

funded through a \$.65 fee paid by ISE market makers for each customer contract they execute. The ISE is proposing to reduce its payment-for-order-flow fee from \$.65 a contract to \$.55 a contract. The ISE also has established a ceiling of \$650,000 in each of the 10 payment-for-order-flow funds it maintains.⁴ The ISE is proposing to lower the cap on each payment-for-order-flow fund from \$650,000 to \$550,000.

The ISE has also established a \$.10 marketing fee, paid by market makers on customer contracts, that funds general ISE marketing efforts to increase order flow from Electronic Access members.⁵ The ISE has waived that fee for the second half of this year.⁶ The ISE is proposing to extend the waiver of the marketing fee from December 31, 2002 to June 30, 2003.

The ISE states that it regularly monitors the levels of these fees and ceilings to help ensure that the payment-for-order-flow and marketing efforts are sufficiently funded and that the fees it imposes on its market makers are no higher than necessary. With respect to payment-for-order-flow, the ISE states that it historically has collected more money than its Primary Market Makers have paid out. The ISE believes that it can adequately maintain this program with the reduced fee and ceiling. With respect to the marketing fee, the ISE currently has sufficient retained funds from the time the fee was in effect to pay for anticipated marketing efforts for the beginning part of next year. Thus, the ISE is proposing to extend this fee waiver through June 2003.

The basis for this proposed rule change is the requirement of section 6(b)(4) under the Act⁷ that an exchange have an equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities.

⁴ See Securities Exchange Act Release Nos. 45128 (December 4, 2001), 66 FR 64325 (December 12, 2001) and 45772 (April 17, 2002), 67 FR 20563 (April 25, 2002). The ISE has divided the options it trades into 10 groups, with one Primary Market Maker assigned to each group. The ISE maintains a payment-for-order-flow fund for each group, consisting of the fees collected from market makers trading options in that group. The Primary Market Maker for the group is responsible for arranging and making all payments to Electronic Access Members for order flow sent to the ISE in options in that group.

⁵ See Securities Exchange Act Release No. 44102 (March 26, 2001), 66 FR 17590 (April 2, 2001).

⁶ See Securities Exchange Act Release No. 46189 (July 11, 2002), 67 FR 47587 (July 19, 2002).

⁷ 15 U.S.C. 78f(b)(4).

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

The ISE believes that the proposed rule change will not impose 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

The ISE has not solicited, and does not intend to solicit, comments on this proposed rule change. The ISE has not received any unsolicited written comments from members or other interested parties.

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

The foregoing rule change has become effective pursuant to section 19(b)(3)(A) of the Act⁸ and Rule 19b-4(f)(2) thereunder⁹ because it changes an ISE fee. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate the 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 20549-0609. 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 the filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to SR-ISE-2002-26 and should be submitted by January 6, 2003.

⁸ 15 U.S.C. 78s(b)(3)(A).

⁹ 17 CFR 19b-4(f)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46948; File No. SR-NASD 2002-157]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding ACT Risk Management

December 4, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 31, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary The Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("SEC" or "Commission") 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 Substance of the Proposed Rule Change

Nasdaq is filing a proposed rule change to NASD Rule 6150 regarding the risk management function provided by Nasdaq's Automated Confirmation Transaction Service ("ACT"). Upon approval of the proposed rule change, Nasdaq will permit members to voluntarily utilize the ACT risk management function, provided that they utilize another risk management tool of equal quality and that they and the correspondent firms for whom they clear trades continue to report clearing-eligible trades to ACT in compliance with applicable ACT rules. The text of the proposed rule change is available at Nasdaq and at the Commission.

¹⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

ACT is an automated trade reporting and reconciliation service that speeds the post-execution steps of price and volume reporting, comparison, and clearing of pre-negotiated trades completed in Nasdaq, OTC Bulletin Board, and other over-the-counter securities. ACT handles transactions negotiated over the phone or executed through any of Nasdaq's automated trading services. It also manages post-execution procedures for transactions in exchange-listed securities that are traded off-board in the Nasdaq InterMarket. Participation in ACT is mandatory for NASD members that are members of a clearing agency registered with the Commission, that have a clearing arrangement with such a member, or that participate in any of Nasdaq's trading services.

An integral part of ACT is the risk management function. The ACT risk management function provides firms that clear for other firms with the capability to establish acceptable levels of credit for their introducing firms. ACT risk management also enables clearing brokers to monitor buy/sell-trading activity of their introducing firms, establish trading thresholds, allow/inhibit large trades, add/delete clearing relationships, and access a real-time database of correspondent trading activity.³ Clearing brokers providing clearing services to correspondent firms are assessed risk management charges of \$0.035 per trade and \$17.25 per month per correspondent firm with charges limited to a maximum of \$10,000 per month per correspondent.⁴ Given their lack of credit exposure, self-clearing

brokers without correspondents have no reason to utilize the ACT risk management function and are not assessed risk management charges.

The ACT service was implemented for self-clearing firms in March 1990.⁵ The ACT service for clearing brokers and their executing correspondents, including the risk management function, was implemented in October 1990;⁶ the ACT risk management service charge was implemented in November 1990.⁷ The NASD's impetus for creating ACT risk management was the market break of 1987. After studying the market break, the Commission urged the NASD to create an automated system to facilitate rapid, reliable trade comparison and clearing. At that time, clearing brokers and clearing Agencies urged the NASD to include a real-time risk management tool within its new automated system.⁸

Nasdaq considers risk management to be a mandatory service for all clearing brokers because effective, real-time, risk management by each and every clearing broker is critical to the protection of investors and other market participants. Recently, however, Nasdaq has learned that clearing brokers have developed their own risk management procedures and controls comparable to the service provided by ACT. While ACT risk management is integral to the surveillance procedures of many clearing firms, Nasdaq recognizes that a one-size-fits-all approach may no longer be appropriate to meet the surveillance needs of all clearing brokers, particularly in light of the constantly evolving ownership structures of many clearing firms and broker-dealers.

As such, Nasdaq would like to make ACT risk management an optional service for all clearing brokers that clear for correspondents reporting trades into ACT. In order to ensure that all clearing brokers continue to effectively manage their risk, Nasdaq will require that a clearing broker meet several conditions prior to opting out of the ACT risk management service. First, a clearing broker must submit a letter that specifies the correspondent or correspondents for which it no longer requires the risk management service. Additionally, it must state in its letter

that it uses an internal risk management capability to monitor the trading activities and risk exposures of its correspondents for which it is opting out of the service. Finally, clearing brokers that discontinue the use of ACT risk management, as well as the correspondents for whom they clear, must continue to comply with all applicable rules governing the reporting of trades to ACT.

Once Nasdaq receives a satisfactory letter from a clearing broker requesting relief from ACT risk management, Nasdaq will discontinue the assessment of risk management charges for the specified correspondent(s) on the first day of the month following the date the firm requested relief from ACT risk management charges.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A of the Act,⁹ in general and with section 15A(b)(6) of the Act,¹⁰ in particular, in that the proposal is designed to promote just and equitable principles of trade and to remove impediments to and perfect the mechanism of a national market system and, in general, to protect investors and the public interest. By requiring clearing brokers to utilize a risk management tool comparable to its own, Nasdaq hopes to ensure that there is no degradation in risk management practices. If, in the future, Nasdaq determines that a degradation of this sort has occurred, Nasdaq will reassess this rule.

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

Nasdaq does not believe that the proposed rule change will impose 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

Nasdaq 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

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 if it finds such

³ See NASD Rule 6150.

⁴ See Securities Exchange Act Release No. 34-42984 (June 27, 2000), 65 FR 41119 (July 3, 2000) (File No. SR-NASD-00-35).

⁵ See Securities Exchange Act Release No. 34-27229 (September 8, 1989), 54 FR 38484 (September 18, 1989) (File No. SR-NASD-89-25).

⁶ See Securities Exchange Act Release No. 34-28583 (October 26, 1990), 55 FR 46120 (November 1, 1990) (File No. SR-NASD-89-25).

⁷ See Securities Exchange Act Release No. 34-28595 (November 5, 1990), 55 FR 47161 (November 9, 1990) (File No. SR-NASD-90-57).

⁸ See SR-NASD-89-25 (May 31, 1989), and Amendments thereto.

⁹ 15 U.S.C. 78o-3.

¹⁰ 15 U.S.C. 78o-3(b)(6).

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 the 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 No. SR-NASD-2002-157 and should be submitted by January 6, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46974; File No. SR-NASD-2002-113]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to the Implementation of a Fingerprinting Program for Nasdaq Employees and Independent Contractors

December 9, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934

¹¹ 17 CFR 200.30-3(a)(12).

(“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 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 (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq amended the proposed rule change on September 10, 2002.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

Nasdaq is proposing to adopt NASD Rule 0140, Fingerprint-Based Background Checks of Nasdaq Employees and Independent Contractors, which will establish a program for conducting fingerprint-based background checks of Nasdaq employees and independent contractors. Nasdaq will implement the proposed rule change as soon as practicable following approval by the Commission. Below is the text of the proposed rule, as amended. Proposed rule language, as amended, is in italics.

0140. Fingerprint-Based Background Checks of Nasdaq Employees and Independent Contractors.

(a) In order to enhance the physical security of the facilities, systems, data, and information of The Nasdaq Stock Market, Inc. (“Nasdaq”), it shall be the policy of Nasdaq to conduct a fingerprint-based criminal records check of (i) all prospective and current employees, (ii) all prospective and current independent contractors who have or are anticipated to have access to Nasdaq facilities for ten business days or longer, and (iii) all prospective and current temporary employees who have or are anticipated to have access to Nasdaq facilities for ten business days or longer. Nasdaq shall apply this policy in all circumstances where permitted by applicable law.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See September 9, 2002, letter from Mary M. Dunbar, Vice President and Deputy General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission (“Amendment No. 1”). In Amendment No. 1, Nasdaq added language to the proposed rule text to indicate that the rule applies only where permitted by applicable law and deleted text from the Purpose sections of the form and draft notice related to the preemption of certain state laws by Commission order.

(b) Nasdaq shall submit fingerprint cards obtained pursuant to the foregoing policy to the Attorney General of the United States or his or her designee for identification and processing. Nasdaq shall at all times maintain the security of fingerprint cards and information received from the Attorney General or his or her designee.

(c) Nasdaq shall evaluate information received from the Attorney General or his or her designee in accordance with the terms of a written fingerprint policy and provisions of applicable law. A felony or serious misdemeanor conviction will be a factor in considering whether to hire a prospective employee, take adverse employment action with respect to a current employee, or deny prospective or current independent contractors or temporary employees access to Nasdaq’s facilities.

(d) A prospective employee who refuses to submit to fingerprinting shall be denied employment by Nasdaq, and a prospective independent contractor or temporary employee who refuses to submit to fingerprinting shall be denied access to Nasdaq facilities. A current employee, independent contractor, or temporary employee who refuses to submit to fingerprinting will be terminated following notice and being given three opportunities to submit.

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, as amended. 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

In the wake of the September 11, 2001 terrorist attacks, Nasdaq has been exploring ways in which to enhance the security of the critical financial infrastructure that it operates. Market participants use Nasdaq systems to execute and report transactions in Nasdaq-listed securities and rely upon Nasdaq for the dissemination of quotation and transaction information,