

arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CHX-2006-05 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-CHX-2006-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CHX-2006-05 and should be submitted on or before September 8, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>167</sup>

**Nancy M. Morris,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54313; File No. SR-NASD-2006-099]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendments to Procedures for the Exercise of Options

August 14, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 10, 2006, the National Association of Securities Dealers, Inc. ("NASD") 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 NASD. NASD filed the proposal as a "non-controversial" proposed rule change pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission.<sup>5</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

NASD proposes to amend Rule 2860(b)(23) (Tendering Procedures for Exercise of Options) to: (1) Simplify the manner in which a Contrary Exercise Advice ("CEA") is submitted; (2) extend by one hour the cut-off time by which members must submit CEA notices; (3) add procedures for exercising a standardized equity option when a modified close of trading is announced; and (4) consolidate all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) instead of having additional and overlapping provisions in Rule 11850 (Tendering Procedures for Exercise of Options) as it currently the case. The text of the proposed rule change is available at NASD, at the Commission, and at [www.nasd.com](http://www.nasd.com).

<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).

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

<sup>5</sup> NASD gave the Commission written notice of its intent to file the proposed rule change on June 16, 2006. See Rule 19b-4(f)(6)(iii). 17 CFR 240.19b-4(f)(6)(iii).

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

In its filing with the Commission, NASD 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. NASD 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

NASD proposes to amend Rule 2860(b)(23) (Tendering Procedures for Exercise of Options) to conform to recent changes of the substantially similar rules of the Options Exchanges.<sup>6</sup> The proposed rule change presents no novel issues.

The proposed rule change simplifies the manner in which a Contrary Exercise Advice ("CEA") is submitted, extends by one hour the cut-off time by which members must submit CEA notices, and adds procedures for exercising a standardized equity option when a modified close of trading is announced. The proposed rule change also consolidates all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) instead of having additional and overlapping provisions in Rule 11850 (Tendering Procedures for Exercise of Options) as is currently the case.

The provisions in Rule 2860(b)(23) apply only to members that are not also members of the exchange on which the option is listed and traded, so-called "access firms."<sup>7</sup> Inasmuch as access firms are not members of an options exchange, it is necessary that the NASD rule subject such firms and customers of such firms to the same requirements for CEAs as customers and firms that are members of an options exchange.

Currently, Rule 2860(b)(23)(A) generally requires that members cannot accept instructions to exercise a

<sup>6</sup> See Rule 980 of the American Stock Exchange; Rule 1042 of the Philadelphia Stock Exchange; Rule 6.24 of the NYSE Arca (formerly the PCX); Rule 11.1 and related Regulatory Circulars RG03-41 and RG 03-54 of the Chicago Board Options Exchange; Rule 1100 of the International Securities Exchange; and Chapter VII Section 1 of the Boston Options Exchange (collectively referred to as the "Options Exchanges").

<sup>7</sup> See Rule 2860(b)(1)(A)(ii).

<sup>167</sup> 17 CFR 200.30-3(a)(12).

standardized option from the account of any customer or any other member after 5:30 p.m. Eastern Time ("ET") on the business day immediately prior to the expiration date of an option contract. Rule 2860(b)(23)(A) also provides for an exception to this exercise cut-off time for specified reasons. Rule 2860(b)(23)(B) requires that members maintain records for each exercise instruction. Additional procedures with respect to the exercise of standardized options contracts that are not included in Rule 2860 are provided in Rule 11850 of the Uniform Practice Code and address The Options Clearing Corporation's ("OCC") exercise-by-exception procedures ("Ex-by-Ex"). The Ex-by-Ex procedures set forth in OCC Rule 805 provide for the automatic exercise of certain options that are in-the-money by a specified amount. Under the Ex-by-Ex procedures, option holders holding an option contract that is in-the-money by a requisite amount and who wish to have their contracts automatically exercised need to take no further action.

However, under OCC Rule 805, option holders who do not want their options automatically exercised or who want their options to be exercised under different parameters than that of the Ex-by-Ex procedure must file a CEA with a national options exchange of which they are a member or where the equity option is listed in accordance with Rule 11850 and instruct the OCC of their "contrary intention." Rule 11850 is designed, in part, to deter individuals from taking improper advantage of late breaking news by requiring evidence of an options holder's intention to exercise or not exercise expiring equity options via the submission of a CEA. Members satisfy the filing requirement by manually submitting a CEA form or by electronically submitting the CEA through OCC's electronic communications system.

If the OCC has waived the Ex-by-Ex procedures for an options class, a member is still required to submit a CEA if the member wants to exercise a standardized equity option that would not have been automatically exercised, or not to exercise a standardized equity option that would have been automatically exercised, had the Ex-by-Ex procedure been in effect.

The Ex-by-Ex procedures contained in the rules of Options Exchanges have recently been amended.<sup>8</sup> In addition,

<sup>8</sup> See Securities Exchange Act Release Nos. 47885 (May 16, 2003), 68 FR 28309 (May 23, 2003) (SR-AMEX-2001-92) (approval order); 48639 (October 16, 2003), 68 FR 60764 (October 23, 2003) (SR-PHLX-2003-65); 48640 (October 16, 2003), 68 FR 60757 (October 23, 2003) (SR-PCX-2003-47);

the Options Exchanges' rules contain provisions for exercising an equity option in the event of a modified close of trading. NASD proposes to (1) amend its rules to conform to the changes to the similar rules of the Options Exchanges, and (2) consolidate the provisions pertaining to the procedures for exercising standardized options set forth in Rule 11850 into Rule 2860(b)(23).

Specifically, Rule 2860(b)(23)(A)(i) would be amended to mirror the provisions of Rule 11850(a)(1) and provide that members may establish fixed procedures as to the latest time they will accept exercise instructions from customers for tender to the OCC.

Rule 2860(b)(23)(A)(ii) would be amended to integrate the provisions of Rule 11850(b)(1)(A) regarding the cut-off time to submit final exercise decisions. In addition, to conform to the similar amendments to the rules of the Options Exchanges, NASD proposes to extend the cut-off time to 6:30 p.m. ET for members to submit CEAs for customer accounts. NASD further proposes to allow members to submit CEAs for non-customer accounts by 6:30 p.m. ET, but only if such member employs an electronic procedure with time stamp recording for the submission of exercise instructions by options holders. Members would have to establish fixed procedures to ensure secure time stamps in connection with the utilization of the electronic stamp provision. If a member does not employ an electronic time stamp and appropriate procedures to ensure secure time stamps, the member would have to submit CEAs for non-customer accounts by 5:30 p.m. ET.

NASD believes that granting members additional time to submit CEAs or Advice Cancels is necessary to address a concern that a 5:30 p.m. ET cut-off time is problematic for customer accounts due to logistical difficulties in the time required to receive customer exercise instructions, and, subsequently, to process them through retail branch systems and back offices before submitting them. NASD believes that extending the cut-off times for CEAs and Advice Cancels for non-customer accounts, if electronically time stamped, is fair and provides for consistent regulation. NASD does not propose to extend the submission cut-off time for members that manually submit CEA and Advice Cancels due to difficulties involved in monitoring manual procedures.

49275 (February 18, 2004), 69 FR 8713 (February 25, 2004) (SR-CBOE-2003-47); 48505 (September 17, 2003), 68 FR 55680 (September 26, 2003) (SR-ISE-2003-20); and 49191 (February 4, 2004), 69 FR 7055 (February 12, 2004) (SR-BSE-2004-04).

Rule 2860(b)(23)(A)(iii) would be amended to incorporate the provisions of Rule 11850(b)(1)(A) regarding the Ex-by-Ex procedures together with conforming language and definitional changes to harmonize the rule with the rules of the Options Exchanges.

A new subparagraph (iv) would be added to Rule 2860(b)(23)(A) to parallel the provisions of Rule 11850(b)(1)(B) for cases in which the Ex-by-Ex procedure has been waived. New subparagraph (iv) also would track the amended rules of the Options Exchanges that provide that no CEA is required to be filed if the option holder does not wish to exercise the expiring standardized equity option.

Rule 2860(b)(23)(A)(v) would provide (as currently provided in Rule 11850(b)(1)(C)) that members that maintain proprietary or public customer positions in expiring standardized equity options must take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. In addition, members that have accepted the responsibility to indicate final exercise decisions on behalf of another member also must take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange.

Rule 2860(b)(23)(A)(vi) would retain the provision (as currently provided in Rule 2860(b)(23)(A)(ii) and Rule 11850(b)(2)) that would allow members to make final exercise decisions after the exercise cut-off time, but before expiration of the standardized equity option subject to the same exceptions as Rule 11850 currently provides which are also consistent with the rules of the Options Exchanges.<sup>9</sup> Rule 2860(b)(23)(B) would also retain the requirements for reporting and record keeping obligations when a member relies on these exceptions as amended by incorporating provisions from Rule 11850(b)(3).

NASD also proposes to add to Rule 2860 a similar provision as found in the rules of the Options Exchanges that address when an options exchange or the OCC establishes a different exercise cut-off time.<sup>10</sup> Specifically, proposed Rule 2860(b)(23)(A)(vii) would apply when a different or modified close of trading is announced. In such cases, the

<sup>9</sup> See Securities Exchange Act Release No. 35389 (February 16, 1995) 60 FR 10135 (February 23, 1995) (SR-NASD-94-78) regarding the Commission's approval of NASD's deletion of the exemption in Rule 11850 that applies "in the case of options contracts carried in an account maintained for another member in which only positions of customers of such other member are carried" in order to conform to the rules of the Options Exchanges.

<sup>10</sup> See *supra* note 6.

option exchange or the OCC would have forewarning of the event and would be required to provide notice of the change in the exercise cut-off time by 5:30 p.m. ET on the business day prior to the last trading day before expiration. Under such circumstances, the deadline for making a final decision to exercise or not exercise would be 1 hour and 28 minutes following the time announced for the close of trading on that day. With respect to the submission of a CEA by members, the cut-off time would be 2 hours and 28 minutes after the close of trading for customer accounts and non-customer accounts where the member firm employs an electronic procedure with time stamp for the submission of exercise instructions. Members that do not employ an electronic submission procedure for exercise instructions would be required to submit a CEA within 1 hour and 28 minutes after the close of trading for its non-customer accounts.

Proposed subparagraphs (viii), (ix) and (x) of Rule 2860(b)(23)(A), wholly incorporate the provisions of Rule 11850(b)(4) through (6), respectively. As noted above, Rule 2860(b)(23)(B) requiring recordkeeping of instructions would be retained and amended by incorporating provisions from Rule 11850(b)(3).

Finally, paragraphs (C) and (D) of Rule 2860(b)(23) govern the allocation of exercise assignment notices and delivery and payment, respectively. Rule 11850(c) and (d) of the Uniform Practice Code have the same provisions as Rule 2860(b)(23) with regard to these provisions. Accordingly, these provisions are deleted from Rule 11850 as they are covered in Rule 2860(b)(23)(C) and (D).

NASD believes that the proposed rule change is necessary to provide its members that are not members of an options exchange with the same treatment as members of the Options Exchanges. Furthermore, as noted above, the proposed rule change will streamline and simplify the NASD rules as well as harmonize NASD's rule with those of the Options Exchanges.

NASD has filed the proposed rule change for immediate effectiveness. NASD will announce the implementation date of the proposed rule change in a *Notice to Members* to be published no later than 60 days following the filing of the rule change with the Commission for immediate effectiveness. The implementation date will be 30 days after the date of the *Notice to Members*.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>11</sup> which requires, among other things, that NASD rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes the proposed rule change will streamline and simplify NASD rules by consolidating overlapping provisions. In addition, NASD believes the proposed rule change will promote consistent regulation by harmonizing NASD's rule with those of the Options Exchanges.

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

NASD does not believe that the proposed rule change will 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

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, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>12</sup> and Rule 10b-4(f)(6) thereunder.<sup>13</sup>

At any time within 60 days of the filing of such 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. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2006-099 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-099. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2006-099 and should be submitted on or before September 8, 2006.

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

**Nancy M. Morris,**

*Secretary.*

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<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

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

<sup>13</sup> 17 CFR 240.19b-4(f)(6).

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