

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,<sup>5</sup> in general, and furthers the objectives of Section 6(b)(4),<sup>6</sup> in particular, in that it provides for equitable allocation of reasonable dues, fees and other charges among its members.

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

The Exchange does not believe that the proposed rule change would impose any inappropriate burden on competition.

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

The foregoing rule change establishes or changes a due, fee, or other charge and, therefore, has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>7</sup> and subparagraph (f)(2) of Rule 19b-4 thereunder.<sup>8</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

## 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. 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 CHX. All submissions should refer to the File No. SR-CHX-2002-21 and should be submitted by August 21, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46248; File No. SR-NASD-2002-95]

### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. to Extend the Manning Pilot on the OTCBB**

July 24, 2002.

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 16, 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") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq has designated the proposed rule change as constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission. On July 19, 2002, the NASD submitted Amendment No. 1 to the proposal.<sup>4</sup> The Commission is publishing this amended notice to solicit comments on the proposed rule change from interested persons.

<sup>9</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> 17 CFR 240.19b-4(f)(6).

<sup>4</sup> See letter from Jeffrey S. Davis, Nasdaq, to Nancy Sanow, Division of Market Regulation, Commission, dated July 19, 2002 ("Amendment No. 1"). In Amendment No. 1, the NASD made certain technical corrections to the narrative description of the proposed rule change.

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

This is a proposal to extend through December 15, 2002, two pilot programs contained in NASD Rule 6541, which prohibits member firms from trading ahead of customer limit orders in designated OTC Bulletin Board ("OTCBB") securities. NASD Rule 6541 was established on a pilot basis through February 8, 2002. Portions of NASD Rule 6541 were separately amended for a pilot period that originally ran for a three-month period from August 1, 2001, to November 1, 2001. This pilot period was extended through January 14, 2002, and again until July 15, 2002. Nasdaq is proposing no changes to the language of NASD Rule 6541.

Pursuant to Rule 19b-4(f) under the Act, Nasdaq has designated this proposal as non-controversial and has provided the Commission with the 5-day notice required by Rule 19b-4(f)(6)(iii). Nasdaq has requested that the Commission waive the 30-day pre-operative requirement contained in Rule 19b-4(f)(6)(iii). If such waiver is granted by the Commission, the two pilots programs would continue in effect until December 15, 2002.

## 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

On February 8, 2001, the Commission approved new NASD Rule 6541 which, on a pilot basis, extended the basic customer limit order protection principles—that presently apply to Nasdaq securities—to designated securities traded on the OTCBB.<sup>5</sup> NASD Rule 6541(a), in general, prohibits member firms that accept customer limit orders in these securities from "trading

<sup>5</sup> See Securities Exchange Act Release No. 43944 (February 8, 2001), 66 FR 10541 (February 15, 2001) (approving SR-NASD-00-22).

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

<sup>6</sup> 15 U.S.C. 78f(b)(4).

<sup>7</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>8</sup> 17 CFR 240.19b-4(e)(2).

ahead" of their customers for their own account at prices equal or superior to the limit orders, without executing them at the limit price. NASD Rule 6541(b) requires member firms to provide a minimum level of price improvement to incoming orders in OTCBB securities if the firm chooses to trade as principal with those incoming orders while holding customer limit orders. If a member firm fails to provide the minimum level of price improvement to the incoming order, the firm must execute its held customer limit orders.

The limit order protection embodied in NASD Rule 6541 is an investor protection tool based on NASD IM-2110-2 (commonly known as the "Manning Rule"). In the *Manning* case, the NASD found and the Commission affirmed that a member firm that accepts a customer limit order has a fiduciary duty not to trade for its own account at prices more favorable than the customer order.<sup>6</sup> NASD Rule 6541 expands to the trading of OTCBB the protections that NASD IM-2110-2 provides to the trading of Nasdaq National Market and SmallCap securities.

On March 2, 2001, and April 6, 2001, the Commission approved modifications to NASD IM-2110-2.<sup>7</sup> In general, these modifications narrowed the amount of price improvement required to avoid the obligation to fill a customer limit order, in recognition of the introduction of decimal pricing of Nasdaq securities. On July 26, 2001, Nasdaq filed and implemented an amendment to NASD Rule 6541(b) (SR-NASD-2001-39) that likewise narrowed the amount of required price improvement for trading of OTCBB securities.<sup>8</sup> As originally drafted, NASD Rule 6541(b) required price improvement of at least the lesser of \$0.05 or one-half of the current inside spread. Under SR-NASD-2001-39, the price improvement requirement was narrowed to \$0.01 or one-half the inside spread (whichever is less) for a market maker wishing to trade in front of a held customer limit order that is priced at or inside the current inside spread for an OTCBB security. For a customer limit order priced less than \$0.01 outside the inside spread, however, SR-NASD-2001-39 required a market maker seeking to trade in front of such limit

order to execute its trades at a price at least equal to the inside bid (with respect to a held customer limit order to buy) or inside offer (for a held order to sell). Moreover, SR-NASD-2001-39 provided that limit order protection would not apply to a customer limit order that was priced more than \$0.01 outside the current inside spread. The amendment to NASD Rule 6541(b) adopted by SR-NASD-2001-39 was effective for a three-month pilot period that ended on November 1, 2001.

At the expiration of that period, Nasdaq amended Rule 6541(b) to eliminate the minimum price improvement requirement for limit orders outside the inside spread.<sup>9</sup> Accordingly, any degree of price improvement would relieve a market maker from the obligation to fill a limit order that is outside of the inside spread. At the same time, Nasdaq eliminated the provision of the pilot that provided no limit order protection to customer limit orders that are priced more than \$0.01 outside the current inside spread. Thus, the basic prohibition on trading ahead of a customer limit order at a price equal or superior to the limit order, without filling the limit order, applies to all limit orders in OTCBB securities covered by NASD Rule 6541. The amount of required price improvement for limit orders priced inside the current inside spread remained the lesser of \$0.01 or one-half of the current inside spread.

Nasdaq believes that a six-month extension of both existing pilot programs is necessary to allow Nasdaq to complete its analysis of the impact of NASD Rule 6541 on trading in this market. Currently, it is Nasdaq's intent to implement limit order protection on a permanent basis at or before the end of this pilot extension.<sup>10</sup>

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act<sup>11</sup> in general, and Section 15A(b)(6) of the Act<sup>12</sup> in particular, in that it is designed to: (1) Promote just and equitable principles of trade; (2) foster cooperation and coordination with persons engaged in regulating, clearing,

settling, processing information with respect to, and facilitating transactions in securities; (3) perfect the mechanism of a free and open market and a national market system; and (4) maintain the current rule language without a lapse, in keeping with the public interest and the protection of investors.

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

Nasdaq does not believe that the proposed rule change would 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.

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

The proposed rule change has been filed by Nasdaq as a non-controversial rule change pursuant to Rule 19b-4(f)(6) under the Act. Nasdaq represents that the foregoing proposed rule change: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest; therefore, it has become immediately effective pursuant to Section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>14</sup>

Nasdaq has requested that the Commission waive the 30-day pre-operative period required by Rule 19b-4(f)(6), which would allow the proposal to become operative immediately. The Commission believes that continuing the two pilot programs will further the aim of protecting investors and the

<sup>6</sup> See *In re E.F. Hutton & Co.*, Securities Exchange Act Release No. 25887 (July 6, 1988) ("Manning").

<sup>7</sup> See Securities Exchange Act Release No. 44030 (March 2, 2001), 66 FR 14235 (March 9, 2001) (approving SR-NASD-2001-09); Securities Exchange Act Release No. 44165 (April 6, 2001), 66 FR 19268 (April 13, 2001) (approving SR-NASD-2001-27). See also Securities Exchange Act Release No. 44529 (July 9, 2001), 66 FR 37082 (July 16, 2001) (SR-NASD-2001-43).

<sup>8</sup> See Securities Exchange Act Release No. 44593 (July 26, 2001), 66 FR 40304 (August 2, 2001).

<sup>9</sup> See Securities Exchange Act Release No. 45011 (November 1, 2001), 66 FR 56587 (November 8, 2001) (SR-NASD-2001-78).

<sup>10</sup> The Commission notes that permanent approval of limit order protection for OTCBB securities would require the NASD to submit a proposed rule change to this effect under Section 19(b) of the Act, 15, U.S.C. 78s(b).

<sup>11</sup> 15 U.S.C. 78o-3.

<sup>12</sup> 15 U.S.C. 78o-3(b)(6).

<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> Because the NASD amended the proposed rule change, the 60-day abrogation period runs from the date of filing of the amendment (July 19, 2002) rather than the date of filing of the original submission (July 16, 2002).

public interest.<sup>15</sup> Accordingly, the Commission hereby grants Nasdaq's request.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, 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 No. SR-NASD-2002-95 and should be submitted by August 21, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46257; File No. SR-OCC-2002-02]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Providing Clearing Services to Options Exchanges That Are Not Stockholders

July 25, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on January 25, 2002, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission

("Commission") and on July 9, 2002, amended 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 persons.

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

The proposed rule change would amend OCC's by-laws and rules in order that OCC could provide clearing services to new options exchanges without having those exchanges become stockholders of OCC.

#### 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 such statements.<sup>2</sup>

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

The purpose of this rule change is to allow OCC to provide clearing services to new options exchanges without issuing new equity to such exchanges. Under OCC's existing by-laws, any new options market desiring to clear options transactions through OCC is required to purchase common stock in OCC and to execute the Stockholders Agreement to which the existing stockholder exchanges are parties. Management of OCC has concluded that the practice of issuing new equity to each market for which it provides clearing services is no longer either necessary or appropriate. Indeed, the practice has already been abandoned with respect to providing clearing services to markets trading only security futures or commodity futures.<sup>3</sup> The present rule change would permit OCC to clear options transactions for

<sup>2</sup> The Commission has modified parts of these statements.

<sup>3</sup> Article XII of the by-laws permits OCC to clear "security futures exchanges" without issuing equity to such exchanges and permits OCC to provide clearing services for other futures products on the same basis (Securities Exchange Act Release Nos. 44434 (June 15, 2001), 66 FR 33283 [File No. SR-OCC-2001-05] and 45946 (May 16, 2002), 67 FR 36056 [File No. SR-OCC-2001-16]).

additional exchanges on a similar basis. OCC believes that there is no more reason to permit or require new options exchanges to become OCC stockholders than to permit or require those other markets to do so.

Exchange ownership of clearing organizations is not required under Section 17A of the Act or of any other provision of the federal securities laws. State law at one time made such ownership necessary. Article VIII of the Uniform Commercial Code ("UCC"), as in effect in Illinois prior to the 1973 amendment, defined a "clearing corporation" as "a corporation all of the capital stock of which is held by or for a national securities exchange or association registered under a statute of the United States such as the Securities Exchange Act of 1934."<sup>4</sup> The UCC as now in effect in all U.S. jurisdictions no longer defines "clearing organization" in terms of ownership, and therefore, the UCC is no longer a constraint in determining the ownership of OCC.

Not only is there no continuing need to have new markets seeking clearing services become stockholders, there are a number of reasons not to do so. First, increasing the number of Class A and Class B stockholders could adversely affect OCC's ability to pursue new business opportunities.<sup>5</sup> Stock ownership gives the existing participant exchanges the right to a representative on OCC's board of directors and veto rights over certain significant transactions (e.g., a merger) or amendments to certain provisions of the constituent documents (e.g., Article VII of the by-laws regarding exchange qualifications). The participant exchanges have divergent and sometimes conflicting interests, and this will only become more prevalent as the number and types of options exchanges proliferates. Expanding the number of stockholders with veto rights increases the likelihood that a single stockholder might block action that is in the best interests of OCC and its other stockholders. Second, continuing to add

<sup>4</sup> The 1973 amendment identified certain other entities that could be owners of a clearing corporation while retaining securities exchanges or associations among the permitted owners.

<sup>5</sup> Holders of OCC Class A common stock have the right, by majority vote, to elect member directors of OCC. Holders of Class B common stock vote on the election of the management director and exchange directors of OCC. In addition, the votes of Class B common stock holders are required to amend OCC's certificate of incorporation, to adopt an agreement of merger or consolidation of OCC with or into any other corporation, to authorize or consent to the sale, lease, or exchange of all or substantially all of the property and assets of OCC, to authorize or consent to the dissolution of OCC, to receive dividends, to receive assets upon partial or final liquidation or dissolution of OCC.

<sup>15</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>16</sup> 17 CFR 200.30-3(a)(12).

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