

the same terms as the NYSE's proposal.<sup>19</sup> Under a pilot program, NASD will have the opportunity to consider comments it received on the proposal, and facilitate the trading in securities futures in securities accounts for those NASD members, who are not also members of the NYSE.

#### IV. Discussion

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 association.<sup>20</sup> In particular, the Commission believes that the proposed rule change is consistent with the requirements of section 15A(b)(6) of the Act,<sup>21</sup> which requires, among other things, to promote just and equitable principles of trade and, in general, to protect investors and the public interest. In addition, the Commission believes that the proposed rule change is consistent with section 7(c)(2)(B) of the Act,<sup>22</sup> which provides, among other things, that the margin requirements for security futures must preserve the financial integrity of markets trading security futures, prevent systemic risk, be consistent with the margin requirements for comparable exchange-traded options, and provides that the margin levels for security futures may be no lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded option.

Moreover, the Commission believes that the proposed rule change is generally consistent with the customer margin rules for security futures adopted by the Commission and the CFTC. In particular, the Commission notes that, consistent with rule 403 under the Act, NASD's proposed rules provide a minimum margin level of 20% of current market value for all positions in security futures carried in a securities account. The Commission believes that 20% is the minimum margin level necessary to satisfy the requirements of section 7(c)(2)(B) of the Act. Rule 403 under the Act<sup>23</sup> also provides that a national securities association may set margin levels lower than 20% of the current market value of the security future for an offsetting position involving security futures and related positions, provided that an association's margin levels for offsetting

positions meet the criteria set forth in section 7(c)(2)(B) of the Act. The offsets proposed by NASD are consistent with the strategy-based offsets permitted for comparable offset positions involving exchange-traded options and therefore consistent with section 7(c)(2)(B) of the Act.

The Commission also believes it is consistent with the Act for the NASD to exclude from its margin requirements positions in SFCs carried in a futures account. The Commission believes that by choosing to exclude such positions from the scope of rule 2520, the NASD's proposal will make compliance by members with the regulatory requirements of several SROs easier.

The NASD has asked the Commission in Amendment No. 2 to approve the proposed rule change on a pilot basis to accommodate the expeditious trading of security futures for NASD customers of broker-dealers who are subject to NASD margin rules. NASD also has requested that the Commission approve the proposed rule change on a pilot basis under the same terms as the NYSE's pilot, pending the resolution of the issues raised by commenters. The Commission believes that there is good cause to approve the proposed rule change, as amended, on a pilot basis until March 6, 2003. The Commission notes that NASD's proposed rule change is substantially the same as NYSE's filing on margin requirements for security futures. Thus, the Commission believes that it is appropriate to approve NASD's proposed rule change on a pilot basis to enable customers of broker-dealers who are subject to NASD margin rules to trade security futures in securities accounts without unnecessary delay. The Commission expects that, similar to the NYSE, NASD will file a proposed rule change to adopt its margin requirements for security futures on a permanent basis, and consider the comments it received on this proposal.

#### V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether the proposed amendment 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 amendments that are filed with the Commission, and all written communications relating to the amendments 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 at the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the NASD.

All submissions should refer to File No. SR-NASD-2002-166 and should be submitted by February 24, 2003.

#### VI. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-NASD-2002-166) is approved on a pilot basis until March 6, 2003.

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

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47259; File No. SR-NASD-2001-47]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Thereto Relating to Audit Trail and Trading Halt Requirements for Alternative Trading Systems That Trade Security Futures

January 27, 2003.

#### I. Introduction

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 30, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change relating to audit trail and trading halt requirements for Alternative Trading Systems ("ATs") that trade security futures.<sup>3</sup> By letter dated August 14, 2002, the Association filed

<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).

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

<sup>3</sup> See Securities Exchange Release No. 44623 (July 30, 2001), 66 FR 41076 (August 6, 2001).

<sup>19</sup> See *supra* note .

<sup>20</sup> In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>21</sup> 15 U.S.C. 78o-3(b)(6).

<sup>22</sup> 15 U.S.C. 78g(c)(2)(B).

<sup>23</sup> 17 CFR 240.403(b)(2).

Amendment No. 1 to the proposed rule change.<sup>4</sup> The Commission received one comment letter.<sup>5</sup> The Commission approves the proposed rule change, as amended, and publishes this notice to solicit comments on Amendment No. 1. The Commission also approves Amendment No. 1 on an accelerated basis.

## II. Description of the Proposed Rule Change

NASD Regulation proposes to add NASD rule 3115 to establish record-keeping requirements for ATSs that trade security futures<sup>6</sup> and to amend NASD rule 3340 to prohibit members and associated persons from publishing a quotation for a security future when there is a regulatory trade halt in effect for the underlying security.

Specifically, NASD Regulation proposes to establish audit trail requirements relating to ATSs for the trading of futures on single securities and narrow-based security indices consistent with the Commodity Futures Modernization Act of 2000 ("CFMA").<sup>7</sup> Under section 6(h)(5) of the Act,<sup>8</sup> as added by the CFMA, a person<sup>9</sup> other than a national securities association or national securities exchange member may not maintain or provide a marketplace or facilities for bringing together purchasers and sellers of security future products unless it is a member of a national securities association or national securities exchange that has: (1) Procedures for coordinated surveillance, (2) rules to require an audit trail necessary or appropriate to facilitate coordinated

surveillance, and (3) rules to require such person to coordinate trading halts with markets trading the securities underlying the security futures products and other markets trading related securities. The NASD, as a national securities association, proposes to meet these CFMA requirements to prepare for the trading of security futures by ATSs.

### a. Requirements for Alternative Trading Systems

With respect to audit trails necessary to facilitate coordinated surveillance, the proposed rule change would require ATSs to record and report audit trail information on a T+1 basis in such form as the NASD requires. The NASD has based the required elements of the audit trail rule on Regulation ATS rule 302, the Commission's recordkeeping rule for ATSs.<sup>10</sup> The form of the reports will be designed to facilitate the NASD's sharing the reports with members of the Intermarket Surveillance Group, an organization whose purpose is to coordinate surveillance among financial markets. The proposed rule change would require that ATSs preserve such records in accordance with rule 17a-4(b) under the Act,<sup>11</sup> which requires preservation of records for at least three years, the first two years in an easily accessible place.

### b. Trading Halts

With respect to coordinated trading halts, the proposed rule change would amend the NASD's existing rule prohibiting trading during a halt. Currently, NASD rule 3340 broadly prohibits broker-dealers and associated persons from effecting a "transaction \* \* \* in any security as to which a trading halt is currently in effect." The NASD proposes to amend this rule by adding a provision that prohibits member firms, including ATSs, from effecting any transaction or publishing a priced bid and/or unpriced indication of interest for: (a) A future on a single stock when the underlying stock is subject to a regulatory trading halt; and (b) a future on a narrow based securities index when one or more underlying securities that constitute 50 percent or more of the market capitalization of the index are subject to a regulatory trading halt.<sup>12</sup> Further, by limiting application of new NASD rule 3340(b) to regulatory trading halts, the NASD intends to exclude halts resulting from events such as an order imbalance or a systems failure.

## III. Comments

The Commission received one comment letter from Island. Island recommended that the Commission require the NASD to: (1) More narrowly tailor the proposed recordkeeping requirements to be consistent with security futures and the regulatory framework governing security futures; and (2) conditionally exempt ATSs from certain aspects of the trading halt rule. Specifically, Island disputed that NASD rule 3115 governing recordkeeping requirements should mirror the existing audit trail rule in Regulation ATS designed for equity and debt securities. Island also noted its belief that the proposed recordkeeping requirements in NASD rule 3115 require far greater audit trail information than is necessary to perform coordinated surveillance to detect manipulation and insider trading as contemplated by the CFMA. In addition, Island did not believe it was appropriate to amend NASD rule 3340 to include ATSs trading security futures because the effective date of the rule had been delayed to clarify the NASD's interpretation of the rule. Island proposed that the rule be interpreted to exempt ATSs that: (1) Do not accept new orders in such security during a trading halt; and (2) have procedures in place reasonably designed to prevent the execution of orders during a trading halt.

In Amendment No. 1, the NASD responded to Island's comment letter. Specifically, the NASD stated that it reviewed the items required by NASD rule 3115 and the information provided by other markets that are expected to trade security futures products with respect to coordinated surveillance by the Intermarket Surveillance Group, and concluded that the NASD rule 3115 requirements are not unnecessarily broad or burdensome. Regarding the amendments to NASD rule 3340, the NASD noted that the rule has been in effect since October 9, 2001, and thus the proposed amendments, which supplement the rule to account for security futures, should be approved.

## IV. Discussion

The Commission has reviewed carefully the proposed rule change, the comment letter, NASD's response to the comment letter, and the entire record herein, and finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations applicable to the Association.<sup>13</sup>

<sup>4</sup> See letter from Gary Goldsholle, Associate General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated August 13, 2002 ("Amendment No. 1"). In Amendment No. 1, the NASD responded to a comment letter from Island, added proposed NASD rule 3115(a)(15) to indicate that the ATS audit trail for security futures trading would include "an account identifier that relates the order back to the account owner(s)," and amended NASD rule 3340(b)(2) to increase the percentage of the market capitalization of underlying securities that trigger a trading halt in a narrow-based security index from 30% to 50%.

<sup>5</sup> See letter from Chris Concannon, Vice-President, Island, to Jonathan Katz, Secretary, Commission, dated August 20, 2001 ("Island Comment Letter").

<sup>6</sup> Section 3(a)(55) of the Act defines a "security future" as a contract of sale for future delivery of a single security or of a narrow-based security index. Security futures are defined as "securities" under the Act, thus making the federal securities laws generally applicable to them.

<sup>7</sup> The CFMA was signed into law on December 21, 2000. Pub. L. No. 106-554, 114 Stat. 2763 (2000).

<sup>8</sup> See 15 U.S.C. 78f(h)(5).

<sup>9</sup> The term "person" means a natural person, company, government, or political subdivision, agency or instrumentality of a government. See 15 U.S.C. 78c(a).

<sup>10</sup> 17 CFR 242.302(c).

<sup>11</sup> 17 CFR 240.17a-4(b).

<sup>12</sup> See Amendment No. 1, *supra* note 4.

<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).

The Commission finds that the proposed rule change, as amended, is consistent with section 15A.<sup>14</sup> Specifically, the Commission finds that the proposed rule change is consistent with section 15A(b)(6) of the Act which requires, among other things, that the Association's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.<sup>15</sup>

In addition, the Commission finds that the proposed rule change is consistent with section 15A(b)(11),<sup>16</sup> which requires that the rules of a registered national securities association be designed to produce fair and informative quotations, prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.

The Commission also believes that proposed rule change, as amended, is consistent with subparagraphs (B) and (C) of section 6(h)(5) of the Act,<sup>17</sup> which sets forth the requirements that must be in place before ATSS provide a marketplace for trading security futures products. Island asserted that NASD rule 3115 requires that ATSS maintain more records than this statutory provision requires. In response, the NASD stated that the rule was not unnecessarily broad or burdensome. Pursuant to section 6(h)(5)(B) of the Act, the NASD, among other requirements, must have "rules to require audit trails necessary or appropriate to facilitate the coordinated surveillance required [under the Act]" before an ATS can trade security futures products.<sup>18</sup> The Commission believes that the proposed rule change satisfies this requirement and agrees with the NASD that it is not unnecessarily broad or burdensome.

The Commission also believes that the amendment to NASD rule 3340 meets the goals of section 6(h)(5)(C) of the Act,<sup>19</sup> which requires a national securities association to adopt rules to require its members "to coordinate trading halts with markets trading the

securities underlying the security future products and other markets trading related securities."<sup>20</sup> Island suggested that the NASD exempt ATSS that: (1) Do not accept new orders in such security during a trading halt; and (2) have procedures in place reasonably designed to prevent the execution of orders during a trading halt. The Commission, however, does not believe that it is necessary for NASD Rule 3340 to provide for the suggested exemption in order for the rule to be consistent with the Act. The Commission also notes that to satisfy other regulatory requirements, some ATSS have been able to block the public dissemination of orders for individual securities on their limit order books. Accordingly, ATSS appear to have the technological capability to restrict the display or publication of orders on their books. Thus, in the Commission's view, the NASD's amendments to its trading halt rule to cover security futures are not overly burdensome or inappropriate.

Finally, the Commission believes that the proposed rule is consistent with the goals expressed in section 11A(a)(1)(C) of the Act,<sup>21</sup> which grants the Commission the authority to require rules designed to ensure appropriate protection of investors and the maintenance of fair and orderly markets to assure: (1) Economically efficient execution of securities transactions; (2) fair competition among brokers and dealers; (3) the availability to brokers, dealers and investors of information with respect to quotations and transactions in securities; (4) the practicability of brokers executing investors' orders in the best market; and (5) an opportunity for investors' orders to be executed without the participation of a dealer.

#### V. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

For the reasons discussed below, the Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the 30th day after the date of publication of notice thereof in the **Federal Register**.

In Amendment No. 1, the NASD proposed NASD rule 3115(a)(15) to indicate that the ATS audit trail for security futures trading would include "an account identifier that relates the order back to the account owner(s)," and amended NASD rule 3340(b)(2) to increase the percentage of the market capitalization of underlying securities subject to a trading halt in a narrow-

based security index from 30% to 50%. The NASD amended the rule to include the account identifier provision because the account identifier has traditionally been a key component of an audit trail. The percentage increase from 30% to 50% in the market capitalization of underlying securities that triggers a trading halt in futures on a narrow-based security index was also proposed to more closely mirror rules approved by the Commission and the Commodity Futures Trading Commission ("CFTC") with respect to trading halts in security futures products.<sup>22</sup> As Amendment No. 1, does not raise any novel regulatory issues, the Commission finds that granting accelerated approval to Amendment No. 1 is appropriate and consistent with section 19(b)(2) of the Act.<sup>23</sup>

#### VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendments No. 1 to NASD-2001-47, including whether the proposed amendment 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 Amendment No. 1 to File No. SR-NASD-2001-47 and should be submitted by February 24, 2003.

#### VII. Conclusion

For the foregoing reasons, the Commission finds that the proposal, as amended, is consistent with the requirements of the Act and rules and regulations hereunder.

<sup>22</sup> See Securities and Exchange Act Release No. 34-45956 (May 17, 2002), 67 FR 36741 (May 24, 2002) (Cash Settlement and Regulatory Halt Requirements for Security Futures Products, Joint Final Rule of CFTC and the Commission).

<sup>23</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 15 U.S.C. 78o-3.

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

<sup>16</sup> 15 U.S.C. 78o-3(b)(11).

<sup>17</sup> 15 U.S.C. 78f(h)(5)(B) and (C).

<sup>18</sup> See 15 U.S.C. 78f(h)(5)(B).

<sup>19</sup> See 15 U.S.C. 78f(h)(5)(C).

<sup>20</sup> See 15 U.S.C. 78f(h)(5)(c).

<sup>21</sup> 15 U.S.C. 78k-1(a)(1)(C).

It is therefore ordered, pursuant to section 19(b)(2) of the Act, <sup>24</sup> that the proposed rule change (SR-NASD-2001-47), as amended, is approved.

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

Jill M. Peterson,

Assistant Secretary.

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-47253; File No. SR-NYSE-2001-27]

**Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Relating to Amendments to Section 804 of the Listed Company Manual and Rule 499 of the Exchange**

January 24, 2003.

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 August 17, 2001, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") 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 the NYSE. On January 22, 2003, the NYSE filed Amendment No. 1 to the proposed rule change with the Commission.<sup>3</sup> 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**

The NYSE proposes to amend Section 804 of the Listed Company Manual to specify that public directors will constitute a majority of the directors of

the Committee for Review voting on final delisting determinations. The NYSE also proposes to codify this change in the parallel Exchange Rule 499, as well as make other minor conforming changes.

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

\* \* \* \* \*

**804.0 Procedure for Delisting**

• If the Exchange staff should determine that a security be removed from the list, it will so notify the issuer in writing, describing the basis for such decision and the specific policy or criterion under which such action is to be taken. The Exchange will simultaneously (1) issue a press release disclosing the company's status and basis for the Exchange's determination and (2) begin daily dissemination of ticker and information notices identifying the security's status, and include similar information on the Exchange's web site.

• The notice to the issuer shall also inform the issuer of its right to a review of the determination by a Committee of the Board of Directors of the Exchange ([comprised of] a majority of the *members of such Committee voting on each determination must be public* Directors), provided a written request for such a review is filed with the Secretary of the Exchange within ten business days after receiving the aforementioned notice.

\* \* \* \* \*

If a review is requested, the review will be scheduled for the first Review Day which is at least 25 business days from the date the request for review is filed with the Secretary of the Exchange, unless the next subsequent Review Day must be selected to accommodate the Committee's schedule. *The chairman of the Committee will disclose to the company and the staff at the commencement of the review which of the industry Directors present will be voting on the matter, although all directors will be entitled to participate in the discussion.* The Committee's review and final decision shall be based on oral argument (if any) and the written briefs and accompanying materials submitted by the parties.

\* \* \* \* \*

**Delisting of Securities**

Suspension from Dealings or Removal from List by Action of the Exchange

\* \* \* \* \*

Rule 499. Securities admitted to the list may be suspended from dealings or removed from the list at any time.

\* \* \* Supplementary Material

\* \* \* \* \*

**.70 Procedure for Delisting**

a. If the Exchange staff should determine that a security be removed from the list, it will so notify the issuer in writing, describing the basis for such decision and the specific policy or criterion under which such action is to be taken. The Exchange will simultaneously (1) issue a press release disclosing the company's status and basis for the Exchange's determination and (2) begin [appending a suffix to the security's ticker symbol identifying the security's status] *daily dissemination of ticker and information notices identifying the security's status, and include similar information on the Exchange's web site.* The notice to the issuer shall also inform the issuer of its right to a review of the determination by a Committee of the Board of Directors of the Exchange ([comprised of] a majority of the *members of such Committee voting on each determination must be public* Directors), provided a written request for such a review is filed with the Secretary of the Exchange within ten business days after receiving the aforementioned notice.

\* \* \* \* \*

c. If a review is requested, the review will be scheduled for the first Review Day which is at least 25 business days from the date the request for review is filed with the Secretary of the Exchange, unless the next subsequent Review Day must be selected to accommodate the Committee's schedule. *The chairman of the Committee will disclose to the company and the staff at the commencement of the review which of the industry Directors present will be voting on the matter, although all directors will be entitled to participate in the discussion.* The Committee's review and final decision shall be based on oral argument (if any) and the written briefs and accompanying materials submitted by the parties.

\* \* \* \* \*

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

In its filing with the Commission, the NYSE 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. The NYSE has prepared summaries, set forth in

<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).

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

<sup>3</sup> See letter from Darla Stuckey, Corporate Secretary, NYSE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated January 17, 2003 ("Amendment No. 1"). In Amendment No. 1, the Exchange replaced its original proposal in its entirety. In part, the Exchange clarified its rotation system with respect to the industry directors voting on a particular matter, clarified the basis for a decision made by the Committee for Review, specified the quorum requirements for the Committee for Review, and made conforming changes to the Exchange's rule text.