

ACTION REQUESTED

NASD By-Law Amendments

Mail Vote—NASD Solicits Vote On Amendments To The NASD By-Laws On Selected Corporate Governance Issues; **Last Voting Date: January 22, 2001**

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Senior Management

KEY TOPICS

- Corporate Governance
- NASD By-Laws

Executive Summary

The National Association of Securities Dealers, Inc. (NASD® or Association) invites members to vote to approve certain amendments to the NASD By-Laws. The amendments address several corporate governance issues: the treatment of staff Governors for purposes of Industry/Non-Industry balancing; the role of the National Nominating Committee (NNC) in contested elections; the petition process by which individuals and slates can be included in the election process; and the industry classifications that must be represented on the Board. Additionally, the amendments reflect the new NASD corporate structure, including the impending separation of The Nasdaq Stock Market, Inc. (Nasdaq®) and NASD and the creation of NASD Dispute Resolution, Inc., a wholly owned subsidiary. The amendments also incorporate certain technical changes. Attachment A is a summary of the proposed changes. Attachment B is the text of the amendments.

It is anticipated that these By-Laws, as amended, will be effective for elections preceding the 2001 annual NASD membership meeting.

The last voting date is January 22, 2001.

Questions/Further Information

Questions concerning this *Notice* may be directed to T. Grant Callery, Senior Vice President and General Counsel, Office of General Counsel, NASD, at (202) 728-8285.

Background

The proposed amendments have several purposes and are described in detail as follows:

Composition, Classification, And Qualifications Of The Board Of Governors

The NASD Board of Governors has both Industry and Non-Industry members and is required by the By-Laws to have a majority of Non-Industry Governors. In 1998, the NASD effected a substantial corporate restructuring which included the acquisition of the American Stock Exchange, LLC (Amex®). As part of this restructuring, the NASD moved to an overlapping Board structure whereby all members of the NASD Regulation, Inc. (NASDR) and Nasdaq Boards became members of the NASD Board. As a result of the 1998 restructuring, the number of Governors serving on the Board by virtue of their status as staff increased to five (the NASD Chief Executive Officer, the NASD Chief Operating Officer, the Presidents of NASDR and Nasdaq and the Chairman of Amex).

In accordance with current NASD By-Laws, these five Governors have counted as Industry Governors for balancing purposes. With this current composition and classification of staff Governors, the only realistic manner for NASD to satisfy its obligation to ensure fair representation of all relevant constituencies has been to increase the number of Industry seats on a given Board, and, in order to maintain the required absolute majority of Non-Industry/Public seats on the Board, increase in the number

of Non-Industry seats as well. These increases have made it extremely difficult for the NASD Board to be small enough to function with optimum efficiency while still satisfying NASD's obligation to ensure fair representation of the relevant constituencies.

To improve the efficiency of the Board while maintaining fair representation of the relevant constituents, the Board has approved an amendment to reclassify the NASD CEO and President of NASD Regulation Governor positions as neutral Governors—that is, neither Industry nor Non-Industry Governors. The reclassification of these Governor positions as neutral is consistent with the neutrality classification other self-regulatory organizations assign to their Board staff members. Additionally, since these neutral Governors will no longer be treated as Industry Governors, the two Industry seats the staff occupied will now be available to Industry candidates elected by the NASD membership.

The approved amendments also reduce the number of staff Governors from the current five to a maximum of four (the NASD CEO, the Presidents of NASD Regulation and Amex, and up to one additional NASD officer appointed by the Board in its discretion should the Board deem it appropriate to name a second staff member). In recognition of the separation of Nasdaq from NASD, the President of Nasdaq will no longer be included on the Board.

The approved amendments also reduce the overall number of Governors to no fewer than 17 nor more than 27. This amendment will result in a smaller, more efficient Board of Governors.

National Nominating Committee - Participation In Contested Elections

The amendments will allow limited National Nominating Committee (NNC) participation in contested elections. Under the current By-Laws, the NASD, NASD staff, the NNC, and other corporate committees are prohibited from taking a position in contested elections. As a result of this prohibition, in contested elections, the NNC has been unable to explain the reasons an NNC-nominated candidate is worthy of support, and has been unable to respond to statements made by other candidates or parties about the NNC nominees. The NNC's current inability to support its candidates in contested elections is a deterrent to qualified individuals accepting nominations.

To remedy this problem, the Board approved an amendment allowing the NNC to provide limited support to NNC nominated candidates. This proposal to limit NNC's support to "responsiveness" has a goal of allowing the NNC to support its candidates but not to unilaterally wage a significant electoral campaign on behalf of those candidates. Specifically, the amendment will allow the NNC to distribute two mailings to NASD voting members in support of its candidates. The amendment will also allow the NNC to respond in kind to vote solicitations and additional mailings by other candidates.

The absolute prohibition on participation in the electoral process by the NASD Board, the staff, and other committees remains in place.

National Nominating Committee - Nominees Proposed By Nasdaq And NASDR

With the departure of Nasdaq as a wholly owned NASD subsidiary, there is no longer a need for NASD Regulation and Nasdaq to propose two candidates each to the NASD Board for appointment to the NNC. The requirement was originally put in place to ensure limited and balanced influence by the regulatory and market subsidiaries. With the departure of a Nasdaq representative from the NASD Board, the Board approved an amendment to eliminate this provision.

Access To The Ballot By Petition

The amendments revise the NASD By-Laws with regard to inclusion on the ballot by petition. Under the current process, Industry candidates seeking nomination by petition can "coattail" other Industry and/or Non-Industry candidates in the same petition-gathering process. This process essentially allows the creation of a "slate" through the use of a single set of petitions signed by three percent of the membership. The Board approved an amendment to allow the nomination by petition of an individual, signed by 3 percent of NASD's voting members, and to permit each member to endorse only one such nominee. The amendments do specifically recognize the validity of slate petitions, but require that the slate be endorsed by 10 percent of NASD's voting members. The Board's adoption of separate thresholds for petition candidates and slate petitions is reasonable given the size and diversity of NASD's membership and is consistent with the practice of other industry organizations, namely the New York Stock Exchange.

Industry Segment Representation

To more accurately represent the full range of relevant industry constituents, the Board approved a proposal to amend the NASD By-Laws and require representation by three additional industry segments: a national retail firm, a regional retail or independent financial planning member firm, and a clearing firm. These segments are in addition to required representation by an investment company, an insurance affiliate, and a small firm. The proposed By-Law amendments require that the Board periodically adopt resolutions establishing the criteria for national retail and regional retail or independent financial planning member representatives. By allowing the Board to establish the

criteria for these categories through Board Resolutions, the Board will be better able to respond to changes in the industry structure and demographics.

Changes To Board Or Committee Composition

In order to ensure balanced representation, the Board approved a proposal to clarify that, when the NASD Regulation Board consists of nine Directors, at least two must be Public Directors. The Board also approved a proposal to provide that any committee appointed by the Board, which may exercise all powers and authority of the Board in the management of the business affairs of the NASD, be balanced.

References To NASD Dispute Resolution And Nasdaq

To set forth the new NASD corporate structure and the change in the NASD-Nasdaq relationship, the Board approved amendments that make several technical changes reflecting the current corporate structure. The changes primarily consist of adding references to the newly formed NASD Dispute Resolution subsidiary, and deleting references to Nasdaq.

The Board asks that you vote in favor of these amendments.

ATTACHMENT A

Amendments To The NASD By-Laws

Substantive changes to the NASD By-Laws are set forth below. Key changes related to the corporate governance of NASD and the new corporate structure are found in Article I; Article IV, Section 1; Article V, Section 2; Article VI, Section 1; Article VII, Sections 1, 3-5, 7, 9-11, 13-14; Article VIII, Section 6; Article IX, Sections 1 and 4; Article X, Section 1; Article XIII, Section 1; and Article XV, Section 4. Stylistic changes and other minor, non-substantive changes are not described.

Article I. Definitions

New definitions have been added, and the terms Industry, Non-Industry and Public "Director" "Governor" and "committee member" have been amended, to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution, Inc., within the family of companies and the changed NASD-Nasdaq relationship.

Article IV. Membership

Application for Membership

Section 1 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Article V. Registered Representatives and Associated Persons

Application for Registration

Section 2 has been amended to reflect the new corporate structure, namely, the inclusion of NASD

Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Article VI. Dues, Assessments, and Other Charges

Power of the NASD to Fix and Levy Assessments

Section 1 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Article VII. Board of Governors

Powers and Authority of Board

Section 1 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Authority to Take Action Under Emergency or Extraordinary Market Conditions

Section 3 has been amended to reflect the new corporate structure, namely, the changed NASD-Nasdaq relationship.

Composition and Qualifications of the Board

Section 4 has been amended to adjust the overall Board composition to no fewer than 17 nor more than 27 Governors, including no more than four staff Governors. This section has also been amended to require representation by three additional industry segments: a national retail firm, a regional retail or independent financial planning member firm and a clearing services firm. Finally, this section has been amended to

allow the Board, by resolution, to specify the criteria for representatives of national retail and regional retail or independent financial planning firms.

Term of Office of Governors

Section 5 has been amended to reflect the changed NASD-Nasdaq relationship and to recognize the Board's discretion in limiting the term of a second NASD officer serving as a Governor.

Filling of Vacancies

Section 7 has been amended by clarifying that the provision applies to elected Governor positions.

The National Nominating Committee

Section 9 has been amended to specify that the NNC may support Governors in contested elections. This section has also been amended to reflect the new corporate structure and to eliminate the requirement that NASDR and Nasdaq propose two candidates each to the NASD Board for appointment to the NNC.

Procedure for Nomination of Governors

Section 10 has been amended to allow nomination by petition for individual ballots by three percent of NASD voting membership, to limit voting members from endorsing more than one individual nominee, and to allow nomination by petition for slates by ten percent of the NASD voting membership.

Communication of Views

Section 11 has been amended to detail the NNC's limited support of NNC nominees.

Election of Governors

Section 13 has been amended by clarifying that the provision applies to elected Governor positions.

Maintenance of Compositional Requirements of the Board

Section 14 has been amended by clarifying that the provision applies to elected Governor positions.

Article VIII. Officers, Agents, and Employees**Resignation and Removal of Officers**

Section 6 has been amended to allow the Board to remove an officer of the NASD by a resolution adopted by a majority of Governors or a consent adopted by all Governors.

Article IX. Committees**Appointment**

Section 1 has been amended to ensure that the Industry/Non-Industry balance of any committee given powers of the Board reflects the same balance of the Board.

Executive Committee

Section 4 has been amended to reflect the changed NASD-Nasdaq relationship.

Article X. Compensation of Board and Committee Members

Section 1 of this Article has been amended to allow member reimbursement of expenditures related to the limited NNC nominee support in contested elections.

Article XIII. Powers of Board to Impose Sanctions

Section 1 has been amended to reflect the new corporate structure, namely, the inclusion of NASD Dispute Resolution within the family of companies and the changed NASD-Nasdaq relationship.

Article XV. Limitation of Powers**Conflicts of Interest**

Section 4 has been amended to reflect the new corporate structure, and to allow a decision by majority vote of disinterested Governors, regardless of whether or not the disinterested Governors constitute a quorum.

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ATTACHMENT B

Deletions appear as Overstrike text surrounded by { }. **Additions** appear as Bold text surrounded by []. **Unmodified** sections have not been included.

BY-LAWS OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

ARTICLE I

Definitions

(n) "Industry Director" means a Director of the NASD Regulation Board or ~~(Nasdaq)~~ **[NASD Dispute Resolution]** Board (excluding the Presidents) who: (1) is or has served in the prior three years as an officer, director, or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (2) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (3) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten 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; (4) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Director or 20 percent or more of the gross revenues received by the Director's firm or partnership; (5) provides professional services to a director, offi-

cer, 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 Director or 20 percent or more of the gross revenues received by the Director's firm or partnership; or (6) has a consulting or employment relationship with or provides professional services to the NASD, NASD Regulation, **[NASD Dispute Resolution,]** Nasdaq, or Amex (and any predecessor), or has had any such relationship or provided any such services at any time within the prior three years;

(o) "Industry Governor" or "Industry committee member" means a Governor (excluding the Chief Executive Officer ~~(and Chief Operating Officer of the NASD, the Presidents of NASD Regulation and Nasdaq, and the Chief Executive Officer of Amex))~~ **[of the NASD and the President of NASD Regulation]**) or committee member who: (1) is or has served in the prior three years as an officer, director~~{}~~ or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (2) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (3) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten 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; (4) 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; (5) 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; (6) is a Floor Governor; or (7) has a consulting or employment relationship with or provides professional services to the NASD, NASD Regulation, **[NASD Dispute Resolution,]** Nasdaq or Amex (and any predecessor), or has had any such relationship or provided any such services at any time within the prior three years;

(v) ["NASD Dispute Resolution" means NASD Dispute Resolution, Inc.;

(w) "Nasdaq" means The Nasdaq Stock Market, Inc.;

~~{(w)}~~ "Nasdaq Board" means the Board of Directors of Nasdaq;

~~(x)~~ "Nasdaq Listing and Hearing Review Council" means a body appointed pursuant to Article V of the Nasdaq By-Laws;

~~{(x)}~~**[(x)]** "NASD Regulation" means NASD Regulation, Inc.;

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~~((z))~~**(y)** "NASD Regulation Board" means the Board of Directors of NASD Regulation;

~~((aa))~~**(z)** "National Adjudicatory Council" means a body appointed pursuant to Article V of the NASD Regulation By-Laws;

~~((bb))~~**(aa)** "National Nominating Committee" means the National Nominating Committee appointed pursuant to Article VII, Section 9 of these By-Laws;

~~((cc))~~**(bb)** "Non-Industry Director" means a Director of the NASD Regulation Board or ~~Nasdaq~~ **[NASD Dispute Resolution]** Board (excluding the Presidents of NASD Regulation and ~~Nasdaq~~ **[NASD Dispute Resolution]**) who is: (1) a Public Director; (2) an officer or employee of an issuer of securities listed on Nasdaq or Amex, or traded in the over-the-counter market; or (3) any other individual who would not be an Industry Director;

~~((dd))~~**(cc)** "Non-Industry Governor" or "Non-Industry committee member" means a Governor (excluding the Chief Executive Officer and ~~Chief Operating Officer~~ **[any other officer]** of the NASD ~~(and),~~ the ~~(Presidents)~~ **[President]** of NASD Regulation ~~(and Nasdaq)~~, any Floor Governor, and the Chief Executive Officer of Amex) or committee member who is: (1) a Public Governor or committee member; (2) an officer or employee of an issuer of securities listed on Nasdaq or Amex, or traded in the over-the-counter market; or (3) any other individual who would not be an Industry Governor or committee member;

~~((ee))~~**(dd)** "person associated with a member" or "associated person of a member" means: (1) a

natural person who is registered or has applied for registration under the Rules of the Association; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the NASD under these By-Laws or the Rules of the Association; and (3) for purposes of Rule 8210, any other person listed in Schedule A of Form BD of a member;

~~((ff))~~**(ee)** "Public Director" means a Director of the NASD Regulation Board or ~~Nasdaq Board~~ **[NASD Dispute Resolution]** who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, **[NASD Dispute Resolution,]** or Nasdaq;

~~((gg))~~**(ff)** "Public Governor" or "Public committee member" means a Governor or committee member who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, **[NASD Dispute Resolution,]** or Nasdaq;

~~((hh))~~**(gg)** "registered broker, dealer, municipal securities broker or dealer, or government securities broker or dealer" means any broker, dealer, municipal securities broker or dealer, or government securities broker or dealer which is registered with the Commission under the Act;

~~(and)~~

~~((ii))~~**(hh)** "Rules of the Association" or "Rules" means the num-

bered rules set forth in the NASD Manual beginning with the Rule 0100 Series, as adopted by the Board pursuant to these By-Laws, as hereafter amended or supplemented~~(-);~~;

~~((jj))~~**(ii)** "Floor Governor" or "Amex Floor Governor" means a Floor Governor of Amex elected pursuant to Article II, Section .01(a) of the Amex By-Laws;

~~((kk))~~ "Nasdaq-Amex" means ~~Nasdaq-Amex Market Group, Inc.;~~

~~((ll))~~**(jj)** "Amex" means American Stock Exchange LLC; **[and]**

~~((mm))~~**(kk)** "Amex Board" means the Board of Governors of Amex~~(-);~~;

ARTICLE IV

MEMBERSHIP

Application for Membership

Sec. 1. (a) Application for membership in the NASD, properly signed by the applicant, shall be made to the NASD via electronic process or such other process as the NASD may prescribe, on the form to be prescribed by the NASD, and shall contain:

(1) an agreement to comply with the federal securities laws, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board and the Treasury Department, the By-Laws of the NASD, NASD Regulation, and ~~Nasdaq~~ **[NASD Dispute Resolution]**, the Rules of the Association, and all rulings, orders, directions, and decisions issued and sanctions imposed under the Rules of the Association;

ARTICLE V**REGISTERED REPRESENTATIVES AND ASSOCIATED PERSONS****Application for Registration**

Sec. 2. (a) Application by any person for registration with the NASD, properly signed by the applicant, shall be made to the NASD via electronic process or such other process as the NASD may prescribe, on the form to be prescribed by the NASD and shall contain:

(1) an agreement to comply with the federal securities laws, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board and the Treasury Department, the By-Laws of the NASD, NASD Regulation, and ~~(Nasdaq)~~ **[NASD Dispute Resolution]**, the Rules of the Association, and all rulings, orders, directions, and decisions issued and sanctions imposed under the Rules of the Association; and

ARTICLE VI**DUES, ASSESSMENTS, AND OTHER CHARGES****Power of the NASD to Fix and Levy Assessments**

Sec. 1. The NASD shall prepare an estimate of the funds necessary to defray reasonable expenses of administration in carrying on the work of the NASD each fiscal year, and on the basis of such estimate, shall fix and levy the amount of admission fees, dues, assessments, and other charges to be paid by members of the NASD and issuers and any other persons using any facility or system which

the NASD, NASD Regulation ~~(, or Nasdaq)~~ **[or NASD Dispute Resolution]** operates or controls. Fees, dues, assessments, and other charges shall be called and payable as determined by the NASD from time to time; provided, however, that such admission fees, dues, assessments, and other charges shall be equitably allocated among members and issuers and any other persons using any facility or system which the NASD operates or controls. The NASD may from time to time make such changes or adjustments in such fees, dues, assessments, and other charges as it deems necessary or appropriate to assure equitable allocation of dues among members. In the event of termination of membership or the extension of any membership to a successor organization during any fiscal year for which an assessment has been levied and become payable, the NASD may make such adjustment in the fees, dues, assessments, or other charges payable by any such member or successor organization or organizations during such fiscal years as it deems fair and appropriate in the circumstances.

ARTICLE VII**BOARD OF GOVERNORS****Powers and Authority of Board**

Sec. 1. (a) The Board shall be the governing body of the NASD and, except as otherwise provided by applicable law, the Restated Certificate of Incorporation, or these By-Laws, shall be vested with all powers necessary for the management and administration of the affairs of the NASD and the promotion of the NASD's welfare, objects, and purposes. In the exercise of such powers, the Board

shall have the authority to:

(c) To the fullest extent permitted by applicable law, the Restated Certificate of Incorporation, and these By-Laws, the NASD may delegate any power of the NASD or the Board to a committee appointed pursuant to Article IX, Section 1, the NASD Regulation Board, the ~~(Nasdaq)~~ **[NASD Dispute Resolution]** Board, or NASD staff in a manner not inconsistent with the Delegation Plan.

Authority to Take Action Under Emergency or Extraordinary Market Conditions

Sec. 3. The Board, or such person or persons as may be designated by the Board, in the event of an emergency or extraordinary market conditions, shall have the authority to take any action regarding:

(a) the trading in or operation of the over-the-counter securities market, the operation of any automated system owned or operated by the NASD ~~(, or)~~ **[or]** NASD Regulation, ~~(, or Nasdaq)~~ and the participation in any such system of any or all persons or the trading therein of any or all securities; and

Sec. 4. (a) The Board shall consist of **[no fewer than 17 nor more than 27 Governors, comprising (i)]** the Chief Executive ~~(Officer and the Chief Operating)~~ Officer of the NASD, ~~(the Presidents of NASD Regulation and Nasdaq,~~ **[(ii) if the Board of Governors determines, from time to time, in its sole discretion, that the appointment of a second officer of the NASD to the Board of Governors is advisable, a second officer of the NASD, (iii) the President of NASD Regulation, (iv)]** the Chair of the National

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Adjudicatory Council, ~~[(v)]~~ the Chief Executive Officer ~~{of Amex,}~~ **[and]** one Floor Governor **[of Amex]**, and **[(vi)]** no fewer than ~~{46}~~ **[12]** and no more than ~~{28}~~ **[22]** Governors elected by the members of the NASD. The Governors elected by the members of the NASD shall 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 representative of a national retail firm, a representative of a regional retail or independent financial planning member firm, a representative of a firm that provides clearing services to other NASD members]**, and a representative of an NASD member having not more than 150 registered persons. ~~{A majority of the}~~ **[The number of Non-Industry]** Governors shall ~~{be Non-}~~ **[exceed the number of]** Industry Governors. If the ~~{Board consists of 23 Governors, at least five shall be}~~ **[number of Industry and Non-Industry Governors is 15 to 17, the Board shall include at least four]** Public Governors. If the ~~{Board consists of 24 to 27 Governors, at least six shall be}~~ **[number of Industry and Non-Industry Governors is 18 to 19, the Board shall include at least five]** Public Governors. If the ~~{Board consists of 28 to 31 Governors, at least seven shall be}~~ **[number of Industry and Non-Industry Governors is 20-25, the Board shall include at least six]** Public Governors.

Term of Office of Governors

Sec. 5. (a) The Chief Executive Officer and ~~{the Chief Operating Officer}~~, **[if appointed, the**

second officer] of the NASD~~[,]~~ the ~~{Presidents}~~ **[President]** of NASD Regulation ~~{and Nasdaq}~~, and the Chief Executive Officer of Amex shall serve as Governors until a successor is elected, or until death, resignation, or removal **[(or, in addition, in the case of a second officer of the NASD, until the Board of Governors, in its sole discretion, determines that such appointment is no longer advisable)]**.

(d) The Governors elected by the members of the NASD shall be divided into three classes and hold office for a term of no more than three years, such term to be fixed by the Board at the time of the nomination or certification of **[each]** such Governor, or until a successor is duly elected and qualified, or until death, resignation, disqualification, or removal. A Governor elected by the members of the NASD may not serve more than two consecutive terms. If a Governor is elected by the Board to fill a term of less than one year, the Governor may serve up to two consecutive terms following the expiration of the Governor's initial term. The term of office of Governors of the first class shall expire at the January 1999 Board meeting, of the second class one year thereafter, and of the third class two years thereafter. At each annual election, commencing January 1999, Governors shall be elected for a term of three years to replace those whose terms expire.

Filling of Vacancies

Sec. 7. If ~~{a}~~ **[an elected]** Governor position becomes vacant, whether because of death, disability, disqualification, removal, or resignation, the National Nominating Committee shall nominate, and the Board shall elect by majority vote of the remaining Governors then in office, a person satisfying the

classification (Industry, Non-Industry, or Public Governor) for the governorship as provided in Section 4 to fill such vacancy, except that if the remaining term of office for the vacant Governor position is not more than six months, no replacement shall be required. If the remaining term of office for the vacant Governor position is more than one year, the Governor elected by the Board to fill such position shall stand for election in the next annual election pursuant to this Article.

The National Nominating Committee

Sec. 9. (a) The National Nominating Committee shall nominate **[and, in the event of a contested election, may, as described in Section 11(b), support]:** Industry, Non-Industry, and Public Governors for each vacant or new Governor position on the NASD Board for election by the membership; Industry, Non-Industry, and Public Directors for each vacant or new position on the NASD Regulation Board and the ~~{Nasdaq}~~ **[NASD Dispute Resolution]** Board for election by the ~~{Board}~~; **[stockholder; and]** Industry, Non-Industry, and Public members for each vacant or new position on the National Adjudicatory Council for appointment by the NASD Regulation Board~~;~~ ~~{and Industry and Non-Industry members for each vacant or new position on the Nasdaq Listing and Hearing Review Council for appointment by the Nasdaq Board}~~.

(d) Members of the National Nominating Committee shall be appointed annually by the Board and may be removed only by majority vote of the whole Board, after appropriate notice, for refusal, failure, neglect, or inability to discharge such member's duties. ~~{The NASD Regulation~~

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~~Board and the Nasdaq Board each shall propose two candidates to the NASD Board for appointment to the National Nominating Committee.]~~

Procedure for Nomination of Governors

Sec. 10. Prior to a meeting of members pursuant to Article XXI for the election of Governors, the NASD shall notify the members the names of each nominee selected by the National Nominating Committee for each governorship up for election, the classification of governorship (Industry, Non-Industry, or Public Governor) for which the nominee is nominated, the qualifications of each nominee, and such other information regarding each nominee as the National Nominating Committee deems pertinent. A person who has not been so nominated may be included on the ballot for the election of Governors if: (a) within ~~{30}~~ **[45]** days after the date of such notice ~~{in 1997, or within 45 days after the date of such notice in 1998 and thereafter}~~, such person presents to the Secretary of the NASD **[(i) in the case of petitions solely in support of such person,]** petitions in support of his or her nomination duly executed by three percent of the members, **and no member shall endorse more than one such nominee, or (ii) in the case of petitions in support of one or more persons, petitions in support of the nominations of such persons duly executed by ten percent of the members];** and (b) the Secretary certifies that (i) the petitions are duly executed by the Executive Representatives of the requisite number of members~~{;}~~**[,]** and (ii) the person satisfies the classification (Industry, Non-Industry, or Public Governor) of the governor-

ship to be filled, based on such information provided by the person as is reasonably necessary to make the certification. The Secretary shall not unreasonably withhold or delay the certification. Upon certification, the election shall be deemed a contested election. After the certification of a contested election or the expiration of time for contesting an election under this Section, the Secretary shall deliver notice of a meeting of members pursuant to Article XXI, Section 3(a).

Communication of Views

Sec. 11. [(a)] The NASD, the Board, ~~{the National Nominating Committee,}~~ a committee appointed pursuant to Article IX, Section 1, and NASD staff shall not take any position publicly or with a member or person associated with or employed by a member with respect to any candidate in a contested election or nomination held pursuant to these By-Laws or the NASD Regulation By-Laws. A Governor or a member of **[any committee (other than] the National Nominating Committee {or any other committee}[]]** may communicate his or her views with respect to any candidate if such Governor or committee member acts solely in his or her individual capacity and disclaims any intention to communicate in any official capacity on behalf of the NASD, the NASD Board, **[or any committee (other than] the National Nominating Committee {or any other committee}[]]**. Except as provided herein, any candidate and his or her representatives may communicate support for the candidate to a member or person associated with or employed by a member.

[(b) In a contested election, the National Nominating Committee may support its

nominees under this Article by sending to NASD members eligible to vote up to two mailings of materials, in the manner set forth in Article VII, Section 12, in support of its nominees. In addition to such two mailings, in the event of mailings and or other communications to the NASD members by or on behalf of a candidate by petition in a contested election, the National Nominating Committee may respond in-kind, but shall not take a position unresponsive, to the contesting candidate's communications.]

Election of Governors

Sec. 13. Governors **[that are to be elected by the members]** shall be elected by a plurality of the votes of the members of the NASD present in person or represented by proxy at the annual meeting of the NASD and entitled to vote thereat. The annual meeting of the NASD shall be on such date and at such place as the Board shall designate pursuant to Article XXI. Any Governor so elected must be nominated by the National Nominating Committee or certified by the Secretary pursuant to Section 10.

Maintenance of Compositional Requirements of the Board

Sec. 14. Each **[elected]** Governor shall update the information submitted 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 of the NASD, and shall report immediately to the Secretary any change in such classification.

ARTICLE VIII

OFFICERS, AGENTS, AND EMPLOYEES

Resignation and Removal of Officers

Sec. 6. (b) Any officer of the NASD may be removed, with or without cause, by resolution adopted by a majority of the Governors then in office at any regular or special meeting of the Board or by a ~~written~~ consent ~~signed~~ **[adopted]** by all of the Governors then in office **[in accordance with applicable law]**. Such removal shall be without prejudice to the contractual rights of the affected officer, if any, with the NASD.

ARTICLE IX

COMMITTEES

Appointment

Sec. 1. Subject to Article VII, Section 1(c), the Board may appoint such committees or subcommittees as it deems necessary or desirable, and it shall fix their powers, duties, and terms of office. Any such committee or subcommittee consisting solely of one or more Governors, to the extent provided by these By-Laws or by resolution of the Board, shall have and may exercise all powers and authority of the Board in the management of the business and affairs of the NASD. **[Any committee having the authority to exercise the powers and authority of the Board shall have a percentage of Non-Industry committee members at least as great as the percentage of Non-Industry Governors on the Board and a percentage of Public committee members at least as great as the percentage of Public Governors on the Board.]**

Executive Committee

Sec. 4. (b) The Executive Committee shall consist of no fewer than six and no more than nine Governors. The Executive Committee shall include the Chief Executive Officer of the NASD, at least one Director of NASD Regulation, ~~at least one Director of Nasdaq,~~ at least one Governor of Amex, and at least two Governors who are not members of either the NASD Regulation Board, ~~the Nasdaq Board, or the Amex Board. The number of Directors of the NASD Regulation Board and the number of Directors of the Nasdaq Board serving on the Executive Committee shall be equal at all times.~~ **[or the Amex Board.]** The Executive Committee shall have a percentage of Non-Industry committee members at least as great as the percentage of Non-Industry Governors on the whole Board and a percentage of Public committee members at least as great as the percentage of Public Governors on the whole Board.

ARTICLE X

COMPENSATION OF BOARD AND COMMITTEE MEMBERS

Sec. 1. The Board may provide for reasonable compensation of the Chair of the Board, the Governors, and the members of any committee. The Board may also provide for reimbursement of reasonable expenses incurred by such persons in connection with the business of the NASD, **[including those expenses incurred in connection with the support of a candidate or candidates by the National Nominating Committee in contested elections in accordance with the By-Laws].**

ARTICLE XIII

POWERS OF BOARD TO IMPOSE SANCTIONS

Sec. 1. The Board is hereby authorized to impose appropriate sanctions applicable to members, including censure, fine, suspension, or expulsion from membership, suspension or bar from being associated with all members, limitation of activities, functions, and operations of a member, or any other fitting sanction, and to impose appropriate sanctions applicable to persons associated with members, including censure, fine, suspension or barring a person associated with a member from being associated with all members, limitation of activities, functions, and operations of a person associated with a member, or any other fitting sanction, for:

(b) violation by a member or a person associated with a member of any of the terms, conditions, covenants, and provisions of the By-Laws of the NASD, NASD Regulation, or ~~Nasdaq~~ **[NASD Dispute Resolution]**, the Rules of the Association, or the federal securities laws, including the rules and regulations adopted thereunder, the rules of the Municipal Securities Rulemaking Board, and the rules of the Treasury Department;

ARTICLE XV

LIMITATION OF POWERS

Conflicts of Interest

Sec. 4. (b) No contract or transaction between the NASD and one or more of its Governors or officers, or between the NASD and any other corporation, partnership, association, or other organization in which one or more of its

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Governors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason if: (i) the material facts pertaining to such Governor's or officer's relationship or interest and the contract or transaction 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 disinter-

ested Governors[, **even though the disinterested governors be less than a quorum**]; or (ii) the material facts are disclosed or become known to the Board or committee after the contract or transaction is entered into, and the Board or committee in good faith ratifies the contract or transaction by the affirmative vote of a majority of the disinterested Governors **[even though the disinterested governors be less than a**

quorum]. Only disinterested Governors may be counted in determining the presence of a quorum at the portion of a meeting of the Board or of a committee that authorizes the contract or transaction. This subsection shall not apply to any contract or transaction between the NASD and ~~(~~Nasdaq-Amex, Nasdaq~~)~~ **[NASD Dispute Resolution]**, or Amex.