

## Disclosure and Dissemination of Information

The Commission believes that Nasdaq's proposal will ensure that investors have information that will allow them to be adequately apprised of the terms, characteristics, and risks of trading the HOLDRs. The prospectus will address the special characteristics of a particular HOLDR basket, including a statement regarding its redeemability and method of creation. The Commission notes that all investors in the HOLDRs who purchase in the initial offering will receive a prospectus. In addition, anyone purchasing a HOLDR directly from the trust (by delivering the underlying securities to the trust) will also receive a prospectus. Finally, all Nasdaq member firms that purchase the HOLDRs from the trust for resale to customers must deliver a prospectus to such customers.

The Commission also notes that prior to the commencement of trading the HOLDRs, Nasdaq will issue a circular to its members explaining the unique characteristics and risks of this type of security. The circular also will note members' prospectus delivery requirements, and highlight the characteristics of purchases in HOLDRs, including that the HOLDRs are not individually redeemable. The circular also will inform members of Nasdaq policies regarding trading halts in HOLDRs.

As described above, the Commission has previously approved similar Amex and NYSE rules that permit the listing and trading of individual Trust Issued Receipts, including the trading of Trust Issued Receipts over-the-counter. In approving these securities for trading, the Commission considered their structure, their usefulness to investors and the markets, and Nasdaq's rules and surveillance programs that govern their trading.

The Commission notes that the HOLDRs that Nasdaq proposes to trade over-the-counter currently trade on other national securities exchanges. The Commission therefore believes that it is appropriate to approve these HOLDRs for trading over-the-counter on Nasdaq, as their trading should produce the same benefits to Nasdaq and to investors.

Nasdaq has requested that the Commission find good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice in the **Federal Register**. The Commission believes that Nasdaq's proposal to trade the HOLDRs over-the-counter will provide investors with a convenient and

less expensive way of participating in the securities markets. The Commission believes that the proposed rule change, as amended, could produce added benefits to investors through the increased competition between other market centers trading the product.

Specifically, the Commission believes that by increasing the availability of the HOLDRs as an investment tool, Nasdaq's proposal should help provide investors with increased flexibility in satisfying their investment needs, by allowing them to purchase and sell a single security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day.

As noted above, the Commission has approved the listing and trading of HOLDRs at other exchanges, under rules that are substantially similar to Nasdaq's rules.<sup>20</sup> The Commission published those rules in the **Federal Register** for the full notice and comment period. No comments were received on the proposed rules, and the Commission found them consistent with the Act.<sup>21</sup> The HOLDRs at issue are currently trading on other securities exchanges pursuant to UTP. The Commission does not believe that trading of this product raises novel regulatory issues that were not addressed in the previous filings. Accordingly, the Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice in the **Federal Register**.

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (SR-NASD-2003-33), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47705; File No. SR-NASD-2003-32]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 by the National Association of Securities Dealers, Inc. Relating to Listing and Trading Standards for Trust Issued Receipts

April 21, 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 March 7, 2003, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. On April 17, 2003, Nasdaq filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons, and to approve the amended proposed rule change on an accelerated basis.

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

Nasdaq proposes to establish listing standards under NASD Rule 4420(l) for the listing and trading, or trading over-the-counter, of Trust Issued Receipts. Nasdaq also proposes to adopt generic listing standards that permit the listing and trading, or trading over-the-counter, of Trust Issued Receipts pursuant to Rule 19b-4(e) of the Act.<sup>4</sup> The text of

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

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

<sup>3</sup> See letter from John D. Nachmann, Senior Attorney, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated April 16, 2003 ("Amendment No. 1"). Amendment No. 1: (1) Makes clarifications and technical corrections to the proposed rule text and the purpose section of the filing; (2) clarifies that a Trust Issued Receipt is a Nasdaq- or exchange-listed and traded instrument; and (3) clarifies that the Commission may review and determine, pursuant to Section 19(b)(2) of the Act, whether continuation of Nasdaq's short sale exemption under Rule 3350 is appropriate.

<sup>4</sup> 17 CFR 240.19b-4(e). Rule 19b-4(e) provides that the listing and trading of a new derivative securities product by a self-regulatory organization ("SRO") shall not be deemed a proposed rule change, pursuant to Rule 19b-4(c)(1) under the Act, if the Commission has approved, pursuant to section 19(b) of the Act, the SRO's trading rules,

Continued

<sup>20</sup> See note 7, *supra*.

<sup>21</sup> *Id.*

<sup>22</sup> 15 U.S.C. 78s(b)(2).

<sup>23</sup> 17 CFR 200.30-3(a)(12).

the proposed rule change is available at the Office of the Secretary, Nasdaq, and at the Commission.

## 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 III 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

Nasdaq proposes to adopt rules to provide standards that permit the listing and trading, or the trading over-the-counter, of Trust Issued Receipts, including generic listing standards of Trust Issued Receipts pursuant to Rule 19b-4(e) of the Act. Nasdaq proposes to adopt listing and trading standards applicable to Trust Issued Receipts consistent with the criteria used by the American Stock Exchange LLC ("Amex"), the New York Stock Exchange ("NYSE"), and other exchanges to trade Trust Issued Receipts on Nasdaq and/or on an over-the-counter basis. Thus, Nasdaq proposes to adopt standards that permit the listing and trading, or the trading over-the-counter, of Trust Issued Receipts under Section 19(b)(2) of the Act.<sup>5</sup> In addition, Nasdaq proposes to adopt "generic" listing and trading standards for the listing and trading, or trading on an over-the-counter basis, of Trust Issued Receipts under Rule 19b-4(e) of the Act.<sup>6</sup>

#### Trust Issued Receipts Generally

Trust Issued Receipts are negotiable receipts that are issued by a trust representing securities of issuers that have been deposited and are held on behalf of the holders of the Trust Issued Receipts. Trust Issued Receipts are designed to allow investors to hold securities from a variety of companies throughout a particular industry in a

single, Nasdaq- or exchange-listed and traded instrument that represents their beneficial ownership in the underlying securities. Holders of Trust Issued Receipts maintain beneficial ownership of each of the underlying securities evidenced by Trust Issued Receipts. Holders may cancel their Trust Issued Receipts at any time to receive the underlying securities.

Beneficial owners of the receipts will have the same rights, privileges and obligations as they would have if they beneficially owned the underlying securities outside of the Trust Issued Receipt program. Holders of the receipts have the right to instruct the trustee to vote the underlying securities evidenced by the receipts, will receive reports, proxies and other information distributed by the issuers of the underlying securities to their security holders, and will receive dividends and other distributions declared and paid by the issuers of the underlying securities to the trustee.

Trust Issued Receipts are not leveraged instruments, and therefore do not possess any of the attributes of stock index options. Nasdaq believes that the level of risk involved in the purchase and sale of Trust Issued Receipts is almost identical to the risk involved in the purchase or sale of the common stocks represented by the receipt.

Trust Issued Receipts will be issued by a trust created pursuant to a depositary trust agreement. After the initial offering, the trust may issue additional receipts on a continuous basis when an investor deposits the requisite securities with the trust. An investor in Trust Issued Receipts will be permitted to withdraw his or her underlying securities upon delivery to the trustee of one or more round-lots of 100 Trust Issued Receipts and to deposit such securities to receive Trust Issued Receipts.

#### Criteria for Initial and Continued Listing and/or Trading

Nasdaq believes that the listing and trading criteria proposed in its new rule are generally consistent with the listing and trading criteria currently used by, among other exchanges, the Amex and the NYSE.<sup>7</sup>

Because of the continuous issuance and cancellation of Trust Issued Receipts, Nasdaq believes that it is

necessary to maintain appropriate flexibility in connection with listing and trading a specific trust. If Trust Issued Receipts are to be listed or traded on Nasdaq, Nasdaq will establish a minimum number of receipts that must be outstanding at commencement of Nasdaq trading, and such minimum number will be included in any required submission to the Commission. Nasdaq anticipates requiring a minimum of 150,000 outstanding receipts before trading can commence.

In connection with continued listing and trading, and because the number of holders can be subject to substantial fluctuations depending on market conditions, Nasdaq believes that it would be inappropriate and burdensome on Trust Issued Receipt holders if Nasdaq considers suspending trading in or delisting a series of receipts with the consequent termination of the trust, unless the number of holders remains severely depressed over an extended time period. Therefore, Nasdaq will consider suspending or delisting a trust from trading when, in its opinion, further dealing in such securities appears unwarranted under the following circumstances:

(a) If the trust has more than sixty days remaining until termination and there have been fewer than fifty record and/or beneficial holders of the Trust Issued Receipts for the previous thirty or more consecutive trading days;

(b) If the aggregate number of Trust Issued Receipts outstanding is less than 50,000;

(c) If the aggregate market value of Trust Issued Receipts publicly held is less than \$1 million; or

(d) If such other event occurs or condition exists which, in the opinion of Nasdaq, makes further dealings on Nasdaq inadvisable.

Nasdaq will not, however, be required to suspend or delist from trading, based on the above factors, any Trust Issued Receipts for a period of one year after the initial listing of such Trust Issued Receipts for trading on Nasdaq. In addition, if the number of companies represented by the underlying securities drops to less than nine, and each time thereafter the number of companies is reduced, Nasdaq will consult with the Commission to confirm the appropriateness of continued listing or trading of the Trust Issued Receipts.

#### Trading Trust Issued Receipts Pursuant to Rule 19b-4(e)

To accommodate the efficient listing and trading, or trading on an over-the-counter basis, Nasdaq proposes to adopt generic listing and trading standards for

procedures and listings standards for the product class that include the new derivative securities product and the SRO has a surveillance program for the product class. See 17 CFR 240.19b-4(e).

<sup>5</sup> 15 U.S.C. 78s(b)(2).

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

<sup>7</sup> See Securities Exchange Act Release No. 41892 (September 21, 1999), 64 FR 52559 (September 29, 1999) (approving the listing and trading of Trust Issued Receipts and Internet HOLDERS on the Amex); Securities Exchange Act Release No. 45718 (April 9, 2002), 67 FR 18965 (April 17, 2002) (approving the listing and trading of Trust Issued Receipts on the NYSE).

Trust Issued Receipts pursuant to Rule 19b-4(e). Rule 19b-4(e) provides that the listing and trading of a new derivative securities product by a self-regulatory organization ("SRO") will not be deemed a proposed rule change, pursuant to paragraph (c)(1) of Rule 19b-4,<sup>8</sup> if the Commission has approved, pursuant to section 19(b) of the Act,<sup>9</sup> the SRO's trading rules, procedures and listing requirements for the product class that include the new derivative securities product, and the SRO has a surveillance program for the product class.<sup>10</sup> Nasdaq believes that the Commission's approval of the proposed generic listing requirements for Trust Issued Receipts will allow Nasdaq to trade qualifying products without the need for notice and comment and Commission approval under Section 19(b) of the Act.<sup>11</sup> Nasdaq's ability to rely on Rule 19b-4(e) for these products potentially reduces the time frame for bringing these securities to the market and thus enhances investors' opportunities.

The Commission has previously approved requests made by the Amex, the NYSE, and other exchanges to provide generic standards to list and/or trade Trust Issued Receipts.<sup>12</sup> Nasdaq believes that its proposed listing and trading requirements for Trust Issued Receipts are substantially similar to the generic listing and trading requirements of the Amex, the NYSE, and other exchanges.

#### Nasdaq Rules Applicable to the Trading of Trust Issued Receipts

Nasdaq represents that dealings in Trust Issued Receipts will be conducted pursuant to Nasdaq and the NASD's existing equity trading rules. Thus, Nasdaq's general dealing and settlement

rules will apply, including its rules on clearance and settlement of securities transactions and its equity margin rules. Other generally applicable Nasdaq equity rules and procedures would also apply.<sup>13</sup> In addition, regular equity trading hours of 9:30 a.m. and 4 p.m. will apply to transactions in Trust Issued Receipts. However, trading rules pertaining to the availability of odd-lot trading in Nasdaq equities will not apply to the trading of Trust Issued Receipts, since they can only be traded in round-lots. NASD's surveillance procedures for Trust Issued Receipts will be similar for those of Portfolio Depository Receipts and Index Fund Shares and will incorporate and rely upon existing NASD surveillance procedures governing equities.

Nasdaq proposes that the trading of Trust Issued Receipts that meet the following criteria at the time they are established will be exempt by Nasdaq from the short sale rule set forth in NASD Rule 3350: (1) The trust holds underlying securities issued by at least 20 companies; (2) each underlying security is actively traded within the meaning of the exception for actively-traded securities set forth in Rule 101(c)(1) of Regulation M; and (3) the initial weighting of the underlying securities issued by each issuer constitutes less than 20% of the total value of the Trust Issued Receipt.<sup>14</sup> The

exemption from Rule 3350 will be eliminated for transactions in a particular Trust Issued Receipt if: (1) Any single security in the Trust Issued Receipt represents more than 51% of the total value of the receipt; (2) a reconstitution event results in a reduction in the number of companies to less than 20; or (3) an underlying security fails to be actively traded within the meaning of the exemption for actively-traded securities set forth in Rule 101(c)(1) of Regulation M. Prior to the occurrence of any of the above events, Nasdaq may consult with the Commission staff to determine the appropriateness of the exemption's continuation. At that time, the Commission, pursuant to Section 19(b)(2),<sup>15</sup> may determine that continuation of the Rule 3350 exemption is appropriate notwithstanding the decrease in the number of or inactivity of one or more securities in the Trust Issued Receipt. Secondary market portfolio or individual sales of the underlying securities which may be made in connection with cancellations of Trust Issued Receipts are not exempt from Rule 3350. This rule will apply (or not apply) to such transactions as to any other portfolio or individual trade.

Prior to the commencement of trading in Trust Issued Receipts, Nasdaq will issue a circular to members highlighting the characteristics of purchases in Trust Issued Receipts including that Trust Issued Receipts are not individually redeemable. In addition, the circular will inform members of Nasdaq policies about trading halts in such securities. Specifically, the circular will note that Trading of Trust Issued Receipts will be halted whenever Nasdaq trading in equity securities generally is halted as a result of activation of market-wide "circuit breakers," which are tied to large decreases in the Dow Jones Industrial Average. Nasdaq may also halt trading in Trust Issued Receipts upon consideration of, among other factors: (1) The extent to which trading has ceased in the underlying security(s); (2) whether trading has been halted or suspended in the primary market(s) for any combination of underlying securities accounting for 20% or more of the applicable current index group

<sup>13</sup> Pursuant to NASD Rule 4613(a)(1)(D), a minimum quotation increment of one penny will apply to transactions of Trust Issued Receipts on Nasdaq.

<sup>14</sup> Nasdaq does not believe that the trading of Trust Issued Receipts that meet these criteria would be susceptible to the practices that Rule 3350 is designed to prevent. A primary purpose of Rule 3350 is to prevent the market price of a stock from being manipulated downward by unrestricted short selling. Nasdaq anticipates that the market value of a Trust Issued Receipt will rise or fall based on the changes in the value of the underlying securities, and that the price of the Trust Issued Receipt would not decline absent a decline in the value of the underlying securities. Thus, the secondary market price of a Trust Issued Receipt should not vary substantially from the current value of the underlying securities. In addition, any temporary disparities in the relative market values between a Trust Issued Receipt and the underlying securities would tend to be corrected immediately by arbitrage activity. Nasdaq notes that the Commission has agreed with this conclusion in the cases of SPDRs, MidCap SPDRs, Country Baskets, DIAMONDS and Select Sector SPDRs, all of which are securities whose prices are reflective of a portfolio of securities held in trust. See letter from Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, to James F. Duffy, Senior Vice President and General Counsel, Amex (January 22, 1993) (regarding SPDRs); letter from Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, to James F. Duffy, Executive Vice President and General Counsel, Amex (April 21, 1995) (regarding MidCap SPDRs); letter from Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, to Michael Simon, Milbank, Tweed, Hadley & McCloy

<sup>8</sup> 17 CFR 240.19b-4(c)(1).

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

<sup>10</sup> See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998).

<sup>11</sup> 15 U.S.C. 78s(b).

<sup>12</sup> Specifically, Nasdaq proposes to provide generic standards to list or trade, pursuant to Rule 19b-4(e), any Trust Issued Receipts that meet the following criteria: (1) Each component security must be registered under section 12 of the Exchange Act; (2) each component security must have a minimum public float of at least \$150 million; (3) each component security must be listed on a national securities exchange or traded through the facilities of Nasdaq and a reported national market system security; (4) each component security must have an average daily trading volume of at least 100,000 shares during the preceding sixty-day trading period; (5) each component security must have an average daily dollar value of shares traded during the preceding sixty-day trading period of at least \$1 million; and (6) the most heavily weighted component security may not initially represent more than 20% of the overall value of the Trust Issued Receipt.

(March 22, 1996) (regarding Country Baskets); letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, Commission, to James F. Duffy, Amex (January 9, 1998) (regarding DIAMONDS); and letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, Commission, to Stuart M. Strauss, Gordon, Altman, Butowsky, Weitzen, Shalov & Wein (December 14, 1998) (regarding Select Sector SPDRs).

<sup>15</sup> See Amendment No. 1, *supra* note 3.

value; and (3) the presence of other unusual conditions or circumstances deemed to be detrimental to the maintenance of a fair and orderly market. The trading in Trust Issued Receipts that has been the subject of a trading halt or suspension, may resume when Nasdaq determines that the conditions which led to the halt or suspension are no longer present or that the interests of a fair and orderly market are served by a resumption of trading.

#### Disclosure to Customers

With respect to investor disclosure, Nasdaq notes that all investors in Trust Issued Receipts who purchase in the initial offering will receive a prospectus. In addition, anyone purchasing a Trust Issued Receipt directly from the trust (by delivering the underlying securities to the trust) will also receive a prospectus. Finally, all members purchasing Trust Issued Receipts from the trust for resale to customers will deliver a prospectus to such customers.

#### The Trust Issued Receipts Portfolio

For Nasdaq to approve Trust Issued Receipts for trading, whether by listing or trading over-the-counter pursuant to Rule 19b4–(e), the companies represented by the securities in the portfolio underlying the Trust Issued Receipts must meet the following minimum criteria:

- (1) Each company's common stock must be registered under section 12 of the Act;
- (2) The minimum public float of each company included in the portfolio must be at least \$150 million;
- (3) Each security must either be listed on a national securities exchange or be traded through the facilities of Nasdaq and be a reported national market system security;
- (4) The average daily trading volume for each security must be at least 100,000 shares during the preceding sixty-day trading period; and
- (5) The average daily dollar value of the shares traded during the preceding sixty-day trading period must be at least \$1 million.

The initial weighting of each security in the portfolio will be based on its market capitalization, however, if on the date such weighting is determined, a security would represent more than 20% of the overall value of the receipt, then the amount of such security will be reduced to no more than 20% of the receipt value. Once initially set, the securities represented by a receipt will not change, except in accordance with the reconstitution events described below.

#### Trading of Trust Issued Receipts

A round-lot of 100 Trust Issued Receipts represents a holder's individual and undivided beneficial ownership interest in the whole number of securities represented by the receipt. The amount of underlying securities for each round-lot of 100 Trust Issued Receipts will be determined at the beginning of the marketing period and will be disclosed in the prospectus to investors. Trust Issued Receipts may be acquired, held or transferred only in round-lot amounts (or round-lot multiples) of 100 receipts. In order to ensure that transactions in Trust Issued Receipts are effected only in such amounts, no member may enter through the facilities of Nasdaq, for the account of a customer or for its own account, a quote or order for Trust Issued Receipts other than for a round-lot or round-lot multiple. The initial offering price for a Trust Issued Receipt will be established on the date the receipts are priced for sale to the public.

Trust Issued Receipts will be eligible to be traded through the Intermarket Trading System and will therefore be subject to the trade-through provisions of NASD Rule 5262. In addition, Trust Issued Receipts that meet specified conditions will not be subject to the short sale rule set forth in Rule 3350. Pursuant to NASD Rule 4613(a)(1)(D), a minimum quotation increment of one penny will apply to transactions in Trust Issued Receipts.

Nasdaq believes that Trust Issued Receipts will not trade at a material discount or premium to the assets held by the issuing trust. Nasdaq represents that the arbitrage process, which provides the opportunity to profit from differences in prices of the same or similar securities (e.g., the Trust Issued Receipts and the portfolio of underlying securities), increases the efficiency of the markets and serves to prevent potentially manipulative efforts should promote correlative pricing between the Trust Issued Receipts and the underlying securities. If the price of the Trust Issued Receipt deviates enough from the portfolio of underlying securities to create a material discount or premium, an arbitrage opportunity is created allowing the arbitrageur to either buy the Trust Issued Receipts at a discount, immediately cancel them in exchange for the underlying securities and sell the shares in the cash market at a profit, or sell the Trust Issued Receipts short at a premium and buy the securities represented by the receipts to deposit in exchange for the Trust Issued Receipts to deliver against the short position. In both instances, the

arbitrageur locks in a profit and the markets move back into line.

#### Maintenance of the Trust Issued Receipts Portfolio

Except when a reconstitution event occurs, as described below, the securities represented by a Trust Issued Receipt will not change. Notwithstanding, the static nature of the portfolio, the number of each security represented in a receipt may change due to certain corporate events such as stock splits or reverse stock splits on the underlying securities or when a reconstitution event occurs. In addition, the relative weightings among the underlying securities will change based on the current market price of the underlying securities and upon the reconstitution events discussed below. Under no circumstances will a new security be added to the list of securities after a particular receipt program is established, nor will weightings of component securities be adjusted after they are initially set. If the portfolio of securities underlying the Trust Issued Receipts drops to fewer than nine, Nasdaq will consult with the Commission to confirm the appropriateness of continued listing of such Trust Issued Receipts.

#### Reconstitution Events

Trust agreements will provide for, and prospectuses for Trust Issued Receipts will describe, the automatic distribution of specified underlying securities in the trust's portfolio to the beneficial owners of Trust Issued Receipts in the circumstances referred to in such trust agreements and prospectuses as "reconstitution events." The reconstitution events occur under the following circumstances:

- (1) If the underlying securities of a company evidenced by a Trust Issued Receipt no longer has a class of common stock registered under section 12 of the Act, then those securities will no longer be considered underlying securities and the trustee will distribute the securities of that company to the owners of the Trust Issued Receipts;
- (2) If the Commission finds that a company with underlying securities evidenced by the Trust Issued Receipts is a company that should be registered as an investment company under the Investment Company Act of 1940, and the trustee has actual knowledge of the Commission's finding, then the trustee will distribute the securities of that company to the owners of the Trust Issued Receipts;
- (3) If the underlying securities of a company evidenced by a Trust Issued Receipt are no longer outstanding as a

result of a merger, consolidation or other corporate combination, the trustee will distribute the consideration paid by and received from the acquiring company to the beneficial owners of Trust Issued Receipts, unless the consideration is additional underlying securities (*i.e.*, the acquiring company's securities are already included in the Trust Issued Receipt as underlying securities), in which case such additional securities will be deposited into the trust; and

(4) If an underlying issuer's underlying securities are delisted from trading on their primary exchange or market and are not listed for trading on another national securities exchange or through Nasdaq within five business days from the date the underlying securities are delisted.<sup>16</sup>

If the trustee removes an underlying security from the trust due to the occurrence of one of the reconstitution events described above, the trustee, in accordance with the depository trust agreement, will deliver the underlying security to the investor as promptly as practicable after the date that the trustee has knowledge of the occurrence of a reconstitution event.

#### Issuance and Cancellation of Trust Issued Receipts

The trust will issue and cancel, and an investor may obtain, hold, trade or surrender, receipts only in a round-lot of 100 Trust Issued Receipts and round-lot multiples. While investors will be able to acquire, hold, transfer and surrender a round-lot of 100 Trust Issued Receipts, the bid and asked prices will be quoted on a per receipt basis. The trust will issue additional receipts on a continuous basis when an investor deposits the required securities with the trust.

A holder may obtain Trust Issued Receipts by either purchasing them on Nasdaq or an exchange by delivering to the trust during its normal business hours the requisite securities evidencing a round-lot of Trust Issued Receipts. The trustee will charge an issuance fee of up to \$10.00 per 100 Trust Issued Receipts. If a holder wants to cancel Trust Issued Receipts and withdraw the underlying securities, the holder may do so by surrendering the receipts to the trust during normal business hours. The

<sup>16</sup> This provision is designed for the purpose of permitting an underlying security to move its listing between a national securities exchange or Nasdaq without requiring the automatic distribution of the underlying security to beneficial owners of the receipts. Should underlying securities be moved to a market other than a national securities exchange or Nasdaq, (*e.g.*, the OTC Bulletin Board) such securities will be automatically distributed to the beneficial owners of the receipts.

trustee will charge a cancellation fee of up to \$10.00 per 100 Trust Issued Receipts. Lower charges may be assigned for bulk issuances and cancellations. The holder will receive the underlying securities no later than the business day after the trustee receives the request.

#### Termination of the Trust

The trust shall terminate upon the earlier of: (i) The removal of the receipts from listing on Nasdaq or a national securities exchange if they are not listed for trading on Nasdaq or a national securities exchange within five business days from the date the receipts are delisted; (ii) the trustee resigns and no successor trustee is appointed within sixty days from the date the trustee provides notice to the initial depositor of its intent to resign; (iii) 75 percent of beneficial owners of outstanding Trust Issued Receipts vote to dissolve and liquidate the trust; or (iv) December 31, 2039. If a termination event occurs, the trustee will distribute the underlying securities to the beneficial owners as promptly as practicable after the termination event.

#### 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A of the Act,<sup>17</sup> in general and with section 15A(b)(6) of the Act,<sup>18</sup> in particular, in that the proposed rule change is designed to promote just and equitable principles of trade, 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. In particular, Trust Issued Receipts provide investors with an alternative to trading a broad range of securities on an individual basis, and give investors the ability to trade Trust Issued Receipts representing a portfolio of securities continuously throughout the business day in secondary market transactions at negotiated prices.

#### *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.

<sup>17</sup> 15 U.S.C. 78o-3.

<sup>18</sup> 15 U.S.C. 78o-3(6).

#### *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. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to file number SR-NASD-2003-32 and should be submitted by May 19, 2003.

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

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of section 15A(b)(6) of the Act,<sup>19</sup> and the rules and regulations thereunder applicable to a national securities association.<sup>20</sup> Specifically, the Commission finds, as it did with the Amex and other exchanges, that the proposal establishes listing standards for Trust Issued Receipts that will provide investors with a convenient and less expensive way of participating in the securities markets. Nasdaq's

<sup>19</sup> 15 U.S.C. 78o-3(6).

<sup>20</sup> The Commission findings in this approval order are prospective only from the date of this order. Prior to Nasdaq's trading of Trust Issued Receipts, the Commission staff notified Nasdaq staff that these listing and trading rules and short sale rule change contained herein were necessary. The Commission is concerned that Nasdaq failed to seek Commission approval of such proposed rules and rule changes until well after Nasdaq began trading Trust Issued Receipts, despite prior notification by Commission staff to do so. The Commission expects Nasdaq to surveil the trading of these products for compliance with applicable rules, including NASD Rule 3350.

proposal should advance the public interest by providing investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell a single security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day. Accordingly, the Commission finds that Nasdaq's proposal will facilitate transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.<sup>21</sup>

As noted in the Amex approval order, the Commission believes that Trust Issued Receipts will provide investors with an alternative to trading a broad range of securities on an individual basis, and will give investors the ability to trade Trust Issued Receipts representing a portfolio of securities continuously throughout the business day in secondary market transactions at negotiated prices. Trust Issued Receipts will allow investors to: (1) Respond quickly to changes in the overall securities markets generally and for the industry represented by a particular trust; (2) trade, at a price disseminated on a continuous basis, a single security representing a portfolio of securities that the investors owns beneficially; (3) engage in hedging strategies similar to those used by institutional investors; (4) reduce transaction costs for trading a portfolio of securities; and (5) retain beneficial ownership of the securities underlying the Trust Issued Receipts.

Although Trust Issued Receipts are not leveraged instruments, and therefore do not possess any of the attributes of stock index options, their prices will be derived and based upon the securities held in their respective trusts. Accordingly, the level of risk involved in the purchase or sale of trust issued receipts is similar to the risk involved in the purchase or sale of traditional common stock, with the exception that the pricing mechanism for Trust Issued Receipts is based on a basket of securities.<sup>22</sup>

<sup>21</sup> In approving this rule, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>22</sup> The Commission has concerns about continued trading of the Trust Issued Receipts whether listed or traded over-the-counter, if the number of underlying securities falls to reflect a cross section of the selected industry. Accordingly, the NASD has represented that it would consult the Commission concerning continued trading, once the trust has fewer than nine underlying securities, and for each subsequent loss of a security thereafter.

#### Trading of Trust Issued Receipts— Listing and Trading Over-the-Counter

The Commission finds that the Nasdaq's proposal contains adequate rules and procedures to govern the trading of Trust Issued Receipts, whether by listing or trading over-the-counter. Trust Issued Receipts are equity securities that will be subject to the full panoply of Nasdaq rules governing the trading of equity securities on Nasdaq, including, among others, rules governing the priority, parity and precedence of orders, responsibilities of the specialist, account opening and customer suitability requirements, and the election of a stop or limit order.<sup>23</sup>

In particular, the Commission notes that the trading of Trust Issued Receipts that meet the criteria mentioned above will be preliminarily exempt from the short sale rule set forth in NASD Rule 3350. Nasdaq has also represented that if certain circumstances occur, the exemption from Rule 3350 will be eliminated. At that time, the Commission, pursuant to section 19(b)(2),<sup>24</sup> may determine that continuation of the Rule 3350 exemption is appropriate notwithstanding the decrease in the number of or inactivity of one or more securities in the Trust Issued Receipt.

In addition, Nasdaq has developed specific listing and delisting criteria for Trust Issued Receipts that will help to ensure that a minimum level of liquidity will exist for Trust Issued Receipts to allow for the maintenance of fair and orderly markets. The delisting criteria also allows Nasdaq to consider the suspension of trading and the delisting of a Trust Issued Receipt if an event occurred that made further dealings in such securities inadvisable. This will give Nasdaq flexibility to delist Trust Issued Receipts if circumstances warrant such action. Nasdaq's proposal also provides procedures to halt trading in Trust Issued Receipts in certain enumerated circumstances.

Moreover, in approving this proposal, the Commission notes Nasdaq's belief that Trust Issued Receipts will not trade at a material discount or premium in relation to the overall value of the trusts' assets because of potential arbitrage opportunities. Nasdaq also represents that the potential for arbitrage should keep the market price of a Trust Issued Receipts comparable to the overall value of the underlying securities.

<sup>23</sup> Trading rules pertaining to the availability of odd-lot trading do not apply because Trust Issued Receipts only can be traded in round-lots.

<sup>24</sup> See Amendment No. 1, *supra* note 3.

The Commission believes that such trading should enhance market liquidity, and should promote more accurate pricing, tighter quotations, and reduced price fluctuations. The Commission also believes that such trading should allow customers to receive the best possible execution of their transactions in Trust Issued Receipts.

Finally, Nasdaq will apply NASD's surveillance procedures for Trust Issued Receipts that will be similar to the procedures used for investment company units and will incorporate and rely upon existing NASD surveillance procedures governing equities. The Commission believes that these surveillance procedures are adequate to address concerns associated with listing and trading Trust Issued Receipts, including any concerns associated with purchasing and redeeming round-lots of 100 receipts. Accordingly, the Commission believes that the rules governing the trading of Trust Issued Receipts provide adequate safeguards to prevent manipulative acts and practices and to protect investors and the public interest.

#### Disclosure and Dissemination of Information

The Commission believes that Nasdaq's proposal will ensure that investors have information that will allow them to be adequately apprised of the terms, characteristics, and risk of trading Trust Issued Receipts. The prospectus will address the special characteristics of a particular Trust Issued Receipt basket, including a statement regarding its redeemability and method of creation. The Commission notes that all investors in Trust Issued Receipts who purchase in the initial offering will receive a prospectus. In addition, anyone purchasing a Trust Issued Receipt directly from the trust (by delivering the underlying securities to the trust) will also receive a prospectus. Finally, all NASD members who purchase Trust Issued Receipts from the trust for resale to customers must deliver a prospectus to such customers.

The Commission also notes that upon the initial listing of any Trust Issued Receipts, Nasdaq will issue a circular to members explaining the unique characteristics and risks of this type of security. The circular will note members' prospectus delivery requirements, and highlight the characteristics of purchases in Trust Issued Receipts. The circular also will inform members of policies regarding trading halts in Trust Issued Receipts.

Trading Trust Issued Receipts Pursuant to Rule 19b-4(e)

The Commission further believes that adopting generic listing standards for these securities pursuant to Rule 19b-4(e) under the Act should fulfill the intended objective of the rule by giving Nasdaq the ability to potentially reduce the time frame for bringing these securities to the market, or for permitting the trading of these securities over-the-counter, and thus enhances investors' opportunities. The Commission notes that it maintains regulatory oversight over any products listed under the generic standards through regular inspection oversight.

The Commission finds that Nasdaq's proposal contains adequate rules and procedures to govern the listing and trading of Trust Issued Receipts pursuant to Rule 19b-4(e) on Nasdaq, or over-the-counter. All Trust Issued Receipt products listed under the generic standards will be subject to the full panoply of NASD and Nasdaq rules and procedures that now govern both the trading of Trust Issued Receipts and the trading of equity securities.

As described above, the Commission has previously approved similar Amex, NYSE, and other exchange rules that permit the generic listing and trading of individual Trust Issued Receipts. In approving these securities for trading, the Commission considered their structure, their usefulness to investors and the markets, and the SROs' rules and surveillance programs that govern their trading. The Commission concluded then, as it does now, that securities approved for listing under those rules would allow investors to: (1) Respond quickly to changes in the overall securities markets generally and for the industry represented by a particular trust; (2) trade, at a price disseminated on a continuous basis, a single security representing a portfolio of securities that the investor owns beneficially; (3) engage in hedging strategies similar to those used by institutional investors; (4) reduce transactions costs for trading a portfolio of securities; and (5) retain beneficial ownership of the securities underlying the Trust Issued Receipts.

The Commission notes that Nasdaq's proposed generic listing standards are substantially similar to the Amex, NYSE, and other SROs. The Commission therefore believes that Trust Issued Receipts that satisfy Nasdaq's proposed generic listing standards should produce the same benefits to Nasdaq and to investors.

Nasdaq has requested that the Commission find good cause for

approving the proposed rule change and Amendment No. 1 prior to the thirtieth day after the date of publication of notice in the **Federal Register**. The Commission believes that the Nasdaq's proposal to trade Trust Issued Receipts, over-the-counter, will provide investors with a convenient and less expensive way of participating in the securities markets. The Commission believes that the proposed rule change, as amended, could produce added benefits to investors through the increased competition between other market centers trading the product. Specifically, the Commission believes that by increasing the availability of Trust Issued Receipts as an investment tool, Nasdaq's proposal should help provide investors with increased flexibility in satisfying their investment needs, by allowing them to purchase and sell a single security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day.

As noted above, the Commission has approved the listing and trading of Trust Issued Receipts at the Amex, under rules that are substantially similar to the Amex, NYSE, and other exchange rules.<sup>25</sup> The Commission published the Amex rules in the **Federal Register** for the full notice and comment period. No comments were received on the proposed rules, and the Commission found them consistent with the Act.<sup>26</sup> Accordingly, the Commission finds good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice in the **Federal Register**.

#### V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>27</sup> that the proposed rule change (File No. SR-NASD-2003-32), as amended, be approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. 03-10390 Filed 4-25-03; 8:45 am]

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<sup>25</sup> See note 6, *supra*.

<sup>26</sup> *Id.*

<sup>27</sup> 15 U.S.C. 78s(b)(2).

<sup>28</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47718; File No. SR-OCC-2002-27]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of a Proposed Rule Relating to Non-Equity Options Exchanges

April 22, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on December 16, 2002, the Options Clearing Corporation ("OCC") 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 primarily by OCC. 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

The proposed rule change incorporates two undertakings made by OCC as party of Filing No. SR-OCC-2002-02 as stated policies under section 1 of Article VII B, Non-Equity Exchanges, of OCC's By-Laws.

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

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>2</sup>

##### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Filing No. OCC-2002-02<sup>3</sup> set forth changes to OCC's by-laws to permit OCC to provide clearing services to new options exchanges without issuing new equity to such exchanges. In connection with the Commission's approval of SR-

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

<sup>2</sup> The Commission has modified parts of these statements.

<sup>3</sup> Securities Exchange Act Release No. 34-46469 (September 6, 2002), 67 FR 58093 (September 13, 2002).