

SPECIAL NASD NOTICE TO MEMBERS 97-75

Mail Vote—NASD Solicits Member Vote On Amendments To NASD By-Laws To Reconfigure NASD Board; **Last Voting Date: November 13, 1997**

Suggested Routing

- Senior Management
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Executive Summary

The National Association of Securities Dealers, Inc. (NASD[®] or Association) invites members to vote to approve amendments to the NASD By-Laws intended to provide for a more efficient and effective corporate structure for the Association. The last voting date is November 13, 1997. The text of the proposed amendments follows this *Notice*. Questions concerning this *Notice* may be directed to T. Grant Callery, Senior Vice President and General Counsel, NASD, at (202) 728-8285.

Background

The proposed amendments are part of a comprehensive revision of the NASD, NASD Regulation, Inc., and The Nasdaq Stock Market, Inc., By-Laws intended to provide for a more efficient and effective corporate structure for the Association, to make the Association's corporate documents more consistent with one another, and to conform the corporate documents to the recently amended Code of Procedure and membership procedures. In particular, the proposed corporate structure is designed to streamline the decisionmaking process to be more responsive to investor interests; improve communication among Board members and the staff; enable the Association to act quickly and decisively when necessary; and preserve the principles set forth in the September 15, 1995, *Report of the NASD Select Committee on Structure and Governance to the NASD Board of Governors* (Select Committee Report) and undertakings agreed to as part of the Association's settlement with the Securities and Exchange Commission (SEC or Commission).¹

The text of the proposed rule change is attached as Attachment A. Proposed new language is underlined; proposed deletions are in brackets.

To achieve the corporate objectives set forth above, the Association will retain the current three-corporation structure, but reduce the overall number of board members for the three corporations. The Nasdaq[®] and NASD RegulationSM Boards will be smaller and become part of an expanded NASD Board.² As a result, the Association will reduce the overall number of board members from 49 to 27, reduce the number of board meetings from 17 to seven, and reduce the number of board committees from nine to five.

The NASD Board will consist of 21 to 27 Governors and include a nucleus of Governors who will not serve as directors on either subsidiary board. The subsidiary boards each will have five to eight Directors, all of whom will be NASD Governors. The number of directors on each subsidiary board will be equal, thereby enabling the nucleus of individuals who serve only as NASD Governors to perform a tie-breaking function on the parent board.

The NASD Board will retain its current authority to review and ratify or reject certain actions of the subsidiaries, although the process of exercising this authority will be expedited by transferring certain functions to new entities under each subsidiary board and changing several meeting schedules. First, the functions of the National Business Conduct Committee, a committee of the NASD Regulation Board composed entirely of Directors, will be transferred to a new entity, the National Adjudicatory Council, which will be appointed by the NASD Regulation Board after nomination by the National Nominating Committee. Similarly, the functions of the Nasdaq Listing and Hearing Review Committee will be transferred to a new Listing Council, whose members will be appointed by the Nasdaq Board after nomination by the National Nominating Com-

mittee. Except for the Chair of the National Adjudicatory Council, members of the councils will not serve on any of the Association's boards. These new councils will meet at least 15 days before the subsidiary boards and will provide written reports of their decisions to their respective boards no later than 15 days before the subsidiary board meetings. The subsidiary board meetings then will be scheduled to occur one day before the meetings of the NASD Board. Although matters delegated to each subsidiary will, as a matter of general practice, be considered by the subsidiary boards before proceeding to the NASD Board, the time required for final disposition will be significantly reduced by these structural and scheduling changes. Under the current structure and meeting schedule, the subsidiaries may have to delay issuing disciplinary, listing, and other decisions and filing rule proposals with the Commission until a parent board meeting is held, which may occur several weeks after the subsidiary board takes action. This delay will be eliminated by the new corporate structure and meeting schedule.

In addition to compressing the time between subsidiary and parent board meetings, the structural refinements will facilitate other efficiencies because members of the revamped subsidiary boards will constitute a subset of NASD Board members. For example, an NASD Regulation rule amendment that clearly warrants consideration by the NASD Board can be taken directly to the NASD Board for action, avoiding the need for duplicative discussions of the same matter. The same will be true of rule amendments that require NASD Board review under the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries (Delegation Plan).³ Thus, action on significant or controversial matters can be accomplished in one step,

rather than the two steps that are currently required. Furthermore, because the Directors of both subsidiary boards will be Governors of the NASD Board, the consideration of matters at the NASD Board level always will have the benefit of subsidiary board participation.

To further expedite decisionmaking, the NASD Board will be specifically authorized by the Delegation Plan to take action on its own initiative. Thus, subsidiary board action on a matter within its sphere of delegated authority will not be a prerequisite to action by the NASD Board.

These changes are consistent with the core principles of corporate governance outlined in the Select Committee Report: maintaining a balanced governance structure, an independent corporate structure, an independent and autonomous operating structure, and a clear and distinct role for each corporation. The amended By-Laws maintain a balanced governance structure by providing for diversity among Industry Governors and Directors; by providing for a majority of Non-Industry Governors on the parent board, including at least five Public Governors; and by providing for at least 50 percent Non-Industry and Public Directors on the boards of each subsidiary. Maintaining two separate, wholly owned subsidiaries with their own Presidents ensures that independent corporate structures continue to exist. Preserving separate and independent professional staffs and substantial deference to the subsidiaries in their areas of jurisdiction reinforces an independent and autonomous operating structure. Finally, each corporation retains its clear and distinct role under the proposed rule change: the NASD continues to resolve conflicts between the subsidiaries and retain ultimate responsibility for statutory obligations, including its responsibilities as a self-regulatory organization; NASD

Regulation continues to regulate broker/dealers and supervise surveillance of Nasdaq and other over-the-counter markets; and Nasdaq continues to own and operate The Nasdaq Stock MarketSM and develop and implement rules governing that market.

The proposed corporate structure also is consistent with the undertakings set forth in the Association's August 8, 1996, settlement with the Commission. Specifically, the amended By-Laws ensure the balancing of the Association's boards and committees; place primary day-to-day responsibility for regulatory matters with NASD Regulation; provide for the autonomy and independence of the regulatory staff of the NASD and its subsidiaries; and ensure the existence of a substantial, independent internal audit staff that reports directly to an audit committee of the NASD Board.

Amendments To The NASD By-Laws

The expanded NASD Board will function much as it does today, with ultimate responsibility for the regulatory and market operation functions that are delegated to the subsidiary boards. Substantive changes to the NASD By-Laws are set forth below. Key changes related to the corporate restructuring are found in Article VII, Sections 4, 5, 9, 10, and 13; Article VIII, Section 1; Article IX, Sections 3 through 6; Article XV, Section 4(b); Article XVI, Section 1; and Articles XX and XXI. Stylistic changes and other minor, non-substantive changes are not described.

Article I. Definitions

Several substantive amendments have been made to Article I, which sets forth definitions for the NASD By-Laws. The following definitions have been moved from the Delegation Plan to the NASD By-Laws:

“Industry Director”; “Industry Governor” or “Industry committee member”; “National Nominating Committee”; “Non-Industry Director”; “Non-Industry Governor” or “Non-Industry committee member”; “Public Director”; “Public Governor” or “Public committee member.” These changes will be found at Article I (n), (o), (bb), (cc), (dd), (ff), and (gg). Parallel changes have been made to the By-Laws of NASD Regulation and Nasdaq.

Refinements have been made to the definitions of “Industry Governor,” “Industry committee member,” “Non-Industry Governor,” and “Non-Industry committee member.” A person who is or was an outside director of a broker or a dealer, or a director not engaged in the day-to-day management of a broker or dealer, is excluded from the definition of “Industry Governor or committee member.” Included in the definition of “Industry Governor, Director, or committee member” is any person who: (1) is an employee of an entity that owns more than five percent of the equity of a broker or dealer, if the broker or dealer accounts for more than 10 percent of the gross revenues received by the consolidated entity; (2) owns more than 10 percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed five percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (3) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Governor or committee member, or 20 percent or more of the gross revenues received by the Governor’s or committee member’s firm or partnership; or (4) provides professional services to a director, officer, or employee of a broker, dealer, or corporation that owns 50 percent or

more of the voting stock of a broker or dealer, and such services relate to the director’s, officer’s, or employee’s professional capacity and constitute 20 percent or more of the professional revenues received by the Governor or committee member, or 20 percent or more of the gross revenues received by the Governor’s or committee member’s firm or partnership.

The Association believes that any person engaged in the day-to-day management of any broker/dealer, including a limited purpose broker/dealer, should be considered an Industry Governor or committee member and, therefore, has deleted from the definition of “Non-Industry Governor or committee member” the following specific references because they are unnecessary: (1) persons affiliated with brokers and dealers that operate solely to assist the securities-related activities of the business of non-member affiliates, such as a broker or dealer established to distribute an affiliate’s securities which are issued on a continuous or regular basis, or process the limited buy and sell orders of the shares of employee owners of the affiliate; and (2) employees of an entity that is affiliated with a broker or dealer that does not account for a material portion of the revenues of the consolidated entity, and who are primarily engaged in the business of the non-member entity.

The term “person associated with a member” has been amended by the addition of a clause clarifying that the term includes any natural person registered under the Rules of the Association.

The definition of “rules of the Corporation” has been deleted to avoid confusion with the more commonly used, but differently defined term, “Rules of the Association.” The term “rules of the Corporation” has been used to refer collectively to the NASD Certificate of Incorporation,

the NASD By-Laws, and the Rules of the Association, but, with the restructuring of the NASD into three legal entities, such a collective term for all of the corporate documents of the Association is no longer useful. Similarly, the definitions of “Boards” and “Corporations” have been deleted and the By-Laws instead refer to each corporate entity by name, as appropriate. The term “Rules of the Association” or “Rules” is defined to mean the numbered rules set forth in the NASD Manual beginning with the Rule 0100 Series, as adopted by the NASD Board pursuant to the NASD By-Laws, as amended or supplemented. A cross-reference from the Rules of the Association to the NASD By-Laws is included in Rule 0121.

Article II. Offices

A new Article II states the location of the registered corporate office of the NASD. This change makes the NASD By-Laws consistent with the NASD Regulation and the Nasdaq By-Laws, which both include such a provision.

Article III. Qualifications of Members and Associated Persons

Current Article II, Qualifications of Members and Associated Persons, is renumbered as Article III. Section 3, which addresses ineligibility of certain persons for membership or association, has been conformed to the Rule 9520 Series, which sets forth rules for the Association’s eligibility proceedings. Specifically, Section 3(d) as amended clarifies that members, but not applicants for membership, may use eligibility proceedings to obtain relief from the Association’s eligibility requirements, *e.g.*, to resolve a statutory disqualification problem.

Section 3(d)(2), which addresses the status of members or persons

engaged in eligibility proceedings, has been deleted because that subject is addressed in the Rule 9520 Series. This change does not result in a substantive change in the Association's practice. Specifically, if a person is already associated with a member at the time a statutory disqualification is discovered, the person may remain associated with the member until final action is taken under the Rules of the Association. If the person is a prospective employee, the person may not become associated with the member until the Association takes final action under the Rule 9520 Series.

A new Section 3(g) clarifies that the Board may delegate its authority under Section 3 in a manner not inconsistent with the Delegation Plan.

Finally, Section 4(h) has been amended to conform it to the Securities Exchange Act of 1934.

Article IV. Membership

Current Article III, Membership, has been renumbered as Article IV. Section 1(a)(3), which requires members to release the Association from liability except for willful malfeasance, has been deleted. Section 7 has been conformed to changes in the Rule 1010 Series, which sets forth procedures for membership applications and changes in a member's operations.

Article V. Registered Representatives and Associated Persons

Current Article IV, Registered Representatives and Associated Persons, has been renumbered as Article V. Section 2(a)(2), which requires registered representatives to release the Association from liability except for willful malfeasance, has been deleted.

Article VI. Dues, Assessments, and Other Charges

Current Article V, Dues, Assessments, and Other Charges, has been renumbered as Article VI. A new Section 5 states that the NASD may delegate its authority regarding dues, assessments, and other charges in a manner not inconsistent with the Delegation Plan.

Article VII. Board of Governors

Current Article VI, Board of Governors, has been renumbered as Article VII. Section 1(c) has been amended to make clear that to the fullest extent permitted by applicable law, the Restated Certificate of Incorporation, and the By-Laws, the NASD may delegate any power of the NASD or the Board to a committee appointed pursuant to Article IX, Section 1, to the NASD Regulation Board, to the Nasdaq Board, or to NASD staff, in a manner not inconsistent with the Delegation Plan. Parallel provisions have been added to the NASD Regulation and the Nasdaq By-Laws.

Section 2, which authorizes the Board to cancel or suspend the membership of a member or suspend the association of a person associated with a member for failure to provide requested information, has been amended to provide for reinstatement pursuant to the Rules of the Association. *See, e.g.*, Rules 8225 and 9516. The delegation to the Chief Executive Officer has been replaced with a delegation provision consistent with other provisions set forth in the proposed NASD By-Laws: that the Board be permitted to delegate its authority under this section in a manner not inconsistent with the Delegation Plan and otherwise in accordance with the Rules of the Association.

Section 4, which addresses the composition and qualifications of the

Board, has been amended to conform to the new corporate structure. The NASD Board will consist of the Chief Executive Officer and the Chief Operating Officer of the NASD, the Presidents of NASD Regulation and Nasdaq, the Chair of the National Adjudicatory Council, and at least 16 and not more than 22 Governors elected by the members of the NASD. Thus, the By-Laws authorize a Board of 21 to 27 Governors in total. Section 4(a) further provides that the Governors elected by the members will include a representative of an issuer of investment company shares or an affiliate of such an issuer, a representative of an insurance company, and a Nasdaq issuer. A majority of the Governors will be Non-Industry Governors, and the Non-Industry Governors will include five or six Public Governors, depending on the size of the Board. Section 4(b) has been amended to prohibit the Chair of the National Adjudicatory Council from serving as Chair of the Board. The Association believes that the responsibilities of each chairmanship require the attention of one individual.

Section 5, Term of Office of Governors, has also been amended to reflect the Board structure. The Chief Executive Officer and the Chief Operating Officer of the NASD and the Presidents of NASD Regulation and Nasdaq will serve as Governors until a successor is selected, or until death, resignation, or removal. The Chair of the National Adjudicatory Council will serve as a Governor for a term of one year, and will generally not serve more than two consecutive terms.⁴ Section 5 also provides that a former Chair of the National Adjudicatory Council may serve as a Governor elected by the members of the NASD. The Governors elected by the members of the NASD will be divided into three classes and serve three-year terms. Such Governors generally may not

serve more than two consecutive terms.

A new Section 6 addresses the disqualification of a Board member and states that a Governor's term of office immediately terminates if the Board determines that: (a) the Governor no longer satisfies the classification (Industry, Non-Industry or Public Governor) for which the Governor was elected; and (b) failure to remove the Governor would violate the compositional requirements of the Board set forth in Section 4. If a Governor's term of office terminates under this Section and the remaining term of office of such Governor was not more than six months, then during the period of vacancy, the Board would not be deemed to be in violation of its compositional requirements by virtue of such vacancy. Section 6 replaces a provision currently in the Delegation Plan that provides for "automatic removal" if a Governor no longer satisfies the classification for which he or she was elected without describing any process for such removal. This change eliminates any potential for the Board to take an *ultra vires* action in the event that a Governor fails to notify the Board promptly of a change in his or her classification and continues to sit on the Board and cast votes before such removal takes place.

Current Section 6, which addresses the filling of vacancies on the Board, has been renumbered as Section 7. In addition, the current provisions of the Delegation Plan that address the filling of vacancies have been moved to this Section. The Section provides further that, if the remaining term of office of the governorship to be filled is more than one year, then the replacement Governor must stand for election in the next annual election.

Current Section 7, which describes nomination and election procedures, has been expanded and renumbered

as Sections 9 through 14. Section 9 sets forth the powers of the National Nominating Committee. The National Nominating Committee nominates Industry, Non-Industry, and Public Governors for each vacant or new Governor position on the NASD Board; Industry, Non-Industry, and Public Directors for each vacant or new position on the NASD Regulation Board and the Nasdaq Board; Industry, Non-Industry, and Public members for each vacant or new position on the National Adjudicatory Council; and Industry and Non-Industry members for the Nasdaq Listing and Hearing Review Council.

Section 9 also includes and clarifies the compositional requirements for the National Nominating Committee previously set forth in the Delegation Plan. Under the amended provision, a National Nominating Committee member may be removed for cause (specifically, refusal, failure, neglect, or inability to discharge such member's duties) by a majority vote of the NASD Board. This same standard for removal is used throughout the Association's corporate documents for committee and council members.

Section 9 also includes a new provision that requires the Secretary of the NASD to collect from each nominee for Governor such information as is reasonably necessary to serve as the basis for a determination of the nominee's classification as an Industry, Non-Industry, or Public Governor. The Secretary will certify to the National Nominating Committee each nominee's classification to ensure that the compositional requirements of each Board are met.

Section 10 replaces current Section 7(c) and adds provisions regarding contested elections currently located in the Delegation Plan. Conforming references also have been made to Article XXI, a new article that pro-

vides for meetings of the membership. Section 10 clarifies the procedures for contested elections and changes the number of members that must sign a petition to support adding a candidate to the ballot for NASD Board elections from two percent of the members of the NASD to three percent. As is currently the case, a petition may be signed only by a member's Executive Representative. Section 10 also transfers the authority to certify the additional candidate from the National Nominating Committee to the Secretary, since the Secretary maintains the records of Executive Representatives and will be charged with reviewing information regarding the classification (Industry, Non-Industry, or Public) for each governorship.

Sections 11, 12, and 15 are new provisions that parallel new provisions added to the NASD Regulation and the Nasdaq By-Laws. Section 11 prohibits the NASD, the Board, the National Nominating Committees, other committees, and NASD staff from taking any official position regarding a contested nomination or election under the proposed NASD or NASD Regulation By-Laws. Section 11 permits Board and committee members to communicate their views with respect to a candidate in a contested election only if the Board or committee member acts solely in his or her individual capacity and disclaims any intention to communicate in any official capacity. Section 12 limits administrative support to the candidates in a contested NASD election to two mailings; any other administrative support in any NASD or NASD Regulation contested election or nomination is prohibited. Section 15 adds resignation provisions.

Section 13, Election of Governors, is largely parallel to current Section 7(a), with conforming amendments to Sections 9 through 12 and a new cross-reference to Article XXI,

which sets forth procedures for membership meetings.

Section 14 is a new procedure that requires each Governor to update the information submitted to the NASD Secretary under Section 9(e) regarding his or her classification as an Industry, Non-Industry, or Public Governor at least annually and upon request of the Secretary, and to report immediately to the Secretary any change in such classification. There are parallel provisions in the NASD Regulation and the Nasdaq By-Laws. These submissions and reports will help the Association ensure that the compositional requirements of the Board and its committees are maintained.

Section 8, which addresses meetings, quorums, and voting of the Board, has been amended to provide that a quorum consists of a majority of the Board then in office, including not less than 50 percent of the Non-Industry Governors. This change ensures that Industry Governors alone can not constitute or dominate a quorum of the Board.

Article VIII. Officers, Agents, and Employees

Current Article VII, Officers, Agents, and Employees, has been renumbered as Article VIII. Section 1 has been amended to require that the Board elect a Secretary and a Chief Operating Officer. These changes have been made in recognition of the number of responsibilities assigned to the Secretary under the By-Laws, the Board's practice of always electing a person to such position, and the fact that the Chief Operating Officer serves on the Board pursuant to Article VII, Section 4.

Section 3 has been amended to specify that agents and employees shall be under the supervision and control of the officers, unless the Board, by res-

olution, provides that an agent or employee shall be under the supervision and control of the Board. Generally, agents and employees are under the supervision and control of the officers, but the Board may wish in certain circumstances to retain control over an employee or agent, as in Section 4, when the Board determines that it wishes to retain counsel.

Current Section 5, which provides for compensation of Board and committee members, has been moved to its own Article, Article X, Compensation of Board and Committee Members.

New Sections 5, 6, and 7 have been added to Article VIII to conform it to Article VII of the NASD Regulation By-Laws and Article VI of the Nasdaq By-Laws. Section 5 permits the Board to delegate the duties and powers of any officer to any other officer. Section 6 provides for the resignation and removal of officers. Section 7 permits the NASD to secure the fidelity of its officers, agents, and employees by bond or otherwise.

Article IX. Committees

Current Article VIII, Committees, which addresses the formation and powers of committees, is renumbered as Article IX. Section 1 has been amended to cross-reference Article VII, Section 1(c), which limits the Board's authority to delegate its powers and authority.

A new Section 2 is designed to help the Association maintain the compositional requirements of certain committees. Undertakings 1 and 6 under the SEC Settlement require certain committees⁵ to have a particular balance of Industry, Non-Industry, and Public committee members. The compositional requirements for the National Nominating Committee and the Audit Committee are found in the

NASD By-Laws. The compositional requirements of the National Adjudicatory Council are found in the NASD Regulation By-Laws. The compositional requirements for the remaining committees are found in the Delegation Plan. To help ensure that compositional requirements are maintained for committees appointed by the NASD Board, Section 2 authorizes the Secretary to collect from each prospective member of a committee that must be balanced such information as is reasonably necessary to serve as the basis for a determination of the prospective committee member's classification as an Industry, Non-Industry, or Public committee member. The Secretary must certify to the Board each prospective committee member's classification. Each committee member must update the information submitted at least annually and upon request of the Secretary of the NASD, and must report immediately to the Secretary any change in such classification. Parallel provisions are set forth in the NASD Regulation and the Nasdaq By-Laws.

Current Section 2, which addresses removal of a committee member, has been renumbered as Section 3 and amended to clarify that a committee member can only be removed for refusal, failure, neglect, or inability to discharge his or her duties by majority vote of the whole Board.

New sections have been added specifically to authorize the appointment of an Executive Committee and a Finance Committee and to require, consistent with Undertaking 6, the appointment of an Audit Committee. Section 4 authorizes the NASD Board to appoint an Executive Committee composed of five to nine members of the NASD Board, with a Non-Industry majority. The Executive Committee will include the NASD CEO/Chairman, at least one member each of the NASD Regula-

tion and Nasdaq Boards, and at least two Governors who are not Directors of NASD Regulation or Nasdaq. A quorum for the transaction of business at Executive Committee meetings will be a majority of Committee members then in office, including at least 50 percent of the Non-Industry Committee members.⁶

Section 5 contains the provisions relating to the Audit Committee currently found in the Delegation Plan, except that the compositional provisions have been amended to require two (rather than one) Public Governors to serve on the Committee.

Section 6 authorizes the Board to appoint a Finance Committee composed of at least four Governors, including the Chief Executive Officer of the NASD. The Finance Committee will be balanced, with the number of Non-Industry Governors equaling or exceeding the Industry Governors plus the Chief Executive Officer.

If any officer of the NASD, NASD Regulation, or Nasdaq serves as a member (other than as an *ex officio* member) of a committee appointed under the By-Laws of any of the three corporations, that officer will be counted among the Industry committee members for the purpose of any compositional or quorum requirements.

Article X. Compensation of Board and Committee Members

As noted previously, current Article VII, Section 5, which addresses compensation of Board and committee members, has been renumbered as Article X, Compensation of Board and Committee Members.

Article XI. Rules

Current Article IX, Rules, which authorizes the NASD to adopt rules, has been renumbered as Article XI.

Article XII. Disciplinary Proceedings

Current Article X, Disciplinary Proceedings, which authorizes disciplinary proceedings, has been renumbered as Article XII.

Article XIII. Powers of Board to Impose Sanctions

Current Article XI, Powers of Board to Prescribe Sanctions, which authorizes the Board to impose sanctions, has been renumbered as Article XIII. Section 1(e) has been amended and a new Section (2) added to clarify that any delegation under the Article must be in conformity with the Delegation Plan.

Article XIV. Uniform Practice Code

Current Article XII, Uniform Practice Code, has been renumbered as Article XIV. Section 2 has been amended to provide that the Board may delegate its authority with respect to administering the Uniform Practice Code to the NASD Regulation Board and Nasdaq Board in accordance with the Delegation Plan.

Article XV. Limitation of Powers

Current Article XIII, Limitation of Powers, has been renumbered as Article XV.

Section 4 addresses conflicts of interest and has been amended by redesignating it as Section 4(a), and therein prohibiting any Governor or committee member from directly or indirectly participating in any adjudication of the interests of any party if the Governor or committee member has a conflict of interest or bias, or if circumstances otherwise exist where his or her fairness might reasonably be questioned. Section 4(a) further requires the Governor or committee member to recuse himself or herself

or be disqualified in accordance with the Rules of the Association (*e.g.*, Rule 9160). Current Section 4 simply references the Rules of the Association. The standard set forth in Section 4(a) is consistent with the conflict of interest standard in Rule 9160.

In addition, a new Section 4(b) has been added to address conflicts of interests in non-adjudicatory matters in a manner consistent with the By-Laws of the NASD Regulation Board and the Nasdaq Board. Section 4(b) provides that a contract or transaction between the NASD and a Governor or officer, or between the NASD and any entity in which a Governor or officer is a director or officer, or has a financial interest, is not void or voidable solely for this reason, or solely because the Governor or officer is present at the meeting of the Board or committee that authorizes the contract or transaction, or solely because the Governor's or officer's vote is counted for such purposes if: (1) the material facts pertaining to such relationship or interest are disclosed or are known to the Board or the committee, and the Board or committee in good faith authorizes the contract or transaction by the affirmative vote of a majority of the disinterested Governors; or (2) the contract or transaction is fair to the NASD as of the time it is authorized, approved, or ratified by the Board or committee. Section 4(b) provides that only disinterested Governors may be counted in determining the presence of a quorum at a meeting of the Board or of a committee which authorizes the contract or transaction. A contract or transaction between the NASD and one of its subsidiaries would not be subject to Section 4(b).

Finally, Section 6, which limits the Association's rulemaking authority over government securities activities, has been deleted to conform the By-Laws to changes previously made to the Association's authority over the

government securities activities of its members.

Article XVI. Procedure for Adopting Amendments to By-Laws

Current Article XIV, Procedure for Adopting Amendments to By-Laws, has been renumbered as Article XVI and amended to provide that committees appointed by the Board may propose By-Law amendments.

Article XVII. Corporate Seal

Current Article XV, Corporate Seal, has been renumbered as Article XVII.

Article XVIII. Checks

Current Article XVI, Checks, has been renumbered as Article XVIII.

Article XIX. Annual Financial Statement

Current Article XVII, Annual Financial Statement, has been renumbered as Article XIX.

Article XX

A new Article XX, Record Dates, has been added. Section 1 permits the Board to fix a record date to determine the members that are entitled to notice of, or to vote at, member meetings. Section 2 provides for a

default record date if the Board does not fix such a date. Section 3 provides that a determination of members of record also applies to an adjournment of a member meeting.

Article XXI

A new Article XXI, Meetings of Members, has been added. Section 1 authorizes the Board to designate a time and place and set an agenda for annual meetings of members. Section 2 sets forth procedures for setting the agenda of special meetings. Section 3 sets forth notice requirements for meetings. Section 4 describes voting procedures. Section 5 states that the Chief Executive Officer of the NASD acts as Chair of the meeting and authorizes the Board to adopt rules and regulations for the conduct of meetings.

Endnotes

¹ Securities Exchange Act Rel. No. 37538 (August 8, 1996), 62 S.E.C. Docket 1346, 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.

² Currently, the NASD Board has 11 Governors, the NASD Regulation Board has 24 Directors, and the Nasdaq Board has 14 Directors.

³ The Delegation Plan is the blueprint for the coordinated efforts of NASD, NASD Regulation, and Nasdaq, and sets forth the purposes, functions, and governance procedures of the three corporations working together.

⁴ The Chair of the National Adjudicatory Council, who serves a term of one year, simultaneously will serve as a Governor of the NASD Board and a Director of the NASD Regulation Board. This change ensures that the terms for each of these positions run concurrently.

⁵ Undertaking 1 sets forth compositional requirements for “the National Nominating Committee, the Trading/Quality of Markets Committee, the Arbitration Committee, the Market Surveillance Committee, the National Business Conduct Committee, the Management Compensation Committee, and all successors thereto.” Undertaking 6 sets forth compositional requirements for an audit committee. The current names of such committees are the National Nominating Committee, the Quality of Markets Committee, the National Arbitration and Mediation Committee, the Market Regulation Committee, the National Business Conduct Committee, the Management Compensation Committee, and the Audit Committee.

⁶ This quorum requirement has been applied also to the Audit, Finance, and National Nominating Committees.

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