

assessments that are required to be paid by national securities exchanges and national securities associations pursuant to Section 31(d) of the Exchange Act for security futures transactions. The proposed amendments to Rule 31-1 also provide guidance on how to calculate fees that are required to be paid by national securities exchanges and national securities associations pursuant to Sections 31(b) and (c) of the Exchange Act, respectively, for sales of securities that result from the physical settlement of security futures.

2. The Commission will consider proposed rules to be issued jointly by the Commission and the Department of the Treasury implementing section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001. Section 326 requires the Secretary of the Treasury to jointly prescribe with the Commission regulations that, at a minimum, require broker-dealers and mutual funds to implement reasonable procedures to (1) verify the identity of any person seeking to open an account, to the extent reasonable and practicable, (2) maintain records of the information used to verify the person's identity, and (3) determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the broker-dealer or mutual fund by any government agency.

At times, changes in Commission priorities require alterations in the scheduling of meeting items. For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact: The Office of the Secretary at (202) 942-7070.

Dated: June 25, 2002.

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46097; File No. SR-NASD-2002-69]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Posting of Margin Disclosure and Day-Trading Risk Disclosure Statements on Web Sites

June 20, 2002.

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 May 30, 2002, the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”), 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 NASD Regulation. 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 Regulation is proposing to amend NASD Rules 2341 and 2361 to require the posting of certain investor disclosure statements on members' Web sites. Specifically, the proposed rule change would amend: (1) Rule 2341 (Margin Disclosure Statement) to require members that permit customers to open accounts on-line or to engage in transactions in securities on-line to post the margin disclosure statement on their Web sites; and (2) Rule 2361 (Day-Trading Risk Disclosure Statement) to require members that promote a day-trading strategy to post the day-trading risk disclosure statement on their Web sites. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

#### 2341. Margin Disclosure Statement

(a) No member shall open a margin account, as specified in Regulation T of the Board of Governors of the Federal Reserve System, for or on behalf of a non-institutional customer, unless, prior to or at the time of opening the account, the member has furnished to the customer, individually, in writing or electronically, and in a separate document, the [following] margin disclosure statement[ *specified in this paragraph (a). In addition, any member that permits non-institutional customers either to open accounts on-line or to engage in transactions in securities on-line must post such margin disclosure statement on the member's Web site in a clear and conspicuous manner.*]

#### Margin Disclosure Statement

Your brokerage firm is furnishing this document to you to provide some basic facts about purchasing securities on margin, and to alert you to the risks involved with trading securities in a

margin account. Before trading stocks in a margin account, you should carefully review the margin agreement provided by your firm. Consult your firm regarding any questions or concerns you may have with your margin accounts.

When you purchase securities, you may pay for the securities in full or you may borrow part of the purchase price from your brokerage firm. If you choose to borrow funds from your firm, you will open a margin account with the firm. The securities purchased are the firm's collateral for the loan to you. If the securities in your account decline in value, so does the value of the collateral supporting your loan, and, as a result, the firm can take action, such as issue a margin call and/or sell securities or other assets in any of your accounts held with the member, in order to maintain the required equity in the account.

It is important that you fully understand the risks involved in trading securities on margin. These risks include the following:

- *You can lose more funds than you deposit in the margin account.* A decline in the value of securities that are purchased on margin may require you to provide additional funds to the firm that has made the loan to avoid the forced sale of those securities or other securities or assets in your account(s).

- *The firm can force the sale of securities or other assets in your account(s).* If the equity in your account falls below the maintenance margin requirements, or the firm's higher “house” requirements, the firm can sell the securities or other assets in any of your account held at the firm to cover the margin deficiency. You also will be responsible for any short fall in the account after such a sale.

- *The firm can sell your securities or other assets without contacting you.* Some investors mistakenly believe that a firm must contact them for a margin call to be valid, and that the firm cannot liquidate securities or other assets in their accounts to meet the call unless the firm has contacted them first. This is not the case. Most firms will attempt to notify their customers of margin calls, but they are not required to do so. However, even if a firm has contacted a customer and provided a specific date by which the customer can meet a margin call, the firm can still take necessary steps to protect its financial interests, including immediately selling the securities without notice to the customer.

- *You are not entitled to choose which securities or other assets in your account(s) are liquidated or sold to meet a margin call.* Because the securities are

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

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

collateral for the margin loan, the firm has the right to decide which security to sell in order to protect its interests.

- *The firm can increase its "house" maintenance margin requirements at any time and is not required to provide you advance written notice.* These changes in firm policy often take effect immediately and may result in the issuance of a maintenance margin call. Your failure to satisfy the call may cause the member to liquidate or sell securities in your account(s).

- *You are not entitled to an extension of time on a margin call.* While an extension of time to meet margin requirements may be available to customers under certain conditions, a customer does not have a right to the extension.

\* \* \* \* \*

(c) In lieu of providing the disclosures specified in paragraphs (a) and (b), a member may provide to the customer *and, to the extent required under paragraph (a) post on its Web site*, an alternative disclosure statement, provided that the alternative disclosures shall be substantially similar to the disclosures specified in paragraphs (a) and (b).

\* \* \* \* \*

#### 2361. Day-Trading Risk Disclosure Statement

(a) Except as provided in paragraph (b), no member that is promoting a day-trading strategy, directly or indirectly, shall open an account for or on behalf of a non-institutional customer unless, prior to opening the account, the member has furnished to each customer, individually, in writing or electronically, the [following] disclosure statement[:] *specified in this paragraph (a).* In addition, any member that is promoting a day-trading strategy, directly or indirectly, must post such disclosure statement on the member's Web site in a clear and conspicuous manner.

#### *Day-Trading Risk Disclosure Statement*

You should consider the following points before engaging in a day-trading strategy. For purposes of this notice, a "day-trading strategy" means an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities.

**Day-trading can be extremely risky.** Day-trading generally is not appropriate for someone of limited resources and limited investment or trading experience and low risk tolerance. You should be prepared to lose all of the

funds that you use for day-trading. In particular, you should not fund day-trading activities with retirement savings, student loans, second mortgages, emergency funds, funds set aside for purposes such as education or home ownership, or funds required to meet your living expenses. Further, certain evidence indicates that an investment of less than \$50,000 will significantly impair the ability of a day trader to make a profit. Of course, an investment of \$50,000 or more will in no way guarantee success.

**Be cautious of claims of large profits from day-trading.** You should be wary of advertisements or other statements that emphasize the potential for large profits in day-trading. Day-trading can also lead to large and immediate financial losses.

**Day-trading requires knowledge of securities markets.** Day-trading requires in-depth knowledge of the securities markets and trading techniques and strategies. In attempting to profit through day-trading, you must compete with professional, licensed traders employed by securities firms. You should have appropriate experience before engaging in day-trading.

**Day-trading requires knowledge of a firm's operations.** You should be familiar with a securities firm's business practices, including the operation of the firm's order execution systems and procedures. Under certain market conditions, you may find it difficult or impossible to liquidate a position quickly at a reasonable price. This can occur, for example, when the market for a stock suddenly drops, or if trading is halted due to recent news events or unusual trading activity. The more volatile a stock is, the greater the likelihood that problems may be encountered in executing a transaction. In addition to normal market risks, you may experience losses due to system failures.

**Day-trading will generate substantial commissions, even if the per trade cost is low.** Day-trading involves aggressive trading, and generally you will pay commissions on each trade. The total daily commissions that you pay on your trades will add to your losses or significantly reduce your earnings. For instance, assuming that a trade costs \$16 and an average of 29 transactions are conducted per day, an investor would need to generate an annual profit of \$111,360 just to cover commission expenses.

**Day-trading on margin or short selling may result in losses beyond your initial investment.** When you day trade with funds borrowed from a firm or someone else, you can lose more than

the funds you originally placed at risk. A decline in the value of the securities that are purchased may require you to provide additional funds to the firm to avoid the forced sale of those securities or other securities in your account. Short selling as part of your day-trading strategy also may lead to extraordinary losses, because you may have to purchase a stock at a very high price in order to cover a short position.

**Potential Registration Requirements.** Persons providing investment advice for others or managing securities accounts for others may need to register as either an "Investment Advisor" under the Investment Advisors Act of 1940 or as a "Broker" or "Dealer" under the Securities Exchange Act of 1934. Such activities may also trigger state registration requirements.

(b) In lieu of providing the disclosure statement specified in paragraph (a), a member that is promoting a day-trading strategy may provide to the customer, individually, in writing or electronically, prior to opening the account, *and post on its Web site*, an alternative disclosure statement, provided that:

(1) The alternative disclosure statement shall be substantially similar to the disclosure statement specified in paragraph (a); and

(2) The alternative disclosure statement shall be filed with the Association's Advertising Department (Department) for review at least 10 days prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changes are recommended by the Association, shall be withheld from use until any changes specified by the Association have been made or, if expressly disapproved, until the alternative disclosure statement has been refiled for, and has received, Association approval. The member must provide with each filing the anticipated date of first use.

\* \* \* \* \*

#### **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 Regulation 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 Regulation 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

Introduction

Rules 2341 and 2361 were developed to provide investors with additional and specific risk disclosures concerning margin and day-trading, respectively. Rule 2341, which was adopted in April 2001,<sup>3</sup> is designed to provide investors with information concerning the operation and risks associated with margin trading. NASD Regulation believed that investors' misconceptions about margin requirements, particularly with respect to maintenance margin, could cause investors to underestimate the risks of margin trading and to misunderstand the operation of and reasons for margin calls. Accordingly, NASD Regulation adopted Rule 2341 requiring members to deliver to non-institutional customers a specified disclosure statement that discusses the operation of margin accounts and the risks associated with trading on margin. Each member is required to deliver the margin disclosure statement to the customer prior to or at the opening of a margin account. Rule 2341 also requires that the margin disclosure statement, or an abbreviated version of the statement as set forth in the Rule, be provided to margin customers annually.

Rule 2361, which was adopted in July 2000,<sup>4</sup> is designed to provide investors with information concerning unique risks arising from day-trading activities. Rule 2361 requires firms promoting a day-trading strategy to provide their non-institutional customers with a day-trading risk disclosure statement prior to opening an account. The day-trading risk disclosure statement discusses several factors that a customer should consider before engaging in day-trading, including that the customer should be prepared to lose all of the funds that he or she uses for day-trading and that day-trading on margin may result in losses beyond the initial investment.

Both Rules further permit member firms to develop an alternative disclosure statement substantially similar to the ones provided in the Rules. In the case of Rule 2361, the alternate day-trading risk disclosure statement must be filed with, and approved by, NASD Regulation's Advertising Department.

<sup>3</sup> See Securities Exchange Act Release No. 44223 (April 26, 2001), 66 FR 22274 (May 3, 2001).

<sup>4</sup> See Securities Exchange Act Release No. 43021 (July 10, 2000), 65 FR 44408 (July 17, 2000).

Posting of Disclosure Statements on Web Sites

While Rules 2341 and 2361 currently require that the disclosure statements be delivered individually to each covered customer, either in writing or electronically, the Rules do not require firms to post the statements on their Web sites. Rather, in developing Rules 2341 and 2361, NASD Regulation focused on ensuring that each individual investor received the required risk disclosure statements. NASD Regulation believed that mandating specific delivery of the risk disclosure statements would be the most effective means of ensuring that customers received the required disclosures.

In 2001, following the adoption of Rule 2341 and Rule 2361, the General Accounting Office ("GAO") issued a report that discusses, among other things, actions taken by securities industry regulators to address on-line trading issues.<sup>5</sup> The 2001 GAO Report recognized that Rules 2341 and 2361 require broker/dealers to furnish investors with certain key investor protection disclosures. It also noted that the margin disclosure statement required under Rule 2341 provides substantial information that is very helpful to investors to understand the risks of trading on margin. The GAO expressed concern, however, that while customers covered by Rules 2341 and 2361 were receiving the margin and day-trading risk disclosure statements, additional benefits could be achieved if the disclosures also were provided on-line, noting that many investors who trade on-line may prefer to review information in that medium and that a Web site posing also would make the information available to other on-line investors who are thinking about engaging in the activities covered by the disclosure statements. In this regard, the 2001 GAO Report recommended that the SEC take steps to ensure broker/dealers disclose additional information on their Web sites regarding, among other things, margin requirements and trading risks.<sup>6</sup>

<sup>5</sup> See *On-Line Trading, Investor Protections Have Improved but Continued Attention is Needed*, Report to Congressional Requesters, GAO, 01-858 (July 2001) (the "2001 GAO Report"). The 2001 GAO Report is a follow-up to a GAO report issued in 2000 (*On-Line Trading, Better Investor Protection Information Needed on Brokers' Web Sites*, Report to Congressional Requesters, GAO, General Government Division, 00-43 (May 2000) (the "2000 GAO Report")) that examined how on-line broker/dealers addressed investor protection issues.

<sup>6</sup> Similarly, noting that the SEC has determined from customer complaints it has received that many investors who traded on-line did not understand margin requirements and may not understand the

While many firms currently post the margin and day-trading risk disclosure statements on their Web sites on a voluntary basis, NASD Regulation believes that the investing public could further benefit from the information contained in the statements if additional on-line and day-trading firms were to post them on their Web sites. Accordingly, NASD Regulation is proposing this rule change which will address the GAO's recommendations and enable a broader array of persons to review the information regarding margin requirements and day-trading risks contained in the mandated disclosure statements.

Consistent with the general recommendations raised in the GAO Reports, the proposed rule change would amend: (1) Rule 2341 to require member firms that permit customers to open accounts on-line or to engage in transactions in securities on-line to post the margin disclosure statement on their Web sites; and (2) Rule 2361 to require member firms that promote a day-trading strategy, directly or indirectly, to post the day-trading risk disclosure statement on their Web sites. The firms would be required to post the statements specified in Rules 2341 or 2361, as applicable, or the alternate statements permitted by the Rules. Under the proposal, the disclosure statements must be displayed on the Web site in a "clear and conspicuous manner," or in a clearly identified location that is readily accessible to investors. While compliance with the "clear and conspicuous" standard would be based on the facts and circumstances surrounding each member's Web site, NASD Regulation's primary concern is that firms not post the disclosure statements in a remote place on their Web sites, where investors or potential investors would be unlikely to locate them.

Importantly, the proposed rule change does not affect a member firm's existing requirements under Rules 2341 and 2361 to deliver individually to each customer covered by the Rules, either in writing or electronically, the disclosure statements mandated under the Rules. In addition, while NASD Regulation is not at this time proposing to require on-line firms that do not promote a day-trading strategy as defined in Rule 2361 to post the day-trading risk disclosure statement in addition to the margin disclosure statement on their Web sites, NASD Regulation encourages all on-line

risks they are taking or the rules and procedures for trading, the 2000 GAO Report also recommended that the SEC ensure that broker/dealers with on-line trading systems include certain investor protection information on their Web sites.

firms to do so. NASD Regulation believes that on-line traders may benefit from the information provided in the day-trading risk disclosure statement regardless of whether the on-line firm whose Web site the trader is visiting or using promotes a day-trading strategy.

## 2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must 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 Regulation believes that the proposed rule change requiring certain member firms to post the margin disclosure and day-trading risk disclosure statements on their Web sites will help protect investors and the public interest in a trading environment where increasing numbers of investors are trading on-line or accessing broker/dealers through Web sites.

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

NASD Regulation 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

The proposed rule change has been filed by the Association as a "non-controversial" rule change under Section 19(b)(3)(A) of the Act,<sup>7</sup> and Rule 19b-4(f)(6) thereunder.<sup>8</sup> Because the foregoing proposed rule change: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days after the date of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that NASD Regulation has given the Commission written notice of its intent to file the proposed

rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>9</sup> thereunder.<sup>10</sup>

A proposed rule change filed under Rule 19b-4(f)(6)<sup>11</sup> requires that a self-regulatory organization give the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing the proposed rule change. However, Rule 19b-4(f)(6)(iii)<sup>12</sup> permits the Commission to designate a shorter time. NASD Regulation seeks to have the five-business-day pre-filing requirement waived with respect to the proposed rule change. The Commission has determined to waive the five-business-day pre-filing requirement. The Commission notes that NASD proposes to make the proposed rule change operative on July 1, 2002.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. 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.

<sup>9</sup> 15 U.S.C. 78(b)(3)(A).

<sup>10</sup> 17 CFR 240.19b-4(f)(6).

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

<sup>12</sup> 17 CFR 240.19b-4(f)(6)(iii).

SR-NASD-2002-69 and should be submitted by July 18, 2002.

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

**Margaret H. McFarland,**  
*Deputy Secretary.*

[FR Doc. 02-16257 Filed 6-26-02; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46096; File No. SR-PCX-2001-17]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. Relating to Auto-Ex Price Improvement Incentive for Market Makers

June 20, 2002.

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 January 16, 2002, the Pacific Exchange, Inc. ("PCX" 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 Exchange. On May 3, 2002, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On June 14, 2002, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>4</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 PCX proposes a rule change that is intended to encourage competition among Market Makers for trades on its automatic execution system for options ("Auto-Ex") by rewarding individual

<sup>13</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 Cindy L. Sink, Senior Attorney, Regulatory Policy, PCX, to Deborah L. Flynn, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 2, 2002 ("Amendment No. 1"). Amendment No. 1 replaced in its entirety the proposed rule text and the Exchange's statement regarding the proposed rule change.

<sup>4</sup> See letter from Michael D. Pierson, Vice President, Regulatory Policy, PCX, to Steven G. Johnston, Special Counsel, Division, Commission, dated June 13, 2002 ("Amendment No. 2"). Amendment No. 2 deleted language from Rule 6.87(k)(2)(c)(ii) and Commentary .04 to Rule 6.87 to reflect changes to PCX's Rules approved by the Commission.

<sup>7</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>8</sup> 17 CFR 240.19b-4(f)(6).