

spreads in question are simply another way of expressing a collection of two or more basic option spreads (*i.e.*, the butterfly spread, the box spread, and the time spread) already covered under the margin rules. The proposed Regulatory Circular is intended to be a temporary measure and will operate as a pilot for one year from the date of approval of the Regulatory Circular by the Commission.

The Regulatory Circular provides that CBOE members may collect a specific amount of margin for each of the seven identified complex spreads.

Specifically, the Regulatory Circular will allow CBOE member organizations to require margin for the identified complex spreads, whether they are established outright or through netting, of not less than the sum of the margin required on each basic spread in its corresponding package.

**III. Summary of Comments**

As noted above, the Commission received one comment in response to the proposed rule change, which supported the proposal. The commenter believed that the issuance of the Regulatory Circular will resolve ambiguity concerning the appropriate margin treatment for these complex spreads, which will benefit all market participants for whom options are an important part of their investment programs.

**IV. Discussion**

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of Section 6 of the Act<sup>5</sup> and the rules and regulations thereunder applicable to a national securities exchange.<sup>6</sup> In particular, the Commission finds that the proposed Regulatory Circular is consistent with Section 6(b)(5) of the Act,<sup>7</sup> which requires, among other things, that the Exchange's rules be designed to perfect

the mechanisms of a free and open market and, in general, to protect investors and the public interest. The Commission believes that the Regulatory Circular should clarify the margin requirements for the identified complex spreads.

The Commission notes that this approval will operate as a one-year pilot from the date of approval of the proposed rule change. The Commission expects that during the pilot period, the CBOE will work to submit a proposed rule change to permanently implement the margin requirements for the subject complex spreads.

**V. Conclusion**

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change, as amended (SR-CBOE-2003-24), is approved until August 7, 2004.

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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**BILLING CODE 8010-01-U**

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-48316; File No. SR-NASD-2003-116]

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Modify the Fees Paid by NNMS Order Entry Firms for Certain Order Executions Through Nasdaq's SuperMontage System**

August 11, 2003.

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

(“Act”),<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on July 31, 2003, the National Association of Securities Dealers, Inc. (“NASD”), through its subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”), submitted to 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 this proposal as one establishing or changing a due, fee or other charge under Section 19(b)(3)(A)(ii) of the Act<sup>3</sup> and Rule 19b-4(f)(2) thereunder.<sup>4</sup> 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 proposes to modify the fees paid by NNMS Order Entry Firms (“OE Firms”) for certain order executions through Nasdaq's SuperMontage system. Nasdaq implemented the rule change on August 1, 2003.

Below is the text of the proposed rule change. Proposed new language is italicized; proposed deleted language is bracketed.

\* \* \* \* \*

**7000. CHARGES FOR SERVICES AND EQUIPMENT**

7010. System Services

(a)-(h) No change.

(i) Nasdaq National Market Execution System (SuperMontage).

The following charges shall apply to the use of the Nasdaq National Market Execution System (commonly known as SuperMontage) by members:

**Order Entry**

Non-Directed Orders (excluding Preferred Orders) ..... No charge

Preferred Orders:

Preferred Orders that access a Quote/Order of the member that entered the Preferred Order) ..... No charge

Other Preferred Orders ..... \$0.02 per order entry

Directed Orders ..... \$0.10 per order entry

**Order Execution**

Non-Directed or Preferred Order that accesses the Quote/Order of a market participant that does not charge an access fee to market participants accessing its Quotes/Orders through the NNMS:

Charge to member entering order ..... \$0.003 per share executed (but no more than \$120 per trade for trades in securities executed at \$1.00 or less per share)

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

<sup>6</sup> In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<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> 15 U.S.C. 78s(b)(3)(A)(ii).

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

Credit to member providing liquidity .....	\$0.002 per share executed (but no more than \$80 per trade for trades in securities executed at \$1.00 or less per share)
Non-Directed or Preferred Order that accesses the Quote/Order of a market participant that charges an access fee to market participants accessing its Quotes/Orders through the NNMS.	\$0.001 per share executed (but no more than \$40 per trade for trades in securities executed at \$1.00 or less per share)
Directed Order .....	\$0.003 per share executed
Non-Directed or Preferred Order entered by a <i>member</i> [Nasdaq Quoting Market Participant] that accesses its own Quote/Order.	No charge
[Non-Directed Order entered by an NNMS Order Entry Firm that accesses its own Quote/Order].	[\$0.001 per share executed (but no more than \$40 per trade for trades in securities executed at \$1.00 or less per share)]
<b>Order Cancellation</b>	
Non-Directed and Preferred Orders .....	No charge
Directed Orders .....	\$0.10 per order cancelled

(j)–(s) No change.

\* \* \* \* \*

**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 May 12, 2003, the Commission approved<sup>5</sup> on a permanent basis a proposed rule change to allow OE Firms<sup>6</sup> to enter non-marketable limit orders into SuperMontage using the SIZE Market Participant Identifier (“SIZE”).<sup>7</sup> The program had originally been approved on a 90-day pilot basis, beginning on February 10, 2003.<sup>8</sup>

At the beginning of the 90-day pilot period, Nasdaq did not assess a charge (or provide a liquidity provider credit) when a market participant’s non-

directed or preferred order executed against its own Quote/Order. Effective April 1, 2003, however, Nasdaq modified its SuperMontage fee schedule to provide that an OE Firm entering a non-directed order that accesses a limit order that the OE Firm itself posted in SIZE would pay \$0.001 per share executed (but no more than \$40 per trade for trades in securities executed at \$1.00 or less per share).<sup>9</sup> In situations where a Quoting Market Participant’s order executes against its own Quote/Order, however, the order execution remained free.

The discount for Quoting Market Participants is based, in part, on an expectation that, in its absence, many Quoting Market Participants would internalize a greater percentage of orders through their own proprietary crossing systems, rather than exposing them to the full market. Based on experience with the program for OE Firms’ use of SIZE, however, Nasdaq has concluded that applying the discount to OE Firms’ orders may also encourage OE Firms to expose a greater percentage of their orders through SuperMontage, in lieu of internalizing them or routing them to competing market centers. Accordingly, Nasdaq is eliminating the \$0.001 fee applicable to order executions in which an OE Firm’s non-directed order is matched with the same firm’s order in SIZE.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act<sup>10</sup> in general, and with Section 15A(b)(5) of the Act<sup>11</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which the NASD operates or controls. Nasdaq states that the proposed rule change will result in an elimination of

the fees payable by an OE Firm for non-directed orders that execute against orders entered by the OE Firm in SIZE. As a result, Nasdaq believes that the fees assessed on OE Firms and Quoting Market Participants for use of SuperMontage will now be identical in all respects.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary and 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 foregoing rule change has become effective upon filing pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>12</sup> and subparagraph (f)(2) of Rule 19b–4 thereunder,<sup>13</sup> because it establishes or changes a due, fee, or other charge imposed by the self-regulatory organization. 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

<sup>5</sup> See Securities Exchange Act Release No. 47830 (May 12, 2003), 68 FR 27126 (May 19, 2003) (SR–NASD–2003–37) (“May Approval Order”).

<sup>6</sup> As noted in the May Approval Order, Nasdaq interprets the term “NNMS Order Entry Firm” to encompass NNMS Market Makers to the extent that they do not make markets in particular stocks. In SuperMontage, such firms are treated the same as other OE Firms when placing orders into the system for stocks in which they do not make a market.

<sup>7</sup> SIZE is the anonymous market participant identifier (“MPID”) that represents the aggregate size of all Non-Attributable Quotes and Orders entered by market participants in Nasdaq at a particular price level. Non-Attributable Quotes and Orders are not displayed in the Nasdaq Quotation Montage using the market participant’s MPID.

<sup>8</sup> See Securities Exchange Act Release No. 47301 (January 31, 2003), 68 FR 6236 (February 6, 2003) (SR–NASD–2002–173).

<sup>9</sup> See Securities Exchange Act Release No. 47530 (March 19, 2003), 68 FR 14730 (March 26, 2003) (SR–NASD–2003–30).

<sup>10</sup> 15 U.S.C. 78o–3.

<sup>11</sup> 15 U.S.C. 78o–3(b)(5).

<sup>12</sup> 15 U.S.C. 78s(b)(3)(a)(ii).

<sup>13</sup> 17 CFR 240.19b–4(f)(2).

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 No. SR-NASD-2003-116 and should be submitted by September 5, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48307; File No. SR-NYSE-2002-63]

### Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Relating to Amendments to Rules 98, 104A.50, 105, and 900 To Permit Single Stock Futures Hedging by Specialists

August 8, 2003.

#### I. Introduction

On November 21, 2002, the New York Stock Exchange ("NYSE" or "Exchange") 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 amend certain Exchange rules to permit single stock futures hedging by specialists. On January 10, 2003, the rule proposal was published for comment in the *Federal Register*.<sup>3</sup> On July 23, 2003 the NYSE filed Amendment No. 1 to the proposed rule

change.<sup>4</sup> The Commission received no comments on the proposed rule change. This order approves the proposed rule change, as amended, grants accelerated approval of Amendment No. 1 and solicits comments from interested persons on Amendment No. 1.

#### II. Description of the Rule Change

Under the rule change, the Exchange will permit specialists to use security futures overlying single securities (hereinafter referred to as "single stock futures") to hedge specialty stock positions. Rule 105 currently permits specialists to use options to hedge their specialty stock positions. Specifically, the Exchange is amending Rules 105, 98, 104A.50, and 900(d)(v).

##### *Amendments to Rule 105*

The Exchange is amending paragraph (d) of the Guidelines to Rule 105 (the "Guidelines") to explain the conditions under which single stock futures may be used to hedge an existing specialty stock. Under the rule change, anticipatory hedging is not permitted. As is the case under Rule 105 with options, only existing specialty stock positions may be hedged.

As amended, Rule 105 will provide three conditions (similar to those applicable to options) that single stock futures transactions must meet:

(i) The transaction must result in a net futures position on the opposite side of the market from the underlying specialty stock position;

(ii) The transaction must be effected solely to offset the risk of making a market in the underlying specialty stock; and

(iii) The resulting net futures position must not exceed the number of shares of the specialty stock position that the specialist is offsetting.

Any single stock futures transaction that does not meet all three of the above conditions would be deemed to be in violation of Rule 105.

Under the rule change, a specialist would be able to use one single stock futures contract to hedge each 100

shares of the existing specialty stock position. A hedge that subsequently exceeds the specialty stock position being hedged as a result of 25% or more in the specialist's stock position or which becomes on the same side of the market as the specialty stock position must be liquidated, unless the equivalent share position is 5000 shares or less.

Similarly, Rule 105 will be amended to specify that, as with options, specialists may also not front-run blocks and must record futures positions in a separate "memo" account. Additionally, specialists must report to the Exchange: (i) accounts in which single stock futures positions are held and (ii) their positions in single stock futures.

Rule 105 permits an approved person of a specialist to act as a primary market maker or specialist with respect to an option on a specialty stock, provided all the requirements of the Rule 98 exemptive program are met. This provision will be amended to incorporate references to market makers in single stock futures so that an approved person of an equity specialist may act as a primary market maker or specialist with respect to a stock futures contract, provided all the requirements of the Rule 98 exemptive program are met.

In addition, Rule 105 prohibits an approved person of an equity specialist from acting as a market maker in any equity security in which the associated specialist is registered as such and which underlies an option as to which the approved person acts as an options market maker. Under the rule change, the same prohibition will apply with respect to market makers in single stock futures contracts.

The Exchange is adding a provision to Rule 105 to explain the combined use of both options and single stock futures to hedge specialty stock positions. Under the rule change, if a specialist chooses to hedge a specialty stock position with positions in both options and single stock futures, the resulting total market position, when established, may not exceed the size of the existing specialty stock position being hedged. Any excess or same side of the market equivalent position must be liquidated in accordance with the provisions of Rule 105.

##### *Other Proposed Amendments*

In addition to the amendments to Rule 105, the Exchange is amending Rules 98, 104A.50, and 900(d)(v) to incorporate appropriate references to single stock futures.

<sup>14</sup> 17 CFR 200.30-3(a)(12).

<sup>15</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. 47160 (January 10, 2003), 68 FR 02064 (January 17, 2003).

<sup>4</sup> In Amendment No. 1, the Exchange amended the definition of "security future" in Rule 105(b) to conform it to the definition of that term in section 3(a)(55) of the Act for uniformity. The Exchange also made certain technical changes to the proposed rule text and added an example that describes the way a combination of options and single stock futures contracts may be used to hedge a specialty stock position. In addition, the Exchange acknowledged that the prohibition in section 6(h)(1) of the Act on effecting transactions in security futures products that are not listed on a national securities exchange would apply to the transactions permitted under the proposed rule change. The Exchange stated further that it will remind its members of this prohibition when it announces the approval of the proposed rule change.