Engine models	Part name	Engine manual section	Inspection
All Models	HPC Rear (CDP) Air Seal (All P/N)	72–31–08	FPI.
All Models	LPT Stage 1 Disk (All P/N)	72–54–03	FPI.
All Models	LPT Stage 2 Disk (All P/N)	72–54–03	FPI.
All Models	LPT Stage 3 Disk (All P/N)	72–54–03	FPI
All Models	LPT Stage 4 Disk (All P/N)	72–54–03	FPI.
CFM56–5C.	LPT Stage 5 Disk (All P/N)	72–54–03	FPI.
All Models	LPT Rotor Support (All P/N)	72–54–05	FPI.
All Models	LPT Shaft (All P/N)	72–55–01	MPI.
CFM56–2, –2A, –2B, –3, –3B and –3C.	LPT Stub Shaft (All P/N)	72–55–02	FPI.

(2) For the purposes of these mandatory inspections, piece-part opportunity means:

(i) The part is considered completely disassembled when accomplished in accordance with the disassembly instructions in the manufacturer's engine manual; and

(ii) The part has accumulated more than 100 cycles in service since the last piece-part opportunity inspection, provided that the part was not damaged or related to the cause for its removal from the engine.''

(b) Except as provided in paragraph (c) of this AD, and notwithstanding contrary provisions in § 43.16 of the Federal Aviation Regulations (14 CFR 43.16), these mandatory inspections must be performed only in accordance with the Time Limits section of the manufacturer's ESM.

Alternative Methods of Compliance

(c) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Engine Certification Office. Operators must submit their request through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Engine Certification Office.

Note 2: Information concerning the existence of approved alternative methods of compliance with this airworthiness directive, if any, may be obtained from the Engine Certification Office.

Special Flight Permits

(d) Special flight permits may be issued in accordance with §§ 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the airplane to a location where the requirements of this AD can be accomplished.

Continuous Airworthiness Maintenance Program

(e) FAA-certificated air carriers that have an approved continuous airworthiness maintenance program in accordance with the record keeping requirement of § 121.369(c) of the Federal Aviation Regulations (14 CFR 121.369(c)) of this chapter must maintain records of the mandatory inspections that result from revising the Airworthiness Limitations Section of the applicable ESM and the air carrier's continuous airworthiness program. Alternatively, certificated air carriers may establish an approved system of record retention that provides a method for preservation and retrieval of the maintenance records that include the inspections resulting from this AD, and include the policy and procedures for implementing this alternate method in the air carrier's maintenance manual required by § 121.369(c) of the Federal Aviation Regulations (14 CFR 121.369 (c)); however, the alternate system must be accepted by the appropriate PMI and require the maintenance records be maintained either indefinitely or until the work is repeated. Records of the piece-part inspections are not required under § 121.380(a)(2)(vi) of the Federal Aviation Regulations (14 CFR 121.380(a)(2)(vi)). All other operators must maintain the records of mandatory inspections required by the applicable regulations governing their operations.

Note 3: The requirements of this AD have been met when the ESM changes are made and air carriers have modified their continuous airworthiness maintenance plans to reflect the requirements in the applicable ESM.

Effective Date

(f) This amendment becomes effective on August 1, 2002.

Issued in Burlington, Massachusetts, on June 17, 2002.

Jay J. Pardee,

Manager, Engine and Propeller Directorate, Aircraft Certification Service.

[FR Doc. 02–16173 Filed 6–26–02; 8:45 am]

BILLING CODE 4910–13–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 231 and 241

[Release Nos. 33–8107; 34–46101; File No. S7–23–02]

Commission Guidance on the Application of Certain Provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and Rules Thereunder to Trading in Security Futures Products

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation; request for comments.

SUMMARY: The Commission is publishing its views regarding the application of certain provisions of the federal securities laws to trading in security futures products. We also are soliciting comment.

DATES: *Effective Date:* The guidance is effective on June 27, 2002.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–23–02; this file number should be included on the subject line if E-mail is used. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW., Washington, DC 20549–0102. Electronically submitted comment letters will be posted on the

Commission's Internet site *(http://www.sec.gov)*.[1]

FOR FURTHER INFORMATION CONTACT: With respect to discussions concerning Securities Act and director, officer, and principal stockholder issues administered by the Division of Corporation Finance, contact Robert Plesnarski, Special Counsel (Securities Act Rule 144) or Anne Krauskopf, Special Counsel (rules under Exchange Act Section 16), (202) 942–2900, Office of Chief Counsel, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0402.

With respect to discussions concerning mergers and acquisitions issues administered by the Division of Corporation Finance, contact Pamela Carmody, Special Counsel, (202) 942–2920, Office of Mergers & Acquisitions, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0303.

With respect to general questions about the interpretive positions expressed by the Division of Corporation Finance in this release, contact N. Sean Harrison, Special Counsel, (202) 942–2910, Office of Rulemaking, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0310.

With respect to discussions concerning market supervision issues administered by the Division of Market Regulation contact Theodore Lazo, Senior Special Counsel, or Andrew Shipe, Special Counsel, (202) 942–0160, Office of Market Supervision, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–1001.

With respect to discussions concerning trading practices issues administered by the Division of Market Regulation contact James Brigagliano, Assistant Director, Nancy Oremland, Special Counsel (Regulation M and Exchange Act Rule 14e–5), Kevin Campion, Special Counsel (Exchange Act Rule 14e–4), Joan Collopy, Special Counsel (Exchange Act Rule 10b–18), or Greg Dumark, Special Counsel (Exchange Act Rule 10a–1 and Rule 3b–3), (202) 942–0772, Office of Trading Practices, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–1001.

With respect to discussions concerning other broker-dealer issues administered by the Division of Market Regulation contact Catherine McGuire, Chief Counsel, Paula Jenson, Deputy Chief Counsel, Kenneth Rosen, Special Counsel, or Christina McGlosson, Special Counsel, (202) 942–0073, Office of Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–1001.

SUPPLEMENTARY INFORMATION:

I. Background

On December 21, 2000, Congress enacted the Commodity Futures Modernization Act of 2000 (''CFMA''),[2] addressing the regulation of security futures products.[3] Security futures products are securities for purposes of the federal securities laws, including the Securities Act of 1933 (''Securities Act'') and the Securities Exchange Act of 1934 (''Exchange Act''), and are ''futures'' for purposes of the Commodity Exchange Act (''CEA'').[4] Because these products are both securities and futures, the CFMA established a framework for the joint regulation of these products by the Securities and Exchange Commission (''SEC'' or ''Commission'') and the Commodity Futures Trading Commission (''CFTC'').

In creating this framework, the CFMA exempted security futures products, as well as certain security futures products intermediaries and markets, from certain provisions of the Securities Act, the Exchange Act, and the CEA, and directed the Commission and the CFTC to coordinate in certain aspects the regulation of dually regulated persons.[5] Accordingly, security futures products must be traded on trading facilities and through intermediaries that are registered with both the Commission and the CFTC. Given this new regulatory framework, various industry participants have requested guidance regarding the application of certain provisions of the federal securities laws to trading in security futures products.

Section II.A. below addresses some of the questions that may arise under certain statutory provisions and rules administered by the Commission's Division of Corporation Finance. Section II.B. addresses some of the questions that may arise under certain statutory provisions and rules administered by the Commission's Division of Market Regulation. Because security futures products are new products, the guidance provided is based on how we expect markets in these products to operate. As these markets develop and we learn more about their operations and security futures products themselves, we may need to revisit some of the guidance provided today or provide guidance on additional issues.[6]

II. Discussion

A. Guidance on Statutory Provisions and Rules Administered by the Division of Corporation Finance

1. Securities Act and Director, Officer, and Principal Stockholder Issues

a. Securities Act Registration and Exemptions From Registration: Securities Act Rule 144

Every offer or sale of a security in interstate commerce or by use of the mails must either be registered under the Securities Act or exempt from

[1] We do not edit personal, identifying information, such as name or e-mail addresses, from electronic submissions. Submit only information you wish to make publicly available.

[2] *See* Pub. L. 106–554, 114 Stat. 2763.

[3] *See* Exchange Act section 3(a)(56) (15 U.S.C. 78c(a)(56)), Securities Act Section 2(a)(16) (15 U.S.C. 77b(a)(16)), and CEA section 1a(32) (7 U.S.C. 1a(32)) define ''secruity futures product'' as a security future or an option on a security future.

[4] Exchange Act section 3(a)(10) (15 U.S.C. 78c(a)(10)) defines a ''security'' to include a security future. The Securities Act defines a ''security'' to include a security future in section 2(a)(1) (15 U.S.C. 77b(a)(1)). The term ''security future'' is defined in Exchange Act section 3(a)(55) and in CEA section 1a(31) (7 U.S.C. 1a(31)) as a contract of sale for future delivery of a single security or of a narrow-based security index. *See also* Securities Act section 2(a)(16) (15 U.S.C. 77b(a)(16)).

[5] Specifically, certain markets and intermediaries that are registered with only the CFTC may register with the SEC by submitting a written notice that is effective upon filing. Exchange Act §§ 6(g) and 15(b)(11) (15 U.S.C. 78f(g) and 78o(b)(11)). *Cf.* CEA §§ 5f and 4f(a)(2) (7 U.S.C. 7b–1 and 6f(a)(2)). A ''notice-registered'' (as opposed to a fully registered) broker-dealer is exempt from provisions specified in section 15(b)(11)(B) of the Exchange Act. A ''notice-registered'' exchange is exempt from provisions specified in section 6(g)(4) of the Exchange Act, and certain floor brokers on such exchanges are exempt from broker-dealer registration and the provisions specified in section 15(b)(12) of the Exchange Act. The CFMA also requires the Commission, in consultation with the CFTC, to issue rules, regulations, or orders as necessary to avoid duplicative or conflicting regulations applicable to firms that are subject to all of the provisions of the Exchange Act and the CEA with respect to the treatment of customer funds, securities, or property, maintenance of books and records, financial reporting, or other financial responsibility rules involving security futures products. *See* Exchange Act section 15(c)(3)(B) [15 U.S.C. 78o(c)(3)(B)]; CEA section 4d(c) (7 U.S.C. 6d(c)).

[6] In addition, some of the guidance provided in this release relates to security futures instead of all security futures products. As noted above, security futures products are a broader set of instruments that include options on security futures as well as security futures themselves. *See supra* note 3. Should the Commission in coordination with the CFTC permit the trading of such instruments in the future, *see* section 6(h)(6) of the Exchange Act (15 U.S.C. 78f(h)(6)), at that time, the Commission could look at the function of such instruments to determine whether this guidance for security futures is appropriate for options on security futures.

registration.[7] Securities Act Rule 144 [8] provides a nonexclusive safe harbor for the unregistered resale of restricted [9] and other securities held by affiliates of an issuer, as well as for the unregistered resale of restricted securities by non-affiliates of the issuer. The Rule sets forth specific standards that, if met, permit persons who hold such securities to sell them publicly without being deemed to be ''underwriters'' under the Securities Act [10] and in reliance on the Securities Act section 4(1) exemption from registration.[11]

The CFMA amended the Securities Act in the following manner:

- It amended Section 2(a)(1) [12] to include security futures products within the definition of ''security.''
- It added section 3(a)(14) [13] to exempt the offer and sale of a security futures product from the registration requirements of Section 5 if the security futures product is: (1) Traded on a national securities exchange or a national securities association registered under section 15A(a) of the Exchange Act [14] and (2) cleared by a clearing agency that is either registered under section 17A of the Exchange Act [15] or exempt from registration under section 17A(b)(7) of the Exchange Act.[16]
- It amended section 2(a)(3) [17] to ensure that security futures products could not be used by an issuer,[18] its affiliates [19] or underwriters to circumvent the registration requirements of Section 5 with respect to the issuer's securities underlying the security futures product. As amended, Section 2(a)(3) provides ''[a]ny offer or sale of a security futures product by or on behalf of the issuer of the securities underlying the security futures product, an affiliate of the issuer, or an underwriter, shall constitute a contract for sale of, sale of, offer for sale, or offer to sell the underlying securities.'' Accordingly, a transaction in a security futures product on a security of an issuer by such persons also is a transaction in the issuer's underlying security that must be registered unless an exemption from registration is available.[20]

Q1: May an affiliate of an issuer rely upon Rule 144 in connection with the offer or sale of securities of that issuer that occurs by virtue of the affiliate's offer or sale of a security future?

A1: Yes. Section 2(a)(3) provides that the offer or sale of the security future by the affiliate also is a concurrent offer or sale of the underlying securities. Accordingly, the concurrent offer or sale of the underlying securities would either have to be registered or satisfy the conditions of an exemption from registration. The affiliate may rely on Rule 144 to establish the availability of the section 4(1) exemption.

Q2: May a person who is not an affiliate of the issuer rely upon Rule 144 in connection with the offer or sale of restricted securities of the issuer that occurs by virtue of the person's offer or sale of a security future?

A2: Yes. If the non-affiliate is an ''underwriter'' of the underlying securities, its offer or sale of the security future also is a concurrent offer or sale of the underlying securities. Accordingly, the concurrent offer or sale of the underlying securities would either have to be registered or satisfy the conditions of an exemption from registration. The non-affiliate seller of restricted securities must, therefore, establish that it is not an ''underwriter'' of the underlying securities. The non-affiliate seller may rely on Rule 144 to establish that it is not an ''underwriter'' of the securities.

Q3: In analyzing whether a seller of securities that are sold by virtue of the sale of a security future may rely on Rule 144 in connection with that sale, when should the sale of the underlying securities be deemed to have occurred?

A3: The transaction in the underlying securities is deemed to have occurred at the same time as the transaction in the related security future. Accordingly, in determining the ability to rely on Rule 144, a seller should assess that reliance at the time of the sale of the security future.[21]

Q4: How should a seller of a security future assess his or her reliance on Rule 144 in connection with the offer or sale of the securities underlying that security future?

A4: The seller should analyze the transaction for purposes of Rule 144 as if it were a transaction in the underlying securities themselves.

Q5: May a non-affiliate settle a security future transaction with restricted securities?

A5: A non-affiliate may settle a security future transaction with restricted securities only if it could rely upon Rule 144 to offer and sell the underlying restricted securities at the time it offered and sold the security future.

Q6: What information should be provided in the Form 144 filed for securities of the issuer that underlie a security future?

A6: The Form 144 should be completed to cover the sale of underlying securities. Persons filing the Form 144 should make reference to the security future in the ''Remarks'' section. For example, disclosure could read: ''This Form 144 reflects the intended deemed sale of 10,000 shares of ABC issuer's securities that underlie (describe security future's material terms).''

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[7] *See* section 5 of the Securities Act (15 U.S.C. 77e).

[8] 17 CFR 230.144.

[9] The term ''restricted securities'' is defined in Rule 144(a)(3) (17 CFR 230.144(a)(3)).

[10] Section 2(a)(11) of the Securities Act (15 U.S.C. 77b(a)(11)) defines an ''underwriter'' as ''[a]ny person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking * * *'' The definition applies to any person. No distinction is made between professional securities dealers and individual investors; any person who performs one of the specified functions in relation to an offering of securities is an underwriter within the meaning of section 2(a)(11).

[11] Securities Act section 4(1) (15 U.S.C. 77d(1)) states that the section 5 registration requirements shall not apply to transactions by any person other than an issuer, underwriter, or dealer.

[12] 15 U.S.C. 77b(a)(1).

[13] 15 U.S.C. 77c(a)(14).

[14] 15 U.S.C. 78o–3(a).

[15] 15 U.S.C. 78q–*1*.

[16] 15 U.S.C. 78q–*l*(b)(7).

[17] 15 U.S.C. 77b(a)(3).

[18] The term ''issuer'' is defined in section 2(a)(4) of the Securities Act and includes ''every person who issues or proposes to issue any security * * *'' (15 U.S.C. 77b(a)(4)).

[19] An ''affiliate'' of an issuer is defined as a ''person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer'' (17 CFR 230.405).

[20] All security futures establish obligations on the purchaser and seller of the security futures to either: (i) Deliver the underlying securities (in the case of a seller of a security future) or accept delivery of the underlying securities (in the case of a purchaser of a security future); or (ii) make or accept a cash payment at maturity of the security future to settle any gains or losses based on the difference between the settlement price of the security future on the last trading day and the price of the security future when the security future was originated. The terms of the security future dictate whether it is settled by physical delivery of the underlying securities or by cash payment.

Issues related to settlement method are raised throughout this interpretive release. However, settlement method may or may not affect the application of particular statutory provisions or rules. This release delineates where settlement method would affect the guidance provided. The Commission typically does not view settlement method of a derivative product as determinative of whether such product is or is not a security. *See, e.g., infra* note 97 (citing *Caiola* amicus curiae brief).

[21] The provision in section 2(a)(3) stating that ''(a)ny offer or sale of a security futures product by or on behalf of the issuer of the securities underlying the security futures product, an affiliate of the issuer, or an underwriter, shall constitute a contract for sale of, sale of, offer for sale, or offer to sell the underlying securities(,)'' applies regardless of whether a security future calls for physical delivery of the underlying security or cash settlement.

b. Disclosure Requirements and Short Swing Profit Recovery: Exchange Act Section 16

The CFMA amended section 16 of the Exchange Act so that it covers ownership of, and transactions in, security futures products.[22] Section 16 applies to every person who is the beneficial owner of more than 10% of any class of equity security registered under section 12 of the Exchange Act, and each officer and director (collectively ''insiders'') of the issuer of such security. Generally:

- Section 16(a) requires an insider to file an initial report with the Commission disclosing his or her beneficial ownership of all equity securities of the issuer upon becoming an insider. To keep this information current, section 16(a) also requires insiders to report changes in such holdings with respect to each month in which such a change occurs.[23]
- Section 16(b) provides the issuer (or shareholders suing on behalf of the issuer) a private right of action to recover from an insider any profit realized by the insider from any purchase and sale (or sale and purchase) of any equity security of the issuer within any period of less than six months.[24]
- Section 16(c) makes it unlawful for an insider to sell any equity security of the issuer if the insider: (1) Does not own the security sold; or (2) owns the security, but does not deliver it against the sale within specified time periods.[25]

The following responses address how section 16 would apply to security futures in some common situations.[26]

Q7: Section 16 applies to every person who is directly or indirectly the beneficial owner of more than ten percent of any class of equity security (other than an exempted security) registered under section 12 of the Exchange Act.[27] Exchange Act Rule 16a–1(a)(1)[28] provides that for purposes of determining whether a person is a ''beneficial owner'' of more than ten percent of any class of equity securities, the term ''beneficial owner'' shall mean any person who is deemed a ''beneficial owner'' pursuant to section 13(d) of the Exchange Act and the rules thereunder.[29] Would the equity securities underlying a security future be counted for purposes of determining whether the purchaser of the security future is a ''beneficial owner'' of more than ten percent of a class of equity security?

A7: Yes. A person is deemed to be the beneficial owner of the equity securities underlying a security future that requires physical settlement[30] of the long security future if the security future is held within 60 days of the last trading day of the security future.[31] However, the purchaser of a cash-settled security future (i.e., a security future that, by its terms, must be settled by a cash payment) is not deemed to beneficially own the securities underlying that security future for purposes of determining whether the purchaser is a ''beneficial owner'' of more than ten percent of the underlying class of equity security, because he or she does not have the right to acquire beneficial ownership of the underlying security.[32]

Q8: Is a security future on an equity security or a narrow-based security index[33] a ''derivative security'' under the Section 16 rules?

A8: Yes. Exchange Act Rule 16a–1(c)[34] generally defines the term ''derivative securities'' as ''any option, warrant, convertible security, stock appreciation right or similar right with an exercise or conversion privilege at a price related to an equity security, or similar securities with a value derived from the value of an equity security,'' subject to specific exclusions. A security future on an equity security or a narrow-based security index would be a ''similar security with a value derived from the value of an equity security'' and thus a ''derivative security'' within the meaning of Rule 16a–1(c), regardless of whether the security future calls for physical or cash settlement.

Q9: Exchange Act Rule 16a–1(b)[35] defines a ''call equivalent position'' as a derivative security position that increases in value as the value of the underlying equity security increases, including, but not limited to, a long convertible security, a long call option, or a short put option position. Is the purchase of a security future by an insider, or a long security future position, a ''call equivalent position?''

A9: Yes. Because the purchaser of a security future, regardless of whether the security future calls for cash or physical settlement, would benefit from an increase in value of the underlying equity security, the purchase of a security future establishes a call equivalent position.

Q10: Exchange Act Rule 16a–1(h)[36] defines a ''put equivalent position'' as a derivative security position that increases in value as the value of the underlying equity decreases, including, but not limited to, a long put option or a short call option position. Is the sale of a security future by an insider, or a short security future position, a put equivalent position?

A10: Yes. Because the seller of a security future, regardless of whether the security future calls for cash or physical settlement, would benefit from a decrease in value in the underlying equity security, the sale of a security future establishes a put equivalent position.

Q11: Exchange Act Rule 16b–6(a)[37] states that the establishment of, or increase, in a call equivalent position, or liquidation of, or decrease, in a put equivalent position shall be deemed a purchase of the underlying security for purposes of section 16(b). Conversely, Rule 16b–6(a) states that the establishment of, or increase, in a put equivalent position, or liquidation of, or decrease, in a call equivalent position shall be deemed a sale of the underlying securities for purposes of section 16(b). How would purchases and sales of security futures be subject to matching for Section 16(b) short-swing profit recovery purposes?

A11: The purchase of a security future (''call equivalent position'') would be matchable with any of the following transactions within any period of less than six months:

- Any disposition of the equity security underlying the security future;
- Any liquidation or decrease in a ''call equivalent position'' on the same class of equity security underlying the security future; or
- Any establishment or increase of a ''put equivalent position'' on the same class of equity security underlying the security future.

[22] Exchange Act section 16(f) (15 U.S.C. 78p(f)).

[23] Exchange Act section 16(a) (15 U.S.C. 78p(a)).

[24] Exchange Act section 16(b) (15 U.S.C. 78p(b)).

[25] Exchange Act section 16(c) (15 U.S.C. 78p(c)).

[26] These examples and other examples in this section are for purposes of section 16 of the Exchange Act only and do not address any other issues under the Exchange Act or the Securities Act. For a discussion of the Securities Act, see Section II.A.1.a.

[27] 15 U.S.C. 78*l*.

[28] 17 CFR 240.16a–1(a)(1).

[29] *See infra* Section II.A.2.

[30] *See supra* note 20.

[31] The last trading day is the day on which the security future terminates trading, *i.e.,* the last day in which an open position in a security future, either a long or short position, can be closed or liquidated either by buying or selling an opposite position. Any security future that has not been liquidated by the close of trading for that security future on the last trading day must be settled pursuant to the terms of the security future.

[32] *See infra* Section II.A.2 (discussing the application of the beneficial ownership rules of Regulation 13D).

[33] The term ''narrow-based security index'' is defined in section 3(a)(55) of the Exchange Act [15 U.S.C. 78c(a)(55)].

[34] 17 CFR 240.16a–1(c).

[35] 17 CFR 240.16a–1(b).

[36] 17 CFR 240.16a–1(h).

[37] 17 CFR 240.16b–6(a).

The sale of a security future (''put equivalent position'') would be matchable with any of the following transactions within any period of less than six months:

- Any acquisition of the equity security underlying the security future;
- Any liquidation or decrease in a ''put equivalent position'' on the same class of equity security underlying the security future; or
- Any establishment or increase of a ''call equivalent position'' on the same class of equity security underlying the security future.

Examples. For purposes of the following four examples, assume that the common stock of Company XYZ is registered under section 12 of the Exchange Act.

Example 1: On January 3, 2003, W, an officer of Company XYZ, purchases 10,000 shares of XYZ common stock. On September 3, 2003, W purchases 100 December delivery security futures on XYZ common stock. Each security future is on 100 shares of XYZ common stock. This purchase establishes a ''call equivalent position'' with respect to 10,000 shares of XYZ common stock. On November 3, 2003, W sells 10,000 shares of XYZ common stock. Interpretation: W's September purchase of the security futures would be matchable with W's November sale of the XYZ shares. Exchange Act Rule 16b-6(c)(2) [38] would apply to the determination of recoverable profits.

Example 2: On January 3, 2003, W purchases 100 September delivery security futures on XYZ common stock. On April 3, 2003, W sells call options on 5,000 shares of XYZ common stock. Interpretation: W's January purchase of the security futures established a ''call equivalent position'' with respect to 10,000 shares of XYZ common stock. W's subsequent sale of the call options established a ''put equivalent position'' with respect to 5,000 shares of XYZ common stock and is matchable with his purchase of 50 of the September delivery security futures.

Example 3: For purposes of this example, assume that W owns 10,000 shares of XYZ common stock. On January 3, 2003, W sells 100 June delivery security futures on XYZ common stock. On April 3, 2003, W sells put options overlying 10,000 shares of XYZ common stock. Interpretation: W's January sale of the security futures established a ''put equivalent position'' with respect to 10,000 shares of XYZ common stock. W's subsequent sale of the put options established a ''call equivalent position'' (W is obligated to purchase the XYZ shares underlying the put options if the holder of the options exercises them) and is matchable with his January sale of the security futures.

Example 4: On January 3, 2003, W purchases 100 September delivery security futures on XYZ common stock. On February 10, 2003, W purchases 10,000 shares of XYZ common stock. On September 5, 2003, W sells 100 September delivery security futures on XYZ common stock, to offset [39] the security futures purchased in January. Interpretation: Because W's sale of the security futures occurred more than six months after both his January purchase of the security futures and his February purchase of the XYZ common stock, the offsetting sale would not be matchable with either purchase. However, the offsetting sale would be matchable with W's purchase of the XYZ shares in February, if it occurred within six months of the February purchase, and it would be matchable with either the January or February purchase (depending upon which transaction had the lowest purchase price) if it occurred within six months of the January purchase.[40]

Q12: Exchange Act Rule 16b–6(b) exempts from Section 16(b) the closing of a derivative security position as a result of its exercise or conversion, and the acquisition of underlying securities at a fixed exercise price due to the exercise or conversion of a call equivalent position, or the disposition of underlying securities at a fixed exercise price due to the exercise of a put equivalent position.[41] The Rule further provides, however, that the acquisition of underlying securities from the exercise of an out-of-the-money [42] option, warrant or right shall not be exempt.

(a) Would the settlement of a security future through delivery or receipt of the underlying equity security be exempted by Rule 16b–6(b)?

(b) Would cash settlement of a security future be exempted by Rule 16b–6(b)?

A12: (a) The disposition of a security future and delivery or receipt of the underlying security upon settlement would be exempted by Rule 16b–6(b). The provision in Rule 16b–6(b) that excludes from the exemption the exercise of out-of-the-money options would not apply. Unlike certain option contracts, where the holder of the option can choose whether or not and (in the case of American style options) when to exercise the option, a security future creates an obligation either to purchase or sell the underlying securities at a specified future date. Accordingly, the physical settlement of a security future is more similar to a conversion for purposes of Rule 16b–6(b). An out-of-the-money conversion that otherwise complies with Rule 16b–6(b) is exempt under that Rule.

(b) For purposes of section 16, cash settlement of a security future, like the cash settlement of any other derivative security, involves the deemed sale of the underlying securities in addition to the transactions described in (a) above that take place upon physical settlement.[43] Where an insider holds a long security future position, cash settlement would involve the insider's deemed sale of the underlying securities back to the counterparty. Where an insider holds a short security future position, cash settlement would involve the insider's deemed repurchase of the underlying securities from the counterparty. Rule 16b-6(b) exempts only the transactions described in (a) above, and does not

[38] 17 CFR 240.16b–6(c)(2). Exchange Act Rule 16b-6(c)(2) sets forth the methods for determining the profits recoverable under section 16(b) from short-swing transactions involving derivative securities with different characteristics but related to the same underlying security (*e.g.,* the purchase and sale of call options with different strike prices and expiration dates), and from short-swing transactions involving derivative securities and the underlying security. Under Rule 16b–6(c)(2), profits from short-swing transactions involving derivative securities having different characteristics but related to the same underlying security, or involving derivative securities and the underlying security, cannot exceed the difference in price of the underlying security on the date of purchase or sale and the date of sale or purchase.

[39] Offset refers to the method of closing or liquidating an outstanding long or short security future position through an opposite trade (*i.e.,* an equal and opposite transaction to the one that opened the position). Offset will occur only if the purchase or sale matches the original security future transaction with respect to the underlying security, number of security futures, and delivery month. Once a party has offset his or her outstanding security future position, the party has no further obligations with respect to the original transaction or the offsetting transaction.

[40] See, for example, *Smolowe* v. *Delendo Corp.,* 136 F.2d 231 (2d Cir. 1943), *cert. denied* 320 U.S. 751 (1943), regarding ''lowest price in highest price out'' profit computation. Under this method, recoverable profit is computed by matching the highest sale price with the lowest purchase price within six months, the next highest sale price with the next lowest purchase price within six months, and so on, until all shares have been included in the computation.

[41] 17 CFR 240.16b–6(b).

[42] For a person who has a long security future position, the security future would be ''out-of-the-money,'' as that term is used in Rule 16b–6(b), if the settlement price of the security future is above the market price of the underlying security on the settlement date. Conversely, a short security future position would be ''out-of-the money'' if the settlement price of the security future is above the market price of the underlying security on the settlement date.

[43] *See* Securities Exchange Act Release No. 28869 (February 8, 1991), 56 FR 7242 (February 21, 1991).

exempt either of these additional transactions.

Q13: Generally, persons subject to the reporting requirements of section 16 must file a report on Form 4 within ten days after the close of any month in which a change in beneficial ownership has occurred in the equity securities of the subject issuer. Unlike most transactions exempt from section 16(b), which are eligible for deferred reporting on Form 5, exercises and conversions of derivative securities that are exempt from section 16(b) must be reported on Form 4.[44] General Instruction 8 of Form 4 specifies transaction codes that should be used to identify the type of transaction being reported. What codes should be used to identify insiders' transactions in security futures?

A13: Transactions in security futures should be reported as follows:

- Purchase of a security future should be identified in Table II, column 4 of the form with transaction code ''P.''
- Sale of a security future should be identified in Table II, column 4 of the form with transaction code ''S.''
- Physical settlement of a long security future should be identified in Table I, column 3 and Table II, column 4 with transaction code ''C.''
- Physical settlement of a short security future should be identified in Table I, column 3 and Table II, column 4 with transaction code ''C.''
- Cash settlement of a long security future should be identified in Table I, column 3 and Table II, column 4 with transaction code ''C,'' and with transaction code ''S'' on a separate line in Table I, column 3 (to report the deemed sale of the underlying securities).
- Cash settlement of a short security future should be identified in Table I, column 3 and Table II, column 4 with the transaction code ''C,'' and with transaction code ''P'' on a separate line in Table I, column 4 (to report the deemed repurchase of the underlying security).

Q14: Exchange Act Rule 16c–4 provides that establishing or increasing a put equivalent position is exempt from section 16(c) so long as the amount of securities underlying the put equivalent position does not exceed the amount of underlying securities otherwise owned by the insider. How would Rule 16c–4 apply to an insider's sale of a security future?

A14: For the duration of the insider's put equivalent position pursuant to the security future, an insider who sells a security future must otherwise own an amount of the underlying securities sufficient to cover his or her delivery obligations under the security future. In computing the amount of underlying securities otherwise owned, an insider may include securities of the same class as the underlying securities on deposit in a margin account.

Example: The common stock of Company XYZ is registered under section 12 of the Exchange Act. On May 5, 2003, S, an officer of Company XYZ, owns 10,000 shares of XYZ common stock. On May 5, 2003, S sells 100 December delivery security futures on XYZ common stock. This sale establishes a ''put equivalent position'' with respect to 10,000 shares of XYZ common stock (each security future is on 100 shares of Company XYZ common stock). S deposits 2,000 shares of Company XYZ common stock as margin on the security futures. Interpretation: Including the 2,000 shares of XYZ common stock S deposited for margin, S otherwise owns a sufficient amount of XYZ shares to cover his obligation to deliver 10,000 XYZ shares upon settlement of the security futures within the meaning of Rule 16c–4. S must continue to otherwise own 10,000 shares of XYZ common stock for the duration of the put equivalent position with respect to the 100 December delivery security futures.

Q15: Are the securities underlying a long security future that calls for physical settlement considered ''otherwise owned'' for purposes of Rule 16c–4?

A15: An insider who is long a security future does not ''otherwise own'' the securities underlying the security future until he or she is obligated to accept delivery under the security future (*i.e.,* if the security future is not offset prior to the close of trading for that security future on the last trading day). Once an insider is obligated to accept delivery, he or she may include the securities underlying the security future in computing the amount of underlying securities ''otherwise owned.'' An insider who is long a cash-settled security future does not ''otherwise own'' the underlying securities.

Example: The common stock of Company XYZ is registered under Section 12 of the Exchange Act. S, an officer of Company XYZ, does not own any shares of XYZ common stock. On May 5, 2003, S purchases 10 December delivery security futures on XYZ common stock. Each security future is on 100 shares of XYZ common stock. The last trading day of the December delivery security futures is the third Friday in December (December 19, 2003). S wishes to buy put options on 1000 shares of XYZ common stock on or after December 19, 2003. Interpretation: S becomes obligated to accept delivery of the 1000 XYZ common shares underlying the 10 December delivery security futures after the close of trading on December 19, 2003. Accordingly, as of the close of trading on December 19, 2003, S is deemed to otherwise own those 1000 XYZ common shares for purposes of Rule 16c–4. Therefore, S's purchase of put options on 1000 shares of XYZ common stock after the close of trading on December 19, 2003, would be exempt from Section 16(c) pursuant to Rule 16c–4.

2. Mergers and Acquisitions Issues

Beneficial Ownership Disclosure Requirements: Exchange Act Regulation 13D[45]

Rule 13d–1 of the Exchange Act[46] requires any person who becomes a beneficial owner of more than five percent of a class of equity security[47] to file a statement containing the information required by either Schedule 13D or Schedule 13G.[48] Under Exchange Act Rule 13d–3(a),[49] a person

[44] Exchange Act Rule 16a–3(f)(1)(i)(A) [17 CFR 240.16a–3(f)(1)(i)(A)].

[45] Regulation 13D also encompasses the Schedule 13G requirements.

[46] 17 CFR 240.13d–1.

[47] For the purpose of Regulation 13D, the term ''equity security'' is defined in Rule 13d–1(i) (17 CFR 240.13d–1(i)) as any equity security of a class which is registered under section 12 of the Exchange Act (15 U.S.C. 78*l*), or any equity security of any insurance company which would have been required to be registered under the Exchange Act except for the exemption contained in section 12(g)(2)(G) of the Exchange Act (15 U.S.C. 78*l*(g)(2)(G)), or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940 (15 U.S.C 80a *et seq.*). The term does not include securities of a class of non-voting securities.

[48] 17 CFR 240.13d–101 or 240.13d–102. Unless otherwise exempt, a person acquiring more than five percent of a class of equity security must file a Schedule 13D within 10 days of the acquisition. A Schedule 13D filer must disclose, among other things, his or her identity and background, the source and amount of funds used to acquire the securities, the purpose of the acquisition and any plans or proposals of the filer concerning the issuer. Institutional investors who acquire more than five percent of a class of equity security in the ordinary course of business, and not with the purpose or effect of changing or influencing control of the issuer, may file the short-form Schedule 13G, in lieu of the Schedule 13D, within 45 days after the end of the calendar year. Passive investors who acquire more than 5% of a class of equity security, but less than 20% of the class, and not with the purpose or effect of changing or influencing control of the issuer, may file the short-form Schedule 13G, in lieu of the Schedule 13D, within 10 days after the acquisition. A Schedule 13G filer must disclose, among other things, his or her identity, residence and citizenship, and amount of securities beneficially owned.

[49] 17 CFR 240.13d–3(a). The Rule states that voting power includes the power to vote or to direct the voting of the security, and that investment

Continued

is deemed to be the beneficial owner of a security, for purposes of sections 13(d) and 13(g) of the Exchange Act,[50] if that person has or shares voting and/or investment power with respect to the security. The Rule deems a person to be the beneficial owner of a security if that person has the right to acquire beneficial ownership of the security within 60 days, including, but not limited to, a right to acquire it through exercise of an option, warrant, right or through the conversion of another security.[51] Any person who acquires the right to acquire a security in this manner with the purpose or effect of changing or influencing control of the issuer of the security is immediately deemed to be the beneficial owner of the security upon acquisition of the right to acquire the security, regardless of when the right is exercisable.[52]

Q16: Is a security future an ''equity security'' that is reportable under Regulation 13D?

A16: No. Security futures are not covered by the Rule 13d–1(i) definition of ''equity security'' [53] because they are exempt from registration under section 12 of the Exchange Act.[54]

Q17: Would the equity securities underlying a security future that requires physical settlement of the security future be counted for purposes of determining whether the purchaser of the security future is subject to the Regulation 13D beneficial ownership reporting requirements?

A17: Yes, but only during the period when there are 60 or fewer days before the last trading day, or immediately upon purchase of the security future if it was acquired for the purpose of changing or influencing control of the issuer of the underlying securities.[55]

Example 1: On June 3, 2002, W purchases 100 security futures for December delivery. Each security future calls for physical delivery of 100 shares of Company XYZ common stock. The last trading day of the December delivery contracts is December 20, 2002. Before his acquisition of the security futures, W was not required to file a beneficial ownership report on either Schedule 13D or 13G. Interpretation: On the purchase date, June 3, 2002, W does not have to count the shares of Company XYZ common stock underlying the security futures contracts for purposes of determining beneficial ownership under Rule 13d–3 because this date is more than 60 days from the last trading day of the security futures.[56] If W has not offset the security futures on or before October 21, 2002, W would count the shares of XYZ common stock underlying the security futures for purposes of determining whether he is subject to the Regulation 13D beneficial ownership reporting requirements.

Example 2: Same facts as in Example 1 above, except W purchases the December delivery security futures (with the last trading day of December 20, 2002) on Company XYZ common stock on October 23, 2002. The amount of Company XYZ common stock beneficially owned by W before his purchase of the security futures, combined with the shares of Company XYZ common stock underlying the contracts, brings W above the five percent beneficial ownership threshold. Interpretation: W must file a Schedule 13D or 13G within 10 days after his purchase of the security futures.[57]

Q18: Would the equity securities underlying a security future that requires cash settlement be counted for purposes of determining whether the purchaser of the contract is subject to the Regulation 13D beneficial ownership reporting requirements?

A18: No. A purchaser of a cash-settled security future (*i.e.,* a security future that, by its terms, must be settled by a cash payment) would not count the equity securities underlying the contract for purposes of determining whether he or she is subject to the Regulation 13D reporting requirements, because he or she does not have the right to acquire beneficial ownership of the underlying security.

Q19: If the equity securities underlying a security future that requires physical settlement are counted for purposes of determining beneficial ownership under Regulation 13D, would the securities underlying a security future that is purchased to liquidate or offset an existing security future position be counted for purposes of determining beneficial ownership?

A19: No, but only to the extent that the offsetting purchase does not establish a new security future position. If a purchaser buys a security future to offset an outstanding short position, the purchaser has no obligation to accept delivery of the securities underlying the long security future.[58]

Q20: Other than for purposes of determining beneficial ownership, how does the purchase or sale of a security future affect Schedule 13D disclosure?

A20: As with other derivative contracts overlying an ''equity security'' under Rule 13d-1(i), a purchaser or seller of a security future who is subject to Schedule 13D reporting requirements with respect to the underlying security may have to amend Schedule 13D to disclose his or her transactions in security futures on securities of a class of equity security beneficially owned by such person, whether settled by physical delivery or in cash. For example, the purchase or sale of a security future may represent a change in the source of funds under Item 3 of Schedule 13D, a possible shift in purpose under Item 4 (particularly to the extent that the transaction is part of a plan or proposal to dispose of Company XYZ securities that W did not disclose previously), or a ''transaction'' in the subject security under Item 5. Furthermore, the security future would be a ''contract, agreement, understanding, or relationship * * * with respect to * * * securities of the issuer'' under Item 6. A Schedule 13G filer would disclose transactions in security futures in accordance with Regulation 13D and the item requirements of Schedule 13G.

B. Guidance on Statutory Provisions and Rules Administered by the Division of Market Regulation

1. Market Supervision Issues

The Duty of Best Execution

Broker-dealers have long been subject to a duty of best execution when effecting securities transactions for customers. This duty derives from

power includes the power to dispose, or to direct the disposition of the security.

[50] 15 U.S.C. 78m(d) and (g).

[51] Rule 13d–3(d)(1)(i) (17 CFR 240.13d–3(d)(1)(i)). Additionally, the Rule deems a person to be the beneficial owner of a security if the person has the right to acquire beneficial ownership of the security within 60 days pursuant to the power to revoke a trust, discretionary account, or similar arrangement through the termination of a trust, discretionary account or similar arrangement. *See* Rule 13d–3(d)(1)(i)(C) and (D) (17 CFR 240.13d–3(d)(1)(i)(C) and (D)).

[52] Rule 13d–3(d)(1) (17 CFR 240.13d–3(d)(1)).

[53] *See supra* note .

[54] Exchange Act section 12(a) (15 U.S.C. 78l(a)) exempts security futures traded on a national securities exchange from registration under both sections 12(b) and section 12(g) of the Exchange Act (15 U.S.C. 78l(b) and (g)). Exchange Act section 12(g) clarifies that security futures are not equity securities of the issuer of the underlying securities.

[55] *See supra* note.

[56] This example assumes that the security futures were not purchased with the purpose or effect of changing or influencing control of the issuer.

[57] In this example, W would be eligible to file on the short-form Schedule 13G if he is an institutional or passive investor and can certify that he did not purchase the security futures for the purpose of changing control of Company XYZ, and the purchase did not have the effect of changing control of Company XYZ. *See* Rule 13d–1(b) and (c) (17 CFR 240.13d–1(b) and (c)).

[58] *See supra* note . A transaction is not an offsetting transaction if it does not liquidate the previously established security future position. Once a security future has been offset, the obligation to accept or make delivery of the underlying securities or to accept or make payment of the value of the underlying securities (in the case of a cash settled security future) is canceled.

common law agency principles and fiduciary obligations, and has been incorporated in self-regulatory organization rules and, through judicial and Commission decisions, in the enforcement of the antifraud provisions of the federal securities laws. Questions have arisen as to the applicability of this duty to security futures products.

Q21: Does the duty of best execution apply to security futures products?

A21: Yes. The duty of best execution requires a broker-dealer ''to seek the most favorable terms reasonably available under the circumstances for a customer's transaction.''[59] The duty of best execution is not limited by the type of transaction or security involved and applies equally to security futures products.

Q22: Are broker-dealers expected to comply with the duty of best execution in the absence of national market system mechanisms for security futures products?

A22: Yes. While the national market system mechanisms adopted under the Exchange Act were designed in part ''to assure * * * the practicability of brokers executing investors'' orders in the best market,''[60] the duty of best execution predates the national market system provisions of the federal securities laws. Accordingly, the Commission has never considered the duty of best execution to be contingent on the existence of such mechanisms.[61] Best execution obligations, for example, also apply to securities for which national market system plans do not exist, such as government securities and corporate debt.[62]

Q23: Are broker-dealers expected to comply with the duty of best execution with respect to instruments that may not be standardized or fungible across markets?

A23: As noted above, the duty of best execution requires a broker-dealer to seek the most favorable terms reasonably available under the circumstances for a customer's transaction. In the absence of specific instructions from a customer, a broker-dealer has an obligation to use reasonable efforts to execute customer orders in the market that maximizes the economic benefit to the customer.[63] The Commission recognizes that it would be difficult to apply these principles to contracts that are materially different as to their terms. If the customer has specified the market or contract in which to trade, the broker-dealer must seek to achieve the best possible execution within that market. If the customer has not specified the market or contract, the Commission reminds broker-dealers that, even with respect to contracts that are materially different, they should consider the applicability of other agency or fiduciary duties, including suitability.

2. Trading Practices Issues[64]

a. Short Sale Regulation: Exchange Act Rules 10a–1 and 3b–3

A short sale is the sale of a security that the seller does not own or that the seller owns but does not deliver. The Commission has plenary authority to regulate short sales of securities registered on a national securities exchange (listed securities) as necessary to protect investors under Section 10(a) of the Exchange Act.[65] The Commission adopted Exchange Act Rule 10a–1[66] to restrict short selling in a declining market.[67] Specifically, Rule 10a–1(a)(1) provides that, subject to certain exceptions, a listed security may be sold short: (i) At a price above the price at which the immediately preceding sale was effected (plus tick), or (ii) at the last sale price if it is higher than the last different price (zero-plus tick). Conversely, short sales are not permitted on minus ticks or zero-minus ticks, subject to narrow exceptions. The operation of these provisions constitute what is commonly described as the ''tick test.''

Exchange Act Rule 3b–3 defines the term ''short sale'' as any sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller. Rule 3b–3 also defines specific instances when a person shall be deemed to own a security, *i.e.,* a long position.

Q24: Will sales of security futures be subject to Rule 10a–1?

A24: No. In authorizing the trading of futures contracts involving single stocks and narrow-based security indices, Congress exempted security futures products from the operation of Section 10(a)(1) of the Exchange Act under which Rule 10a–1 is adopted.[68]

Q25: Does a security future convey ownership under Rule 3b–3 for the purposes of short sale regulation?

A25: A person who holds a security future obligating him to take delivery of the underlying securities by physical settlement would not be considered long these securities for the purposes of Rule 3b–3 until the security future terminates trading.[69] This interpretation is consistent with the way Rule 3b–3 addresses several instances where a person owns a security that entitles a person to acquire securities underlying the instrument, *e.g.,* options, rights, warrants, and convertibles. In those instances, Rule 3b–3 requires the option, right, warrant, or convertible to be exercised, tendered, or converted before the person can be considered as having a long position in the underlying security. These provisions also implicitly contemplate that the person will shortly acquire the security being sold. For a physically-settled security future, the holder will obtain the underlying security only after the security future terminates trading. A security future settled by receipt of cash has no effect on a person's long position.

b. Safe Harbor for Issuer Repurchases: Exchange Act Rule 10b–18

Exchange Act Rule 10b–18[70] provides a non-exclusive ''safe harbor'' from liability for manipulation under sections 9(a)(2) and 10(b) of the Exchange Act, and Rule 10b–5 under the Exchange Act, when an issuer or its affiliated purchaser bids for or purchases shares of the issuer's common stock in accordance with the Rule's manner, timing, price, and volume conditions. Because Rule 10b–18 is a voluntary safe harbor, an issuer is not required to comply with the provisions of the Rule when making market purchases, and no adverse inference about manipulation may be drawn if an issuer's purchases do not satisfy the Rule's conditions or are not covered by the Rule. Rule 10b–18's conditions are

[59] Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290, 48322 (September 12, 1996).

[60] 15 U.S.C. 78k–1(a)(1)(C)(iv).

[61] *See* Securities Exchange Act Release No. 43591 (November 17, 2000), 65 FR 75439, 75439–40 (December 1, 2000) (discussing best execution obligations with respect to exchange-listed options).

[62] *See* NASD Rule 2320.

[63] *See Newton* v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.,* 135 F.3d 266, 270 (3d Cir. 1998) (en banc); NASD Rule 2320.

[64] Exchange Act Rules 15c2–4 and 15c2–8 [17 CFR 240.15c2–4 and 240.15c2–8] apply to sales of security futures by brokers and dealers that constitute distributions. We anticipate that security futures will be issued by clearing agencies, and brokers and dealers therefore will not participate in distributions of security futures. If brokers and dealers, however, participate in a distribution of security futures, we will address any questions regarding Rules 15c2–4 and 15c2–8 at that time.

[65] 15 U.S.C. 78j(a).

[66] 17 CFR 240.10a–1.

[67] *See* Securities Exchange Act Release No. 1548 (January 24, 1938), 3 FR 213 (January 26, 1938).

[68] *See* 15 U.S.C. 78j(a)(2).

[69] Termination of trading is the moment at which an open position in a security future, either a long or short position, can no longer be closed or liquidated either by buying or selling an opposite position. Similarly, a person obligated to deliver would be considered short at the termination of trading.

[70] 17 CFR 240.10b–18.

designed to limit the market impact of the issuer's repurchase activity. In so doing, Rule 10b–18 provides a measure of assurance to investors that a security's market price is based on independent market forces and not influenced in a manipulative manner by the issuer.

Q26: Is the Rule 10b–18 safe harbor available for issuer repurchase transactions involving security futures (including the receipt of securities underlying such futures)?

A26: No. Rule 10b–18 only applies to what is defined as a ''Rule 10b–18 purchase.'' [71] A Rule 10b–18 purchase encompasses only purchases by an issuer or its affiliate of its common stock. It does not apply to any other type of security—even if related to the common stock (*e.g.,* transactions in derivative securities such as warrants, options, or security futures that are physically-settled).[72] Thus, consistent with the treatment of options under Rule 10b–18, we view the term ''Rule 10b–18 purchase'' as not including issuer repurchase transactions involving security futures (including the receipt of securities underlying such futures).

c. The Short Tender Rule: Exchange Act Rule 14e–4

Exchange Act Rule 14e–4,[73] commonly referred to as the ''short tender rule,'' is generally designed to preclude persons from tendering more shares than they own in order to avoid or reduce the risk of pro rata acceptance in a partial tender offer. A person may tender shares into a partial tender offer only if both at the time of tender and at the end of the proration period the person has a ''net long position'' in the subject security or an equivalent security equal to or greater than the amount tendered into the partial tender offer. Under Rule 14e–4, a person's ''net long position'' in a subject security equals the excess, if any, of such person's ''long position'' over a person's ''short position.'' The calculation of the net long position must be done both at the time of tender and at the end of the proration period, or period during which securities are accepted by lot, including any extension thereof.

Q27: How should a security future be considered in calculating a person's *long position* for the purposes of Rule 14e–4 when the underlying security is the subject of a partial tender offer?

A27: A person who holds a security future obligating him to take delivery of a subject security by physical settlement will be considered to be long the subject security for the purposes of Rule 14e–4 only after the security future terminates trading.[74] This interpretation is consistent with the treatment of standardized options positions in Rule 14e–4. The owner of a standardized option in a subject security is not considered to be long the underlying security under Rule 14e–4 for tendering purposes until the standardized option is exercised. A security future settled by receipt of cash has no effect on the shareholder's long position.

Q28: How should a security future be considered in calculating a person's *short position* for the purposes of Rule 14e–4 when the underlying security is the subject of a partial tender offer?

A28: In order to prevent hedged tendering and over-tendering, Rule 14e–4 requires a person tendering into a partial tender offer to include in the calculation of his or her short position the amount of subject securities such person is obligated to deliver pursuant to a security future that was entered into on or after the date that a tender offer is first publicly announced or otherwise made known by the bidder to the holders of the security to be acquired, if the security future terminates trading at or before the end of the proration period. If one or more tender offers for the same security are ongoing on such date, the announcement date shall be that of the first announced offer. This requires inclusion of the amount of such subject securities in the person's short position, regardless of the price of the security future relative to the price of the subject security underlying the security future, because (in contrast to an option, discussed below) the security future requires the person to deliver the securities upon maturity.

This interpretation is consistent with the treatment of standardized options positions in Rule 14e–4. Rule 14e–4 requires a person tendering into a partial tender offer to include in the calculation of his or her short position the amount of subject securities that the person is obligated to deliver upon exercise of a standardized in-the-money call option that was sold on or after the date that a tender offer is first publicly announced or otherwise made known by the bidder to the holders of the security to be acquired. For purposes of Rule 14e–4, in-the-money call options are those options with strike prices below the highest tender offer price or stated amount of consideration offered for the subject security. A security future settled by receipt of cash has no effect on the person's short position.[75]

d. Purchases Outside of a Tender Offer: Exchange Act Rule 14e–5

In connection with a tender offer for equity securities, Rule 14e–5 of the Exchange Act [76] generally prohibits a covered person from directly or indirectly purchasing or arranging to purchase outside of the tender offer (i) the securities or class of securities that are sought to be acquired in the transaction or that are otherwise the subject of the transaction (''subject securities''), or (ii) securities that are immediately convertible into, exchangeable for, or exercisable for subject securities (''related securities'').[77]

Q29: Would Rule 14e–5 apply to the purchase by a covered person of security futures during a tender offer for the securities underlying the security futures?

A29: The security futures would not be subject securities. Nor would the security futures be related securities because they would not be ''immediately convertible into, exchangeable for, or exercisable for'' the subject securities (*i.e.,* the underlying securities). However, if the security futures provide for physical settlement, and the security futures will terminate trading [78] prior to expiration of the tender offer, the purchase of the security futures would be prohibited under Rule 14e–5 as an arrangement (*i.e.,* the security future contract) to purchase subject securities (*i.e.,* the underlying securities) during the tender offer.

Q30: Would Rule 14e–5 prohibit the physical settlement of a long security futures position by a covered person during a tender offer for the underlying security?

A30: The acquisition of the underlying securities upon physical settlement of a long security futures position would be considered a purchase of subject securities. Rule 14e–5(b)(1), however, permits transactions by covered persons to convert, exchange, or exercise related securities owned *before* public announcement of

[71] *See* Exchange Act Rule 10b–18(a)(3) (17 CFR 240.10b–18(a)(3)).

[72] Rule 10b–18 also would not apply to security futures that are cash-settled, as these products do not result in a purchase of the common stock for purposes of the Rule.

[73] 17 CFR 240.14e–4.

[74] *See supra* note 69 (explaining termination of trading).

[75] Further, the holder of a cash-settled futures contract is not considered to own the subject securities underlying the contract for purposes of Rule 14e–4, and so cannot tender shares on the basis of the security future. As such, security futures settled by receipt of cash have no effect on the number of subject securities eligible to be tendered into an offer.

[76] 17 CFR 240.14e–5.

[77] Relevant terms are defined in paragraph (c) of Rule 14e–5.

[78] *See supra* note 69.

the tender offer into subject securities. Because the acquisition of subject securities upon the physical settlement of security futures is substantially similar to acquisitions of subject securities by conversion, exchange or exercise of other securities, the acquisition of underlying securities that are the subject of a tender offer upon physical settlement of a long security futures position is within the Rule 14e–5(b)(1) exception, if the covered person owned the security futures before public announcement of the tender offer.

Q31: Would Rule 14e–5 prohibit the acquisition of subject securities to satisfy an obligation to deliver those securities upon physical settlement of a short position in security futures?

A31: The acquisition of the underlying securities in order to physically settle a short position in security futures would be considered a purchase of subject securities. Rule 14e–5(b)(6), however, permits purchases that are made to satisfy an obligation to deliver a subject security arising from the exercise of an option by a non-covered person or a short sale, provided that (i) the short sale or option was established before public announcement of the tender offer, and (ii) the short sale or option transaction was made in the ordinary course of business and not to facilitate the offer. Because the acquisition of subject securities upon the physical settlement of a short security futures position is substantially similar to the acquisition of subject securities in a covering transaction arising from a short sale or the exercise of an option by a non-covered person, the acquisition is within the Rule 14e–5(b)(6) exception, provided the obligation to settle by physical delivery was established before public announcement of the tender offer and the security future transaction was made in the ordinary course of business and not to facilitate the offer.

Q32: Would Rule 14e–5 apply to the cash settlement by a covered person of a long security futures position?

A32: No. The cash settlement of a long security futures position would not involve an acquisition of the securities underlying the security futures.

e. Anti-manipulation Rules Regarding Distributions: Regulation M

Regulation M[79] is intended to preclude manipulative conduct by persons with an interest in the outcome of an offering of securities. It governs the activities of underwriters, issuers, selling security holders, and others that participate in the offering, as well as their affiliated purchasers. Regulation M prohibits such persons from directly or indirectly bidding for, purchasing, or attempting to induce any person to bid for or purchase, any security that is the subject of a distribution (a ''subject security''), or any ''reference security'' (together, ''covered securities''), until after the applicable restricted period.[80]

Q33: Would Regulation M apply to the purchase of security futures during a distribution of the securities underlying the security futures?

A33: Yes. The purchase of the security futures would be considered within the prohibition against directly or indirectly bidding for, purchasing, or attempting to induce any person to bid for or purchase, a covered security (*i.e.,* the underlying securities) because, at a minimum, the purchase of the security futures would be an indirect purchase of a covered security.

Q34: Is the actively-traded securities exception available in connection with acquisitions of security futures during distributions of the underlying stock?

A34: The actively-traded securities exception under Rule 101(c)(1) would be available to acquisitions of security futures by distribution participants and their affiliated purchasers where the underlying securities are actively-traded securities. However, that exception is not available to purchases of security futures by issuers, selling security holders, or affiliated purchasers of the underlying securities who are governed by Rule 102(d)(1).[81]

Q35: Would Regulation M prohibit the physical settlement of a long security futures position during a distribution of the underlying security?

A35: The acquisition of the underlying security upon physical settlement of a long security futures position would be considered the purchase of a covered security. Rules 101(b)(4) and 102(b)(4), however, permit distribution participants, and issuers and selling shareholders, respectively, to acquire a covered security through the exercise of any option, warrant, right, or any conversion privileges set forth in the instrument governing a security. In adopting these exceptions, the Commission stated that it believes that exercises or conversions of derivative securities generally have an uncertain and attenuated manipulative potential.[82] Because the acquisition of underlying securities upon physical settlement of a long security future is substantially similar to the acquisition of a covered security upon the exercise of an option, warrant, right, or conversion privilege, the acquisition is within the exceptions in Rules 101(b)(4) and 102(b)(4).

Q36: Would Regulation M apply to the cash settlement of a long security futures position?

A36: No. Regulation M would not prohibit the cash settlement of a long security futures position.

3. Other Broker-Dealer Issues

a. Eligible OTC Derivative Instruments: Exchange Act Rule 3b–13

OTC derivatives dealers are a class of registered dealers that limit their trading to eligible over-the-counter derivative products and certain related transactions.[83] Registration with the Commission as an OTC derivatives dealer is an alternative to registration as a full broker-dealer.[84] OTC derivatives dealers may engage in dealer activities in ''eligible OTC derivative instruments,'' as that term is defined in Exchange Act Rule 3b–13.[85] OTC derivatives dealers may also engage in certain additional securities activities related to conducting an OTC derivatives business.[86]

Q37: Would security futures products be eligible OTC derivative instruments as defined in Exchange Act Rule 3b–13?

A37: No. Exchange Act Rule 3b–13(b)(2)(i) defines an eligible OTC derivative instrument, and specifically excludes from the definition of eligible OTC derivative instrument a security that is listed or traded on a securities exchange. Security futures products are

[79] 17 CFR 242.100–242.105.

[80] Relevant terms, including ''distribution,'' ''reference security,'' and ''restricted period,'' are defined in Rule 100 of Regulation M.

[81] *See* 17 CFR 242.102.

[82] Securities Exchange Act Release No. 38067 (December 20, 1996), 62 FR 520, 528 (January 3, 1997).

[83] *See* 17 CFR 240.3b–12.

[84] *See* Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362 (November 3, 1998).

[85] 17 CFR 240.3b–13.

[86] *Id.* In particular, an OTC derivatives dealer must limit its securities activities to: (1) Engaging in dealer activities in eligible OTC derivative instruments (as defined in Rule 3b–13) that are securities; (2) issuing and reacquiring securities that are issued by the dealer, including warrants on securities, hybrid securities, and structured notes; (3) engaging in cash management securities activities (as defined in Rule 3b–14); (4) engaging in ancillary portfolio management securities activities (as defined in Rule 3b–15); and (5) engaging in such other securities activities that the Commission designates by order pursuant to Rule 15a–1(b)(1). 17 CFR 240.3b–12(a). In addition, such dealer's securities activities must consist primarily of those described in categories (1) through (3), 17 CFR 240.3b–12(b), and do not consist of any other securities activities, including engaging in any transaction in any security that is not an eligible OTC derivative instrument, except as permitted in categories (3) through (5). 17 CFR 240.3b–12(c). Moreover, an OTC derivatives dealer must also be affiliated with a fully regulated broker-dealer. 17 CFR 240.3b–12.

exchange listed instruments.[87] Because a security futures product is a security that is listed on a registered national securities exchange, it is excluded from the definition of an eligible OTC derivative instrument.[88] Accordingly, an OTC derivatives dealer that wishes to engage in activities involving security futures products would be limited to those activities permissible in securities that are not eligible OTC derivative instruments—activities such as ancillary portfolio management securities activities.[89]

b. Addressing Conflicts Associated With Proprietary Trading and Trading for Discretionary Accounts by Exchange Members: Exchange Act Section 11(a)

Section 11(a) of the Exchange Act [90] prohibits a member of a national securities exchange (other than a notice-registered exchange) from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises investment discretion, unless an exemption applies. Members of notice-registered futures exchanges are exempt from section 11(a) for purposes of their activities on those notice-registered exchanges, but are subject to a similar restriction.[91]

Congress enacted section 11(a) to encourage fair dealing and fair access in the exchange markets by reducing the conflicts arising from an exchange member trading for its own account in the public exchange markets.[92] Exempt from this prohibition are certain types of transactions that ''* * * contribute to the fairness and orderliness of exchange markets or which have not given rise to serious problems.''[93] For instance, section 11(a)(1)(A) provides an exemption from the prohibitions of section 11(a) for any transaction by a dealer acting in the capacity of a market maker.[94] Another type of transaction specifically exempted from section 11(a) is ''any bona fide hedge transaction involving a long or short position in an equity security and a long or short position in a security entitling the holder to acquire or sell such equity security. * * *''[95] The Commission implemented this exemption in 1979 by adopting Exchange Act Rule 11a1–3(T).[96]

Q38: Are both cash-settled and physically-settled security futures securities ''entitling the holder to acquire or sell an equity security'' so as to permit stock-to-futures, options-to-futures and futures-to-futures hedging transactions?

A38: Yes. Security futures are classic futures contracts—agreements to buy or sell a specific amount of a security at a particular price on a stipulated future date. Whether settlement on that date is done by cash or by physical delivery of the underlying securities, such an instrument can be used as a hedging vehicle.

From a regulatory perspective, cash-settlement is not a determinative factor in this context. The Commission has long considered security options that are cash-settled, as opposed to physically-settled, to be ''options on securities'' within the definition of security in Exchange Act section 3(a)(10).[97] Such an approach helps to ''meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits.''[98] For similar reasons, whether cash or physically-settled, security futures are securities ''entitling the holder to acquire or sell an equity security'' as contemplated by Rule 11a1–3(T).

Moreover, Congress did not intend to impose excessively rigid limits on the activities of arbitrageurs and other specialized traders in connection with transactions of the types listed in section 11(a)(1)(D), which includes bona fide hedge transactions.[99] Section 11(a)(1) was not designed to narrow or unduly complicate arbitrage activities and hedging transactions.[100] Because

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[87] *See* Exchange Act Sections 6(h)(1) [15 U.S.C. 78f(h)(1)].

[88] Exchange Act Rule 3b–13(b)(2)(i) specifically excludes from the definition of eligible OTC derivative instrument a contract, agreement or transaction that provides, in whole or in part, on a firm or contingent basis, for the purchase or sale of, or is based on the value of, or any interest in, any security, (or group or index of securities), and is listed on, or traded on or through, a national securities exchange or registered national securities association or a facility or market thereof. *See* 17 CFR 240.3b–13(b)(2)(i).

[89] Exchange Act Rule 3b–15 defines ancillary portfolio management securities activities. As the Commission explained in adopting the Rule:

These securities activities must be limited to transactions in connection with the OTC derivatives dealer's dealer activities in eligible OTC derivative instruments, the issuance of securities by the dealer, or such other securities activities that the Commission designates by order. They must also (1) be conducted for the purpose of reducing the dealer's market or credit risk or consist of incidental trading activities for portfolio management purposes; and (2) be limited to risk exposures within the market, credit, leverage, or liquidity risk parameters set forth in the trading authorizations granted to the associated person (or to the associated person's supervisor) who executes the transaction for the dealer, and in the written guidelines approved by the dealer's governing body and included in the dealer's internal risk management control system (as required under new (Exchange Act) Rule 15c3–4). Rule 3b–15 also requires that ancillary portfolio management securities activities be conducted only by associated persons of the dealer who perform substantial duties for the dealer in connection with its dealer activities in eligible OTC derivative instruments.

See Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362 (November 3, 1998); 17 CFR 240.3b–15. *See also supra* note (noting generally other permissible activities).

[90] 15 U.S.C. 78k(a).

[91] As directed by the CFMA, the CFTC recently adopted rules that prohibit futures intermediaries from trading for accounts in which they have any interest, during the same trading session that they also trade for the accounts of customers, the same security futures product on the same designated contract market or registered derivatives transaction execution facility. These rules also specifically require electronic markets to adopt rules to prohibit the execution of customer orders through systems that provide an unfair advantage to market intermediaries. That unfair advantage may be a time and place advantage, or the ability to influence or guide an order once the order enters the system. *See* Commodity Exchange Act Release No. 3038–AB83 (March 1, 2002), 67 FR 11223 (March 13, 2002).

[92] *See* Securities Act Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 94–75, 9th Cong., 1st Sess. 99 (1975).

[93] Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 94–75, 9th Cong., 1st Sess. 99 (1975).

[94] *See* Exchange Act section 11(a)(1)(A) (15 U.S.C. 78k(a)(1)(A)); Exchange Act Section 3(a)(38) (15 U.S.C. 78c(a)(38)) (defining market maker).

[95] Exchange Act section 11(a)(1)(D) (15 U.S.C. 78k(a)(1)(D)).

[96] Exchange Act Rule 11a1–3(T) provides that:

(a) bona fide hedge transaction effected on a national securities exchange by a member for its own account or an account of an associated person thereof and involving a long or short position in a security entitling the holder to acquire or sell an equity security, and a long or short position in one or more other securities entitling the holder to acquire or sell such equity security, shall be deemed to be of a kind which is consistent with the purposes of section 11(a)(1) of the Act, the protection of investors, and the maintenance of fair and orderly markets.

17 CFR 240.11a1–3(T).

[97] Exchange Act section 3(a)(10) (15 U.S.C. 78c(a)(10)). *See, e.g.,* Brief of the SEC, *Amicus Curae,* in Support of Appellant on Issues Addressed at 10–11, *Louis S. Caiola* v. *Citibank, N.A.,* On Appeal from the United States District Court for the Southern District of New York (No. 01–7545) (explaining that Congress did not intend to exclude cash-settled options on securities from the definition of ''security'' in the Exchange Act).

[98] *SEC* v. *W.J. Howey Co.,* 328 U.S. 293, 299 (1946).

[99] *See* Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S.249, S. Rep. No. 94–75, 9th Cong., 1st Sess. 99 (1975).

[100] *See id.* The exemption for bona fide hedge transactions in Exchange Act Rule 11a1–3(T) was drafted broadly to encompass the variety and complexity of hedging techniques. As the Commission noted when it adopted Rule 11a1–3(T):

The question whether particular combinations of stock positions and options positions result in risk reduction in each of the positions involves subjective judgments as to the volatility and risk characteristics of those positions. * * * The Commission recognizes that the calculation of volatility and risk can only be approximate, and believes that, for purposes of section 11(a)(1)(D), the determination of what constitutes an offset may be made by the use of any responsible method of calculating the risk of stock and options positions.

Securities Exchange Act Release No. 15533 (January 29, 1979), 44 FR 6093 (January 31, 1979).

the bona fide hedge exemptions in section 11(a)(1)(D) and Rule 11a1–3(T) were intended to be interpreted broadly to encompass the variety and complexity of hedging techniques, we interpret section 11(a)(1)(D) of the Exchange Act and Rule 11a1–3(T) to permit cash-to-futures, options-to-futures and futures-to-futures hedging with security futures.

Q39: Would floor traders effecting transactions in security futures products on a fully registered national securities exchange qualify for the market making exemption under section 11(a)(1)(A)?

A39: Section 11(a)(1)(A) of the Exchange Act exempts from the general prohibitions of section 11(a) any transaction by a dealer acting in the capacity of a market maker, as that term is defined in section 3(a)(38) of the Exchange Act.[101] This exemption reflects the special role of market makers in our securities markets. Section 3(a)(38) defines a market maker as ''any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an interdealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis.'' As a practical matter, consistent with this definition of ''market maker,'' fully registered national securities exchanges—*i.e.,* those not registered pursuant to Exchange Act section 6(g)[102]—have established both affirmative and negative obligations, including appropriate dual trading restrictions, for specialists and other market makers.[103] Such obligations are significant, because floor traders generally buy and sell securities for their own benefit and interest, unless the market imposes obligations to serve the market or public interest. Thus, only to the extent a floor trader is acting subject to the type of exchange imposed obligations applicable to market makers in other securities, including dual trading restrictions, will such floor trader be deemed acting in a market making capacity in a security futures product on a fully registered national securities exchange.

c. Extensions of Credit: Exchange Act Section 11(d) and Exchange Act Rule 10b–16

Section 11(d) of the Exchange Act[104] generally prohibits any person that does business as both a broker and a dealer from extending credit to a customer on any security that was part of a new issue when the broker-dealer participated in the distribution of the new issue within thirty days prior to the customer's transaction.[105] Exchange Act Rule 10b-16[106] prohibits the extension of credit by a broker-dealer to a customer in connection with any securities transaction unless the broker-dealer has established procedures to ensure that the customer is given, at the time the account is opened and periodically thereafter, specified information with respect to the amount of and reasons for credit charges.[107]

A security future potentially raises various issues related to the extension of credit. For instance, questions may arise as to whether the contract should be viewed as an instrument in and of itself, or viewed as a down payment on ownership of the underlying security. We provide guidance about the security future itself and extensions of credit in relation to that instrument.

Q40: Would a security future constitute an extension of credit under section 11(d) of the Exchange Act and for purposes of the disclosure requirements of Rule 10b–16?

A40: A security future itself is not an extension of credit. The value of a security future can fluctuate throughout the life of the contract based on the value of the underlying security, with each party to the contract exposed to such fluctuations. Traditionally, marking to market of futures contracts allows gains and losses on futures contracts to be transferred regularly between contract parties throughout the life of the contract. While this practice could in a sense be viewed as involving only partial payment for a security, we believe that it actually reflects the nature of a futures contract, and not an attempt to extend credit in the sense contemplated by section 11(d) or Rule 10b–16. As one commentator on futures explained, ''margin in futures accounts does not represent partial payment of the security as it does in stock transactions. No loan is involved. Margin in futures contracts simply represents a good faith deposit against performance.''[108]

Q41: Would extensions of credit in relation to a security future be considered extensions of credit in relation to a *new issue* for purposes of section 11(d)(1)?

A41: No. We expect security futures to be issued by clearing agencies and not underwritten or distributed by broker-dealers. Although credit may be extended in relation to security futures (*e.g.,* advance funds to meet margin calls or make periodic variation payments), such extensions of credit are intended to support the margining system for futures contracts, a system set up to manage risk in the clearance and settlement system for this particular type of instrument. It is generally recognized that section 11(d)(1) is primarily intended to prohibit ''share pushing'' by broker-dealers engaged in a distribution of a new issue of non-exempted securities.[109] Further, section 11(d)(1) serves a related customer protection purpose by precluding the overextension of customers with respect to new issue securities. As stated by the staff of the Federal Reserve Bank of New York, ''inducing customers to buy new issues on margin was perceived as a sales technique used by underwriters to reduce rapidly their exposure to risk

[101] *See* 15 U.S.C. 78e(a)(38).

[102] 15 U.S.C. 78f(g).

[103] For example, registered traders in options on the American Stock Exchange (''Amex'') are subject to Amex Rule 958, prohibiting them from initiating options transactions for any account in which they have an interest except in accordance with the Rule's provisions. Moreover, section (c) of Rule 958 generally requires that when a registered trader enters a trading crowd in other than a floor brokerage capacity, or is called upon by a Floor Official or a Floor Broker acting in an agency capacity, the registered trader ''is required to make competitive bids and offers as reasonably necessary to contribute to the maintenance of a fair and orderly market and shall engage, to a reasonable degree under the existing circumstances, in dealings for his own account when there exists a lack of price continuity, a temporary disparity between the supply of and demand for option contracts of a particular series, or a temporary distortion of the price relationships between option contracts of the same class.'' *See* Amex Rule 958(c); *see also* Amex Rule 958, cmt. .01 (designating registered trader engaging in Exchange options transactions as a Specialist for purposes of certain provisions of the Exchange Act and the rules and regulations thereunder); Amex Rule 111(c) (''No Registered Trader shall effect, on the Floor of the Exchange, a transaction for an account in which he has an interest and execute as broker an off-Floor order in the same stock during the same trading session.'') (incorporated into the option rules by Amex Rule 950(c)).

[104] 15 U.S.C. 78k(d).

[105] *See* H. R. Rep. No. 1383, 73d Cong., 2d Sess. (1934) 22; *see also* S. Rep. No. 792, 73d Cong., 2d Sess. (1934) 12. Congress stated that section 11(d) ''* * * strikes at one of the greatest potential evils inherent in the combination of the broker and dealer function in the same person, by assuring that he will not induce his customers to buy on credit, securities which he has undertaken to distribute to the public.'' *Id.* This prohibition applies to the direct or indirect extension or maintenance of credit, as well as arranging for the extension or maintenance of credit. *See also supra* note (concerning expectation that security futures will be issued by clearing agencies and not broker-dealers).

[106] 17 CFR 240.10b-16.

[107] *See* Securities Exchange Act Release No. 8773 (December 8, 1969), 34 FR 19717 (December 16, 1969).

[108] *See* New York Institute of Finance, *Stocks Bonds Options Futures, Investments and Their Markets* 184 (Stuart R. Veale, ed. 1987).

[109] *See* VII Loss & Seligman, *Securities Regulation* 3290 n.420 (3d ed. 1991).

and as a technique that had resulted in credit-financed purchases which were not always appropriate for the buyers of new issues.''[110] For purposes of section 11(d)(1), we expect markets in security futures issued by clearing agencies to operate more like secondary markets than markets in new issues. Moreover, leverage in such markets should derive more from the nature of the instrument than from a desire for broker-dealers to extend credit to induce additional sales to deplete an underwriting inventory. Thus, the traditional public policy concerns underlying section 11(d)(1)'s limitations on credit activities in relation to new issues do not appear to be present for security futures. In the event private parties or broker-dealers begin to issue security futures, we might revisit extensions of credit in relation to such instruments.

Q42: Does Rule 10b–16 apply to extensions of credit related to security futures, including an extension of credit to fund a margin obligation?

A42: Yes. While the future itself is not an extension of credit, Rule 10b–16 applies to all extensions of credit, directly or indirectly, to any customer in connection with any securities transaction, including a security future. Investors in security futures, including those extended credit in connection with margining, should benefit from the transparency of credit terms fostered by this Rule.

d. Ancillary Securities Activities by Notice-Registered Broker-Dealers

Under the Exchange Act, only broker-dealers that limit their securities activities to security futures products and government securities pursuant to Exchange Act Rules 3a43–1 [111] and 3a44–1 [112] can be ''notice-registered,'' as opposed to fully registered broker-dealers.[113] Some have suggested identifying additional securities activities that would not trigger the need to fully register.

Q43: Will the Commission provide an exemption from full broker-dealer registration for notice-registered broker-dealers that engage in ancillary activities in securities other than, but in relation to, security futures products?

A43: At this time, we do not believe broad exemptive relief is necessary for any additional ancillary securities activities of notice-registered broker-dealers.[114] In providing for notice registration, Congress envisioned that a notice-registered broker-dealer would engage in only security futures product activities.[115] Limiting the scope of such notice registrants' activities serves the public interest because a wide array of broker-dealer regulations aimed at protecting investors and maintaining fair and orderly securities markets are not applied to notice-registered broker-dealers.[116] Moreover, protections afforded by those notice registrants' other regulator, the CFTC, focus on futures, not securities markets.[117] Should additional securities activities be necessary in conjunction with security futures products transactions, a notice-registered broker-dealer could direct customers to a fully registered broker-dealer or could fully register itself.[118]

Of note, futures commission merchants already offer futures on broad-based stock indexes without special relief to engage in activities in the equity securities underlying such indexes without registering as broker-dealers.[119] The intermediaries themselves may determine whether to register fully as broker-dealers in order for them to expand the scope of their securities activities. The Commission stands ready to address requests for exemptive relief, consistent with the public interest and the protection of investors, for highly delineated securities activities, where the services of a fully registered broker-dealer are unavailable and full registration is impractical.

III. Solicitation of Comments

As noted above, security futures products are new products and markets in these products have only begun to develop. Guidance provided necessarily is based on how we expect security futures products markets to operate. Accordingly, we solicit comment to identify market developments that might make it necessary to revisit our guidance or to provide guidance on additional issues.

List of Subjects in 17 CFR Parts 231 and 241

Securities.

Amendments to the Code of Federal Regulations

For the reasons set forth above, the Commission is amending title 17, chapter II of the Code of Federal Regulations as set forth below:

PART 231—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND GENERAL RULES AND REGULATIONS THEREUNDER

1. Part 231 is amended by adding Release No. 8107 and the release date of June 21, 2002, to the list of interpretive releases.

PART 241—INTERPRETIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

2. Part 241 is amended by adding Release No. 46101 and the release date of June 21, 2002 to the list of interpretive releases.

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[110] *See* Federal Reserve Bank of New York Staff Study: Securities Credit Regulations of the Board of Governors of the Federal Reserve System, pt. 1, at 126 (1979).

[111] 17 CFR 240.3a43–1.

[112] 17 CFR 240.3a44–1.

[113] *See supra* note 5.

[114] The Commission already has addressed the issue of a notice-registered broker-dealer handling certain securities upon expiration of a security future that is physically-settled. As we stated when we adopted rules to permit notice registration, a notice-registered broker-dealer that accepts and occasionally delivers the underlying securities upon the expiration of a security future is not acting as a broker or a dealer with respect to those securities. It therefore is not required to register as a full broker-dealer. Because most futures transactions are generally closed out by offsetting transactions, and not by physical settlement, this should not be an issue for most notice-registered broker-dealers. A futures commission merchant that routinely closes out its transactions in security futures products by physical delivery, however, should register as a full broker-dealer. *See* Securities Exchange Act Release No. 44730 (August 21, 2001), 66 FR 45138 (August 27, 2001).

[115] *See* 15 U.S.C. 78o(b)(11)(A). The fact that certain financial intermediaries could want to engage in a wider range of activities that would require both full broker-dealer and full futures commission merchant registration is reflected in the statute as well. *See, e.g.,* 15 U.S.C. 78o(c)(3)(B); *supra* note 5.

In addition, previously when Congress specifically envisioned the exemption of CFTC registrants from broker-dealer registration solely for government securities activities incidental to their futures business, Congress explicitly provided a statutory basis for such action. *See* Securities Exchange Act Release No. 24726 (July 22, 1987), 52 FR 27962 (July 24, 1987) (adopting Exchange Act Rules 3a43–1 and 3a44–1 implementing amendments to Section 3(a)(43) and 3(a)(44) of the Exchange Act defining government securities broker and government securities dealer contained in the Government Securities Act of 1986).

[116] *See supra* note 5.

[117] *See, e.g.,* CEA Section 16(e) [7 U.S.C. 20(e)].

[118] In addition, in connection with the management of its proprietary account, a notice-registered broker-dealer itself could effect transactions in equity securities in its own account with a fully registered broker-dealer. Such activities generally would not independently trigger the need to fully register as a broker-dealer unless they constituted activities of a ''dealer'' as that term is defined in the federal securities laws.

[119] Exchange Act Rules 3a43–1 and 3a44–1 provide some relief from broker-dealer registration related to a future commission merchant's ancillary government securities activities. *See* 17 CFR 240.3a43–1; 240.3a44–1. However, such rules are inapposite to notice-registered broker-dealers wishing to engage in equity securities activities in addition to activities in security futures products. *See supra* note 115.

By the Commission.

Dated: June 21, 2002.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–16211 Filed 6–26–02; 8:45 am]

BILLING CODE 8010–01–P

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR PART 12

[T.D. 02—30]

RIN 1515–AD12

Extension of Import Restrictions Imposed on Archaeological and Ethnological Materials From Peru; Correction

AGENCY: Customs Service, Treasury.

ACTION: Final rule; correction.

SUMMARY: This document contains corrections to the final rule (T.D. 02–30) that was published in the **Federal Register** on June 6, 2002. The final rule extended for a period of five years from June 9, 2002, the import restrictions that were already in place for certain archaeological and ethnological materials from Peru. This document corrects the Internet web site address for accessing the Designated List of Archaeological and Ethnological Materials from Peru to which the import restrictions apply and an accompanying image database. The document also clarifies that the beginning date of the five year extension is June 9, 2002.

EFFECTIVE DATE: June 9, 2002.

FOR FURTHER INFORMATION CONTACT: (Regulatory Aspects) Joseph Howard, Intellectual Property Rights Branch (202) 927–2336; (Operational Aspects) Al Morawski, Trade Operations (202) 927–0402.

SUPPLEMENTARY INFORMATION:

Background

A final rule document, published as T.D. 02–30 in the **Federal Register** (67 FR 38877) on Thursday June 6, 2002, extended for a period of five years from June 9, 2002, the import restrictions that were already in place for certain archaeological and ethnological materials from Peru. The final rule amended section 12.104g(a), Customs Regulations (19 CFR 12.104g(a)).

This document corrects an error in the Background section of the document regarding the Internet web site address that was set forth to enable the public to access the Designated List of Archaeological and Ethnological Materials from Peru, which describes the materials covered by the import restrictions, and an accompanying image database. The document also clarifies that the beginning date of the five year extension is June 9, 2002, by changing the effective date of the regulation to June 9, 2002.

Corrections

In rule FR Doc. 02–14219, published on June 6, 2002 (67 FR 38877), make the following corrections:

1. On page 38877, in the first column, the **EFFECTIVE DATE** section should read as follows:

EFFECTIVE DATE: June 9, 2002.

2. On page 38877, in the third column, the first full sentence should read as follows:

The list and accompanying image database may also be found at the following Internet web site address: *http://exchanges.state.gov/culprop.*

Dated: June 24, 2002.

Sandra L. Bell,

Acting Assistant Commissioner, Office of Regulations and Rulings.

[FR Doc. 02–16235 Filed 6–26–02; 8:45 am]

BILLING CODE 4820–02–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 510 and 520

New Animal Drugs; Change of Sponsor

AGENCY: Food and Drug Administration, HHS.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) is amending the animal drug regulations to reflect a change of sponsor for two approved new animal drug applications (NADAs) and an approved abbreviated new animal drug application (ANADA) from Lambert-Kay, A Division of Carter-Wallace, Inc., to Church & Dwight Co., Inc. The drug labeler code for Church & Dwight Co., Inc., is also being listed.

DATES: This rule is effective June 27, 2002.

FOR FURTHER INFORMATION CONTACT: Lonnie W. Luther, Center for Veterinary Medicine (HFV–101), Food and Drug Administration, 7500 Standish Pl., Rockville, MD 20855, 301–827–0209, e-mail: lluther@cvm.fda.gov.

SUPPLEMENTARY INFORMATION: Lambert-Kay, A Division of Carter-Wallace, Inc., P.O. Box 1001, Half Acre Rd., Cranbury, NJ 08512–0181, has informed FDA that it has transferred ownership of, and all rights and interest in, NADA 101–497 for TINY TIGER (dichlorophene/toluene) Worming Capsules, NADA 101–498 for LK (dichlorophene/toluene) Worming Capsules, and ANADA 200–028 for EVICT (pyrantel pamoate) Liquid Wormer to Church & Dwight Co., Inc., 469 North Harrison St., Princeton, NJ 08543–5297. Accordingly, the agency is amending the regulations in §§ 520.580 and 520.2043 (21 CFR 520.580 and 520.2043) to reflect the transfer of ownership.

Church & Dwight Co., Inc., has not been previously listed in the animal drug regulations as a sponsor of an approved application. Following these changes of sponsorship, Lambert-Kay is no longer the sponsor of any approved applications. Accordingly, 21 CFR 510.600(c)(1) and (c)(2) is being amended to add entries for Church & Dwight Co., Inc., and to remove the entries for Lambert-Kay. Also, § 520.2043 is being revised to reflect a current format.

This rule does not meet the definition of ''rule'' in 5 U.S.C. 804(3)(A) because it is a rule of ''particular applicability.'' Therefore, it is not subject to the congressional review requirements in 5 U.S.C. 801–808.

List of Subjects

21 CFR Part 510

Administrative practice and procedure, Animal drugs, Labeling, Reporting and recordkeeping requirements.

21 CFR Part 520

Animal drugs.

Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs and redelegated to the Center for Veterinary Medicine, 21 CFR parts 510 and 520 are amended as follows:

PART 510—NEW ANIMAL DRUGS

1. The authority citation for 21 CFR part 510 continues to read as follows:

Authority: 21 U.S.C. 321, 331, 351, 352, 353, 360b, 371, 379e.

2. Section 510.600 is amended in the table in paragraph (c)(1) by removing the entry for ''Lambert-Kay, A Division of Carter-Wallace, Inc.'' and by alphabetically adding an entry for ''Church & Dwight Co., Inc.'' and in the table in paragraph (c)(2) by removing the entry ''011615'' and by numerically adding an entry for ''010237'' to read as follows: