

address those concerns to the Commission's satisfaction, including convening a special subcommittee on PMM issues, proposing two different sets of PMM standards, and being continuously available and responsive to Commission staff to discuss this issue. Despite these efforts, the Commission and Nasdaq have been unable to establish satisfactory PMM standards. Nasdaq believes that reinstating the PMM standards set forth in NASD Rule 4612 would be extremely disruptive to the market and harmful to investors.

Nasdaq also notes that the Commission has signaled to the securities industry that it is considering fundamental changes to Rule 10a-1 of the Exchange Act that could impact the manner in which Nasdaq and the other markets regulate short sales. On October 20, 1999, the Commission issued a Concept Release on Short Sales in which it sought comment on, among other things, revising the definition of short sale, extending short sale regulation to non-exchange listed securities, and eliminating short sale regulation altogether.²⁰ Nasdaq believes it would be inappropriate for Nasdaq to alter its regulation of short sales while the Commission is considering changing Rule 10a-1.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 10, including whether the proposed Amendment is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 File No. SR-NASD-98-26 and should be submitted by July 30, 2001.

²⁰ See Securities Exchange Act Release No. 42037 (October 20, 1999), 64 FR 57996 (October 28, 1999).

IV. Commission's Findings and Order Granting Accelerated Approval of the Amendment

After careful consideration, the Commission finds, for the reasons set forth below, that the extension of the Short Sale Rule pilot and the suspension of the existing PMM standards until March 1, 2002 is consistent with the requirements of the Act and the rules and regulations thereunder. In particular, the extension is consistent with section 15A(b)(6)²¹ of the Act, which requires that the NASD's rules be designed, among other things, to remove impediments to and perfect the mechanism of a free and open market and a national market system and to promote just and equitable principles of trade.

The Commission finds that continuation of the Short Sale Rule pilot and the continued suspension of the current PMM standards will maintain the status quo while the Commission is considering amending Rule 10a-1 under the Exchange Act. However, this extension of the pilot and continued suspension of the current PMM standards is subject to modification or revocation should the Commission amend Rule 10a-1 in such a manner as to deem the extension or suspension unnecessary or in conflict with any adopted amendments.²²

The Commission finds good cause for approving the extension of the Short Sale Rule pilot and the suspension of existing PMM standards prior to the 30th day after the date of publication of notice of the filing in the **Federal Register**. It could be disruptive to the Nasdaq market and confusing to market participants to reintroduce the previous PMM standards while new PMM standards are being developed, and while the Commission is considering amending Rule 10a-1 under the Exchange Act.

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,²³ that Amendment No. 10 to the proposed rule change, SR-NASD-98-26, which extends the NASD Short Sale Rule pilot and the suspension of the current PMM standards to March 1, 2002, is approved on an accelerated basis.²⁴

²¹ 15 U.S.C. 78o-3(b)(6).

²² Absent an exemption, Rule 10a-1 of the Exchange Act would apply to Nasdaq upon Commission approval of their exchange registration.

²³ 15 U.S.C. 78s(b)(2).

²⁴ In approving Amendment No. 10, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁵

Jonathan G. Katz,
Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44499; File No. SR-NASD-2001-14]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. To Modify Certain Initial and Continued Listing Standards on Nasdaq

June 29, 2001.

I. Introduction

On March 8, 2001, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4² thereunder, a proposal to modify certain initial and continued listing standards on Nasdaq. Nasdaq also requested that the Commission grant accelerated approval for a pilot program that would give certain of the proposed new listing standards immediate effectiveness. On April 26, 2001, Nasdaq submitted Amendment No. 1 to the proposal.³ On May 1, 2001, the Commission published notice of the proposal in the **Federal Register** and approved the proposed pilot program on an accelerated basis.⁴ The Commission received one comment on the proposal. This order approves the proposed rule change and Amendment No. 1.

II. Description of the Proposal

Nasdaq proposed to amend NASD Rules 4200, 4310, 4320, 4420, and 4450 and thereby to modify certain quantitative initial and continued listing

²⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Sara Nelson Bloom, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission (April 25, 2001). In Amendment No. 1, Nasdaq provided a chart that clarifies the proposed schedule for implementing the new listing standards and made certain technical corrections to the proposal.

⁴ See Securities Exchange Act Release No. 44243 (May 1, 2001), 66 FR 23285 (May 8, 2001).

standards on Nasdaq. These amendments would: (1) Replace the net tangible assets standard with an equity standard; (2) require that currently trading issuers applying for initial listing under the market capitalization alternative demonstrate 90 days of sustained compliance with the bid price and market capitalization requirements before they are eligible to apply to become listed; (3) clarify that Nasdaq will exclude extraordinary or non-recurring items for purposes of determining compliance with the income standard; and (4) adjust the bid price requirement associated with continued listing on the Nasdaq National Market under the market capitalization standard from \$5 to \$3. Nasdaq stated that these changes were designed to have minimal impact on issuers in the marketplace while providing greater transparency and consistency.

The Equity Standard

Companies may qualify for initial or continued inclusion on the Nasdaq National Market or the Nasdaq SmallCap Market based, in part, on their net tangible assets. Net tangible assets are defined as total assets less total liabilities less goodwill. Nasdaq proposed to replace the net tangible assets standard with an equity standard for several reasons. First, Nasdaq stated that the equity standard is more transparent to investors, as it is reflected in issuer financial statements, as opposed to the net tangible assets standard which must be manually calculated. Nasdaq concluded that, for this reason, the equity standard would also provide a better framework for complimentary standards in Nasdaq's developing international markets. Second, Nasdaq asserted that the change would respond to recent accounting developments which may tend to require an increase in the booking of goodwill. Finally, Nasdaq stated that the use of an equity standard is consistent with listing standards on the New York Stock Exchange ("NYSE") and the American Stock Exchange ("Amex").⁵

With respect to the Nasdaq National Market, the \$6 million net tangible assets requirement for initial listing under Entry Standard 1 (for companies with pre-tax income of at least \$1 million in the latest fiscal year or two of the last three years) would be changed to a \$15 million stockholders' equity requirement, and the \$18 million

net tangible assets requirement under Entry Standard 2 (for companies without the above-referenced pre-tax income) would be changed to \$30 million in stockholders' equity. In addition, the \$4 million net tangible assets continued listing requirement would be changed to \$10 million in stockholders' equity. With respect to the SmallCap Market, the \$4 million net tangible assets initial inclusion requirement would be changed to \$5 million in stockholders' equity, and the \$2 million net tangible assets continued inclusion requirement would be changed to \$2.5 million in stockholders' equity.

Seasoning Period for Applicants Relying on the Market Capitalization Standard

Companies may qualify for listing on Nasdaq based, in part, on their market capitalization. The market capitalization listing standards were originally adopted in 1997 to permit the inclusion of certain financially sound issuers that could not qualify under the net tangible assets requirement as a result of accounting conventions such as the booking of goodwill associated with various merger and acquisition activities or significant depreciation charges.⁶ These standards permit an issuer to list with a bid price of \$5 and a market capitalization of \$75 million (in the case of the Nasdaq National Market) or a bid price of \$4 and a market capitalization of \$50 million (in the case of the Nasdaq SmallCap Market).

Since the adoption of the rule, Nasdaq has noted certain instances where publicly traded companies (including companies quoted on the OTC Bulletin Board) have applied to list on Nasdaq based on the market capitalization listing standards. In these circumstances, companies may be able to evidence compliance based on short-term price reaction to favorable news, which price increase may not be sustainable over the long term. Accordingly, Nasdaq proposed a "seasoning" period of 90 days for currently traded issuers, such that an issuer must maintain the required bid price and market capitalization for that period prior to applying for listing. Nasdaq believes that this seasoning period, especially when coupled with the time necessary to review and process any such application, would provide assurances that a company would be unable to secure a Nasdaq listing based on an unsustainable, short-term run-up in its stock price.

Extraordinary and Non-Recurring Income Items

The income standards for the Nasdaq Stock Market currently make no provision for the exclusion of extraordinary or non-recurring items when assessing an issuer's compliance with the income requirements for listing on Nasdaq. However, Nasdaq believes that it is appropriate to exclude extraordinary and non-recurring income items because they do not provide a continuing benchmark of the issuer's financial performance. Accordingly, Nasdaq proposed that the National Market and SmallCap Market rules relating to the income standards be amended to indicate that the income determination will exclude extraordinary and non-recurring items.

Bid Price Standard for Issuers Qualifying Under the Market Capitalization Standard

Issuers that seek to qualify for the Nasdaq National Market pursuant to the market capitalization alternative⁷ must demonstrate a \$5 bid price for both initial and continued inclusion. Nasdaq proposed to adjust the continued inclusion standard, applicable to Nasdaq National Market companies qualifying under the market capitalization standard, from \$5 to \$3. This would harmonize this standard with other standards by providing a differential between the initial inclusion and continued inclusion requirements.

Implementation

To minimize disruption to existing issuers and to allow adequate time for necessary corporate action to comply with the stockholders' equity standard, Nasdaq proposed to provide its issuers with 18 months following Commission approval of the proposed pilot to come into compliance with the new standard. During this time, issuers that do not meet the new stockholders' equity standard could qualify for continued listing under the net tangible assets standard.

Similarly, for issuers that applied for listing prior to the effective date of the rule, Nasdaq proposed that they continue to be able to qualify for listing under the listing standards in force at the time of their application for a period of 90 days from the effective date of the proposed rule change, and thereafter receive the same grace periods provided to current issuers to come into compliance with the new equity test. Alternatively, such issuers may qualify for listing under the new stockholders' equity test for initial inclusion.

⁵ See NYSE Rules 102 and 103 (initial listing standards), 802 (continued listing standards); Amex Listing Rules 102 (initial listing standards) and 1003 (continued listing standards).

⁶ See Securities Exchange Act Release No. 38961 (August 22, 1997), 62 FR 45895 (August 29, 1997) (approving SR-NASD-97-16).

⁷ See NASD Rules 4420(c) and 4450(j).

In addition, Nasdaq proposed a pilot program that would allow issuers that meet the new original listing and maintenance standards but not the old standards to remain listed on Nasdaq for a short period while the Commission considers the overall proposal. The pilot program was designed to ensure that issuers that meet the new standards but not the existing standards are not delisted before the Commission takes final action on the proposed rule change. The standards included in the pilot are: (1) The new bid price requirement found in NASD Rule 4450(b)(4); and (2) the new equity standard, which replaces the old net tangible assets standard, found in NASD Rules 4310(c)(2)(A)(i), 4310(c)(2)(B)(i), 4320(e)(2)(A)(i), 4320(e)(2)(B)(i), 4420(a)(5), 4420(b)(1), and 4450(a)(3). Nasdaq proposed that the pilot program would expire on July 1, 2001, or such earlier time as the Commission takes action on the overall proposal. The Commission approved the pilot program on an accelerated basis on May 1, 2001.⁸

III. Comment Received

The Commission received one comment on the proposal, from Princeton Video Image, Inc. ("PVI").⁹ PVI agreed with Nasdaq that shifting from a net tangible assets standard to a stockholders' equity standard was an improvement, in that it would be more transparent to investors. PVI asserted, however, that Nasdaq had provided no justification for the simultaneous 150% increase in the dollar threshold for the test. PVI also noted that the proposed rule change would force many companies to raise capital that they do not otherwise need for operations or investment. PVI concluded that the rule would unfairly and unnecessarily dilute shareholders' interests, particularly in companies that have sufficient net tangible assets under the existing standard to meet operating requirements but do not yet generate positive earnings due to revenue recognition requirements or amortization of non-cash charges.

In response to PVI's comment, Nasdaq responded that, since the net tangible assets standard excludes certain intangible assets that are included in equity such as goodwill, it believes that a higher equity requirement is necessary in order to maintain its listing standard at the existing level.¹⁰ An impact

analysis conducted by Nasdaq at the end of April 2001 showed that less than 2% of the compliant National Market companies and approximately 3% of the compliant SmallCap companies would not be able to meet the new equity standard. To allow these issuers a sufficient opportunity to come into compliance with the new equity requirement, Nasdaq proposed that the new standard would not be implemented until 18 months after the pilot program is approved by the Commission.

IV. Discussion

After considering the comment submitted by PVI and Nasdaq's response thereto, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the regulations thereunder applicable to the NASD.¹¹ In particular, the Commission believes that the proposal is consistent with Section 15A(b)(6) of the Act.¹² Section 15A(b)(6) requires, among other things, that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest.

With respect to Nasdaq's proposal to move from a net tangible assets standard to a stockholders' equity standard as part of its listing requirements, the Commission notes that it previously approved a proposal by the NYSE to institute market capitalization and stockholders' equity requirements.¹³ In that case, the Commission stated that the amount of stockholders' equity is not an inappropriate measure of a company's suitability for listing on an exchange.¹⁴ Accordingly, the Commission finds that it is reasonable and consistent with the Act to allow Nasdaq to implement a stockholders' equity standard, and that the required minimum thresholds selected by Nasdaq for this standard are reasonable. Relying on Nasdaq's response to the PVI comment, the Commission believes that only a small number of issuers might be

adversely affected by the transition from a net tangible assets standard to a stockholders' equity standard, and that the 18-month transition period should provide such issuers with a reasonable amount of time to conform to the new standards.

With respect to Nasdaq's proposal to lower the bid price requirement in Maintenance Standard 2 of NASD Rule 4450 from \$5 to \$3, the Commission notes that the bid price requirement for initial listing will remain \$5.¹⁵ Nasdaq's listing rules generally establish a higher initial threshold for most criteria and a somewhat lower continued requirement to allow for market fluctuations.¹⁶ Establishing a new bid price requirement of \$3 for continued listing will make this standard similar to other existing standards that allow issuers to comply with maintenance requirements that are more flexible than the original listing requirements. Accordingly, the Commission finds that it is reasonable and consistent with the Act to approve this aspect of the proposal.

With respect to the proposed "seasoning period," the Commission notes that applicants for listing may be able to evidence compliance based on a short-term price increase that may not be sustainable over the long term. The seasoning period will assure potential investors that the issuer's compliance with the market capitalization standard was not based on an unsustainable, short-term run-up in its stock price. Therefore, the Commission finds that this aspect of the proposal will protect investors and promote just and equitable principles of trade.¹⁷

The Commission also finds that it is appropriate and consistent with the Act for Nasdaq to exclude extraordinary and non-recurring income items when assessing an issuer's compliance with the listing standards, because financial statements that include such items do not provide a continuing benchmark of an issuer's financial performance. The Commission believes that excluding such items will allow prospective investors to more accurately assess the

¹⁵ See NASD Rules 4420(a)(5), 4420(b)(4), and 4420(c)(3).

¹⁶ Compare NASD Rule 4420 (giving issuers of Nasdaq National Market securities the option of meeting one of three entry standards which include requirements that the market value of publicly held shares be at least \$8 million, \$18 million, or \$20 million, respectively) with NASD Rule 4450 (giving issuers of Nasdaq National Market securities the option of meeting one of two maintenance standards which include requirements that the market value of public held shares be at least \$5 million or \$15 million, respectively).

¹⁷ However, Nasdaq has stated that this requirement would not apply to an issuer listing as part of its initial public offering, because the same concerns do not exist.

⁸ See Securities Exchange Act Release No. 44243 (May 1, 2001), 66 FR 23285 (May 8, 2001).

⁹ See Letter from Lawrence L. Epstein, Vice President and Chief Financial Officer, PVI, to Secretary, Commission, dated June 15, 2001.

¹⁰ See Email from John D. Nachmann, Senior Attorney, Nasdaq, to Michael Gaw, Special Counsel,

Division of Market Regulation, Commission, dated June 29, 2001.

¹¹ In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78o-3(b)(6).

¹³ See Securities Exchange Act Release No. 42194 (December 1, 1999), 64 FR 69311 (December 10, 1999) (approving SR-NYSE-99-29).

¹⁴ See *id.*, 64 FR 69314.

financial health of companies listed on Nasdaq in which they might invest.

Finally, Nasdaq proposed a transition period following the Commission's final action on the overall proposal that would allow issuers to rely on certain of the old listing standards for a limited period of time, rather than require them to come into immediate compliance with the new standards.¹⁸ The Commission notes that certain issuers who may reasonably have relied on Nasdaq's prior listing standards to obtain or maintain listing might not be able to obtain or maintain listing if immediate compliance with the new standards were required. Therefore, the Commission finds that it is reasonable and consistent with the Act to allow issuers a short period of time during which they may obtain or maintain listing on Nasdaq pursuant to either the old or the new listing standards.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-NASD-2001-14) and Amendment No. 1 thereto are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Jonathan G. Katz,
Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44498; File No. SR-OCC-2001-06]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change by The Options Clearing Corporation Relating to Clearing Member Qualifications

June 29, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,¹ notice is hereby given that on June 26, 2001, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission the proposed rule change as described in Items I and II, below, which Items have been prepared by OCC. The Commission is publishing this notice and order to solicit comments on the proposed rule

change from interested persons and to grant accelerated approval.

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

The proposed rule change will eliminate from Article V, Section 1 of OCC's by-laws the requirement that applicants for membership in OCC "propose to engage upon acceptance in the clearance of options transactions for the applicant's firm account or for the accounts of customers."

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

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.²

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

OCC wishes to delete from Article V, Section 1 of its by-laws the requirement that applicants for OCC membership "propose to engage upon acceptance in the clearance of options transactions for the applicant's firm account or for the accounts of customers." OCC's by-laws currently contain a membership category designated as "Hedge Clearing Member" for clearing members who want to participate in OCC's stock loan/hedge program.³ OCC has always intended to allow this membership category to be available to firms wanting to participate in this program that do not plan to clear options transactions but meet all other OCC membership criteria. However, OCC overlooked the requirement in Article V, Section 1 when filing the stock loan/hedge program rule changes.⁴

OCC believes that deleting the requirement that members engage in the clearance of options transactions will

allow broader participation in the stock loan/hedge program because many firms engaged in the stock loan business do not conduct an options business. Deleting this requirement will also allow OCC to admit firms that intend to clear security futures but not security options.⁵

OCC believes that the proposed rule change is consistent with Section 17A of the Act because it fosters cooperation and coordination with persons engaged in the clearance and settlement of securities transactions and removes impediments to and perfects the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.

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

OCC believes that the proposed rule change will not impose any burden on competition.

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

OCC did not solicit or receive written comments with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Section 17A(b)(3)(F) of the Act⁶ requires that the rules of a clearing agency be designed to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible. The Commission finds that the proposed rule change is consistent with OCC's obligations under Section 17A of the Act. Under the proposal, OCC will continue to employ its monitoring and risk reduction procedures, which were subject to prior Commission review and approval, with respect to members that participate in the stock loan/hedge program but do not clear options transactions. Furthermore, the rule change will allow OCC to admit additional applicants to participate in its stock loan/hedge program. This should help to perfect the mechanism of a national system for the prompt and

¹⁸ See 66 FT at 23288 (table showing transition stages).

¹⁹ *Id.*

²⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² The Commission has modified the text of the summaries prepared by OCC.

³ Under the stock/loan hedge program, OCC administers stock loan and borrow transactions between participating clearing members and allows certain stock loan and borrow positions resulting from such transactions to constitute hedges against stock option positions overlying the same stocks for purposes of OCC's margin calculation.

⁴ See Securities Exchange Act Release No. 40083 (June 11, 1998), 63 FR 33424 (June 18, 1998); Securities Exchange Act Release No. 32638 (July 15, 1993), 58 FR 39264 (July 22, 1993).

⁵ OCC will not admit to membership any applicant that is seeking to clear only security futures until its rules for the clearance and settlement of security futures have been approved by the Commission.

⁶ 15 U.S.C. 78q-1(b)(3)(F).