

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44609; File No. SR-NASD-2001-37]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Clarifying the Extent of Nasdaq's Authority To Halt Trading in a Security in Response to Extraordinary Market Activity

July 27, 2001.

#### I. Introduction

On May 11, 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 ("Commission"), 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> a proposed rule change to clarify the extent of Nasdaq's authority to halt trading in a security in response to extraordinary market activity that Nasdaq believes may be caused by the misuse or malfunction of an electronic system that is operated by, or linked to, Nasdaq. Notice of the proposed rule change appeared in the **Federal Register** on May 22, 2001.<sup>3</sup> Nasdaq submitted an amendment to the proposed rule change on July 27, 2001.<sup>4</sup> The Commission received no comments on the proposed rule change. This order approves the proposed rule change, as amended, on a pilot basis through October 27, 2001.

#### II. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the proposed Amendment No. 1, including whether the proposed rule change, as amended, 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-2001-37 and should be submitted by August 24, 2001.

#### III. Discussion and Commission Findings

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association<sup>5</sup> and, in particular, the requirements of Section 15A of the Act<sup>6</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with Section 15A(b)(6) of the Act<sup>7</sup> because it will provide Nasdaq with clearer authority to respond to and alleviate market disruptions and thereby protect investors and the public interest.

The Commission finds good cause for accelerating approval of Amendment No. 1 to the proposed rule change prior to the thirtieth day after publication in the **Federal Register**. The Commission notes that Amendment No. 1 makes no substantive changes, but merely requests that the Commission approve the proposed rule change on a three month pilot basis. Accordingly, the Commission finds that good cause exists, consistent with Sections 15A(b)(6) of the Act,<sup>8</sup> and Section 19(b) of the Act<sup>9</sup> to accelerate approval of Amendment No. 1 to the proposed rule change.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act<sup>10</sup>, that the proposed rule change (SR-NASD-2001-37), as amended, be, and it hereby is, approved on a pilot basis through October 27, 2001.

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

<sup>7</sup> 15 U.S.C. 78o-3(b)(6).

<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

<sup>9</sup> 15 U.S.C. 78s(b).

<sup>10</sup> 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 01-19435 Filed 8-2-01; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44616; File No. SR-NYSE-2001-08]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 to the Proposed Rule Change by the New York Stock Exchange, Inc. Amending Its Rules To Provide for the Trading of Exchange-Traded Funds on an Unlisted Trading Privileges Basis

July 30, 2001.

#### I. Introduction

On April 25, 2001, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), 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> a proposed rule change to amend certain NYSE rules and policies to accommodate the trading of certain exchange-traded funds ("ETFs") on an unlisted trading privileges ("UTP") basis. On May 22, 2001, the NYSE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change and Amendment No. 1 were published in the **Federal Register** on June 5, 2001.<sup>4</sup> No comments were received on the proposal, as amended. On July 18, 2001, the NYSE filed Amendment No. 2 to the proposed rule change.<sup>5</sup> On July 27, 2001, the NYSE filed Amendment No. 3 to the proposed rule change.<sup>6</sup> This order

<sup>11</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 21, 2001 ("Amendment No. 1"). In Amendment No. 1, the NYSE amended the proposed rule text to reflect the correct wording of current NYSE Rule 36.

<sup>4</sup> See Securities Exchange Act Release No. 44352 (May 25, 2001), 66 FR 30256 ("Notice").

<sup>5</sup> See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Nancy Sanow, Assistant Director, Division, Commission, dated July 18, 2001 ("Amendment No. 2"). The NYSE withdrew Amendment No. 2 on July 27, 2001.

<sup>6</sup> See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Nancy Sanow,

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

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

<sup>3</sup> See Securities Exchange Act Release No. 44307 (May 15, 2001), 65 FR 28209.

<sup>4</sup> Letter from Thomas P. Moran, Associate General Counsel, Nasdaq, to Alton Harvey, Division of Market Regulation, dated July 27, 2001 ("Amendment No. 1"). Amendment No. 1 requests the Commission to approve the proposed rule change on a three month pilot basis expiring on October 27, 2001.

approves the proposed rule change, as amended. The Commission also seeks comment on Amendment no. 3 from interested persons.

## II. Description of the Proposed Rule Change

The NYSE proposes to amend its rules and policies to accommodate the listing and trading ETFs on a UTP basis. These ETFs may include the NASDAQ 100 Trust (symbol QQQ), Standard and Poor's Depository Receipts (symbol SPY) and the Dow Industrials DIAMONDS (symbol DIA).

The NYSE proposes to amend the following NYSE rules and policies: NYSE Rule 98, NYSE Rule 36, paragraph (l) of the Guidelines to NYSE Rule 105, NYSE Rule 13, NYSE Rules 104.20 and 104.21, and the NYSE's Market-On-Close/Limit-At-The-Close and Pre-Opening Price Indications Policies.

### A. NYSE Rule 98

NYSE Rule 98 provides that affiliates of a specialist organization can receive an exemption from certain rules applicable to specialists, provided that they establish a system of information barriers between themselves and the affiliated specialist. One of the conditions for the NYSE Rule 98 exemption is that the specialist organization be capitalized separately and apart from any affiliate. The Exchange is proposing to delete this requirement in the case of a specialist organization that is registered solely in ETFs. However, a specialist organization that is registered only in ETFs will remain subject to the minimum capital requirements specified in NYSE Rule 104.20.

### B. NYSE Rule 105

Currently, Guideline (1) to NYSE Rule 105 prohibits affiliates of specialist units from acting as a primary market maker in the option on a specialty security. The NYSE proposes to permit an affiliate of an NYSE ETF specialist to act in any market making capacity with respect to options on an ETF as long as

Assistant Director, Division, Commission, dated July 27, 2001 ("Amendment No. 3"). In Amendment No. 3, the NYSE withdrew the proposed amendment to NYSE Rule 111; revised the rule text of NYSE Rule 36 to clarify that if an order in a component security of an ETF is executed on the Exchange floor, the order must be in compliance with NYSE Rule 112.20 and Rule 11a2-2(T) under the Act, 17 CFR 240.11a2-2(T), and must be for the purpose of hedging a position in the ETF; and revised its proposed amendment to NYSE Rule 13 to require Floor Official approval in a situation where the bid or offer that would elect a stop or stop limit order is more than 0.10 point away from the last sale and is made for the specialist's dealer account.

NYSE Rule 98 information barriers are established.<sup>7</sup> The Exchange also proposes to permit an affiliate of the ETF specialist to act in a market making capacity, but not as a specialist, in the ETF itself on another market center, as long as NYSE Rule 98 information barriers are established.

### C. NYSE Rules 36.30

NYSE Rule 36.30 governs the establishment of telephone or electronic communications between the Exchange's trading floor and any other location.<sup>8</sup> The Exchange proposes to permit ETF specialists to use communication devices at the post to enter proprietary orders in options<sup>9</sup> and futures on the ETF, on the ETF itself on another market center, or in component securities of the ETF,<sup>10</sup> and would permit the ETF specialist to obtain market information with respect to ETFs options, futures, and component securities.

### D. NYSE Rule 13

NYSE Rule 13 currently provides that stop and stop limit orders in an ETF can be elected by a bid (in the case of an order to buy) or an offer (in the case of an order to sell), provided that the specialist obtains the prior approval of a Floor Governor or two Floor Officials. The Exchange proposes to amend this prior approval requirement for ETFs to require floor official approval only where the bid or offer that would elect a stop or stop limit order is more than 0.10 point away from the last sale and is made for the specialist's dealer account.<sup>11</sup>

### E. NYSE Rules 104.20 and 104.21

The Exchange proposes to amend NYSE Rules 104.20 and 104.21 to

<sup>7</sup> As discussed above, the NYSE proposes to eliminate the separate capital requirement with respect to ETF specialists. See also Securities Exchange Act Release No. 44175 (April 11, 2001), 66 FR 19825 (April 17, 2001).

<sup>8</sup> Currently, NYSE Rule 36.30 allows specialists to have telephone lines to its off-floor office or its clearing firm for the purpose of entering options or futures hedging orders. The specialist also is permitted to transmit such orders through a member on the floor of the options or futures exchange.

<sup>9</sup> Any proprietary order for an option based on an ETF for which the specialist is registered must comply with the requirements of NYSE Rule 105.

<sup>10</sup> See Amendment No. 3, *supra* note 6. Any order in a component security of the ETF that is to be executed on the NYSE floor must be entered and executed in accordance with the principles of Exchange Rule 112.20 and Rule 11a2-2(T) under the Act, 17 CFR 240.11a2-2(T), and must be for the purpose of hedging a position in the ETF.

<sup>11</sup> See Amendment No. 3, *supra* note 6. This amendment parallels the specialist's responsibility to obtain floor official approval under NYSE Rule 123A.40 in situations where the specialist is the party to the electing trade.

provide a capital requirement of \$500,000 per ETF. A specialist registered only in an ETF would be subject to the \$1,000,000 minimum capital requirement of NYSE Rule 104.20.

### F. NYSE's Market-on-Close/Limit-At-The-Close Policy

The Exchange proposes that orders in ETFs will not be subject to the Exchange's Market-on-Close ("MOC")/Limit-At-The-Close ("LOC") policy concerning order entry limitations, cancellation of orders during a regulatory halt, imbalance publications, and any other limitations or procedures with respect to MOC/LOC procedures. A MOC/LOC order in an ETF could be permitted to be entered at any time without regard to the limitations of the Exchange's MOC/LOC policies. In addition, the closing price of an ETF will not be subject to publication of imbalances under the Exchange's MOC/LOC policy. Furthermore, ETFs will trade until 4:15 p.m.<sup>12</sup>

### G. NYSE's Pre-Opening Price Indications Policy

Similarly, the Exchange proposes that its policies regarding mandatory dissemination of pre-opening price indications (other than ITS pre-opening notifications) in the case of significant order imbalances and potentially large price dislocation from the prior close will not apply to ETFs.

The Exchange will inform its members and member organizations of these proposed changes to its policies by publication of an Information Memo.

## III. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>13</sup> In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,<sup>14</sup> which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest. The Commission notes that the

<sup>12</sup> *But see* Securities Exchange Act Release No. 44595 (July 26, 2001), which amended the time of close for ETFs to 4:05 p.m. on the last business day of each month.

<sup>13</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

proposed amendments to NYSE rules and policies are designed to facilitate the introduction of ETFs trading on the Exchange on a UTP basis.

NYSE Rule 98 provides that, as long as certain information barriers are in place between a specialist and its affiliates, the affiliates of a specialist organization can receive an exemption from certain rules applicable to specialist organization that is registered only in the ETFs, the Exchange has proposed to eliminate the requirement for the NYSE Rule 98 exemption that a specialist organization be capitalized separate and apart from any affiliate. The Commission notes that this amendment merely removes the requirement that specialists and their affiliates keep their capital separate and does not diminish the amount of capital required of the ETF specialists will still be required to be adequately capitalized pursuant to NYSE Rule 104. Further, the Exchange will continue to monitor the adequacy of capital of its ETF specialists through its special allocation committee. The Commission also notes that all other NYSE Rule 98 requirements must be satisfied as a condition to an NYSE Rule 98 exemption.

In addition, the Exchange proposes to revise NYSE Rules 104.20 and 104.21 to provide for a capital requirement of \$500,000 per ETF.<sup>15</sup> The Commission finds that the amendments to eliminate the separate capitalization requirement in the limited context noted above and to establish a capital requirement of \$500,000 per ETF are consistent with the Act.

Currently, Guideline (1) to NYSE Rule 105 provides that affiliates of a specialist may not act as primary market makers in the options overlying its specialty security. The NYSE proposes to amend Guideline (1) to allow an affiliate of an NYSE specialist to act in any market making capacity in options overlying an ETF, subject to the condition that NYSE Rule 98 information barriers are in place. In addition, the Exchange proposes to allow an affiliate of an ETF specialist to act in any market capacity, other than as a specialist in the ETF itself, on other market centers, as long as NYSE Rule 98 information barriers are in place. The Commission finds that the revision to Guideline (1) of NYSE Rule 105 is consistent with the Act.

The Commission also finds the amendment to NYSE Rule 36.30 to

allow ETF specialists to maintain telephone lines at their off-floor offices or clearing firm, to members of options and futures exchanges, and to maintain order entry terminals to be consistent with the Act. ETF specialists will be permitted to enter proprietary options<sup>16</sup> and futures orders, proprietary orders in the ETF on other market centers, and in component securities of the ETF. In addition, specialists will be permitted to obtain market information regarding the ETF, options, and futures on the ETF, and component securities of the ETF.<sup>17</sup> The Commission notes that the specialist entering proprietary orders in a component security of the ETF with the upstairs clearing firm for execution on the floor of the Exchange must enter and execute the orders in accordance with Rule 11a2-2(T) under the Act<sup>18</sup> and NYSE Rule 112.20 and must enter such orders only for the purpose of hedging a position in the ETF.<sup>19</sup>

The NYSE proposes to amend NYSE Rule 13 to remove the requirement that the specialist obtain the prior approval of a Floor Governor or two Floor Officials before electing a stop order or a stop limit order by a quotation. The specialists, however, must obtain Floor Official approval in the situation where the bid or offer that would elect a stop or stop limit order is more than 0.10 point away from the last sale and is made for the specialist's dealer account.<sup>20</sup> The Commission believes that the amendment to NYSE Rule 13 is consistent with the Act.

The Commission notes that, pursuant to the proposed rule change, ETFs will not be subject to the NYSE's MOC/LOC policy regarding order entry limitations, cancellation of orders during a

regulatory halt, imbalance publications, and any other limitations or procedures with respect to MOC/LOC procedures. Moreover, ETFs will trade until 4:15 p.m., except on the last business day of each month.<sup>21</sup> ETFs will not be subject to the NYSE's policies concerning mandatory pre-opening price indications and notifications in cases of order imbalances because ETF prices are based on the values of the underlying component securities, notwithstanding any other imbalance. The Exchange will publish Information Memos to notify member organizations of the foregoing policies. The Commission finds that these policies, as revised, are appropriate in the context of ETFs.

Finally, the Commission, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> finds good cause for approving Amendment No. 3 to the proposed rule change prior to the thirtieth day after the date of publication in the **Federal Register**. In Amendment No. 3, the NYSE withdrew the proposed amendment to NYSE Rule 111; revised the rule text of NYSE Rule 36 to clarify that if an order in a component security of an ETF is executed on the Exchange floor, the order must be in compliance with NYSE Rule 112.20 and Rule 11a2-2(T) under the Act,<sup>23</sup> and must be for the purpose of hedging a position in the ETF; and revised its proposed amendment to NYSE Rule 13 to require Floor Official approval in a situation where the bid or offer that would elect a stop or stop limit order is more than 0.10 point away from the last sale and is made for the specialist's dealer account. The Commission finds these changes are necessary to clarify the rules governing the ability of specialists to execute trades for their own account on the Exchange. Therefore, accelerated approval of Amendment No. 3 is appropriate.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the whether Amendment No. 3 to 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

<sup>16</sup> Any proprietary options order must be executed in compliance with NYSE Rule 105, which generally restricts specialist's specialty options transactions to hedging transactions.

<sup>17</sup> The Commission notes that the specialist will only be able to gain public market information from other market centers. See, e.g., NYSE Rule 115.

<sup>18</sup> 17 CFR 240.11a2-2(T).

<sup>19</sup> See Amendment No. 3, *supra* note 6. NYSE Rule 112.20 states, in relevant part, that a member using a communication facility located on the Floor of the Exchange to enter an order for his own account will be deemed to be initiating an off-Floor order if such order is routed through a clearing firm's order room, where a time-stamped record of the order is maintained, before such order re-transmitted to the Floor for execution. However, an off-Floor order for an account in which a member has an interest is to be treated as an on-Floor order if it is executed by the number who initiated it. Rule 11a2-2(T) under the Act relates to conditions surrounding a member's ability to trade for his own account or for the account of an associated person on the floor of the Exchange.

<sup>20</sup> The Commission notes that the amendment to NYSE Rule 13 parallels the specialist's responsibility to obtain floor official approval under NYSE Rule 123A.40 in situations where the specialist is a party to the electing trade.

<sup>21</sup> See *supra* note 12.

<sup>22</sup> 15 U.S.C. 78s(b)(2).

<sup>23</sup> 17 CFR 240.11a2-2(T).

<sup>15</sup> The Commission notes that specialists registered only in an ETF are subject to the \$1,000,000 minimum capital requirement of NYSE Rule 104.20.

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 NYSE. All submissions should refer to File No. SR-NYSE-2001-08 and should be submitted by August 24, 2001.

## V. Conclusion

for the foregoing reasons, the Commission finds that the NYSE's proposal to amend its rules and policies to accommodate the trading of certain ETFs on a UTP basis, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-NYSE-2001-08), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>25</sup>

**Jonathan G. Katz,**

*Secretary.*

[FR Doc. 01-19436 Filed 8-2-01; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44608; File No. SR-OCC-2001-02]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to Deposits of Nasdaq SmallCap Securities as Margin Collateral Pursuant to Rule 604(d)

July 27, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> notice is hereby given that on April 11, 2001, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The proposed rule change would amend OCC Rule 604(d) to allow Nasdaq SmallCap Market Securities to be deposited as margin collateral. The rule change also makes certain other technical changes to the rule.<sup>2</sup>

### 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 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>3</sup>

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

The primary purpose of this rule change is to allow securities traded in the Nasdaq SmallCap market to the deposited as collateral pursuant to Rule 604(d). The rule change also makes certain other technical changes to the rule.

#### Nasdaq SmallCap Securities

In 1984, OCC received Commission approval to amend Rule 604(d) to allow the deposit of securities traded in the Nasdaq National Market System ("NMS") as a form of margin collateral.<sup>4</sup> Nasdaq formed the NMS market in 1982 to distinguish NMS securities as those securities that met its highest listing standards and that were subject to real-time sale price and volume reporting. Securities that did not meet NMS standards were termed "regular Nasdaq securities." While the eligibility criteria found in Rule 604(d) have remained relatively unchanged since 1984, the structure of the Nasdaq market has evolved substantially since then.

The Nasdaq market structure has had many notable changes. For example, in

<sup>2</sup> A copy of OCC's proposed rule change is available at the Commission's Public Reference Section or through OCC.

<sup>3</sup> The Commission has modified the text of the summaries prepared by OCC.

<sup>4</sup> Securities Exchange Act Release No. 20558 (January 18, 1984), 49 FR 2183 [File No. SR-OCC-83-17] (order approving an OCC rule change allowing clearing members to deposit certain common stocks not underlying options to satisfy their margin obligations).

1992, all Nasdaq securities became subject to real-time last sale price and volume reporting requirements, increasing the transparency for all Nasdaq issues (*i.e.*, NMS and regular Nasdaq securities).<sup>5</sup> Then, in 1994, the Nasdaq Stock Market was created with two distinct tiers: The Nasdaq National Market<sup>®</sup> ("NNM," formerly the NMS market) and the SmallCap market (formally the regular Nasdaq securities).<sup>6</sup> Later, in 1997, the qualification standards of both the NNM and the SmallCap market tiers were substantially upgraded.<sup>7</sup>

The upgraded qualification standards applicable to Nasdaq SmallCap issuers set forth minimum and ongoing financial criteria (*e.g.*, assets, capitalization, and income), share float and price criteria, corporate governance (*e.g.*, independent directors, audit committee formation and activities, auditor peer review, and voting rights), and public disclosure (*e.g.*, timely filing and distribution of annual and interim financial reports and annual meeting of shareholders).<sup>8</sup> These qualification criteria exceed the standards that governed the Nasdaq NMS securities at the time those securities were approved for margin purposes in 1984. The Nasdaq SmallCap qualification standards approximate American Stock Exchange ("Amex") listing criteria applicable to equity securities.<sup>9</sup> Such Amex listed equity securities are accepted by OCC for margin purposes. OCC therefore believes that the qualification standards that are applicable to SmallCap issues provide sufficient safeguards to address concerns about the quality of securities trade in that market tier.

The ten dollar minimum price per share requirement and concentration limit (*i.e.*, the securities of any one issuer cannot exceed 10% of the margin requirement for any one clearing member account) of Rule 604(d) also provide additional safeguards to

<sup>5</sup> Securities Exchange Act Release No. 30569 (April 16, 1992), 57 FR 13396 [File No. SR-NASD-91-50] (order approving a rule change requiring real-time trade reporting of transactions in Nasdaq securities, except convertible debt, and allowing the NASD to publicly disseminate the information).

<sup>6</sup> Securities Exchange Act Release No. 34928 (November 9, 1994), 59 FR 55906 [File No. SR-NASD-94-48] (order clarifying the two tiers of the Nasdaq Stock Market as the Nasdaq SmallCap Market and the Nasdaq National Market).

<sup>7</sup> Securities Exchange Act Release No. 38961 (August 29, 1997), 62 FR 45895 [File No. SR-NASD-97-16] (order revising the listing and maintenance standards to increase the quality of companies listed on Nasdaq and raising the level of investor protection).

<sup>8</sup> NASD Rules 4310 and 4350.

<sup>9</sup> American Stock Exchange Company Guide, Sections 101, 102, and 120-132.

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

<sup>25</sup> 17 CFR 200.30-3(a)(12)

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