

consistent with Section 6(b)(7)⁹ of the Act. The proposed rule change provides fair procedures for disciplining its members and associated persons by changing the composition of Disciplinary Panels to allow professional hearing officers to serve as chairmen and voting members on these panels. Providing more responsibility and authority to these professional hearing officers lends credibility to the disciplinary process because all parties involved in the dispute will benefit from their expertise and knowledge of the law as it applies to the securities industry. This expertise and knowledge should result in speedier Panel decisions without sacrificing due process.

The Commission notes, however, that the Exchange's rules do not specifically address the possibility of conflicts of interest between the panelist and parties in the dispute.¹⁰ In response, the Exchange states that its Hearings Department screens panel members for conflicts of interest.¹¹ Initially, prospective panel members are chosen who do not present apparent conflicts. These prospective panelists are then given the names of the parties, names of lawyers or agents representing the parties, names of any potential witnesses disclosed by the parties, and the nature of the case. Prospective panelists are then asked whether they have any past or present relationships with any of the persons mentioned and whether they are aware of any other conflict presented by any of the persons mentioned or by the nature of the case. The Exchange also forwards the names of prospective panelists to the parties so that the parties can conduct their own conflicts check. In the Commission's view, this procedure should go on a long way in removing any interested persons from the list of prospective panelists before the panel is selected, thereby minimizing the possibility of conflicts.

The Commission agrees that extending the right of indemnification to persons serving on Disciplinary Panels and to Exchange Officials should

allow the Exchange to attract and retain qualified persons to serve in these capacities. By eliminating the possibility of litigation and potential judgment as factors in deciding whether to participate on a Panel, the pool of qualified candidates should increase and their decisions will be based on impartial analysis of the evidence and circumstances, not fear of reprisal. Finally, the Commission supports the Exchange vesting in the Executive Committee the authority to hear all appeals. Streamlining the appeals process should result in expedited enforcement action where necessary, which will, in turn, benefit the public.

IV. Conclusion

For the above reasons, the Commission believes that the proposed rule change is consistent with the provisions of the Act, and in particular with Section 6(b)(7).

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹² that the proposed rule change (SR-AMEX-97-30) be, and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39998; File No. SR-CHX-98-06]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 to the Proposed Rule Change by the Chicago Stock Exchange, Inc. Relating to Registration Requirements

May 18, 1998.

I. Introduction

On February 18, 1998, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposal to amend its rules to clarify the persons required to register with the CHX. On March 18, 1998, the CHX filed Amendment No. 1

to the proposal.³ The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on April 1, 1998.⁴ On May 7, 1998, the CHX filed Amendment No. 2 to the proposal.⁵ On May 15, 1998, the CHX filed Amendment No. 3 to the proposal.⁶ No comments were received regarding the proposal. This order approves the proposed rule change, as amended.

II. Description of the Proposal

CHX Article VI, "Restriction and Requirements," Rule 2, "Registration and Approval of Member and Member Organization Personnel," governs the registration and approval of member and member organization personnel and other associated persons. The CHX proposes to replace the current text to CHX Article VI, Rule 2 with new text in order to clarify those persons who are required to register with the Exchange. Specifically, new CHX Article VI, Rule 2(a), "Registration," will require all registered persons, as defined in CHX Article VI, Rule 2(b), to register with the CHX.⁷ The CHX may waive the registration requirement or permit a short-form registration or notification for an individual who is properly registered with another self-regulatory organization ("SRO").

New CHX Article VI, Rule 2(b), "Definition of Registered Persons," defines "registered persons" as all members and persons associated with a member or member organization who are engaged or will be engaged in the securities business of a member or

³ See Letter from Patricia L. Levy, Senior Vice President and General Counsel, CHX, to Katherine A. England, Division of Market Regulation ("Division"), Commission, dated March 17, 1998 ("Amendment No. 1"). Amendment No. 1 revises CHX Article VI, Rule 2(a) to state that registered persons, as defined in CHX Article VI, Rule 2(b), must register with the CHX.

⁴ See Securities Exchange Act Release No. 39804 (March 25, 1998), 63 FR 15906.

⁵ See Letter from Patricia L. Levy, Senior Vice President and General Counsel, CHX, to Yvonne Fraticelli, Attorney, Division, Commission, dated May 6, 1998 ("Amendment No. 2"). Amendment No. 2 revises CHX Article VI, Rule 2(b) to include members in the CHX's definition of registered persons.

⁶ See Letter from Patricia L. Levy, Senior Vice President and General Counsel, CHX, to Yvonne Fraticelli, Division, Commission, dated May 15, 1998 ("Amendment No. 3"). Amendment No. 3 revises Interpretation and Policy .01 to CHX Article VI, Rule 2, to indicate that amendments to Form U-4 and Form BD regarding any registered person must be filed within 30 days after the registered person learns the facts or circumstances requiring the forms to be revised or, if the revision involves a statutory disqualification, as defined in the Act, within 10 days after the statutory disqualification occurs. The CHX's original proposal did not include the 10-day limit for the filing of amendments involving a statutory disqualification.

⁷ See Amendment No. 1, *supra* note 3.

⁹ Section 6(b)(7) requires the Commission to determine that a registered national securities exchange's rules are designed to provide a fair procedure for the disciplining of members and persons associated with members.

¹⁰ *Cf.* CBOE Rule 2.1(c) (no member shall participate in adjudication of a matter in which he is personally interested) and PCX Rule 10.8(b) (review board member required to disclose any circumstances that might preclude him from rendering an objective and impartial determination) and Rule 11.3 (no committee member shall participate in an adjudication of a matter in which he is personally interested).

¹¹ See *supra* note 4, Amendment No. 2 at p.2.

¹² 15 U.S.C. 78s(b)(2).

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

member organization, or the management of such securities business, including those persons whose functions include supervision, solicitation, conduct or business and the training of other persons associated with the member or member organization for any of these functions. CHX Article VI, Rule 2(b) also enumerates, without limitation, specific persons who are within the definition of registered persons, including: (i) Sole proprietors; (ii) officers; (iii) partners; (iv) principal stockholders (as defined in CHX Article II, Rule 4); (v) directors; (vi) branch office managers; (vii) nominees; (viii) representatives (including any persons performing the duties customarily performed by a salesperson or registered representative); (ix) persons whose functions include (a) underwriting, trading or sales of securities; (b) research or investment advice, other than general economic information or advice, with respect to the activities described in the preceding clause (a); and (c) activities other than those specifically mentioned that involve communication, directly or indirectly, with public investors in securities in connection with the activities described in the preceding clauses (a) and (b); and (x) persons listed on Schedule A, B, or C of the member's or member organization's Form BD.⁸

With regard to independent contractors associated with members and member organizations, the CHX notes that it has been the long-standing policy of the Commission to characterize and treat independent contractors whose actions are controlled by a member or member organization as employees for purposes of the Act.⁹

⁸ Schedule A of Form BD requests information concerning direct owners and executive officers; Schedule B requests information concerning indirect owners; and Schedule C is used to amend Schedules A and B.

⁹ See Letter from Douglas Scarff, Director, Division, Commission, to Gordon S. Macklin, President, National Association of Securities Dealers, Inc., dated June 18, 1982 ("1982 Letter"). In its 1982 Letter, the Division noted that the Act requires that a person selling securities be registered with the Commission as a broker-dealer under Section 15(a) unless he or she is an associated person as defined in Section 3(a)(18) of the Act. With regard to securities salespersons designated as independent contractors, the Division stated that unless an independent contractor's activities are subject to control by a broker-dealer within the scope of Section 3(a)(18) of the Act, the salesperson must be registered individually as a broker-dealer. The Division noted that an independent contractor salesperson whose activities are subject to control by a broker-dealer must be registered with an SRO and should be covered by the employer broker-dealer's fidelity bond. Finally, the Division stated that a firm is responsible for ensuring either that an independent contractor is registered as a broker-dealer or assuming the supervisory responsibilities attendant to a relationship with an associated person.

This characterization and treatment applies irrespective of whether such persons might be deemed employees in an unrelated statutory context (e.g., for purposes of IRS regulations). Accordingly, an independent contractor, as well as any other person associated with a member or member organization, must register with the CHX if he or she falls within the definition of registered person.

New CHX Article VI, Rule 2(c), "Persons Exempt from Registration," exempts from registration persons associated with a member or member organization (i) whose functions are solely and exclusively ministerial; or (ii) who are not actively engaged in the securities business.¹⁰

The sole new provision in CHX Article VI, Rule 2(d), "Other Registration Requirements," prohibits members from making application for the registration of any associated person where there is no intent to employ such person in the member's securities business.¹¹ The CHX's proposal also amends Interpretation and Policy .01 to CHX Article VI, Rule 2 to state that amendments to Form U-4 and Form BD regarding any registered person must be filed within 30 days after the registered person learns the facts or circumstances requiring the forms to be amended or, if the amendment involves a statutory disqualification, as defined in the Act, within 10 days after the statutory disqualification occurs.¹²

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5)¹³ in that it is designed to prevent fraudulent and

manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest.¹⁴ In addition, the Commission finds that the proposal is consistent with Section 6(c)(3)(B)¹⁵ of the Act, which allows a national securities exchange to require that any person associated with a member, or any class of such persons, register with the exchange in accordance with procedures established by the rules of the exchange.

New CHX Article VI, Rule 2(a) will require all registered persons, as defined in CHX Article VI, Rule 2(b), to register with CHX.¹⁶ New CHX Article VI, Rule 2(b) generally defines registered persons as members and persons associated with a member who are engaged or will be engaged in the securities business of a member, or in the management of such business, including the functions of supervision, solicitation, conduct of business or the training of associated persons for any of these functions. New CHX Article VI, Rule 2(b) also enumerates, without limitation, specific persons who are within the definition of registered person. In addition to the persons required to register under the CHS's current rule, new CHX Article VI, Rule 2(b) also will require that the following persons register with the CHX: sole proprietors; principal stockholders (as defined in CHX Article III, Rule 4); persons listed on Schedules A, B, or C of a member's Form BD;¹⁷ and persons engaged on behalf of a member in underwriting, trading, or sales of securities, research or investment advice, or other activities involving communication with the public in connection with underwriting, trading, sales of securities, or research or investment advice.

The Commission believes that new CHX Article VI, Rules 2(a) and 2(b) will clarify the persons who are required to register with the Exchange, thereby facilitating compliance with the CHX's registration requirements and helping to ensure that all persons who are or will be engaged in a member's securities business are registered with the CHX. Because register persons and persons seeking to register are subject to the

¹⁴ In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁵ 15 U.S.C. 78f(c)(3)(B).

¹⁶ However, the CHX may waive the registration requirement or permit a short-form registration or notification for an individual who is properly registered with another SRO.

¹⁷ See note 8, *supra*.

¹⁰ Persons in this category may include, for example, senior officers in a division of a broker-dealer that does not participate in the member's securities business. Telephone conversation between Patricia L. Levy, Senior Vice President and General Counsel, CHX, and Yvonne Fraticelli, Attorney, Division, Commission, on March 13, 1998 ("March 13 Conversation").

¹¹ The current version of CHX Article VI, Rule 2 contains the other requirements listed in new CHX Article VI, Rule 2(d). In general, these provisions include the requirements that members: (1) terminate their relationship with an associated person for whom the CHX has withdrawn or withheld registration or approval; (2) obtain CHX approval before allowing a person subject to a statutory disqualification to become associated with the member; (3) take reasonable care to determine the existence of a statutory disqualification prior to employing an associated person; and (4) promptly notify the CHX if an associated person becomes subject to a statutory disqualification.

¹² See Amendment No. 3, *supra* note 6.

¹³ 15 U.S.C. 78f(b)(5)(1998).

CHX's jurisdiction,¹⁸ the proposal also will facilitate the CHX's oversight of such persons by ensuring that the CHX has the authority to enforce its rules and the federal securities laws against such persons.

The CHX's proposal also protests investors and the public interest by noting that a person characterized as an independent contractor must register with the CHX if he or she falls within the definition of registered person. This position is consistent with the 1982 Letter,¹⁹ which stated, among other things, that an independent contractor salesperson whose activities are subject to control by a broker-dealer must be registered with a SRO. By providing a clear statement of the CHX's policy regarding the registration of independent contractors, the CHX's proposal should help to ensure that independent contractors who come within the CHX's definition of registered person register with the CHX.

CHX Article VI, Rule 2(c), "Person Exempt from Registration," provides exemptions from registration for associated persons who functions are solely and exclusively clerical or ministerial or who are not actively engaged in the securities business.²⁰ The Commission notes that the rules of the National Association of Securities Dealers, Inc. ("NASD") also provide these exemptions from registration.²¹ Accordingly, the Commission believes that these exemptions from registration are reasonable and raise no new regulatory issues.

New CHX Article VI, Rule 2(d), "Other Registration Requirements," prohibits members from making application for the registration of any associated person when there is no intent to employ such person in the member's securities business. NASD Rule 1031(a) also contains this prohibition. Accordingly, the Commission believes that this provision of the CHX's proposal is reasonable and raises no new regulatory issues.

The Commission believes that it is reasonable for the CHX to amend Interpretation and Policy .01 to indicate that amendments to Forms U-4 and BDA regarding any registered person must be submitted to the CHX within 30 days after the registered person learns

the facts or circumstances requiring the forms to be revised, or, if the amendment involves a statutory disqualification, as defined in the Act, within 10 days after the disqualification occurs.²² The Commission notes that the rules of the NASD contain a similar provision.²³ Accordingly, the Commission believes that the CHX's amendment to Interpretation and Policy .01 is reasonable and raises no new regulatory issues.

The Commission finds good cause for approving Amendment Nos. 2 and 3 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 2 clarifies new CHX Article VI, Rule 2(b) by indicating that members, as well as associated persons, are registered persons under CHX Article VI, Rule 2(b). This change reflects the inclusion of sole proprietors within CHX Article VI, Rule 1(b)'s enumerated list of registered persons and eliminates an inconsistency that would arise if the CHX defined registered persons to include only persons associated with members and member organizations. Amendment No. 3 strengthens the CHX's proposal by requiring the filing of amendments to Forms U-4 and BD that involve a statutory disqualification within 10 days after the statutory disqualification occurs. Accordingly, the Commission believes that it is consistent with Sections 6 and 19(b) of the Act to approve Amendment Nos. 2 and 3 on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether Amendment Nos. 2 and 3 are consistent with the Act. 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 persons, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be

available for inspection and copying at the principal office of the CHX. All submissions should refer to file number SR-CHX-98-06 and should be submitted by June 16, 1998.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁴ that the proposed rule change (SR-CHX-98-06) is approved.

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

[FR Doc. 98-13816 Filed 5-22-98; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40001; File No. SR-NASD-97-95]

Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change By the National Association of Securities Dealers, Inc. Relating to Amendments to the Free-Riding and Withholding Interpretation

May 18, 1998.

I. Introduction

On December 23, 1997,¹ the National Association of Securities Dealers Regulation, Inc. ("NASD Regulation") 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"),² and Rule 194-b thereunder.³ Notice of the proposal appeared in the **Federal Register** on February 11, 1998.⁴ The Commission received one comment letter regarding the proposal.⁵ The

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).

¹ On March 12, 1998, NASD Regulation filed Amendment No. 1 to the proposal. Amendment No. 1 revised Paragraph (b)(9)(A)(ii) to include the shares of a member's parent that are publicly traded on an exchange or Nasdaq in the exemption granted for shares of members traded on an exchange or Nasdaq. Section III of this approval order contains a further discussion of this amendment. In brief, the technical amendment was necessary to reflect the fact that members are often part of a holding company structure wherein the parent of the member is the entity that actually trades on an exchange or Nasdaq. Amendment No. 1 also corrected a drafting error in the original proposal's Paragraph (d) of IM-2110-1 to clarify that both employees and directors may take advantage of an exemption for issuer directed securities programs. Because this amendment is technical the statute does not require that it be published for comment.

² 15 U.S.C. 78s(b)(1).

³ 17 CFR 240-19b-4.

⁴ Securities Exchange Act Release No. 39620 (February 4, 1998), 63 FR 7026 (February 11, 1998).

⁵ See letter from Sullivan & Cromwell to Jonathan G. Katz, Secretary, SEC, dated March 13, 1998.

¹⁸ Registered persons submit to the authority of the organizations or states to which they apply for registration on the Form U-4.

¹⁹ See 1982 Letter, *supra* note 9.

²⁰ As noted above, persons in this category may include, for example, for example, senior officers in a division of a broker-dealer that does not participate in the member's securities business. See March 13 Conversation, *supra* note 10.

²¹ See NASD Rule 1060(a)(1) and (2).

²² See Amendment No. 3, *supra* note 6.

²³ See NASD By-Law Article V, Section 2(c).