

**Jeffrey S. Holik**  
**Vice President and**  
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October 17, 2001

**By Hand**

Katherine A. England  
Assistant Director  
Division of Market Regulation  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

**Re: SR-NASD-2001-74 - Amendments to NASD Regulation, Inc. By-Laws**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3 1/2" disk containing the rule filing in Word to facilitate production of the Federal Register.

On October 9, 2001, we provided written notice to the Commission of our intent to file this rule change pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934 and Rule 19b-4(f)(6) thereunder. As required by Rule 19b-4(f)(6)(iii), we attached the draft text of the proposed rule change.

In our letter of October 9, 2001, we requested that the proposed rule change take effect upon filing with the Commission. It is our understanding that the Commission has waived the requirement that the rule change, by its terms, does not become operative for 30 days after the date of the filing set forth in 19b-4(f)(6)(iii), and that the rule change will thus be effective and operative on filing.

If you have any questions, please contact Norman Sue, Jr., Office of General Counsel, NASD Regulation, at (202) 728-8117. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Jeffrey S. Holik  
Vice President and  
Acting General Counsel

Enclosures

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C.

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Form 19b-4

Proposed Rule Change

by

**NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.**

Pursuant to Rule 19b-4 under the  
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), The National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to make certain amendments to the NASD Regulation By-Laws in order to change the term of office of members of the National Adjudicatory Council (“NAC”) from two years, with the opportunity to serve no more than two consecutive terms, to a single three-year term.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

\* \* \*

**BY-LAWS OF NASD REGULATION, INC.**

**Article V**

**National Adjudicatory Council**

**Term of Office**

**Sec. 5.4**

(a) Except as otherwise provided in this Article, each National Adjudicatory Council member shall hold office for a term of [two] three years or until a successor is duly appointed and qualified, except in the event of earlier termination from office by reason of death, resignation, removal, disqualification, or other reason.

(b) [In 1998, each National Adjudicatory Council member shall hold office for a term of one year or until a successor is duly appointed and qualified, except in the event of earlier

termination from office by reason of death, resignation, removal, disqualification, or other reason.

(c) Beginning in January [1999] 2002 [and thereafter], the National Adjudicatory Council shall be divided into [two] three classes. The term of office of those of the first class shall expire in January [2000] 2003, [and] the term of office of those of the second class shall expire [one year thereafter] in January 2004, and the term of office of those of the third class shall expire in January 2005. Beginning in January [2000] 2003, members shall be appointed for a term of [two] three years to replace those whose terms expire.

[(d) (c) Beginning in [2000] 2002, no member may serve [more than two] consecutive terms, except that if a member is appointed to fill a term of less than one year, such member may serve [up to two consecutive] a single three year term[s] following the expiration of such member's initial term.

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## Article VI

### National Adjudicatory Council Regional Nominations for Industry Members

#### Notice to Chair

**Sec. 6.8** [On or before August 1, 1998, the Secretary of NASD Regulation shall send a written notice to the Chair of each Regional Nominating Committee to initiate the process for nominating an individual to represent the region on the National Adjudicatory Council for a term of office of one or two years, as determined by the Board, beginning in 1999.] On or before August 1, 1999, and annually thereafter, the Secretary of NASD Regulation shall send a written notice to the Chair of a Regional Nominating Committee if the term of office of the National

Adjudicatory Council member representing the region shall expire in the next calendar year. The notice shall describe the nomination procedures for filling the office.

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2. Procedures of the Self-Regulatory Organization

(a) The proposed NASD Regulation By-Law amendments were approved by the NASD Board of Governors on September 20, 2001. Counsel for the Nasdaq Stock Market, Inc. and NASD Dispute Resolution, Inc. have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries. No other action by the NASD is necessary for the filing of the rule change.

(b) Questions regarding this rule filing may be directed to Norman Sue, Jr., Associate Vice President and Associate General Counsel, NASD Regulation, Office of General Counsel, (202) 728-8117.

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

The NAC is a balanced committee of the NASD consisting of 14 members—seven industry members and seven non-industry members. Two industry members are at-large, and five are nominated to represent one of the NASD's five geographic regions. All members must be nominated by the NASD's National Nominating Committee and must be appointed by the NASD Regulation Board.

The NAC hears appeals and calls for review of disciplinary matters; acts on applications in statutory disqualification and membership proceedings; acts on certain disciplinary settlement

proposals; exercises exemptive authority; and acts in other proceedings as set forth in the NASD Code of Procedure. The NAC also advises NASD Regulation staff and the Board on enforcement policy and proposed rules relating to the business and sales practices of NASD members and associated persons.

Currently, NAC members serve terms of two years, with no member allowed to serve more than two consecutive two-year terms. In 2000, the outgoing NAC Chair requested staff to consider the feasibility of extending the term of NAC members to three years. During 2001, staff solicited input from several District Committees, the NASD Advisory Council (the Chairs of all NASD District Committees and the Market Regulation Committee), and the NAC, all of which favored making the change. Staff developed a proposal, which was reviewed and supported by the NASD Small Firm Advisory Board. On September 20, 2001, the NASD Board of Governors voted unanimously in favor of the change.

The purpose for extending the NAC term from two to three years is to provide for greater continuity and to make better use of the experience and expertise of NAC members with respect to the specialized work of the NAC, particularly industry members. Increasingly, incumbent NAC members eligible for a second consecutive two-year term have not been renominated by their Regional Nominating Committees, thus capping their service on the NAC at two years. The staff believes that a three-year term would enable members to make more effective contributions to the work of the NAC, and it would make the term of service of NAC members consistent with the terms of members of NASD District Committees and the NASD Regulation Board. To assure appropriate turnover, NAC members would be restricted from serving consecutive terms.

The transition from two-year to three-year NAC terms will be implemented by the NASD National Nominating Committee and the NASD Regulation Board beginning in January 2002. The current NAC membership will be divided into three classes, as nearly equal in number and as evenly divided between industry and non-industry seats as possible. Class I NAC members will serve until January 2003; Class II members will serve until January 2004; and Class III members will serve until January 2005. Commencing in January 2003, newly elected members will assume three-year terms. The designation of current NAC members into these three classes is designed to assure an orderly transition by: a) providing appropriate continuity in the composition of the NAC (both industry and non-industry members) during the transition period; and b) minimizing, to the greatest possible extent, the number of current NAC members whose terms would be reduced by the transition.

Based on the above, the NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(4) of the Act, which requires, among other things, that the Association's rules must be designed to assure a fair representation of its members in the administration of its affairs. The NASD believes that the proposed rule change enhances the Association's ability to assure fair representation on the NAC and the NASD Regulation Board.

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

NASD 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.

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

Written comments were neither solicited nor received.<sup>1</sup>

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3)

The proposed rule change is effective upon filing in that NASD Regulation has designated the proposed rule change as constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 under the Act, and the Commission has waived the requirement that the rule change, by its terms, does not become operative for 30 days after the date of the filing. Therefore, the rule change is both effective and operative upon the Commission's receipt of this filing. The NASD National Nominating Committee will meet on October 26, 2001 to nominate a slate of NAC candidates for appointment by the NASD Regulation Board. The NASD Regulation Board will consider the nominations on December 5, 2001. It is thus necessary for the rule change to be both effective and operative on filing in order to meet this timetable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

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<sup>1</sup> This proposed By-Law change was not published for comment by the NASD through its Notice to Members process, but as noted above was endorsed by several NASD District Committees, the NASD Advisory Council, the Small Firm Advisory Board, and the NAC.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

BY: \_\_\_\_\_  
Jeffrey S. Holik  
Vice President and  
Acting General Counsel

Date: October 17, 2001

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2001- )

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to a Change in the Term of Office of National Adjudicatory Council Members

**[leave space for date]**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on , the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. NASD Regulation has designated the proposed rule change as constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 under the Act, and the Commission has waived the requirement that the rule change, by its terms, does not become operative for 30 days after the date of the filing. Therefore, the rule change is both effective and operative upon the Commission's receipt of this filing. The NASD National Nominating Committee will meet on October 26, 2001 to nominate a slate of NAC candidates for appointment by the NASD Regulation Board. The NASD Regulation Board will consider the nominations on December 5, 2001. It is thus necessary for the rule change to be

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

both effective and operative on filing in order to meet this timetable. 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

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 ("Act"), NASD Regulation is herewith filing a proposed rule change to change the term of office of members of its National Adjudicatory Council ("NAC") members from two years to three years. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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**BY-LAWS OF NASD REGULATION, INC.**

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(c) Beginning in January [1999] 2002 [and thereafter], the National Adjudicatory Council shall be divided into [two] three classes. The term of office of those of the first class shall expire in January [2000] 2003, [and] the term of office of those of the second class shall expire [one year thereafter] in January 2004, and the term of office of those of the third class shall expire in January 2005. Beginning in January [2000] 2003, members shall be appointed for a term of [two] three years to replace those whose terms expire.

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## **Article VI**

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Adjudicatory Council member representing the region shall expire in the next calendar year. The notice shall describe the nomination procedures for filling the office.

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II. Self-Regulatory Organization's Statement Of The Purpose Of, And Statutory Basis For, The Proposed Rule Change

In its filing with the Commission, NASD Regulation 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. NASD 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

The NAC is a balanced committee of the NASD consisting of 14 members - seven industry members and seven non-industry members. Two industry members are at-large, and five are nominated to represent one of the NASD's five geographic regions. All members must be nominated by the NASD's National Nominating Committee and must be appointed by the NASD Regulation Board.

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enforcement policy and proposed rules relating to the business and sales practices of NASD members and associated persons.

Currently, NAC members serve terms of two years, with no member allowed to serve more than two consecutive two-year terms. In 2000, the outgoing NAC Chair requested staff to consider the feasibility of extending the term of NAC members to three years. During 2001, staff solicited input from several District Committees, the NASD Advisory Council (the Chairs of all NASD District Committees and the Market Regulation Committee), and the NAC, all of which favored making the change. Staff developed a proposal, which reviewed and supported by the NASD Small Firm Advisory Board. On September 20, 2001, the NASD Board of Governors voted unanimously in favor of the change.

The purpose for extending the NAC term from two to three years is to provide for greater continuity and to make better use of the experience and expertise of NAC members with respect to the specialized work of the NAC, particularly industry members. Increasingly, incumbent NAC members eligible for a second consecutive two-year term have not been renominated by their Regional Nominating Committees, thus capping their service on the NAC at two years. The staff believes that a three-year term would enable members to make more effective contributions to the work of the NAC, and it would make the term of service of NAC members consistent with the terms of members of NASD District Committees and the NASD Regulation Board. To assure appropriate turnover, NAC members would be restricted from serving consecutive terms.

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as evenly divided between industry and non-industry seats as possible. Class I NAC members will serve until January 2003; Class II members will serve until January 2004; and Class III members will serve until January 2005. Commencing in January 2003, newly elected members will assume three-year terms. The designation of current NAC members into these three classes is designed to assure an orderly transition by: a) providing appropriate continuity in the composition of the NAC (both industry and non-industry members) during the transition period; and b) minimizing, to the greatest possible extent, the number of current NAC members whose terms would be reduced by the transition.

## 2. Statutory Basis

Based on the above, NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(4) of the Act, which requires, among other things, that the Association's rules must be designed to assure a fair representation of its members in the administration of its affairs. The NASD believes that the proposed rule change enhances the Association's ability to assure fair representation on the NAC and the NASD Board of Governors.

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

NASD 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

Written comments were neither solicited nor received.<sup>3</sup>

III. Date Of Effectiveness Of The Proposed Rule Change And Timing For Commission Action

The proposed rule change has been filed by the Association as a "non-controversial" rule change under Rule 19b-4(f)(6) under the Act.<sup>4</sup> In accordance with Rule 19b-4(f)(6)(iii), prior to the filing date, NASD Regulation submitted written notice of its intent to file the proposed rule change along with a brief description and text of the proposed rule change. In that notice of its intent, NASD Regulation requested that the Commission waive the requirement that the rule change, by its terms, not become operative for 30 days after the date of the filing, as consistent with the protection of investors and the public interest. The Commission agreed to waive that requirement. Accordingly, the proposed rule change will become both effective and operative upon filing pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such creation is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation Of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the

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<sup>3</sup> This proposed By-Law change was not published for comment by the NASD through its Notice to Members process, but as noted above was endorsed by several NASD District Committees, the NASD Advisory Council, the Small Firm Advisory Board, and the NAC.

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 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 NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

Jonathan G. Katz  
Secretary

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<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> 17 CFR 200.30-3(a)(12).