

limit, positions identified as a qualified hedge strategy would be subject to the increased position limits, or exempted from position limit calculations, as appropriate. The exemption would be automatic (*i.e.*, it will not require pre-approval from NASD) to the extent that a member identifies that a pre-existing qualified strategy is in place or is employed from the point that an account's position reaches the standard limit and provides the required supporting documentation to NASD.<sup>10</sup> The exemption would remain in effect to the extent that the exempted position remains intact and NASD is provided with any required supporting documentation.

The Commission notes that it has previously approved changes to similar rules of the options exchanges that eliminated standardized equity option position and exercise limits for certain qualified hedge strategies and established position and exercise limits of five times the standard limit for certain of those strategies when they include an over-the-counter (OTC) option contract.<sup>11</sup> The Commission does not believe that the proposed rule changes raises novel regulatory issues that were not already addressed and should benefit NASD members by permitting them greater flexibility in using hedge strategies advantageously, while providing an adequate level of protection against the opportunity for manipulation of these securities and disruption in the underlying market.

The Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Amendment No. 1 merely provides technical corrections and clarification to the proposed rule text. The Commission, therefore, believes that granting accelerated approval of Amendment No. 1 is appropriate and consistent with section

15A(b)(6)<sup>12</sup> and section 19(b)<sup>13</sup> of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether it is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2002-134 and should be submitted by March 4, 2003.

#### V. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (File No. SR-NASD-2002-134), as amended, be and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47310; File No. SR-NASD-2003-12]

#### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc., To Extend the Pilot for Limit Order Protection of Securities Priced in Decimals

February 4, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

(“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 31, 2003, the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its subsidiary, the Nasdaq Stock Market, Inc. (“Nasdaq”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. Nasdaq filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6)<sup>4</sup> thereunder, which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Nasdaq proposes to extend through May 31, 2003, the current pilot price-improvement standards for decimalized securities contained in NASD Interpretative Material 2110-2—Trading Ahead of Customer Limit Order (“Manning Interpretation” or “Interpretation”). Without such an extension these standards would terminate on January 31, 2003. Nasdaq does not propose to make any substantive changes to the pilot; the only change is an extension of the pilot's expiration date through May 31, 2003. Nasdaq requests that the Commission waive both the 5-day notice and 30-day operative requirements contained in Rule 19b-4(f)(6)(iii)<sup>5</sup> of the Act. If such waivers are granted by the Commission, Nasdaq will implement this rule change immediately.

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

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for its proposal and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

<sup>10</sup> Under the proposed rule change, the existing reporting procedures that serve to identify and document hedged positions above a certain threshold continue to apply. Paragraph (b)(5) of NASD rule 2860 requires reporting to NASD of aggregate positions of 200 more contracts of the put class and the call class on the same side of the market covering the same underlying security.

<sup>11</sup> See Securities Exchange Act Release No. 45603 (March 20, 2002), 67 FR 14751 (March 27, 2002) (CBOE-2000-12); Securities Exchange Act Release No. 45650 (March 26, 2002), 67 FR 15638 (Apr. 2, 2002) (AMEX-2001-71); Securities Exchange Act Release No. 45737 (April 11, 2002), 67 FR 18975 (Apr. 17, 2002) (PCX-2000-45); Securities Exchange Act Release No. 45899 (May 9, 2002), 67 FR 34980 (May 16, 2002) (PHLX-2002-33); and Securities Exchange Act Release No. 46228 (July 18, 2002), 67 FR 48689 (July 25, 2002) (ISE-2002-15).

<sup>12</sup> 15 U.S.C. 78o-3(b)(6).

<sup>13</sup> 15 U.S.C. 78s(b).

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

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

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

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

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

<sup>5</sup> 17 CFR 240.19b-4(f)(6)(iii).

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

1. Purpose

NASD's Manning Interpretation requires NASD member firms to provide a minimum level of price improvement to incoming orders in NMS and SmallCap securities if the firm chooses to trade as principal with those incoming orders at prices superior to customer limit orders they currently hold. If a firm fails to provide the minimum level of price improvement to the incoming order, the firm must execute its held customer limit orders. Generally, if a firm fails to provide the requisite amount of price improvement and also fails to execute its held customer limit orders, it is in violation of the Manning Interpretation.

On April 6, 2001,<sup>6</sup> the Commission approved, on a pilot basis, Nasdaq's proposal to establish the following price improvement standards whenever a market maker wished to trade proprietarily in front of its held customer limit orders without triggering an obligation to also execute those orders:

(1) For customer limit orders priced at or inside the best inside market displayed in Nasdaq, the minimum amount of price improvement required is \$0.01; and

(2) For customer limit orders priced outside the best inside market displayed in Nasdaq, the market maker must price improve the incoming order by executing the incoming order at a price at least equal to the next superior minimum quotation increment in Nasdaq (currently \$0.01).<sup>7</sup>

Since approval, these standards have operated on a pilot basis and are currently scheduled to terminate on January 31, 2003. After consultation with Commission staff, Nasdaq seeks an extension of its current Manning pilot until May 31, 2003. Nasdaq believes that such an extension provides for an

<sup>6</sup> See Securities Exchange Act Release No. 44165 (April 6, 2001), 66 FR 19268 (April 13, 2001) (order approving proposed rule change modifying NASD's Interpretative Material 2110-2—Trading Ahead of Customer Limit Order).

<sup>7</sup> Pursuant to the terms of the Decimals Implementation Plan for the Equities and Options Markets, the minimum quotation increment for Nasdaq securities (both National Market and SmallCap) at the outset of decimal pricing is \$0.01. As such, Nasdaq displays priced quotations to two places beyond the decimal point (to the penny). Quotations submitted to Nasdaq that do not meet this standard are rejected by Nasdaq systems. See Securities Exchange Act Release No. 43876 (January 23, 2001), 66 FR 8251 (January 30, 2001).

appropriate continuation of the current Manning price-improvement standard while the Commission analyzes the issues related to customer limit order protection for decimalized securities, and reviews Nasdaq's separately filed rule proposal to make this pilot permanent.<sup>8</sup>

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act<sup>9</sup> in that it is designed to: (1) Promote just and equitable principles of trade; (2) foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities; (3) perfect the mechanism of a free and open market and a national market system; and (4) protect investors and the public interest.

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

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

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

Written comments were neither solicited nor received.

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

Because the foregoing proposed rule change does not:

- (i) Significantly affect the protection of investors or the public interest;
- (ii) impose any significant burden on competition; and
- (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>10</sup> and Rule 19b-4(f)(6) thereunder.<sup>11</sup> At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public

interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Nasdaq has requested that the Commission waive both the 5-day notice and the 30-day operative delay. The Commission believes waiving the 5-day notice and 30-day operative delay is consistent with the protection of investors and the public interest. Acceleration of the operative date will allow the pilot to continue uninterrupted through May 31, 2003, and will allow Nasdaq and the Commission to analyze the issues related to customer limit order protection in a decimals environment. For these reasons, the Commission designates the proposal to be effective and operative upon filing with the Commission.<sup>12</sup>

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of Nasdaq. All submissions should refer to file number SR-NASD-2003-12 and should be submitted by March 4, 2003.

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

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

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<sup>12</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>13</sup> 17 CFR 200.30-3(a)(12).

<sup>8</sup> See SR-NASD 2002-10.

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

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