

waivers are granted by the Commission, Nasdaq will implement this rule change immediately.

## 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 its proposal and discussed any comments it received regarding the proposal. 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 March 2, 2001, the Commission approved, on a one-year pilot basis ending March 1, 2002,<sup>6</sup> Nasdaq's proposal to establish a \$0.01 above the bid standard for legal short sales in Nasdaq National Market securities as part of the Decimals Implementation Plan for the Equities and Options Markets. The pilot program has been continuously extended since that date and is currently set to expire on September 30, 2002.<sup>7</sup> Nasdaq now proposes to extend, through January 31, 2003, that pilot program. Extension until January 31st, will allow Nasdaq and the Commission to continue to evaluate the impact of the penny short sale pilot and thereafter take action on Nasdaq's separate pending proposal to make the penny short sale standard permanent.<sup>8</sup> If approved, Nasdaq would continue during the pilot period to require NASD members seeking to effect "legal" short sales when the current best (inside) bid displayed by Nasdaq is lower than the previous bid, to execute those short sales at a price that is at least \$0.01 above the current inside bid in that security. Nasdaq believes that continuation of this pilot standard appropriately takes into account the important investor protections provided by the short sale rule and the ongoing relationship of the valid short sale price amount to the minimum quotation increment of the Nasdaq market (currently also \$0.01).

<sup>6</sup> Securities Exchange Act Release No. 44030 (March 2, 2001), 66 FR 14235 (March 9, 2001).

<sup>7</sup> Securities Exchange Act Release No. 45761 (April 16, 2002), 67 FR 19788 (April 23, 2002).

<sup>8</sup> See SR-NASD 2002-09.

#### 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act<sup>9</sup> 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) 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 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

Written comments were neither solicited nor received.

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

Because the foregoing proposed rule change does not:

- (i) Significantly affect the protection of investors or the public interest;
- (ii) Impose any significant burden on competition; and
- (iii) 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, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>10</sup> and Rule 19b-4(f)(6) thereunder.<sup>11</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.

Nasdaq has requested that the Commission waive both the 5-day notice and the 30-day operative delay. The Commission believes waiving the 5-day notice and 30-day operative delay is consistent with the protection of investors and the public interest. Acceleration of the operative date will allow the pilot to continue uninterrupted through January 31, 2003,

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(6).

and will provide Nasdaq and the Commission with an opportunity to evaluate the impact of the penny short sale pilot. For these reasons, the Commission designates the proposal to be effective and operative upon filing with the Commission.<sup>12</sup>

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal 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 Nasdaq. All submissions should refer to file number SR-NASD-2002-131 and should be submitted by October 31, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46595; File No. SR-OCC-2002-06]

### Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Adjustment Procedures for Stock Futures

October 3, 2002.

#### I. Introduction

On April 12, 2002, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange

<sup>12</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. 15 U.S.C. 78c(f).

<sup>13</sup> 17 CFR 200.30-3(a)(12).

Commission ("Commission") proposed rule change File No. SR-OCC-2002-06 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the **Federal Register** on August 9, 2002.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

## II. Description

The proposed rule change amends OCC's adjustment procedures for stock futures to provide for adjusting stock futures contracts to compensate for special cash dividends and for rights distributions that expire in the money during the life of the futures contract. Security futures markets and certain firms interested in trading stock futures have expressed to OCC their belief that in order for stock futures to be successful they must replicate a position in the underlying stock as closely as possible. This means that, among other things, if an unanticipated corporate event (*i.e.*, an event that cannot be discounted in futures prices) materially affects the value of an underlying stock, the terms of futures contracts on that stock should be adjusted to compensate for the event. There are two types of corporate events that cause particular concern from this perspective: (1) Special (*i.e.*, non-recurrent) cash dividends and (2) rights distributions.

OCC does not, as a general rule, adjust options for cash dividends unless the amount of the dividend exceeds 10 per cent of the value of the underlying stock. If the holder of a call option wants to capture a dividend below that threshold, he can do so by exercising his option. Because stock futures, like other futures products, are not exercisable, the holder of a long stock future would not have that ability. Recurrent cash dividends are not regarded as a problem because they can be anticipated and discounted in futures settlement prices. But there is no economical way for holders of long stock futures positions to ensure themselves the benefit of unscheduled dividends.

Similarly, if the issuer of an underlying stock declares a rights distribution and the rights will expire before the options do, the holder of a call option can capture the value of the rights by exercising the option before the rights expire. In contrast, the holder of a long stock future would have no way of obtaining the benefit of a rights

distribution if the rights expire before the future does.

OCC's by-laws currently specify adjustment procedures for stock futures that generally parallel the adjustment rules for options. These procedures do not take into account the economic differences between options and futures discussed above. The security futures markets and firms interested in trading stock futures strongly believe that OCC's adjustment provisions should accommodate these differences.<sup>3</sup>

This rule change addresses that concern. OCC's by-laws presently provide that, as a general rule, outstanding stock futures contracts will not be adjusted to compensate for "ordinary" cash dividends. A cash dividend is deemed "ordinary" if the amount does not exceed 10 per cent of the value of the underlying stock on the declaration date. This rule change amends Article XII, Section 3, of the by-laws to provide that in the case of stock futures, a cash dividend would be deemed "ordinary" if OCC determined that it was declared pursuant to a policy or practice of paying such dividends on a quarterly or other regular basis regardless of the size of the cash dividend.<sup>4</sup> This change recognizes that market pricing mechanisms can compensate for anticipated cash dividends, but because the market cannot anticipate and cannot price for special dividends, the rule change provides for adjustments to outstanding stock futures when a company pays a special (*i.e.*, non-recurring) cash dividend without regard to size. This will be done through a one-time adjustment in the futures settlement price that has the effect of causing the short holder to pass the value of the dividend to the long holder.

Article XII, Section 3, of OCC's By-Laws currently provides that outstanding stock futures will not be adjusted to compensate for rights distributions where the rights expire before the maturity date of the future. Under the rule change, if rights will expire before they are to be delivered under a stock futures contract, the futures contract will be adjusted

<sup>3</sup> Although this would cause the adjustment procedures for stock futures to diverge from those applicable to equity options, the consensus among prospective markets and market participants appears to be that it is more important to avoid discontinuity between stock futures and the underlying stocks than between futures and options.

<sup>4</sup> Quarterly stock dividends will be deemed "ordinary" regardless of size. Stock futures contracts will ordinarily be adjusted for other stock distributions, even if recurrent (*e.g.*, annual), to avoid creating an unnecessary discontinuity with equity options.

through a one-time adjustment in the futures settlement price in an amount equal to the value of the rights as determined by OCC. OCC's good-faith determination of value will be conclusive and binding on investors.

Because Interpretation and Policy .11 to Article XIII applies only to certain types of adjustments, it is being deleted because OCC has concluded that it is likely to be more confusing than useful.

## III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the protect investors and the public interest.<sup>5</sup> Because OCC's current procedures do not allow for price adjustments to stock futures, which include securities futures, in the event of special cash dividends and rights distributions, there can be a disconnect between the value of stock futures and the value of the underlying stock. This proposed rule change, which allows OCC to make adjustments to stock futures contracts in these circumstances, will address this possible disconnect and will allow the price of stock futures to more accurately reflect the price of the underlying stock.

## IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 17A(b)(3)(F) of the Act and the rules and regulations thereunder applicable.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-2002-06) be, and hereby is, approved.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SOCIAL SECURITY ADMINISTRATION

### Agency Information Collection Activities: Emergency Request and Proposed Request

The Social Security Administration (SSA) publishes a list of information collection packages that will require clearance by the Office of Management

<sup>5</sup> 15 U.S.C. 78q-1(b)(3)(F).

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

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

<sup>2</sup> Securities Exchange Act Release No. 46312 (August 5, 2002), 67 FR 51919.