Manual;

(ii) The peer review program should be subject to oversight by an independent body comparable to the organizational structure of the Public Oversight Board as codified in the AICPA's SEC Practice Section Reference Manual; and

(iii) The administering entity and the independent oversight body of the peer review program must, as part of their rules of procedure, require the retention of the peer review working papers for 90 days after acceptance of the peer review report and allow Nasdaq access to those working papers.

(f) No change.

4400. Nasdaq National Market—Issuer Designation Requirements

Pursuant to SEC Rule 11Aa2-1, those securities for which transaction reporting is required by an effective transaction reporting plan are designated as national market system securities. A transaction reporting plan has been filed with the Commission under which securities satisfying the requirements of this Rule 4400 Series are covered by the transaction reporting plan and transactions in such securities are subject to the transaction reporting provision of the Rule 4630 Series. [The Association has filed with the Commission a transaction reporting plan under which securities satisfying the requirements of this Rule 4400 Series are covered by the transaction reporting plan and transactions in such securities are subject to the transaction reporting provisions of the Rule 4630 Series.]

4420. Quantitative Designation Criteria

In order to be designated, an issuer shall be required to substantially meet the criteria set forth in paragraphs (a), (b), (c), (d), [or (e)] (e), (f), or (g) below. Initial Public Offerings substantially

meeting such criteria are eligible for immediate inclusion in the Nasdaq National Market upon prior application and with the written consent of the managing underwriter that immediate inclusion is desired. [All other qualifying issues, excepting special situations, are included on the next inclusion date established by Nasdaq.]

(a) [Alternative 1] *Entry Standard 1*

(1) The issuer of the security had annual pre-tax income of at least [\$750,000] *\$1,000,000* [and net income of at least \$400,000] in the most recently completed fiscal year or in two of the last three most recently completed fiscal years.

(2) There are at least [500,000] *1,100,000* publicly held shares.

(3) The market value of publicly held shares is at least [\$3] *\$8* million.

(4) The *bid* price per share [on each of the five business days prior to the date of application by the issuer] is \$5 or more.

(5) The issuer of the security has net tangible assets of at least [\$4] *\$6* million.

(6) The issuer has a minimum of [800] *400 round lot* shareholders [if the issuer has between 500,000 and 1 million shares publicly held, or a minimum of 400 shareholders if the issuer has either (A) over 1 million shares publicly held or (B) over 500,000 shares publicly held and average daily trading volume in excess of 2,000 shares per day for the six months preceding the date of application].

(7) There are [A] at least [two] *three registered and active* [dealers act as Nasdaq] market makers with respect to the security [on each of the five business days preceding the date of application by the issuer].

(b) [Alternative 2] *Entry Standard 2*

(1) The issuer of the security has net tangible assets of at least [\$12] *\$18* million.

(2) There are at least [1 million] *1,100,000* publicly held shares.

(3) The market value of publicly held shares is at least [\$15] *\$18* million.

(4) The *bid* price per share [on each of the five business days prior to the date of application by the issuer] is [\$3] *\$5* or more.

(5) There are [A] at least [two] *three registered and active* [dealers act as Nasdaq] market makers with respect to the security [on each of the five business days preceding the date of application by the issuer].

(6) The issuer has a [three-year] *two-year* operating history.

(7) The issuer has a minimum of 400 *round lot* shareholders.

(c) *Entry Standard 3*

An issuer designated under this paragraph need not also be in compliance with the quantitative criteria for initial inclusion in the Rule 4300 series.

(1) There are at least 1,100,000 publicly held shares.

(2) The market value of publicly held shares is at least \$20 million.

(3) The bid price per share is \$5 or more.

(4) There are at least four registered and active market makers with respect to the security.

(5) The issuer has a minimum of 400 round lot shareholders.

(6) The issuer has:

(A) a market capitalization of \$75 million; or

(B) total assets and total revenue of \$75 million each for the most recently completed fiscal year or two of the last three most recently completed fiscal years.

[(c)] (d) Warrants

(1) No change.

(2) No change.

[(d)] (e) Computations

The computations required by paragraph (a)(1), (a)(5), and (b)(1) shall be taken from the issuer's most recent financial information filed with Nasdaq. The computations required in paragraphs (a)(2), (a)(3), (b)(2), [and] (b)(3), (c)(1), and (c)(2) shall be as of the date of application of the issuer. Determinations of beneficial ownership for purposes of paragraphs (a)(2) [and], (b)(2), and (c)(1) shall be made in accordance with SEC Rule 13d-3. In the case of American Depositary Receipts, the computations required by paragraphs (a)(1), (a)(5), and (b)(1) shall relate to the foreign issuer and not to any depositary or any other person deemed to be an issuer for purposes of Form S-12 under the Securities Act of 1933.

[(e)] (f) Other Securities

(1) *Nasdaq* [The corporation] will consider designating any security not otherwise covered by the criteria in paragraphs (a), (b), [or] (c), or (d) of this Rule, provided the instrument is otherwise suited to trade through the facilities of Nasdaq. Such securities will be evaluated for designation against the following criteria:

(A) The issuer shall have assets in excess of \$100 million and stockholders' equity of at least \$10 million. In the case of an issuer which is unable to satisfy the income criteria set forth in paragraph (a)(1), *Nasdaq* [the Corporation] generally will require the

issuer to have the following: (i) assets in excess of \$200 million and stockholders' equity of at least \$10 million; or (ii) assets in excess of \$100 million and stockholders' equity of at least \$20 million.

(B)—(D) No change.

(2) No change.

(3) No change.

[(f)] (g) *Nasdaq* will consider designating as Nasdaq National Market securities Selected Equity-linked Debt Securities (SEEDS) that generally meet the criteria of this paragraph [(f)] (g). SEEDS are limited-term, non-convertible debt securities of an issuer where the value of the debt is based, at least in part, on the value of another issuer's common stock or non-convertible preferred stock (or sponsored American Depositary Receipts (ADRs) overlying such equity securities).

(1)—(2) No change.

(3) No change.

(A)—(B) No change.

(C) be issued by:

(i) No change.

(ii) a non-U.S. company (including a company that is traded in the United States through sponsored ADRs) (for purposes of this paragraph (g) [(f)], a non-U.S. company is any company formed or incorporated outside of the United States) if:

a. the Association *or its subsidiaries* has a comprehensive surveillance sharing agreement in place with the primary exchange in the country where the security is primarily traded (in the case of an ADR, the primary exchange on which the security underlying the ADR is traded);

b. the combined trading volume of the non-U.S. security (a security issued by a non-U.S. company) and other related non-U.S. securities occurring in the U.S. market and in markets with which the Association *or its subsidiaries* has in place a comprehensive surveillance sharing agreement represents (on a share equivalent basis for any ADRs) at least 50% of the combined world-wide trading volume in the non-U.S. security, other related non-U.S. securities, and other classes of common stock related to the non-U.S. security over the six month period preceding the date of designation; or

c.—d. No change.

(4) No change.

(5) Prior to the commencement of trading of a particular SEEDS designated pursuant to this subsection, the Association *or its subsidiaries* will distribute a circular to the membership providing guidance regarding member firm compliance responsibilities (including suitability recommendation

and account approval) when handling transactions in SEEDS.

4450. Quantitative Maintenance Criteria

After designation as a Nasdaq National Market security, a security must substantially meet the criteria set forth in paragraphs (a) or (b), and (c), (d), (e), and (f) below to continue to be designated as a national market system security. A security maintaining its designation under paragraph (b) need not also be in compliance with the quantitative maintenance criteria in the Rule 4300 series.

(a) *Maintenance Standard 1—Common Stock, Preferred Stock, Shares or Certificates of Beneficial Interest of Trusts and Limited Partnership Interests in Foreign or Domestic Issues*

(1) [200,000] 750,000 shares publicly held;

(2) Market value of publicly held shares of \$[1] \$5 million;

(3) The issuer has net tangible assets of at least \$4 million; [:]

[(A) \$1 million;

(B) \$2 million if the issuer has sustained losses from continuing operations and/or net losses in two of its three most recent fiscal years; or

(C) \$4 million if the issuer sustained losses from continuing operations and/or net losses in three of its four most recent fiscal year;]

(4) 400 shareholders [or 300 shareholders] of round lots; and

(5) Minimum bid price per share of \$1 [or, in the alternative, market value of public float of \$3 million and \$4 million of net tangible assets].

(b) *Maintenance Standard 2—Common Stock, Preferred Stock, Shares or Certificates of Beneficial Interest of Trusts and Limited Partnership Interests in Foreign or Domestic Issues*

(1) The issuer has:

(A) a market capitalization of \$50 million; or

(B) total assets and total revenue of \$50 million each for the most recently completed fiscal year or two of the last three most recently completed fiscal years.

(2) 1,100,000 shares publicly held;

(3) Market value of publicly held shares of \$15 million;

(4) Minimum bid price per share of \$5;

(5) 400 shareholders of round lots; and

(6) At least four registered and active market makers.

[(b)] (c) Other Securities Designated Pursuant to Rule 4420 [(e)] (f)

The aggregate market value or principal amount of publicly-held units must be at least \$1 million.

[(c)] (d) Rights and Warrants

Common stock of issuer must continue to be designated.

[(d)] (e) Market Makers

At least two [authorized] *registered and active market makers, except that an issue must have at least four registered and active market makers to satisfy Maintenance Standard 2 under paragraph (b) of this rule.*

[(e)] (f) Bankruptcy and/or Liquidation

Should an issuer file under any of the sections of the Bankruptcy Act or announce that liquidation has been authorized by its board of directors and that it is committed to proceed, Nasdaq may suspend or terminate the issuer's securities unless it is determined that the public interest and the protection of investors would be served by continued designation.

4460. Non-Quantitative Designation Criteria for Issuers Excepting Limited Partnerships

(a)–(b) No change.

(c) Independent Directors

Each NNM issuer shall maintain a minimum of two independent directors on its board of directors. [For purposes of this section, “independent director” shall mean a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the board of directors, would interfere with the exercise of independent judgement in carrying out the responsibilities of a director.]

(d)–(g) No change.

(h) Conflicts of Interest

Each NNM issuer shall conduct an appropriate review of all related party transactions on an ongoing basis and shall utilize the company's Audit Committee or a comparable body of the board of directors for the review of potential conflict of interest situations where appropriate.

(i) Shareholder Approval

(1) No change.

(2) Exceptions may be made upon application to Nasdaq [the Association] when:

(A) No change.

(B) reliance by the company on this exception is expressly approved by the Audit Committee [of the Board] or a comparable body of the board of directors.

(C) in connection with the acquisition of the stock or assets of another company if:

(i) No change.

(ii) where, *due to* the present or potential issuance of common stock, or securities convertible into or exercisable for common stock, other than a public offering for cash[.];

a. [if] the common stock has or will have upon issuance voting power equal to or in excess of 20% of the voting power outstanding before the issuance of stock or securities convertible into or exercisable for common stock[.]; or

b. the number of shares of common stock to be issued is or will be equal to or in excess of 20% of the number of shares or common stock outstanding before the issuance of the stock or securities; or

(D) No change.

(3)–(6) No change.

(j)–(l) No change.

(m) Peer Review

(1) Each issuer must be audited by an independent public accountant that:

(A) has received an external quality control review by an independent public accountant (“peer review”) that determines whether the auditor's system of quality control is in place and operating effectively and whether established policies and procedures and applicable auditing standards are being followed; or

(B) is enrolled in a peer review program and within 18 months receives a peer review that meets acceptable guidelines.

(2) The following guidelines are acceptable for purposes of paragraph (m):

(A) The peer review should be comparable to AICPA standards included in Standards for Performing on Peer Reviews, codified in the AICPA's SEC Practice Section Reference Manual;

(B) The peer review program should be subject to oversight by an independent body comparable to the organizational structure of the Public Oversight Board as codified in the AICPA's SEC Practice Section Reference Manual; and

(C) The administering entity and the independent oversight body of the peer review program must, as part of their rules of procedure, require the retention of the peer review working papers for 90 days after acceptance of the peer review report and allow Nasdaq access to those working papers.

4470. Non-Quantitative Designation Criteria for Issuers That Are Limited Partnerships

(a)–(h) No change.

(i) Conflict of Interest

Each NNM issuer which is a limited partnership shall conduct an

appropriate review of all related party transactions on an ongoing basis and shall utilize the Audit Committee or a comparable body of the board of directors for the review of potential material conflict of interest situations where appropriate.

4480. Termination Procedure

(a) No change.

(b) An issuer that is subject to termination of its designation may request a review by a *Panel authorized to hear appeals* [Committee of the Board of Governors]. If a review is requested, the issuer is entitled to submit materials and arguments in connection with such review.

(c) The *Panel* [Committee] may grant or deny continued designation on the basis of the written submission by the issuer and whatever other date it deems relevant.

(d) Determinations by the *Panel* [Committee] may be appealed to the *Nasdaq Listing and Hearing Review Committee* [Association's Board of Governors] by any aggrieved person. An appeal to the *Nasdaq Listing and Hearing Review Committee* [Board] shall not operate as a stay of the decision of the Panel unless the *Nasdaq Listing and Hearing Review Committee* [Board] in its discretion determines to grant such stay.

(e) *The Rule 9700 series sets forth procedures applicable to the review of the termination of an issuer's designation.*

(e) Renumbered as (f).

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

In its filing with the Commission, Nasdaq 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. Nasdaq 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

Background

Nasdaq qualification requirements for listing of securities on the National Market and SmallCap Market were last revised in 1989 and 1991, respectively.⁴

Since that time, Nasdaq has witnessed significant growth in terms of the size and number of listings, and volume of transactions. Accompanying this growth has been an increase in participation of individual investors, and heightened public awareness and expectations for Nasdaq listed companies. Nasdaq recognizes that along with this growth and the changes in the market, a commensurate level of quality and investor protection must be assured. Nasdaq believes it is extremely important to place an emphasis not only on ensuring that all Nasdaq companies warrant listing by virtue of their compliance with the applicable qualification requirements, but also that the qualification requirements themselves are in fact appropriate and designed to foster the protection of investors and enhance the credibility of the market.

Given Nasdaq's objective of providing necessary safeguards to public investors in Nasdaq securities, and given the growth and changes in the market, the structural enhancements to Nasdaq now underway, and the time that has passed since the listing standards were last changed, Nasdaq determined to undertake a thorough review of its qualifications requirements. In conducting this review, Nasdaq carefully sought to balance its role in facilitating legitimate capital formation for issuers with Nasdaq's responsibility to provide the appropriate protection to public investors in its markets, and to maintain the trust and confidence reposed in Nasdaq generally. Such capital formation continues to be an important source of new jobs and investment opportunities in the United States today.

While Nasdaq recognizes that certain companies may not be able to meet the more stringent standards proposed herein, it is important to note that companies not in compliance will have the opportunity to achieve compliance with the applicable standards during a reasonable interval of time. In addition, for those companies who are unable to effect compliance with the new standards, a meaningful alternative is now available through their eligibility for quotation in the OTC Bulletin Board ("OTCBB"). The OTCBB is a quotation medium used by NASD members to reflect quotations in non-Nasdaq securities. Securities quoted in the OTCBB are subject to real-time trade reporting,⁵ thus providing a level of

transparency not present when the listing standards were last revised.

Summary of Proposed Rule Change⁶

Elimination of the Alternative to the \$1 Minimum Bid Price. Under the existing standards, issuers with securities trading below \$1 may remain listed on the Nasdaq National and SmallCap Markets if they meet an alternative test.⁷ Nasdaq is proposing to eliminate the alternative test for several reasons. First, it will remove the incentive to engage in large, below market private placements (generally pursuant to Regulation S) which cause dilution and concomitant harm to Nasdaq investors. It will also provide a safeguard against certain market activity associated with low-priced securities. Further, when the alternative test was adopted, it was intended to address "temporary adverse market conditions" resulting in a bid price below \$1.⁸ Contrary to this intent, issuers have used the alternative test as a permanent means of meeting the listing standards. Finally, Nasdaq believes that a \$1 minimum bid price would serve to increase investor confidence and the credibility of its market commensurate with its increased prominence.

After careful consideration of comments received on this provision of the proposal, and as discussed further below, Nasdaq believes that the proposal should be modified to provide for a reasonable expansion in the time period that an issuer's stock price remains below \$1 before it is deemed a deficiency.

Corporate Governance Standards for SmallCap Issuers. Nasdaq is proposing to extend the important shareholder protection benefits of its corporate governance requirements to the SmallCap Market. These are the same requirements that currently apply to National Market issuers, and include, among other things: (1) a minimum of two independent directors; (2) an audit committee with a majority of independent directors; (3) an annual shareholder meeting; and (4) shareholder approval for certain

⁶ See Nasdaq Bulletin dated November 15, 1996, attached as Exhibit 2 to the rule filing, for a detailed chart comparing the current listing standards to the proposed rule change.

⁷ On SmallCap, the alternative requirement is \$1 million in market value of public float and \$2 million in capital and surplus. On the National Market, the alternative requirement is \$3 million in market value of public float and \$4 million in net tangible assets.

⁸ See Exchange Act Release No. 28391 (September 5, 1990), 55 FR 36372.

⁴ These requirements are contained in NASD Rule 4300 Series and Rule 4400 Series.

⁵ See NASD Rule 6550 (requiring that transactions in OTCBB-eligible securities be reported pursuant to the requirements of the Rule 6600 Series).

corporate actions.⁹ These requirements provide investors with a means to become more actively involved in corporate affairs. The shareholder approval requirement should prevent the further potential for dilutive stock issuances in the SmallCap Market without the prior knowledge of investors. The audit committee, independent director and annual meeting requirements will provide vastly enhanced safeguards to the investing public.

Increase in the Quantitative Standards for Both the SmallCap and National Markets. Increases to the quantitative standards are believed to be wholly appropriate given the passage of time since the standards were last adjusted, the opportunities for improvement gleaned from experience over that period, and the concomitant increases in the growth of the market and the rate of inflation. These increases are believed capable of further strengthening the financial criteria consistent with the goal of enhancing the quality of Nasdaq companies, while preserving the ability of qualified Nasdaq companies to raise capital.

Market Capitalization Test for National Market. Consistent with the abiding interest of Nasdaq in facilitating capital formation for high-technology industries and the corresponding opportunity for growth in employment, it was determined that there was a need to recognize and appropriately respond to the unique operating characteristics of certain industries represented in this market. Nasdaq has therefore proposed an accommodation for companies that may fail to comply with the National Market net tangible asset test as a result of accounting for goodwill associated with various merger and acquisition activities, or as in the case of the telecommunications industry, significant depreciation charges.

Specifically, an issuer that is unable to meet either of two alternative net tangible asset tests, as amended by the proposed rule change,¹⁰ could be afforded designation as a National Market issuer provided it initially had a

market capitalization of \$75 million, or total assets and total revenue of \$75 million each. For continued listing, these issuers would have to maintain a market capitalization of \$50 million, or total assets and total revenue of \$50 million.

The changes provide access for Nasdaq National Market caliber companies that would otherwise not qualify due to accounting conventions associated with certain business combinations and specialized industries.

Peer Review for Auditors of Nasdaq Listed Companies. Nasdaq solicited comment to further its evaluation of a requirement that auditors of Nasdaq listed companies be subject to a practice monitoring program under which the auditor's quality control system would be reviewed by an independent peer auditor on a periodic basis. Currently, companies whose shares are publicly traded are not required to have auditors who are subject to such peer review. Although neither the New York Stock Exchange nor the American Stock Exchange have a peer review requirement, certain banking agencies such as the Federal Deposit Insurance Corporation ("FDIC") have successfully implemented a peer review requirement for certain financial institutions. In addition, the Commission has generally expressed support for the concept of peer review.¹¹ Although it withdrew its mandatory peer review proposal, the Commission nonetheless confirmed its belief that "the peer review process contributes significantly to improving the quality control systems of accounting firms auditing Commission registrants and enhances the consistency and quality of practice before the Commission."¹²

Consistent with this, Nasdaq also received strong support from commenters on this requirement. Accordingly, Nasdaq has determined to include a peer review requirement as part of the proposed changes to the listing criteria.

The language of the proposed rule is similar to the peer review requirement of the FDIC.¹³ Specifically, all independent public accountants auditing Nasdaq listed companies must have received, or be enrolled in, a peer review that meets acceptable guidelines. Acceptable guidelines would include comparability to standards of the American Institute of Certified Public

Accountants ("AICPA") included in the Standards for Performing on Peer Reviews codified in the AICPA's SEC Practice Section Reference Manual, and oversight by an independent body comparable to the organizational structure of the Public Oversight Board as codified in the AICPA's SEC Practice Section Reference Manual. Further, copies of peer review reports, accompanied by any letters of comment and letters of response, would be maintained by the administering entity of the peer review program and be made available to Nasdaq upon request. Similarly, working papers of the administering entity and the independent oversight body would also be required to be retained for a period after the report is filed, and be made available to Nasdaq upon request.

Other Clarifying and Conforming Changes. Nasdaq also is proposing changes to specify that the shareholder number requirements in the SmallCap Market are based on the number of "round lot" holders of an issuer's shares. This conforms with the standards on the National Market and other exchanges, and ensures that issuers maintain a broad and significant shareholder base justifying a listing on a national securities market.

In addition, Nasdaq is proposing to conform the stock price compliance mechanism for initial listing under the National Market standards with that of the SmallCap Market by specifying that the applicable price is the bid price, and by removing the provisions under the National Market standards that require satisfaction of the applicable stock price only "on each of the five business days prior to the date of application by the issuer." This clarifies and ensures that issuers must be in compliance with the bid price requirement at the time of listing, and not just at the time coinciding with the filing of the application.

Furthermore, where possible, certain provisions and cross-references have been conformed and renumbered, outdated references and a definition have been deleted, and headings have been renamed for clarity.

Impact Analysis

Nasdaq analyzed the impact the new listing standards would have on both the SmallCap and National Market by applying the proposed standards to current Nasdaq issuers, using financial data from periodic filings to the Commission, and relevant price and volume data. With respect to the listing standards for initial entry for each market, Nasdaq applied the proposed criteria to issuers successfully listing

⁹ It is contemplated that, as is currently the case with respect to National Market issuers, Nasdaq would have the discretion to waive or modify these corporate governance standards for foreign SmallCap issuers where the standards are contrary to generally accepted business practices in the issuer's country of origin.

¹⁰ As amended under the proposed rule change for initial listing on the National Market, an issuer must have net tangible assets of \$18 million, or \$6 million if the issuer has had earnings of \$1 million in the most recent year or two of the last three years. Net tangible assets equals total assets (including the value of patents, copyrights and trade marks but excluding the value of goodwill) less total liabilities. See NASD Rule 4200(w).

¹¹ See Securities Act Release No. 6695 (April 1, 1987), 52 FR 11665.

¹² See Exchange Act Release No. 31197 (September 17, 1992), 57 FR 45287, n. 26.

¹³ See 12 CFR 363, Appendix A.

from June 30, 1994 to August 30, 1996. With respect to maintenance standards, Nasdaq applied the proposed criteria to all current Nasdaq issuers. This resulted in the following estimated impact.

With respect to the SmallCap Market entry criteria, of the 457 issuers successfully listing from June 30, 1994 to August 30, 1996, 229 or 50% would not have qualified for listing. With respect to the SmallCap Market maintenance criteria, of the 1,318 issuers currently listed on SmallCap, 394 or 30% would no longer be eligible for continued listing.

With respect to the National Market entry criteria, of the 1,151 issuers successfully listing from June 30, 1994 to August 30, 1996, 176 or 15% would not have qualified for listing. With respect to the National Market maintenance criteria, of the 3,910 issuers currently listed on National Market, 171 or 4% would no longer be eligible for continued listing.

Nasdaq believes the analysis overstates the impact of the proposed listing standards on issuers for several reasons. For example, certain of the standards, such as public float, are within the control of the issuer and may be adjusted to meet the new standards within a relatively short time frame. Further, a majority of the issuers failing the new criteria only failed one of the standards. Given time, many of these issuers may be able to come into compliance, by, for example, raising additional capital. Past experience supports this belief. In 1991, Nasdaq performed a similar analysis which predicted that 526 issuers would not qualify upon application of the new standards. In fact, after undertaking corrective corporate actions, only 125 issuers (24%) were unable to qualify.

Implementation

Nasdaq recognizes the potential impact the proposed standards would have on existing issuers and issuers applying for initial listing. Therefore, Nasdaq believes the new standards should be made effective six months after the proposed rule change is approved by the Commission to provide current issuers with adequate time to enact the corporate actions necessary to comply with the new rules.

For issuers applying for initial listing after the date the proposed rule change is submitted to the SEC, the new listing standards would be retroactively applied once the proposed rule change was approved. This provides advance notice to issuers applying for listing that they would be subject to higher listing standards upon approval of the rule, so such issuers would not be prejudiced.

These issuers will be afforded ninety days after the SEC approves the proposed rule change to meet the new listing entry criteria. In addition, an issuer will be deemed to have satisfied the new listing entry criteria once the proposed rule change is approved by the Commission, if the issuer is in compliance with the new listing standards at any time after the issuer commenced trading, but prior to Commission approval. This removes an incentive to apply prior to approval of the new criteria for the purpose of circumventing the new standards. Thus, it avoids a rush to apply and provides for the orderly processing of listing applications by Nasdaq staff.

For initial listing of an issuer that applied before the proposed rule change is submitted to the Commission, but which is still pending as of that date, the issuer would have 90 days from the date the proposed rule change is submitted to commence trading on Nasdaq under the existing listing entry criteria. These issuers would not be required to meet the new listing entry criteria after approval by the Commission, but like all other listed issuers, would have to meet the new maintenance criteria six months after approval by the Commission. These procedures are similar to those used when the listing standards were last revised.

Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act¹⁴ in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and in general, to protect investors and the public interest. Nasdaq believes that the extension of the corporate governance requirements to the SmallCap market will permit greater participation by investors in corporate affairs. The elimination of the alternative to the \$1 minimum bid price requirement is an important step to provide a safeguard against certain market activity associated with low priced securities, to remove the incentive for large, below market issuances, and to generally enhance the credibility of the market. The increase in the quantitative standards for both the National Market and SmallCap Market is necessary and appropriate to strengthen the qualification requirements for Nasdaq issuers, and is consistent with a nationwide securities marketplace. Finally, the peer-review requirement for auditors of Nasdaq

companies will provide further safeguards for investors by ensuring that an auditing firm's quality control systems are subject to an industry-accepted level of review.

In sum, the proposed rule change has been designed to ensure the protection of investors and the public interest while maintaining the proper balance between small entrepreneurial companies' access to capital and investors' access to quality companies. Nasdaq has carefully considered public feedback while developing this proposal and appropriate modifications were made where necessary.

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

Nasdaq states that it does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

In November of 1996, Nasdaq sought public comment on the proposed rule change. In an effort to seek the broadest possible solicitation of comments from investors, Nasdaq widely distributed a Nasdaq Bulletin and a Nasdaq Notice to NASD Members to investors, issuers, NASD member firms, and other interested parties. In addition, the entire proposal was posted on the Nasdaq website (www.nasdaq.com), which also solicited comments via E-mail. In total, 227 comments were received. A copy of the Nasdaq Bulletin is attached to the rule filing as Exhibit 2. Copies of the comments received are attached to the rule filing as Exhibit 3.

Of the 227 comments received, 143 were from private investors. 109 comments expressed an opinion regarding the overall proposal, of which 32 were in favor and 77 were opposed. Of those comments expressing general opposition, many were in the form of a brief E-mail, and at least fifteen were reproductions of a letter submitted by a trade association.¹⁵ The single issue evoking the most significant negative comment, mostly from investors, concerned the elimination of an alternative to the \$1 bid price requirement. Commenters expressed strong support for the proposals to extend corporate governance requirements to the SmallCap Market and to establish a peer review

¹⁵ See letter from Jeffrey Adduci, President, Regional Investment Bankers Association to Perry Perego, Vice President, Nasdaq, dated December 19, 1996.

¹⁴ 15 U.S.C. 78o-3.

requirement for auditors of Nasdaq issuers.

Of those comments expressing opposition to the proposed rule change, three general themes emerged:

- The bid price is not within the direct control of the issuer.
- The proposal singles out small issuers.
- More emphasis should be placed on regulating the activity of broker-dealers who engage in fraudulent activity, rather than stigmatizing issuers.

First, with respect to comments opposing the proposed rule change on the basis that the bid price is not within the direct control of the issuer, Nasdaq notes that elimination of the alternative to the minimum bid price requirement is intended to address the following: (1) The concern that securities trading below \$1 are more susceptible to certain activity by stock promoters; (2) the elimination of the incentive for large, below market issuances which may harm Nasdaq investors; (3) the curtailing of its use as a permanent solution to bid price deficiencies; and (4) the enhancement of the credibility of the market. Some issuers argued that a stock's bid price is not within their direct control, and thus the \$1 minimum bid price may unfairly penalize these issuers. Market anomalies such as year-end tax selling or short-term price swings could trigger a bid price deficiency resulting in the initiation of de-listing proceedings for what may otherwise be a viable company with long-term prospects. In a related vein of comments, many investors argued that, as current investors in low-priced stocks, they would be harmed if these companies were to lose their Nasdaq listing.

Nasdaq continues to believe that the minimum bid price would be an important component to the listing standards, and would benefit, in the long run, all market participants, including both present and future investors. However, in response to concerns that bid price is not within the direct control of the issuer, Nasdaq is proposing to expand from 10 to 30 consecutive business days the time period that an issuer's stock price, and its related market value of public float, must remain below the applicable standard before it is deemed a deficiency. Once an issuer's stock falls below \$1 for 30 consecutive business days, it will continue to have 90 days to come back into compliance with the maintenance standards. Compliance can be achieved with respect to the bid price or market value deficiency by meeting the applicable maintenance standard for

any consecutive 10 business days during the 90 day compliance period.

Secondly, with respect to comments opposing the proposed rule change on the basis that it singles out small issuers, Nasdaq recognizes that some companies may be unable to satisfy the revised listing standards. As discussed in the section on implementation above, companies that are at risk of not complying with the new maintenance standards would have a period of time to come into compliance. Companies that are ultimately delisted would be eligible for quotation in the OTCBB, which currently provides real-time quote and real-time last sale price information for issuer's securities.¹⁶ Moreover, Nasdaq is currently in the process of requesting an exemption from the Securities and Exchange Commission under SEC Rule 15c2-11, similar to an exemption obtained in 1992 after standards were last increased. This would, under most circumstances, permit member firms to continue providing liquidity by quoting issuers in the OTCBB without interruption immediately following a de-listing from Nasdaq.

Finally, commenters stated that more emphasis should be placed on regulating the activity of broker-dealers who engage in fraudulent activity, rather than stigmatizing issuers. Nasdaq agrees that a strong regulatory and enforcement program is an indispensable element in the operation of any securities marketplace. Nasdaq consulted with its sister corporation responsible for regulating the activities of broker-dealers, NASD Regulation, Inc. ("NASDR"),¹⁷ in developing these revised listing standards. Further, Nasdaq continues to work with NASDR on formulating regulatory initiatives to enhance the oversight and regulation of activities of NASD member firms generally. It should be noted that NASDR has brought a record number of

¹⁶ Contrary to statements mischaracterizing the OTCBB, as contained in letters from the Regional Investment Bankers Association and others echoing statements therein, NASD rules in fact permit market makers to insert *unlimited* quotation updates throughout the day for domestic equity securities quoted in the OTCBB. These quotes are in turn disseminated to the public on a real-time basis. See NASD Rules 6520 and 6540(b)(1). The "twice-daily update restriction" referred to in these letters only applies to certain unregistered foreign securities subject to a limitation involving an exemption from registration under Exchange Act Rule 12g3-2(b). Furthermore, transactions in domestic and Canadian securities quoted in the OTCBB are now subject to real-time last sale trade reporting and dissemination, thus providing a level of transparency not present when the listing standards were last revised.

¹⁷ NASDR is also a wholly owned subsidiary of the NASD.

disciplinary actions this past year.¹⁸ Nonetheless, Nasdaq believes that these efforts can and should be complemented with appropriately designed listing standards to further the NASD's obligation as a self-regulatory organization to provide the necessary protection that investors and the marketplace have come to expect and deserve.

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, 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. The Commission requests comments on the proposed listings standards in light of the goals of the Exchange Act; the impact of the proposals on small businesses; and on any alternatives to the proposal that could achieve the objectives identified by the NASD and Nasdaq. Commenters are encouraged to provide data where possible.

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 at the Commission's Public Reference Room. Copies of such filing will also be

¹⁸ These include the recent expulsion of Stratton Oakmont, Inc., a firm with an extensive and serious regulatory history. Major enforcement cases have also been brought against: Sterling Foster; H.J. Meyers & Co. (f/k/a Thomas James Associates, Inc.); A.R. Baron & Co., Inc.; and Lew Lieberbaum & Company, Inc.

available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-97-16 and should be submitted by April 30, 1997.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38466; File No. SR-NASD-97-22]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Amend the Damage Ceilings for Claims Under the Standard Arbitration and Simplified Arbitration Procedures

April 2, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on March 27, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items has been prepared by the self-regulatory organization. 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

NASD Regulation, Inc. ("NASDR") is proposing to amend the Code of Arbitration Procedure ("Code") of the NASD to: (1) Raise the ceiling for disputes to be eligible for resolution by a single arbitrator under simplified arbitration procedures from \$10,000 to \$25,000; and (2) raise the ceiling for disputes eligible for resolution by a single arbitrator under standard arbitration procedures from \$30,000 to \$50,000.

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 self-regulatory organization 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 self-regulatory organization 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

In its January 1996 Report on Securities Arbitration Reform, the NASD's Arbitration Policy Task Force ("Task Force") recommended that the ceiling for cases eligible for resolution by a single arbitrator under simplified arbitration procedures should be raised from \$10,000 to \$30,000. The Task Force also recommended that the ceiling for cases eligible for resolution by a single arbitrator under standard arbitration procedures should be raised from \$30,000 to \$50,000. The Task Force recommended that these changes apply to all NASD arbitrations—public customer and intra-industry. The Task Force stated, and NASDR concurs, that raising the threshold, which will cause a larger percentage of cases to be resolved under the simplified arbitration procedures, will "strike an appropriate balance between the desire for faster and less expensive arbitration on the one hand and more expansive procedures on the other."¹

NASDR has consulted with the Securities Industry Conference on Arbitration ("SICA") and the New York Stock Exchange ("NYSE") on the appropriate threshold for simplified and single-arbitrator proceedings. While SICA and the NYSE agree with the Task Force's rationale, they are concerned that setting the threshold for simplified arbitrations too high could disadvantage customer claimants by limiting their procedural rights² under the Code in

cases that have significant economic value to the customer. In view of these concerns, NASD is instead proposing to set the threshold for simplified arbitration at \$25,000, instead of \$30,000. SICA approved of the adjusted thresholds at its October 17, 1996 meeting.

Accordingly, NASD is proposing to amend Rules 10202, Composition of Panels (former Section 9) and 10308, Designation of Number of Arbitrators (formerly Section 19)³ of the Code to establish the threshold for single arbitrator cases at \$50,000. NASDR is also proposing to amend Rules 10203, Simplified Industry Arbitration (formerly Section 10) and 10302, Simplified Arbitration (formerly Section 13) of the Code to establish the threshold for simplified arbitrations at \$25,000. In addition, NASD is proposing to amend each of those rules to state that the threshold amount is "exclusive of attendant costs and interest."

Under the proposed rule change to Rules 10302(d) and 10308(b), claims involving public customers and exceeding \$25,000, exclusive of attendant costs and interest, will be heard by a three member arbitration panel, rather than a panel of no less than three and no more than five arbitrators. Under the proposed rule change to Rule 10302 (f) and (h)(3), the Director of Arbitration will "appoint," rather than "select," the public arbitrator for simplified arbitration. The proposed rule change amends Rule 10308(a) to state that a majority of the arbitrators on a three member arbitration panel (for claims that are less than or equal to \$50,000 but where a party or arbitrator requested a panel of three arbitrators) shall be public arbitrators, rather than stating that a majority of the three arbitrator panel "shall not be from the securities industry." The proposed rule change also includes several technical changes designed to correct inconsistencies in the rule language and which were also adopted by SICA.

2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the

¹ See Report of the Arbitration Policy Task Force on Securities Arbitration Reform, at 73.

² Under the simplified arbitration procedures for matters between a public customer and an associated person or member, cases are resolved without a hearing (so-called "paper cases") by a single public arbitrator. A public customer may, however, demand a hearing, or the arbitrator may call a hearing, in which case the arbitrator will hold a hearing and the parties will have the benefit of all of the available forms of discovery. See Rule 10302. Under the standard arbitration procedures for all matters involving public customers, cases in which the claims are more than \$10,000 but less than \$30,000 may be heard by a single public arbitrator. These cases are not decided on the papers; rather, the arbitrator holds a hearing. However, any party may demand a three person panel. See Rule 10308.

³ NASDR will shortly be filing a proposed rule change to amend Rule 10308 to implement the list selection process for the selection of arbitrators recommended by the Task Force. The list selection rule filing will further substantially amend Rule 10308, but will not be implemented until NASD has developed the technology and procedures to administer the process and developed a pool of arbitrators sufficient to provide lists of arbitrators in accordance with the requirements of the rule. Accordingly, NASD is amending Rule 10308 in the interim until the list selection rule is filed, approved and implemented.

¹⁹ 17 CFR 200.30-3(a)(12).