

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

1. Purpose

Under Exchange Rule 11.10A(k), members have received a 50 percent pro rata transaction credit based on *net* Tape B revenue since July 2001.⁴ Prior to that time, the Program was based on *gross* Tape B revenues. In keeping with recent trends in the securities industry, the Exchange is proposing to amend the Program so that the pro rata percentage is once again based on *gross* Tape B revenue, but only in those fiscal quarters where the Exchange's overall revenues (not just Tape B revenues) offset capital expenses and working capital needs. Otherwise, if capital expenses and working capital needs are not met, the calculation based on *net* Tape B revenues will continue to apply.

2. Statutory Basis

The proposed rule change is generally consistent with Section 6(b) of the Act.⁵ The proposed rule also furthers the objectives of Section 6(b)(5) of the Act,⁶ particularly, in that it is designed to promote just and equitable principles of trade and to remove impediments to and perfect the mechanism of a free and open market and a national market system and, generally, in that it protects investors and the public interest. The proposal also is consistent with Section 6(b)(4)⁷ in that it is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among Exchange members by crediting members on a pro rata basis.

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

The CSE does not believe that the proposed rule change will impose any inappropriate burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

⁴ See Securities Exchange Act Release No. 44579 (July 20, 2001), 66 FR 39068 (July 26, 2001) (SR-CSE-01-03) (among other things, added the word "Net" before the term "Tape 'B' revenue" to CSE Rule 11.10A(k)).

⁵ 15 U.S.C. 78f(b).

⁶ 15 U.S.C. 78f(b)(5).

⁷ 15 U.S.C. 78f(b)(4).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange 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 CSE. All submissions should refer to file number SR-CSE-2003-01 and should be submitted by February 24, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47244; File No. SR-NASD-2002-166]

Self-Regulatory Organizations; Order Granting Approval of a Proposed Rule Change and Amendment No. 1 and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. With Respect to Margin Rule Amendments for Security Futures Contracts on a Pilot Basis

January 24, 2003.

I. Introduction

On November 15, 2002, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change, pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and rule 19b-4 thereunder,² to amend NASD rule 2520 ("Margin Requirements") to establish margin rules for security futures contracts. On November 22, 2002, NASD filed Amendment No. 1 to the proposed rule change.³ The proposal, as amended, was published in the **Federal Register** on December 24, 2002.⁴ The Commission received one comment letter on the proposed rule change.⁵ This commenter also submitted a comment letter on the NYSE's pilot to amend NYSE rule 431 to establish margin requirements for security futures contracts.⁶ On January 15, 2003, NASD filed Amendment No.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Gary L. Goldsholle, Associate General Counsel, NASD to Katherine England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated November 22, 2002 ("Amendment No. 1"). Amendment No. 1 makes technical changes to the proposed rule text.

⁴ Securities Exchange Act Release No. 46995 (December 13, 2002), 67 FR 78543.

⁵ See letter from Edward J. Joyce, President and Chief Operating Officer, Chicago Board Options Exchange ("CBOE"), to Jonathan G. Katz, Secretary, Commission, dated December 20, 2002.

⁶ See letter from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Jonathan G. Katz, Secretary, Commission, dated December 9, 2002. On November 7, 2002, the Commission approved, on a 60-day pilot basis, a proposed rule change by the New York Stock Exchange, Inc. ("NYSE") amending NYSE rule 431 ("Margin Requirements") to establish margin requirements for security futures contracts. See Securities Exchange Act Release No. 46782 (November 7, 2002), 67 FR 69052 (November 14, 2002) (SR-NYSE-2002-53). In January 2003, the NYSE pilot was extended for an additional 60 days, expiring on March 6, 2003. See Securities Exchange Act Release No. 47129 (January 6, 2002), 68 FR 2094 (January 15, 2003) (SR-NYSE-2003-01).

⁸ 17 CFR 200.30-3(a)(12).

2 to the proposed rule change.⁷ This order approves the proposed rule change, as amended, on a pilot basis until March 6, 2003.

II. Description of the Proposed Rule Change

NASD is proposing to amend NASD rule 2520 ("Margin Requirements") to establish margin requirements for security futures contracts ("SFCs"). The proposed rule change is being made to make NASD's margin rule consistent with the margin rules for security futures adopted by the SEC and the Commodity Futures Trading Commission ("CFTC"), and the rules adopted by the NYSE, Nasdaq-Liffe Markets, and One Chicago, LLC.

The CFTC and SEC adopted customer margin requirements for SFCs ("SEC/CFTC Margin Regulations")⁸ pursuant to authority delegated to them by the Federal Reserve Board ("FRB") under section 7(c)(2)(B) of the Act.⁹ These margin regulations became effective on September 13, 2002. NASD is proposing to conform its margin rules to these new requirements, and to be comparable to the NYSE's margin requirements under NYSE rule 431.

NASD rule 2520 prescribes specific margin requirements for members of NASD that must be maintained in all accounts of their customers, based on the type of securities product held in such accounts. As proposed, NASD rule 2520(b) and (c) would provide that the amount of initial and maintenance margin required for long and short SFCs held in a securities account shall be 20 percent of the current market value of such SFC.

NASD rule 2520(e)(6) ("Broker/Dealer Accounts") would permit introducing

broker/dealers trading SFCs to deduct from their proprietary accounts the amount of any deficiency between the equity in the account and the haircut requirements pursuant to rule 15c3-1 under the Act ("Net Capital Rule")¹⁰ in computing the net capital of the member, in lieu of collecting margin.

NASD rule 2520(f)(11) ("Customer Margin Rules Relating to Security Futures") would provide that transactions in SFCs in a securities account be subject to all other provisions of NASD rule 2520, including rule 2520(f)(8)(B) ("Day Trading"). Excluded from the margin requirements of the rule are arrangements between a creditor and a borrower, whereby the borrower is defined as an "Exempted Person" under rule 401(a)(9)¹¹ of the Act, and rule 41.43(a)(9)¹² under the Commodity Exchange Act. SFCs transacted in a futures account would not be subject to the requirements of NASD rule 2520.

NASD rule 2520(f)(11)(B)(iii) ("Permissible Offsets") would permit margin lower than the 20 percent general requirement, and thereby recognize the hedged nature of certain offsetting positions involving SFCs and related positions. In doing so, margin levels for offsetting positions involving SFCs and related positions would be lower than would be required if those positions were margined separately.

Further, the proposed rule change makes NASD's rule consistent with the table of offsets included in the recently adopted SEC/CFTC Margin Regulations.

NASD rule 2520(f)(11)(D) ("Security Futures Dealers' Accounts"), NASD rule 2520(f)(11)(E) ("Approved Options Specialists" or Market Maker's Accounts"), and NASD rule 2520(f)(11)(F) ("Approved Specialists' Accounts/others") would permit "good faith" margin treatment for specified hedged offset positions carried in the accounts noted above.¹³ NASD rule

2520(f)(11)(G)(i) would permit money market mutual funds as defined in rule 2a-7 under the Investment Company Act of 1940 to be used for satisfying margin requirements for securities transactions, provided that the requirements of rule 404(b)¹⁴ under the Act and rule 41.46(b)(2)¹⁵ under the CEA are satisfied.¹⁶

III. Summary of Comments

As noted above, the Commission received one comment letter on the proposed rule change.¹⁷ This commenter also submitted a comment letter on NYSE's proposal regarding margin requirements for securities futures contracts.¹⁸ First, the commenter believes that both the NYSE and NASD rules on margin requirements for security futures should not be approved by the Commission on a permanent basis until the rules provide an exemption from the existing day trading provisions of NYSE rule 431. The commenter believes that applying the margin restrictions on day trading to security futures will create a disparity between security futures contracts that are held in a securities account and contracts that are held in a futures account, which is inconsistent with the principles of the Commodity Futures Modernization Act.

Second, the commenter would like to delete references in the proposed rule language to "bona fide" market maker or specialist transactions. Specifically, the commenter believes that the NYSE and NASD intend to determine which transactions of a "bona fide" market maker/specialist would fit within this definition. The commenter is concerned that NYSE and NASD may not rely on the other self-regulatory organizations' ("SROs") rules regarding who is a market maker and that, therefore, the NYSE's and NASD's rules would not be consistent with the rules of these other SROs. This commenter believes that if the SEC approves an SRO rule regarding who as a market maker, the NYSE and NASD margin rules should defer to that SRO's rule in defining a market maker or specialist.

In response to these substantive concerns, NASD has requested that its proposal be approved as a pilot under

⁷ See letter from Gary L. Goldsholle, Associate General Counsel, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated January 15, 2003 ("Amendment No. 2"). In Amendment No. 2, NASD requested that the Commission approve the proposed rule change on a pilot basis under the same terms as the NYSE's pilot, pending the resolution of the issues raised by commenters.

⁸ 17 CFR 242.400 through 406; 17 CFR 41.42 through 41.48.

⁹ 15 U.S.C. 78g(c)(2)(B). As noted in the adopting release, section 7(c)(2) of the Act provides that the customer margin requirements for SFCs must satisfy four requirements: (1) They must preserve the financial integrity of markets trading security futures contracts; (2) they must prevent systemic risk; (3) they must (a) be consistent with the margin requirements for comparable options traded on an exchange registered pursuant to section 6(a) of the Act (15 U.S.C. 78f) and (b) provide for initial and maintenance margin that are not lower than the lowest level of margin, exclusive of premium, required for comparable exchange traded options; and (4) they must be and remain consistent with the margin requirements established by the FRB under Regulation T. See Securities Exchange Act Release no. 46292 (August 1, 2002), 67 FR 53146 (August 14, 2002).

¹⁰ 17 CFR 240.15c3-1.

¹¹ 17 CFR 242.401(a)(9).

¹² 17 CFR 41.43(a)(9).

¹³ NASD noted that, unlike the amendments proposed by other SROs, on security futures, it believes that its proposed amendment will permit members to accord offset treatment in accounts carried for such specialists, market makers and security futures dealers only when their activity is limited to bona fide specialist or market making transactions. According to NASD, the limitations imposed are consistent with NASD's belief that market makers bear the primary responsibility and obligation to maintain fair and orderly markets, and provide liquidity to the marketplace. Were a revenue or other test substituted for the affirmative obligation standard here proposed, NASD believes that entities other than qualified market makers would be permitted to receive the more favorable market maker margin treatment. NASD believes that such was not the Commission's or CFTC's intent when adopting the SEC/CFTC Margin Regulations.

¹⁴ 17 CFR 242.404(b).

¹⁵ 17 CFR 41.46(b)(2).

¹⁶ Presently, money market mutual funds may be used as collateral to satisfy margin requirements under Regulation T in a securities margin account. The amendments to NASD rule 2520 would now permit the use of such funds as collateral for SFCs as is required by the new SEC/CFTC Margin Regulations described above.

¹⁷ See *supra* note .

¹⁸ For further details on SR-NYSE-2002-53, see *id.*

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

IV. Discussion

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

Moreover, the Commission believes that the proposed rule change is generally consistent with the customer margin rules for security futures adopted by the Commission and the CFTC. In particular, the Commission notes that, consistent with rule 403 under the Act, NASD's proposed rules provide a minimum margin level of 20% of current market value for all positions in security futures carried in a securities account. The Commission believes that 20% is the minimum margin level necessary to satisfy the requirements of section 7(c)(2)(B) of the Act. Rule 403 under the Act²³ also provides that a national securities association may set margin levels lower than 20% of the current market value of the security future for an offsetting position involving security futures and related positions, provided that an association's margin levels for offsetting

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

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

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

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether the proposed amendment is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed amendments that are filed with the Commission, and all written communications relating to the amendments between the Commission

and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the NASD.

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

VI. Conclusion

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

For the Commission, by the Division of Market Regulation, pursuant to the delegated authority.²⁵

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

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

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

January 27, 2003.

I. Introduction

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and rule 19b-4 thereunder,² notice is hereby given that on July 30, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change relating to audit trail and trading halt requirements for Alternative Trading Systems ("ATSs") that trade security futures.³ By letter dated August 14, 2002, the Association filed

¹⁹ See *supra* note .

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

²¹ 15 U.S.C. 78o-3(b)(6).

²² 15 U.S.C. 78g(c)(2)(B).

²³ 17 CFR 240.403(b)(2).

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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