

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56147; File No. SR-NASD-2007-054)

July 26, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Incorporate Certain NYSE Rules Relating to Member Firm Conduct

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 July 24, 2007, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change to incorporate into its rulebook certain rules of the New York Stock Exchange LLC (“NYSE”) relating to the regulation of member firm conduct (“Incorporated NYSE Rules”) as described in Items I and II below, which Items have been substantially prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is simultaneously approving the proposal on an accelerated basis.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

In connection with the proposed transaction to combine the member regulation operations of NASD and NYSE into a single organization (“Transaction”), NASD proposes to add the Incorporated NYSE Rules to its rules. As discussed below, the Incorporated NYSE Rules will apply solely to members of the Financial Industry Regulatory Authority, Inc. (“FINRA”)<sup>3</sup> that

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

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

<sup>3</sup> In connection with the Transaction, NASD will change its corporate name to FINRA as of the date of closing of the Transaction (“Closing”). See Securities Exchange Act Release No. 56146 (July 26, 2007) (changing the name of NASD to FINRA in the Restated Certificate of Incorporation).

also are members of NYSE (“Dual Members”) on or after the date of closing (“Closing”) of the Transaction. The text of the proposed rule change, including the list of the Incorporated NYSE Rules, is available at NASD, the Commission’s Public Reference Room, and <http://nasd.complinet.com>.

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 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 III 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

Currently, both NASD and NYSE Regulation, Inc. (“NYSE Regulation”)<sup>4</sup> oversee the activities of U.S.-based broker-dealers doing business with the public, approximately 170 of which are regulated by both organizations. According to NASD, the result is a duplicative, sometimes conflicting system that makes inefficient use of resources and, as such, can be detrimental to the ultimate goal of investor protection.

NASD states that it has long supported the adoption of a hybrid model of self-regulation, with one self-regulatory organization (“SRO”) having responsibility for all member firm regulation.<sup>5</sup> NASD further notes that, at the same time, the Commission, Congress, securities

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<sup>4</sup> NYSE Regulation is a wholly-owned subsidiary of NYSE.

<sup>5</sup> See NASD comment letter dated March 15, 2005 in response to the SEC’s Concept

firms and independent observers have long encouraged greater efficiencies, clarity and cost savings in the regulation of the U.S. financial markets.

With these goals in mind, on November 28, 2006, NASD and the NYSE Group, Inc. (“NYSE Group”) announced a plan to consolidate their member regulation operations into a combined organization that will be the sole U.S. private-sector provider of member firm regulation for securities firms that conduct business with the public.<sup>6</sup> This consolidation is intended to streamline the broker-dealer regulatory system, combine technologies, and permit the establishment of a single set of rules and group examiners with complementary areas of expertise in a single organization—all of which will serve to enhance oversight of U.S. securities firms and help ensure investor protection. Moreover, NASD notes that the new organization will be committed to reducing regulatory costs and burdens for firms of all sizes through greater regulatory efficiency.

### **Incorporation of NYSE Conduct Rules – General**

NASD represents that FINRA will work expeditiously to consolidate the rules that apply to its member firms, reducing to one the two sets of rules currently applicable to Dual Members. During an interim period, however, until the approval of a consolidated rulebook, NASD is proposing to incorporate into FINRA’s rulebook the Incorporated NYSE Rules.<sup>7</sup> The

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Release Concerning Self-Regulation, Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004) (File No. S7-40-04).

<sup>6</sup> Today, the Commission approved the amendments to the NASD’s By-Laws proposed in connection with the Transaction. Securities Exchange Act Release No. 56145 (July 26, 2007).

<sup>7</sup> The text of the Incorporated NYSE Rules, as of the effective date of the proposed rule change, will be available on the FINRA Web site. To the extent the Commission has approved an amendment to an Incorporated NYSE Rule that has not yet become effective prior to the closing of the Transaction, NASD is proposing to incorporate any such amendment into FINRA’s rulebook (with such amendment becoming effective upon its

Incorporated NYSE Rules will apply solely to Dual Members until such time as FINRA adopts, subject to Commission approval, consolidated rules applicable to all of its members.<sup>8</sup>

The proposed rule change would incorporate those NYSE rules pertaining to the regulation of member firm conduct.<sup>9</sup> In applying the Incorporated NYSE Rules to Dual Members, FINRA also would incorporate the related interpretative positions set forth in the NYSE Rule Interpretations Handbook and NYSE Information Memos.

Importantly, under the proposed rule change, there would be no new rule requirements placed on member firms as a result of the Transaction. Until the adoption of a consolidated rulebook by FINRA, those members that are NASD-only members as of the date of the Closing would continue to comply with NASD (and not NYSE) rules; those members that were Dual Members as of the date of Closing would continue to be subject to NASD and NYSE rules; and NYSE members that were not also members of NASD as of the date of Closing (“NYSE-only members”) would continue to comply with NYSE (and not NASD) rules, provided that any such NYSE-only member does not engage in any activities that would require it to be an NASD

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scheduled effective date). In the event the NYSE were to file a proposed rule change to amend an NYSE rule relating to member firm conduct following the closing of the Transaction, NASD is not proposing to incorporate any such amendment into FINRA’s rulebook, absent a separate rule filing by FINRA to adopt conforming changes.

<sup>8</sup> The Incorporated NYSE Rules would continue to apply to the same categories of persons to which they currently apply. In other words, in addition to applying to Dual Members, the Incorporated NYSE Rules would apply to persons affiliated with those firms to the same extent and in the same manner that the Incorporated NYSE Rules currently apply. NASD stated that it expects FINRA to submit to the Commission within one year of the date of Closing proposed rule changes that would constitute a significant portion of a harmonized rulebook, with the remaining rules being submitted to the Commission within two years of the Closing. See Letter from T. Grant Callery, Executive Vice President and General Counsel, NASD to Nancy M. Morris, Secretary, Commission, dated July 16, 2007.

<sup>9</sup> To the extent an Incorporated NYSE Rule includes a reference to NYSE or the Exchange, such terms will be construed to mean FINRA, unless the context otherwise requires.

member, in which case the NYSE-only member would be subject to both NYSE and NASD rules.<sup>10</sup> In short, the proposed rule change is designed to ensure that all firms, whether Dual Members or members of only NYSE or NASD, will have the same set of regulatory obligations immediately following the Closing of the Transaction that those firms had prior to the Closing of the Transaction.

Because NYSE Group would maintain the functions it currently carries out with respect to market operations, including market surveillance functions, the proposed rule change would not incorporate NYSE rules in such areas as market regulation, including those rules addressing NYSE's Order Tracking System ("OTS") and listing standards. The proposed rule change also would not incorporate NYSE's proxy rules. Further, the proposed rule change would not incorporate NYSE arbitration rules, as FINRA would operate its arbitration and mediation forums pursuant to the NASD Code of Arbitration Procedure.<sup>11</sup>

### **Disciplinary Matters**

Because FINRA would conduct its disciplinary proceedings in accordance with the NASD Code of Procedure, the proposed rule change would not incorporate the NYSE disciplinary rules. With respect to any disciplinary investigations pending at NYSE Regulation as of the Transaction's Closing date that pertain to the Incorporated NYSE Rules, the applicable

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<sup>10</sup> NASD anticipates NYSE's filing a proposed rule change to require its members to be members of FINRA, and expects to file a separate rule change to establish a waive-in application process for the NYSE-only members. These NYSE-only members will be subject to FINRA's By-Laws and Schedules to the By-Laws, including Schedule A (Assessments and Fees), as well as the NASD Rule 8000 Series (Investigations and Sanctions) and Rule 9000 Series (Code of Procedure).

<sup>11</sup> NYSE recently filed a proposed rule change to provide guidance regarding new and pending arbitration claims in light of the consolidation of NYSE Regulation's arbitration department with that of NASD Dispute Resolution, Inc. See Securities Exchange Act Release No. 56015 (July 5, 2007), 72 FR 37811 (July 11, 2007) (Notice of Filing of Proposed Rule Change and Amendment No. 1) (SR-NYSE-2007-48).

rules and forum would depend on whether NYSE Regulation has filed a Charge Memorandum or Stipulation of Facts and Consent to Penalty (“Stipulation and Consent”) as of the date of Closing. In the event NYSE Regulation has filed a Charge Memorandum or Stipulation and Consent as of the date of Closing, the matter (including any later appeals) would be adjudicated in accordance with the NYSE disciplinary rules and before the NYSE Hearing Board. Similarly, to the extent an NYSE Hearing Board decision remains subject to appeal as of the date of Closing, any such appeal would be addressed pursuant to the NYSE disciplinary rules.<sup>12</sup>

In contrast, if as of the date of Closing, NYSE Regulation has not filed a Charge Memorandum or Stipulation and Consent in an investigation relating to the Incorporated NYSE Rules, the matter (including any later appeals) would be adjudicated by FINRA, pursuant to the FINRA Code of Procedure, which includes the Acceptance, Waiver and Consent process pursuant to the FINRA Code of Procedure.<sup>13</sup>

Regarding summary proceedings currently adjudicated pursuant to NYSE Rule 475, the applicable rule and forum would depend on whether NYSE Regulation has notified the person or entity in writing of the summary action before the Closing date. If the notification in writing has occurred before the Closing date, then the matter would be adjudicated pursuant to NYSE

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<sup>12</sup> See SR-NYSE-2007-69 (Information Memo to NYSE members reflecting changes to disciplinary proceedings at NYSE Regulation as a result of the Transaction).

<sup>13</sup> Under the proposed rule change, FINRA would incorporate NYSE Rule 477 (Retention of Jurisdiction-Failure to Cooperate) with respect to matters relating to potential violations of the Incorporated NYSE Rules. NYSE Rule 477 governs, among other things, NYSE’s retention of jurisdiction over certain persons for purposes of initiating disciplinary actions. The rule generally provides that NYSE shall retain jurisdiction over such persons if, prior to termination, or within one year following receipt by NYSE of written notice of the termination, of a person’s status as a member, member organization, allied member, approved person or registered or non-registered employee of a member or member organization, NYSE serves written notice on such person that it is making inquiry into matters occurring prior to the termination of such person’s status.

disciplinary rules. If no such notification has occurred, the matter would be addressed by FINRA, pursuant to FINRA rules.

Finally, with regard to fines imposed pursuant to NYSE Rule 476A (Imposition of Fines for Minor Violation(s) of Rules) (or summary fines), if a summary fine notice is issued before the date of Closing, the matter would be handled pursuant to NYSE rules. With respect to matters arising after the date of Closing, NASD expects to file with the Commission a proposed rule change to modify its Minor Rule Violation Plan (“MRVP”) to include the Incorporated NYSE Rules that, as of the date of such filing, are enumerated in NYSE’s MRVP. Thus, NASD states that after the date of Closing, if the Commission were to approve the proposed rule changes, FINRA would be authorized to impose fines under NASD’s MRVP for minor violations by Dual Members of the NYSE rules that are set forth in FINRA’s MRVP.

#### **Non-Exclusive Common Rules**

As further detailed in the Agreement between NASD, NYSE, and NYSE Regulation pursuant to Rule 17d-2 under the Act<sup>14</sup> (“Rule 17d-2 Agreement”), certain of the Incorporated NYSE Rules have been designated “Non-Exclusive Common Rules” for which both FINRA and NYSE will bear responsibility when performing their respective regulatory responsibilities. To the extent a Non-Exclusive Common Rule pertains to matters other than member firm regulation as set forth in the Rule 17d-2 Agreement, the potential violation of such a rule would continue to be adjudicated by NYSE Regulation, in accordance with NYSE disciplinary rules. In addition, NYSE Regulation would retain sole authority to investigate and prosecute any violations of the NYSE rules that are not Incorporated NYSE Rules.

The effective date of the proposed rule change will be the Closing date of the

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<sup>14</sup> 17 CFR 240.17d-2.

Transaction. The proposed rule change will not become effective if the Transaction does not close.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>15</sup> including Section 15A(b)(2) of the Act,<sup>16</sup> in that it will permit FINRA to carry out the purposes of the Act, to comply with the Act and to enforce compliance by FINRA members and persons associated with members with the Act, the rules and regulations thereunder and FINRA rules. NASD further believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>17</sup> which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. As a result of the proposed rule change, firms that currently are regulated by both NASD and NYSE Regulation will continue to comply with the same set of rules applicable to their operations, with minimal disruption to the businesses. FINRA will work expeditiously to consolidate the rules applicable to such members, so that they are required to comply with only one set of rules.

### 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.

### 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.

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<sup>15</sup> 15 U.S.C. 78o-3.

<sup>16</sup> 15 U.S.C. 78o-3(b)(2).

<sup>17</sup> 15 U.S.C. 78o-3(b)(6).



### III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2007-054 on the subject line.

#### Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2007-054. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit

personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2007-054 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

#### IV. Commission Findings

After careful consideration, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities association.<sup>18</sup> Specifically, the Commission finds that the proposal is consistent with Section 15A(b)(6) of the Act<sup>19</sup> in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Commission also finds that the proposed rule change is consistent with Section 15A(b)(2) of the Act<sup>20</sup> in that it will permit FINRA to be so organized to carry out the purposes of the Act, to comply with the Act and to enforce compliance by FINRA members and persons associated with members with the Act, the rules and regulations thereunder, and FINRA rules.

As a result of the proposed rule change, firms that currently are regulated by both NASD and NYSE will continue to comply with the same member conduct rules following the Transaction until the member conduct rules of the NASD and NYSE Regulation are consolidated into a single set of FINRA rules. NASD represents that FINRA will work expeditiously to

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<sup>18</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>19</sup> 15 U.S.C. 78o-3(b)(6).

<sup>20</sup> 15 U.S.C. 78o-3(b)(2).

consolidate the rules applicable to Dual Members.<sup>21</sup> In the Commission's view, the proposed rule change is an important step in the process of consolidating the member firm regulatory functions of the NASD and NYSE. This regulatory consolidation is intended, among other things, to increase efficient, effective, and consistent regulation of securities firms, provide cost savings to securities firms of all sizes, and strengthen investor protection and market integrity.

The Commission notes that the Incorporated NYSE Rules will be subject to the Rule 17d-2 Agreement in which the regulatory responsibility for these rules will be allocated to FINRA, although specified Non-Exclusive Common Rules as set forth in the Rule 17d-2 Agreement also would continue to be adjudicated by NYSE in accordance with NYSE disciplinary rules.<sup>22</sup> The proposed rule change also provides clarity with respect to the handling of disciplinary proceedings and summary proceedings initiated by NYSE prior to the date of Closing.

The Commission finds good cause to approve the proposed rule change prior to the thirtieth day after the proposal was published for comment in the Federal Register. Accelerating approval of the proposed rule change facilitates the proposed consolidation of NASD and NYSE's regulatory functions without delay. No changes are being made to the Incorporated NYSE Rules aside from their placement in FINRA's rulebook and no changes are being made to the class of members to which the Incorporated NYSE Rules apply. As NASD noted, the proposed rule change is designed to ensure that all firms, whether Dual Members, NYSE-only members, or NASD-only members, will have the same set of regulatory obligations immediately following the Closing of the Transaction that such firms had prior to the Closing of the

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<sup>21</sup> See supra note 8.

<sup>22</sup> The Commission declared the Rule 17d-2 Agreement effective today. See Securities and Exchange Act Release No. 56148 (July 26, 2007).

Transaction. In addition, the Commission finds good cause to approve the proposal that any disciplinary matter in which a Charge Memorandum or Stipulation and Consent is filed after the date of Closing would be adjudicated pursuant to the FINRA Code of Procedure and that any summary proceeding in which the person or entity is notified in writing after the date of Closing, would be adjudicated pursuant to FINRA rules. This proposal reflects the fact that as of the date of Closing, FINRA will be responsible, under the Rule 17d-2 Agreement, for conducting disciplinary proceedings involving violations of FINRA's rules, including the Incorporated NYSE Rules, by Dual Members. Dual Members are already familiar with, and subject to, the NASD Code of Procedure, which is the FINRA Code of Procedure, and NASD rules, which are FINRA rules. While there are some distinctions between NASD's and NYSE's rules, both sets of rules applicable to the disciplinary process were previously approved by the Commission as consistent with the Act, generally following full notice and comment. Accordingly, although Dual Members and their associated persons no longer would be subject to NYSE's disciplinary procedures, but to FINRA's instead, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,<sup>23</sup> to grant accelerated approval to the proposed rule change.

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<sup>23</sup> 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NASD-2007-054) is hereby approved on an accelerated basis.<sup>24</sup>

By the Commission.

Nancy M. Morris  
Secretary

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<sup>24</sup> 15 U.S.C. 78s(b)(2).