

MEMO# 13123

February 5, 2001

SEC PROPOSED RULE RELATING TO PROPOSED RULE CHANGES OF SELF- REGULATORY ORGANIZATIONS

[13123] February 5, 2001 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 5-01 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 4-01 FIXED-INCOME ADVISORY COMMITTEE No. 1-01 SEC RULES COMMITTEE No. 13-01 RE: SEC PROPOSED RULE RELATING TO PROPOSED RULE CHANGES OF SELF- REGULATORY ORGANIZATIONS The Securities and Exchange Commission has published for comment a proposed rule¹ to amend the requirements applicable to self-regulatory organization ("SRO")² filings of proposed rule changes with the SEC. Specifically, the SEC is proposing to replace current Securities Exchange Act Rule 19b-4 with new Exchange Act Rule 19b-6. The SEC release is attached and the most significant aspects of the proposed rule are summarized below. Comments on the proposed rule are due to the SEC no later than April 6, 2001. If you have any comments you would like the Institute to consider including in its comment letter, please provide them to the undersigned by phone at (202) 371-5408, by fax at (202) 326-5839, or by e-mail at aburstein@ici.org no later than February 28. Background Currently, each SRO is required by the Exchange Act to file with the SEC its proposed rule changes accompanied by a statement of the basis for, and purpose of, the proposed rule change. After filing, the SEC is required to publish the proposed rule change for public comment. The proposed rule change may not take effect unless and until the SEC subsequently approves it. The Exchange Act also provides that, in certain circumstances, a proposed rule change may become effective upon filing with the SEC absent the normal notice and approval procedures if designated by an SRO as (1) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the SRO; (2) establishing or changing a due, fee, or other charge imposed by the SRO; or (3) concerned solely with the administration of the SRO. 1 Securities Exchange Act Release No. 43860 (January 19, 2001), 66 FR 8912 (February 5, 2001) ("Release"). 2 The Securities Exchange Act defines the term "self-regulatory organization" to mean any national securities exchange, registered securities association, registered clearing agency, and, for purposes of Exchange Act Section 19(b) and other limited purposes, the Municipal Securities Rulemaking Board. 2 Issuance of a Release Within Ten Business Days of Filing Proposed Rule 19b-6 would require the SEC to issue a release relating to filed proposed rule changes within ten business days of receipt by the SEC or within such longer period as to which the SRO consents in writing. The proposed rule delineates the items that must be included in a rule filing for it to be considered properly filed. Specifically, proposed Rule 19b-6 states that in order for a proposed rule change to be properly filed, it must (1) provide an accurate statement of the authority for and basis of the proposed rule change, including the impact on competition, as well as a summary of any written comments

received by the SRO; (2) not be inconsistent with the existing rules of the SRO; and (3) contain a certification from a senior SRO official regarding its accuracy and completeness. If the filing is complete, the SEC will post the proposal on its web site and send it to the Federal Register for publication. Proposed Changes to Non-Controversial Filings Category Currently, Rule 19b-4 allows proposed rule changes that are non-controversial to become effective upon filing with the SEC, provided that the SRO submits written notice of its intent to file the proposal at least five business days in advance of filing. In addition, these proposed rule changes currently will not become operative until 30 days after the date of filing, unless the SEC shortens or waives these requirements. The Release states that in light of its experience with this provision, the SEC believes that it may now be appropriate to eliminate the five-day pre-filing requirement and the 30-day delayed operational date for non-controversial rule filings. The SEC notes, however, that it will retain its statutory authority to abrogate a proposed rule change submitted under this provision within 60 days of the date of filing of the proposed rule change if, for example, the rule change was controversial and warranted further public comment. The SRO would then be required to refile the proposed rule change for regular notice and comment.

Immediate Effectiveness of Trading Rules

The Release states that proposed Rule 19b-6 is intended, among other things, to eliminate the competitive disadvantage that SROs may face from Alternative Trading Systems, including ECNs, which are not registered as exchanges and therefore do not have self-regulatory responsibilities, and, consequently, are not required to file trading rules with the SEC for approval. The Release states that the SEC, therefore, is proposing to revise the process for filing and approving SRO trading rules to allow SROs to amend the majority of these rules without waiting for SEC approval. Specifically, under proposed Rule 19b-6, SROs would have the choice to file proposed rule changes governing most trading rules under the regular notice and approval procedures or under the procedures to have the proposed rule change become immediately effective upon filing with the SEC. To become immediately effective upon filing, the SRO must establish procedures for the effective surveillance of activity conducted pursuant to the trading rule and for enforcement of the rule. However, those trading rules that make fundamental structural changes to the securities market and that significantly affect the protection of investors or the public interest, or that impose a significant burden on competition, would not be eligible to become immediately effective and would be subject to the regular notice and comment period. Trading rules would be defined broadly to include SRO rules governing the trading of securities through the SRO or its facilities.³ In particular, the Release states that rules eligible for immediate effectiveness would include rules: extending the close of trading; affecting the crossing of orders or the priority of orders; mandating executions of orders up to a particular size at the displayed bid or offer; affecting the operation of certain small order execution systems; suspending firm quotes in fast markets; or requiring the dissemination of an inferior quote whenever the market maker fails to execute the full size of an incoming order. The Release notes that the definition of trading rule would not include rules governing membership, member regulation, discipline, arbitration, or financial responsibility (such as margin, net capital, and recordkeeping) as well as rules affecting customer communications or suitability and rules affecting listing standards or corporate governance.

Other Proposed Changes

The SEC is proposing to allow SROs to file proposed rule changes with the SEC electronically, as opposed to the current paper filing requirement, provided they promptly file paper copies thereafter, one of which must be manually signed. In addition, the Release states that the SEC is considering issuing abbreviated approval orders for proposed rule changes filed under the regular notice and comment period process if a proposal raises no significant issues and the SEC does not receive any comment letters. Specifically, an abbreviated approval order would cite the relevant statutory provisions, but would not include a detailed analysis. Request for

Comment The Release specifically requests comment on certain aspects of the proposed rule. In particular, the SEC requests comment on whether: (1) the definition of a trading rule is appropriate; (2) proposed rule changes that are considered non-controversial or that govern trading rules should become operative immediately or should the operative date be suspended for 60 days to allow the SEC to abrogate those proposed rule changes without disrupting the operation of the SROs; and (3) there are other types of proposed rule changes the SEC should consider making eligible for immediate effectiveness. The SEC specifically used rule changes involving listing standards, new products, or position limits as examples of rules that the SEC would consider making eligible for immediate effectiveness. Ari Burstein Associate Counsel Attachment 3 The definition of trading rules includes, among other things, rules governing: use of or access to an order entry, routing, or execution system; display of quotations; market maker activities; trading units; order types; priority of orders, bids, and offers (but not handling of customer orders, including limit orders); fast markets; trading hours; disagreements on executions; obligations of specialists to maintain fair and orderly markets; special offerings; activities of floor brokers; and trading activities of specialists and lead market makers. 4Attachment (in .pdf format)

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