



THE NASDAQ STOCK MARKET, INC.  
1801 K STREET, NW  
WASHINGTON, DC 20006

January 15, 2003

**By Hand**

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

**RE: SR-NASD-2002-139 – Amendment 1**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith is Amendment 1 to the above-numbered rule filing. This amendment replaces in its entirety the original rule proposal filed October 9, 2002. I am also enclosing a 3-1/2" disk containing the rule filing in Word 7.0 to facilitate production of the Federal Register notice.

If you have any questions, please contact Eleni Constantine, Office of General Counsel, The Nasdaq Stock Market, Inc., at (202) 912-3042. The fax number of the Office of General Counsel is (202) 912-3199.

Very truly yours,

Mary M. Dunbar  
Vice President and  
Deputy General Counsel

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C.

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Form 19b-4

Proposed Rule Change

by

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

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

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> the National Association of Securities Dealers, Inc. (“NASD”), through its subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”), is filing with the Securities and Exchange Commission (“Commission”) a proposed rule change to Rule 4350 to require listed companies to adopt a code of conduct for all directors, officers and employees, as described below. Nasdaq plans to implement the rule effective six months after approval. The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in brackets.

**4350. Qualitative Listing Requirements for Nasdaq National Market and Nasdaq Small Cap Market Issuers Except for Limited Partnerships traded on the Nasdaq National Market**

(a) – (l) No change.

(m) Each Issuer shall adopt a code of conduct applicable to all directors, officers and employees, which shall be publicly available. A code of conduct satisfying this rule must comply with the definition of a “code of ethics” set out in Section 406(c) of the Sarbanes – Oxley Act of 2002 (“the Sarbanes-Oxley Act”) and any regulations promulgated thereunder by the Commission. In addition, the code must provide for an enforcement mechanism. Any waivers of the code for directors or executive officers must be approved by the Board and must be disclosed in the issuer’s public filings, not later than the next periodic report.

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

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

**IM-4350-7:**

Ethical behavior is required and expected of every corporate director, officer and employee whether or not a formal code of conduct exists. The requirement of a publicly available code of conduct applicable to all directors, officers and employees of an issuer is intended to demonstrate to investors that the board and management of Nasdaq issuers have carefully considered the requirement of ethical dealing and have put in place a system to ensure that they become aware of and take prompt action against any questionable behavior. For company personnel, a code of conduct with enforcement provisions provides assurance that reporting of questionable behavior is protected and encouraged, and fosters an atmosphere of self-awareness and prudent conduct.

Rule 4350(m) requires issuers to adopt a code of conduct complying with the definition of a "code of ethics" under Section 406(c) of the Sarbanes-Oxley Act of 2002 ("the Sarbanes-Oxley Act") and any regulations promulgated thereunder by the Commission. Thus, the code must include such standards as are reasonably necessary to promote the ethical handling of conflicts of interest, full and fair disclosure, and compliance with laws, rules and regulations, as specified by the Sarbanes-Oxley Act. However, the code of conduct required by Rule 4350(m) must apply to all directors, officers, and employees. Issuers can satisfy this obligation by adopting one or more codes of conduct, such that all directors, officers and employees are subject to a code that satisfies the definition of a "code of ethics."

As the Sarbanes-Oxley Act recognizes, investors are harmed when the real or perceived private interest of a director, officer or employee is in conflict with the interests of the company, as when the individual receives improper personal benefits as a result of his or her position with the company, or when the individual has other duties, responsibilities or obligations that run counter to his or her duty to the company. Also, the disclosures an issuer makes to the Commission are the essential source of information about the company for regulators and investors – there can be no question about the duty to make them fairly, accurately and timely. Finally, illegal action must be dealt with swiftly and the violators reported to the appropriate authorities.

Each code of conduct must require that any waiver of the code for executive officers or directors may be made only by the board and must be promptly disclosed to shareholders, along with the reasons for the waiver. This disclosure requirement provides investors the comfort that waivers are not granted except where they are truly necessary and warranted, and that they are limited and qualified so as to protect the company to the greatest extent possible. Disclosure should be made in the issuer's public filings, not later than the next periodic report. Thus, a domestic issuer must make this disclosure in its next quarterly or annual report, whichever is sooner, and foreign issuers must make it in their next semi-annual report. An issuer may alternatively choose to include this disclosure in an 8-K filed before its next periodic report.

Each code of conduct must also contain an enforcement mechanism that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations.

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2. Procedures of the Self-Regulatory Organization

The Board of Directors of Nasdaq (“Nasdaq Board”) approved the proposed rule change unanimous written consent on November 14, 2002, and the NASD Board had an opportunity to review it on December 9, 2002. The staff of Nasdaq has provided an opportunity for the staff of NASD Regulation, Inc. to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries. No other action by the NASD is necessary for the filing of the rule change.

Issuers will be required to comply with this rule as of six months from the date of approval.

Questions regarding this rule filing may be directed to Eleni Constantine, Associate General Counsel, The Nasdaq Stock Market, Inc. at (202) 912-3042 or (202) 912-3199 (fax).

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

a. Purpose

The proposed rule change requires companies to adopt and make publicly available a code of conduct applicable to directors, officers, and employees, which complies with the definition of a “code of ethics” set out in Section 406(c) of the

Sarbanes-Oxley Act and any regulations promulgated by the SEC thereunder, and provides for an enforcement mechanism. Any waivers of the code for directors or executive officers must be approved by the board and must be promptly made publicly available. By expressly setting out the inherent obligation of ethical conduct in this manner, Nasdaq intends to provide further assurance to investors, regulators and itself that each of its issuers has in place a system to focus attention throughout the company on the obligation of ethical conduct, encourage reporting of potential violations, and deal fairly and promptly with questionable behavior. A code of conduct provides objective standards for compliance, increasing transparency and accountability in this key area.

b. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>3</sup> in general and with Section 15A(b)(6) of the Act,<sup>4</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

<sup>4</sup> 15 U.S.C. 78o-3(6).

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

Written comments were not solicited. Nasdaq received one comment, stating that requiring a code of conduct applicable to all employees would be extremely burdensome for companies with large numbers of hourly employees and that such employees were unlikely to be faced with ethical issues. We believe that the rule filing as amended addresses this concern by clarifying that companies have the flexibility to design more than one code of conduct, such that there is an appropriate code for various types of employees. Thus, a company could adopt a simpler code for its hourly employees than for its senior management in recognition of the fewer ethical issues typically facing hourly employees.

6. Extension of Time Period for Commission Action

Nasdaq consents to an extension of the time periods specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

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

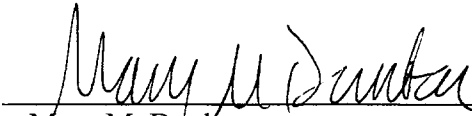
Not applicable.

9. Exhibits

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

Pursuant to the requirements of the Securities Exchange Act of 1934, Nasdaq has caused this filing to be signed by the duly authorized undersigned.

THE NASDAQ STOCK MARKET, INC.

BY: 

Mary M. Dunbar  
Vice President and  
Deputy General Counsel

Date: January 14, 2003

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. SR-NASD-2002-139)

January \_\_, 2003

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. to Rule 4350 to Require Listed Companies to Adopt a Code of Conduct For All Directors, Officers and Employees

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 October 9, 2002, the National Association of Securities Dealers, Inc. (“NASD”), through its subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”), filed with the Securities and Exchange Commission (“Commission”), and amended on January 15, 2003<sup>3</sup> the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Nasdaq proposes to amend Rule 4350 to require listed companies to adopt a code of conduct for all directors, officers and employees. Issuers must comply with the rule as of six months from the date of approval.

The text of the proposed rule change is below. Proposed new language is in italics; proposed deletions are in brackets.

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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> Amendment No. 1 to SR-NASD-2002-139 replaced and superceded the original rule filing.

**4350. Qualitative Listing Requirements for Nasdaq National Market and Nasdaq Small Cap Market Issuers Except for Limited Partnerships traded on the Nasdaq National Market**

(b) – (l) No change.

(m) Each Issuer shall adopt a code of conduct applicable to all directors, officers and employees, which shall be publicly available. A code of conduct satisfying this rule must comply with the definition of a “code of ethics” set out in Section 406(c) of the Sarbanes –Oxley Act of 2002 (“the Sarbanes-Oxley Act”) and any regulations promulgated thereunder by the Commission. In addition, the code must provide for an enforcement mechanism. Any waivers of the code for directors or executive officers must be approved by the Board and must be disclosed in the issuer’s public filings, not later than the next periodic report.

**IM-4350-7:**

Ethical behavior is required and expected of every corporate director, officer and employee whether or not a formal code of conduct exists. The requirement of a publicly available code of conduct applicable to all directors, officers and employees of an issuer is intended to demonstrate to investors that the board and management of Nasdaq issuers have carefully considered the requirement of ethical dealing and have put in place a system to ensure that they become aware of and take prompt action against any questionable behavior. For company personnel, a code of conduct with enforcement provisions provides assurance that reporting of questionable behavior is protected and encouraged, and fosters an atmosphere of self-awareness and prudent conduct.

Rule 4350(m) requires issuers to adopt a code of conduct complying with the definition of a “code of ethics” under Section 406(c) of the Sarbanes-Oxley Act of 2002 (“the Sarbanes-Oxley Act”) and any regulations promulgated thereunder by the Commission. Thus, the code must include such standards as are reasonably necessary to promote the ethical handling of conflicts of interest, full and fair disclosure, and compliance with laws, rules and regulations, as specified by the Sarbanes-Oxley Act. However, the code of conduct required by Rule 4350(m) must apply to all directors, officers, and employees. Issuers can satisfy this obligation by adopting one or more codes of conduct, such that all directors, officers and employees are subject to a code that satisfies the definition of a "code of ethics."

As the Sarbanes-Oxley Act recognizes, investors are harmed when the real or perceived private interest of a director, officer or employee is in conflict with the interests of the company, as when the individual receives improper personal benefits as a result of his or her position with the company, or when the individual has other duties, responsibilities or obligations that run counter to his or her duty to the company. Also, the disclosures an issuer makes to the Commission are the essential source of information about the company for regulators and investors – there can be no question about the duty to make them fairly, accurately and timely. Finally, illegal action must be dealt with swiftly and the violators reported to the appropriate authorities.

Each code of conduct must require that any waiver of the code for executive officers or directors may be made only by the board and must be promptly disclosed to shareholders, along with the reasons for the waiver. This disclosure requirement provides investors the comfort that waivers are not granted except where they are truly necessary and warranted, and that they are limited and qualified so as to protect the company to the greatest extent possible. Disclosure should be made in the issuer's regular public filings, not later than the next periodic report. Thus, a domestic issuer must make this disclosure in its next quarterly or annual report, whichever is sooner, and foreign issuers must make it in their next semi-annual report. An issuer may alternatively choose to include this disclosure in an 8-K filed before its next periodic report.

Each code of conduct must also contain an enforcement mechanism that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations.

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

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at

the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The proposed rule change requires companies to adopt and make publicly available a code of conduct applicable to directors, officers, and employees, which complies with the definition of a "code of ethics" set out in Section 406(c) of the Sarbanes-Oxley Act and any regulations promulgated by the SEC thereunder, and provides for an enforcement mechanism. Any waivers of the code for directors or executive officers must be approved by the board and must be promptly made publicly available. By expressly setting out the inherent obligation of ethical conduct in this manner, Nasdaq intends to provide further assurance to investors, regulators and itself that each of its issuers has in place a system to focus attention throughout the company on the obligation of ethical conduct, encourage reporting of potential violations, and deal fairly and promptly with questionable behavior. A code of conduct provides objective standards for compliance, increasing transparency and accountability in this key area.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>4</sup> in general and with Section 15A(b)(6) of the Act,<sup>5</sup> in particular,

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<sup>4</sup> 15 U.S.C. 78o-3.

in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were not solicited. Nasdaq received one comment, stating that requiring a code of conduct applicable to all employees would be extremely burdensome for companies with large numbers of hourly employees and that such employees were unlikely to be faced with ethical issues. We believe that the rule filing as amended addresses this concern by clarifying that companies have the flexibility to design more than one code of conduct, such that there is an appropriate code for various types of employees. Thus, a company could adopt a simpler code for its hourly employees than for its senior management in recognition of the fewer ethical issues typically facing hourly employees.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date

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<sup>5</sup> 15 U.S.C. 78o-3(6).

if it finds such longer period to be appropriate and publishes its reasons for so finding or

(ii) as to which the self-regulatory organization consents, the Commission will:

A. by order approve such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. 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. 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 number SR-NASD-2002-139 and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

Margaret H. McFarland  
Deputy Secretary

Action as set forth or recommended herein  
APPROVED pursuant to authority delegated by  
the Commission under Public Law 87-592.

For the Division of Market Regulation

by: \_\_\_\_\_  
(DATE)

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<sup>6</sup> 17 CFR 200.30-3(a)(12).