

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39958; File No. SR-NASD-97-92]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed By-Law Amendment Requiring Members to Update Firm Contact Information Electronically, to Maintain Electronic Mail Account and for Other Purposes

May 5, 1998.

On December 19, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder.² The filing was thereafter amended on April 22, 1998.³ In this filing, as amended, the Association proposed amendments to the NASD By-laws, to require members to communicate with the Association electronically. Under this proposal, members will be required to set up and maintain an electronic mail account and must update their firm contact information through the Internet. In addition, the Association has included a technical amendment to the composition of the NASD National Nominating Committees, correcting a misprint from an earlier filing.⁴ Notice of the proposal was published in the Federal Register on January 16, 1998

("Notice").⁵ The Commission received three comment letters on the filing.⁶

I. Introduction and Background

On August 5, 1997, the Membership Committee of the NASD Regulation, Inc. ("NASD Regulation") Board of Directors recommended requiring each member's executive representative to maintain an Internet electronic mail account for communication with the NASD and to update firm contact information via NASD Regulation's Internet web site. Following approval by the NASD Regulation Board of Directors and the NASD Board of Governors, the Notice was filed with the Commission and published in the Federal Register.⁷ When polled on this proposal, as required by the NASD By-laws, the NASD membership voted more than two to one in favor of requiring maintenance of electronic mail accounts.⁸

II. Description of the Proposal

A. Electronic Mail Accounts and Updating of Member Information

The Proposal promotes Internet use by the Association and its members as a communication tool. As revised, the NASD By-laws will require each member to acquire and maintain an Internet electronic mail address on behalf of its executive representative before January 1, 1999.

In addition to maintaining electronic mail accounts, members will also be required to update firm contact information electronically. In its filing, the NASD maintained that the present method of collecting firm contact information (which is used for member balloting, compliance purposes and targeting key individuals for informational mailings, etc.) through physical filing of an *NASD Member Firm Questionnaire* ("Member Questionnaire") needs improvement. There are significant problems with current procedures. First, information is often stale, because members rarely update the filings. Second, the Member Questionnaire information, which is

currently stored and made available through the Central Registration Depository or "CRD," is not readily available for use in other computer programs and systems. Finally, the planned system enhancements to the CRD do not contemplate inclusion of Member Questionnaire data. Using the new electronic mailboxes, the NASD intends to transmit e-mail reminders to members to update their Membership Questionnaires on a periodic basis. Member firms can then easily access their respective Member Questionnaire via the NASD Regulation Web Site for updating.⁹ The Association has indicated that information provided in this manner is more readily interfaced to the internal NASD Regulation systems requiring the data.

The three comment letters received by the Commission on this rule filing all react negatively to required use of the Internet and electronic mail accounts. The main objections relate to the costs involved in setting up and maintaining such services. One commentator suggested that the decision to maintain an electronic mail account should be discretionary, rather than mandatory.¹⁰ Concerns about lack of member of NASD control over the Internet and internet functionality, reliability, access, integrity and security were also noted.¹¹ The Association's response argues that the minimal costs involved in connecting to the Internet (as little as ten dollars a month for an account and less than one thousand dollars for a computer and modem) are "reasonable in light of the tremendous benefits that electronic mail and Internet communication will bring to the membership."¹² The NASD also stressed its belief that all, rather than some, members should have an electronic mail account, to "strive for uniformity of notice and enable speedy and relatively inexpensive communication with all members."¹³

B. Technical Amendment to Nominating Committee Composition

The NASD also proposes a technical amendment to Article VII, Section 9(b) of the NASD By-Laws. In November, 1997, the Commission approved a comprehensive revision to the Association By-Laws, implementing a

⁵ See Securities Exchange Act Release No. 39539 (January 12, 1998), 63 FR 2709 (January 16, 1998) (File No. SR-NASD-97-92). Amendment No. 1 to the proposed rule filing was filed on April 22, 1998. See *supra* note 3.

⁶ See Letter from Marc B. Horin, National Compliance Consultants to Secretary, Commission, dated January 23, 1998; Letter from John B. Simmon, Morris Group Inc. to Secretary, Commission, dated January 22, 1998; and Letter from Marc B. Horin, National Compliance Consultants to Secretary, Commission, dated January 30, 1998.

⁷ Release No. 34-39539, *supra* note 5.

⁸ See Amendment No. 1, *supra* note 3. The membership vote was 1,884 in favor, 876 against. *Id.*

⁹ A firm would be able to access only its own Member Questionnaire; the information would be password-protected to prevent any public access.

¹⁰ See Letter from Marc B. Horin, National Compliance Consultants to Secretary, Commission, dated January 30, 1998.

¹¹ *Id.*

¹² Amendment No. 1, *supra* note 3 at 2.

¹³ *Id.*

³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4

³ Letter from T. Grant Callery, Senior Vice President and General Counsel, NASD to Katherine A. England, Assistant Director, Division of Market Regulation, Commission dated April 22, 1998. The amendment provides the members' vote and responses to the comment letters. It is technical in nature and therefore not subject to a notice and comment requirement.

⁴ See Securities Exchange Act Release No. 39326 (Nov. 14, 1997), 62 FR 62385 (Nov. 21, 1997); see also *infra* text surrounding note 7.

more streamlined corporate structure.¹⁴ When voted on by the NASD members prior to Commission approval, however, Article VII, Section 9(b) incorrectly stated that the number of Industry committee members on the National Nominating Committee should equal or exceed the number of Non-Industry committee members. The terms "Industry" and "Non-Industry" had been transposed. By Commission order, the National Nominating Committee must have an equal or greater number of Non-Industry participants.¹⁵

Only one commentator addressed this portion of the proposal. This writer questioned numerical inconsistencies within the amendment.¹⁶ In its response, the NASD pointed out that the commentator incorrectly assumed that the terms "Non-Industry member" and "Public Member" were synonymous. Since they are not (because Public members are a subset of Non-Industry members) there is no inconsistency.¹⁷

III. Discussion

As discussed below, the Commission has determined at this time to approve the Association's proposal. The standard by which the Commission must evaluate a proposed rule change is set forth in Section 19(b) of the Act. The Commission must approve a proposed NASD rule change if it finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that govern the NASD.¹⁸ In evaluating a given proposal, the Commission examines the record before it and all relevant factors and necessary information. In addition, Section 15A of the Act establishes specific standards for NASD rules against which the Commission must measure the proposal.¹⁹

A. Electronic Mail Accounts and Updating of Member Information

The Commission has determined to approve the Association's proposal requiring members to acquire and maintain the ability to communicate

electronically. Use of the Internet as a business tool is expanding rapidly. As a general matter, it is becoming widely recognized as an efficient and cost-effective means of communication in the business world. Specifically, use of electronic mailboxes is expected to facilitate timely communications between the Association and its members, the more rapid distribution of NASD information, notices, and publications, and reduction or elimination of printed publications. Overall, the enhanced use of electronic communications should result in significant cost savings to the Association without significant disadvantage to the member. Moreover, as noted above, the costs involved in obtaining and maintaining Internet service are minimal.²⁰ According to research conducted by the Association, any phone line in the United States can support Internet service.²¹ Finally, the Commission agrees with the Association that "concerns over the lack of NASD control over the Internet as well as its integrity, security, and functionality also exist for other modes of communication, such as the United States mail. In many cases, Internet communication is more desirable given its speed, timely notice of undeliverable mail, and accessibility 24 hours a day."²² Since the proposal complies with the requirements of Sections 15A and 19(b)(2) of the Act, and the advantages clearly outweigh any disadvantages, the Commission is approving the filing.

b. Composition of National Nominating Committee

The Commission will also approve the adjustments to the composition of the National Nominating Committee at this time. This is necessary to ensure that membership in the National Nominating Committee conforms to the requirements of the SEC Order and related Undertakings issued in August 1996.²³ Based on the Commission's specific findings in the SEC Order, the Association agreed to "implement and maintain at least fifty percent independent public and non-industry membership in its Board of Governors, the Board(s) of Governors or Directors of all of its subsidiaries and affiliates that

exercise or have delegated self-regulatory functions, and * * * the National Nominating Committee."²⁴ For the past several months, the Association has maintained compliance with both the SEC Order and the misprinted effective language by maintaining an equally balanced committee.²⁵ Revising the language to correct the misprint will allow the Association to introduce additional Non-Industry members, which furthers the intent of the SEC Order and other related Commission proceedings.

IV. Conclusion

The Commission believes that the proposed rule change is consistent with the Act, and, particularly, with Section 15A thereof.²⁶ In approving the proposal, the Commission has considered its impact on efficiency, competition, and capital formation.²⁷ In particular, the electronic mail accounts and updating proposal promotes procedures that are cost-efficient and will promote the fair and efficient operation of the Association and conduct of its self-regulatory responsibilities. In addition, adjustment of the National Nominating Committee composition is important, to conform the language to the intent of the Association and the Commission when originally approved. This change will help to ensure a fair representation of NASD members in the selection of Association Directors and Governors and administration of its affairs and provide an appropriate number of Governors or Directors that are representative of issuers and investors and not associated with a member of the Association, a broker, or a dealer.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁸ that the proposed rule change (SR-NASD-97-92), including Amendment No. 1 thereto, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁹

Margaret H. McFarland,

Deputy Secretary.

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¹⁴ See Securities Exchange Act Release No. 39326 (Nov. 14, 1997), 62 FR 62385 (Nov. 21, 1997).

¹⁵ See Securities Exchange Act Release No. 37538 (Aug. 8, 1996) (SEC Order Instituting Public Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, In the Matter of National Association of Securities Dealers, Inc., Administrative Proceeding File No. 3-9056) ("SEC Order"). The SEC Order includes fourteen Undertakings adopted by the Association to remediate the problems identified in the order.

¹⁶ Letter from Marc B. Horin, National Compliance Consultants to Secretary, Commission, dated January 30, 1998.

¹⁷ See Amendment No. 1, *supra* note 3 at 2.

¹⁸ 15 U.S.C. 78s(b).

¹⁹ 15 U.S.C. 78o-3.

²⁰ See *supra* text accompanying note 12.

²¹ See E-Mail from Mary Dunbar, Office of General Counsel, NASD to Mandy Cohen, Office of Market Supervision, Commission dated April 30, 1998 (indicating that "NASD Regulation staff conferred with MCI, which informed NASD Regulation that modems were widely available that are capable of providing Internet access via any telephone line used in the United States").

²² See Amendment No. 1, *supra* note 3 at 2.

²³ See SEC Order, *supra* note 15.

²⁴ *Id.*

²⁵ Telephone call from Mary Dunbar, Office of General Counsel, NASD Regulation to Mandy Cohen, Office of Market Supervision, Commission dated May 5, 1998.

²⁶ 15 U.S.C. § 78o-3.

²⁷ 15 U.S.C. § 78c(f).

²⁸ 15 U.S.C. § 78s(b)(2).

²⁹ 17 CFR 200.30-3(a)(12).