

2004–07 and should be submitted on or before August 12, 2004.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–50015; File No. SR–ISE–2003–22]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 by the International Securities Exchange, Inc. Relating to Permanent Approval of a Pilot Program for Quotation Spreads

July 14, 2004.

I. Introduction

On September 24, 2003, the International Securities Exchange, Inc. (“ISE” or “Exchange”), filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b–4 thereunder,² a proposed rule change requesting permanent approval of a pilot program permitting the allowable market maker quotation spread for all options listed on the ISE to be \$5, regardless of the price of the bid (“Pilot Program”). On May 20, 2004, the ISE filed Amendment No. 1 to the proposal.³ Amendment No. 1 revised the proposal to expressly include in the Pilot Program all index options listed on the ISE as well as all equity options listed on the ISE.

The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on May 27, 2004.⁴ The Commission received no comments regarding the proposal. This order approves the proposed rule change, as amended.

II. Description

On March 19, 2003, the Commission approved an ISE proposal to establish the Pilot Program on a six-month pilot

basis until September 19, 2003.⁵ The Pilot Program, which initially included options on up to 50 equity securities listed on the ISE, was extended several times and expanded to include all options listed on the ISE.⁶

The Pilot Program permits an ISE market maker to quote any equity or index option listed on the ISE with a difference of no more than \$5 between the bid and the offer following the opening rotation.⁷ Prior to the opening rotation, the maximum bid/ask differentials range from \$.25 to \$1.00, depending on the price of the option.⁸

As required by the Pilot Program Approval Order, the ISE submitted a report providing information concerning the quotations in the 50 equity options initially included in the Pilot Program. In addition, following the expansion of the Pilot Program,⁹ the ISE submitted a second Pilot Program report providing quotation information concerning all of the options included in the ISE’s expanded Pilot Program.

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁰ In particular, the

⁵ See Securities Exchange Act Release No. 47532 (March 19, 2003), 68 FR 55685 (March 26, 2003) (“Pilot Program Approval Order”).

⁶ See Securities Exchange Act Release Nos. 48514 (September 22, 2003), 68 FR 55685 (September 26, 2003) (notice of filing and immediate effectiveness of File No. SR–ISE–2003–21) (extending the Pilot Program through January 31, 2004); 49149 (January 29, 2004), 69 FR 05627 (notice of filing and immediate effectiveness of File No. SR–ISE–2004–02) (extending the Pilot Program through March 31, 2004); 49509 (March 31, 2004), 69 FR 18411 (April 7, 2004) (notice of filing and immediate effectiveness of File No. SR–ISE–2004–10) (extending the Pilot Program through June 29, 2004, and expanding the Pilot Program to include all options listed on the ISE) (“Pilot Expansion Notice”); and 49918 (June 25, 2004), 69 FR 40427 (July 2, 2004) (notice of filing and immediate effectiveness of File No. SR–ISE–2004–23) (extending the Pilot Program through July 29, 2004).

⁷ See ISE Rule 803(b)(4).

⁸ Specifically, prior to the opening rotation, ISE Rule 803(b)(4) requires options market makers to bid and offer so as to create differences of no more than \$.25 between the bid and offer for each options contract for which the bid is less than \$2; no more than \$.40 where the bid is at least \$2 but does not exceed \$5; no more than \$.50 where the bid is more than \$5 but does not exceed \$10; no more than \$.80 where the bid is more than \$10 but does not exceed \$20; and no more than \$1 where the bid is \$20 or greater. The bid/offer differentials do not apply to in-the-money options series when the spread in the underlying securities market is wider than the differentials set forth above. For such series, ISE Rule 803(b)(4) permits the bid/ask differential to be as wide as the quotation on the primary market of the underlying security.

⁹ See Pilot Expansion Notice, *supra* note 6.

¹⁰ In approving this proposal, the Commission has considered the proposed rule’s impact on

Commission finds that the proposal is consistent with Section 6(b)(5) of the Act¹¹ in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

In the Pilot Program Approval Order,¹² the Commission noted that although the Commission believes generally that maximum quotation spread parameters in the options market could provide an important safeguard to ensure that market maker quotes in options are not unnecessarily wide, the Commission nevertheless believed that the ISE provided sufficiently strong incentives for market makers to disseminate competitive quotes without maximum quotation spread parameters. In this regard, the Pilot Program Approval Order noted that each ISE market maker uses an automatic quotation system to quote independently, customers and professional traders can enter limit orders on the ISE’s book, and market makers are only allocated trades when they are quoting at the best price. Moreover, the larger the size of a market maker’s quote, the larger portion of a trade it is allocated. The Commission believed that these attributes and rules of the ISE provided strong market incentives for market makers to maintain narrow and competitive quotation spreads.¹³

The Commission believes that the two Pilot Program reports submitted by the ISE indicate that market maker quotation spreads for options included in the Pilot Program have not widened significantly during the operation of the Pilot Program. Accordingly, the Commission believes that permanent approval of the Pilot Program is consistent with the Act.

IV. Conclusion

For the foregoing reasons, the Commission finds that the proposal, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁴ that the

efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹¹ 15 U.S.C. 78f(b)(5).

¹² See note 5, *supra*.

¹³ See Pilot Program Approval Order, *supra* note 5.

¹⁴ 15 U.S.C. 78s(b)(2).

⁶ 17 CFR 200.30–3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b–4.

³ See letter from Michael J. Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated May 19, 2004, and accompanying Form 19b–4 (“Amendment No. 1”).

⁴ See Securities Exchange Act Release No. 49754 (May 21, 2004), 69 FR 30352.

proposed rule change (SR-ISE-2003-22), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50018; File No. SR-NASD-2004-058]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change Relating to Partial Customer Account Transfers

July 14, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on April 1, 2004, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by the NASD. The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change.

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

The NASD is amending Rule 11870 to make the procedures for non-standard transfers of customer account assets through the Automated Customer Account Transfer Service ("ACATS") consistent with the procedures for transferring security account assets in their entirety.

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

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The NYSE has prepared summaries, set forth in sections (A), (B), and (C) below, of the

most significant aspects of these statements.²

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

The purpose of the proposed rule change is to amend NASD Rule 11870 so that the procedures for making non-standard transfers of customer assets³ through ACATS consistent with the procedures for standard transfers of customer assets through ACATS.⁴ The proposed rule change also permits a customer to authorize the delivering member to transfer specifically designated account assets outside of ACATS. In addition, the proposed rule change permits a customer to authorize an account transfer, in whole or in part, using an electronic signature in a format recognized as valid under federal law to conduct interstate commerce. This modification contemplates legal alternatives to written notice, as currently required, on the condition that such methods otherwise comply with the requirements of Rule 11870. The proposed rule change conforms to recently adopted amendments to the New York Stock Exchange's ("NYSE") Rule 412 and the Interpretations of Rule 412.⁵

Rule 11870(a) sets forth the procedures for members to use when transferring customer assets. The rule currently states that broker-dealers must utilize ACATS for non-standard as well as standard transfers; however, the current rule generally refers to the transfer of an entire securities account. As amended by this proposed rule change, Rule 11870 will generally apply the same procedures to both standard and non-standard transfers of customer account assets through ACATS.

Because customer and broker-dealer obligations resulting from the transfer of an entire account differ from the obligations arising from the transfer of specified assets within an account that will remain active at the delivering firm after the transfer, the proposed amendments to Rule 11870 will distinguish between the transfer of

security account assets "in whole" (*i.e.*, entire accounts) and the transfer of security account assets "in specifically designated part" (*i.e.*, partial transfers). This distinction is necessary given the different obligations that arise depending on if a broker-dealer is transferring an entire account to a receiving firm or is only transferring specified assets to a receiving firm. For example, it would not be necessary for a customer to instruct the delivering firm as to the disposition of his or her assets that are non-transferable if the customer is not transferring the account in whole.

The proposed rule change also permits customers to authorize alternative instructions for the transfer of "specifically designated assets" from one broker-dealer to another. This proposed rule change therefore creates an exception to a member's obligation to transfer specifically designated assets (*i.e.*, partial transfers) through ACATS. The ability to authorize alternative instructions refers to partial transfers only and does not provide an exception to the members' obligation to otherwise accomplish transfers in accordance with the rules of the National Securities Clearing Corporation ("NSCC").

Further, Rule 11870 currently states that a customer who wishes to transfer securities account assets to another member must give "written notice of that fact to the receiving member" and must "sign" a broker-to-broker transfer instruction form. The proposed rule change to Rule 11870 will provide that the customer may authorize an account transfer, in whole or in part, using either the customer's actual signature or an electronic signature "in a format recognized as valid under federal law to conduct interstate commerce."

Currently Rule 11870 requires that members use the transfer instructions and provide the reports prescribed by the NASD when accomplishing account transfers pursuant to the rule. The NASD is deleting this requirement in the proposed rule because it believes this provision is no longer necessary.

In order to allow members sufficient time to develop and implement necessary system changes to comply with amended Rule 11870, the NASD proposes to set an implementation date of September 13, 2004. The NASD will announce the implementation date in a Notice to Members to be published no later than thirty days following the Commission's notice of the proposed rule change.⁶

² The Commission has modified the text of the summaries prepared by the NASD.

³ Non-standard transfers of customer assets include such things as partial transfers of account assets, fail reversals, reclaims, and mutual fund clean-ups.

⁴ Standard transfers of customer assets is generally a transfer of all assets in a customer's account where none of the securities in the account are "nontransferable assets" as that term is defined in NASD Rule 11870.

⁵ Exchange Act Release No. 49415 (March 12, 2004), 69 FR 13608 (March 23, 2004) [File No. SR-NYSE-2003-29].

⁶ In its filing to the Commission, the NASD indicated an implementation date of September 30, 2004.

¹⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).