

therefore, this provision does not make sense in terms of how members perform a fairness opinion evaluation.

In Amendment No. 4, FINRA stated that the procedure required by the Original Proposal was intended to guard against potential conflicts of interest between the member issuing the fairness opinion and those insiders who may stand to gain an economic benefit from the transaction, and who generally are in a position to make determinations about which member will perform the fairness opinion evaluation. In response to comments, however, in Amendment No. 4 FINRA deleted the procedures in paragraph (b)(3) of the Original Proposal and added the disclosure requirements in paragraph (a)(6) to new Rule 2290. The Commission finds that this provision is responsive to comments received and is consistent with the Exchange Act, particularly Sections 15A(b)(6) and 15A(b)(9).

#### IV. Accelerated Approval of Amendment No. 4 and Solicitation of Comments

The Commission finds good cause to approve Amendment No. 4 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing of the amendment in the **Federal Register**. The proposed rule change was published in the **Federal Register** on April 11, 2006.<sup>9</sup> FINRA submitted Amendment No. 4 in response to comments received on the proposed rule change. The Commission believes that Amendment No. 4 clarifies the obligations of FINRA member firms. Amendment No. 4 does not contain major modifications that are more restrictive than the scope of the proposed rule change as published in the **Federal Register**. The Commission believes that approving Amendment No. 4 will provide greater clarity and simplify compliance, thus furthering the public interest and the investor protection goals of the Exchange Act. Finally, the Commission finds that it is in the public interest to approve the proposed rule change as soon as possible to expedite its implementation.

Accordingly, the Commission believes good cause exists, consistent with Sections 15A(b)(6) and 19(b) of the Exchange Act,<sup>10</sup> to approve Amendment No. 4 to the proposed rule change on an accelerated basis.

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 4, including whether Amendment No. 4 is consistent with the Act. Comments

may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-080 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2005-080. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2005-080 and should be submitted on or before November 8, 2007.

#### V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Exchange Act,<sup>11</sup> that the proposed rule change (SR-NASD-2005-080), as modified by Amendment Nos. 1, 2, 3, and 4, be, and hereby is, approved.<sup>12</sup>

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Florence E. Harmon,**  
*Deputy Secretary.*

[FR Doc. E7-20585 Filed 10-18-07; 8:45 am]

BILLING CODE 8011-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56661; File No. SR-NASD-2005-100]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc. (n/k/a Financial Industry Regulatory Authority, Inc.); Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto, To Require Members To Provide Customers in TRACE-Eligible Debt Securities With Additional, Transaction-Specific Disclosures and To Notify Customers of the Availability of a Disclosure Document

October 15, 2007.

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 August 19, 2005, the National Association of Securities Dealers, Inc. ("NASD"), n/k/a Financial Industry Regulatory Authority, Inc. ("FINRA"),<sup>3</sup> filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA.<sup>4</sup> On December 21, 2005, NASD filed Amendment No. 1 to the proposed rule change. On January 26, 2007, NASD filed Amendment No. 2 to the proposed rule change. On July 16, 2007, NASD

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

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

<sup>3</sup> On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Release No. 56146 (July 26, 2007), 72 FR 42190 (August 1, 2007).

<sup>4</sup> Commission staff made certain changes to the description of the proposed rule change with the consent of FINRA staff to further clarify the description, to reflect the organization's name change, and to make other changes incidental to the consolidation during a telephone conversation between Sharon Zackula, Associate Vice President and Associate General Counsel, and James Eastman, Assistant General Counsel, FINRA, and Joshua Kans, Senior Special Counsel, and Kristina Fausti, Special Counsel, Division of Market Regulation, Commission, on March 20, 2007; telephone conversations between Sharon Zackula and James Eastman, and Kristina Fausti, on August 17, 2007, and August 20, 2007, respectively; and a telephone conversation between Sharon Zackula, and Josh Kans and Kristina Fausti, on September 21, 2007.

<sup>9</sup> See *supra* note 3.

<sup>10</sup> 15 U.S.C. 78o-3(b)(6), and 78s(b).

<sup>11</sup> 15 U.S.C. 78s(b)(2).

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

filed Amendment No. 3 to the proposed rule change. On August 21, 2007, FINRA filed Amendment No. 4 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

FINRA is proposing to: (1) Adopt NASD Rule 2231, which would require members, subject to specified exceptions, to provide customers in transactions in debt securities that are TRACE-eligible securities, as defined in NASD Rule 6210(a), with additional, transaction-specific disclosures relating to applicable charges, credit ratings, the availability of last-sale transaction information, and certain interest, yield and call provisions; and (2) amend NASD Rule 2340 (customer account statements) to require members to notify certain customers of the availability of a disclosure document discussing debt securities authored by FINRA and deliver the document to customers upon request. The text of the proposed rule change and the associated disclosure document are set forth below. Proposed new language is in italics; proposed deletions are in brackets.

#### *2231. Confirmation of Transactions in Debt Securities*

##### *(a) Confirmation of Transactions in Debt Securities.*

*(1) Except as otherwise provided herein, any member that is required to disclose to a customer information pursuant to Rule 10b-10 under the Act in connection with any transaction in a debt security also shall, with respect to any TRACE-eligible security, disclose to the customer, other than an institutional account, the information set forth in paragraph (b). Except as otherwise provided herein, this information shall be disclosed in the same manner and at the same time in which the member discloses to the customer information in connection with the transaction pursuant to Rule 10b-10 under the Act. A member need not disclose to customers information required to be disclosed under this Rule if the member discloses such information pursuant to Rule 10b-10 under the Act.*

*(2) For purposes of this Rule:*

*(A) "Institutional account" shall have the same meaning it has in Rule 3110 and means an account that, within the past twelve months, the member has determined is an institutional account;*

*(B) "Debt security" shall have the same meaning it has in Rule 10b-10 under the Act, except that any*

*exempted security or asset-backed security is excluded from this definition;*

*(C) "Exempted security" shall have the same meaning it has in Section 3(a)(12) of the Act;*

*(D) "Asset-backed security" shall have the same meaning it has in Rule 10b-10 under the Act;*

*(E) "Nationally recognized statistical rating organization" ("NRSRO") shall have the same meaning it has in Rule 15c3-1 under the Act;*

*(F) "Clearing member" shall have the same meaning it has in Rule 3230;*

*(G) "Service bureau" shall have the same meaning it has in IM-4632-1 under Rule 4632; and*

*(H) "TRACE-eligible security" shall have the same meaning it has in Rule 6210(a).*

##### *(b) Information Required To Be Disclosed*

*(1) Debt security information. A member must disclose the debt security's CUSIP number and the TRACE symbol of the debt security if one has been designated by NASD.*

*(2) Broker-dealer charges. A member must disclose, if acting as principal, the following: "The broker-dealer's remuneration on this transaction has been added to the price in the case of a purchase or deducted from the price in the case of a sale."*

*(3) Credit rating. A member must disclose the lowest credit rating(s) it has received at the time the transaction confirmation is generated, the date of such credit rating(s), and the NRSRO(s) assigning the credit rating(s) of the debt security the member purchased for or from or sold to or for a customer, if:*

*(A) The member has entered into a written agreement with the NRSRO to receive such credit rating(s);*

*(B) A service bureau that provides confirmation services to the member for the transaction has entered into a written agreement with the NRSRO to receive such credit rating(s) and provides them to the member as part of the confirmation services at no additional cost; or*

*(C) A member that acts as a clearing member for, and provides confirmation services to, the member for the transaction has entered into a written agreement with the NRSRO to receive such credit rating(s) and provides them to the member as part of the confirmation services at no additional cost.*

*(4) Indicators of marketability and liquidity. A member must disclose that transaction price information for the securities subject to this Rule is publicly available on the Internet at <http://www.bondinfo.com> for the customer's non-commercial use at no charge, or at*

*other sources that provide such information.*

*(5) Cash flow information. For purchases only, a member must disclose on a per debt security basis the following:*

*(A) The frequency of interest and/or principal payments as applicable, if either are paid on a periodic, fixed schedule. If the debt security does not pay interest or principal on a regular schedule, a member must disclose the following: "This security does not pay interest or principal on a regular schedule. Information regarding the frequency of interest or principal payments for this security will be furnished to you upon written request." A member shall provide such additional information in writing within three business days of receiving a customer's written request, or within ten business days if such a request is received more than six months after the transaction's settlement date.*

*(B) Yield to maturity, and, if the debt security is subject to call prior to maturity through any means, a notation of "callable" shall be included. The date and price of the next pricing call shall be included and so designated. If the debt security is continuously callable (i.e., callable on any date after the first call date), a member must disclose the following: "This security is continuously callable." If there are any call features in addition to the next pricing call, a member must disclose the following: "Additional call features exist that may affect yield; additional information will be furnished to you upon written request." A member shall provide such additional information in writing within three business days of receiving a customer's written request, or within ten business days if such a request is received more than six months after the transaction's settlement date.*

*(C) For debt securities carrying a variable coupon rate, a member must disclose the following: "The coupon rate may vary. Additional information that describes the way in which the debt security's interest and principal payments are calculated will be furnished to you upon written request." A member shall provide such additional information in writing within three business days of receiving a customer's written request, or within ten business days if such a request is received more than six months after the transaction's settlement date. Any such additional information shall contain:*

*(i) The amount of the next interest payment based on the current coupon rate,*

(ii) A statement that this amount will change if the coupon rate changes  
(iii) How often the coupon rate may be recalculated,

(iv) An explanation of the event(s) that may trigger the recalculation, and  
(v) The formula for recalculating such coupon rate.

(D) For debt securities that are callable and, at issuance, are not structured to include scheduled interest payments (e.g., "zero coupon bonds"), the dollar equivalent of the debt security's imputed interest until the next occurring call date (assuming that the price at which the debt security may be called is paid to the holder).

\* \* \* \* \*

#### 2340. Customer Account Statements

(a)–(d) No change.

(e) Notice of Availability of NASD Disclosure on Debt Securities

(1) Except as otherwise provided in subparagraph (2) below, a member that has provided a customer disclosure under Rule 2231 during the period since the last account statement was sent to the customer also must disclose the following: "A disclosure document discussing your rights as a bondholder and some of the risks related to buying and holding bonds, titled 'Important Information You Need to Know About Investing in Corporate Bonds,' has been prepared by NASD and is available online at [www.finra.org](http://www.finra.org). A paper version of this document is available from your broker upon your written request."

(2) In lieu of disclosing the internet Web site address "[www.finra.org](http://www.finra.org)" in the statement set forth in subparagraph (1), a member may disclose the member's internet Web site address, provided that the document, "Important Information You Need to Know About Investing in Corporate Bonds," or an internet hyperlink directly thereto, is easily accessible from the internet address that is disclosed.

(3) A member shall provide the document, "Important Information You Need to Know About Investing in Corporate Bonds," to any customer to whom a statement is provided pursuant to subparagraph (1) within three business days of receiving a customer's written request, or within ten business days if such a request is received more than six months after the transaction's settlement date. This document provides information that an investor should know immediately prior to buying or selling a bond such as the basics of bond pricing, yield, and the difference between yield to maturity and yield to call. It also describes certain risks that bond investors assume in such

transactions (e.g., interest rate risk and liquidity risk). This document also contains a short description of basic types of bonds (e.g., floating rate bonds, zero coupon bonds and convertible bonds) as well as debt structure (e.g., junior or subordinated debt). Finally it informs investors that even if they are not charged a commission they are nevertheless paying a fee to their broker-dealer when they buy or sell bonds.

[(e)](f) Exemptions

Pursuant to the Rule 9600 Series, the Association may exempt any member from the provisions of this Rule for good cause shown.

\* \* \* \* \*

#### Important Information You Need to Know About Investing in Corporate Bonds

This document is intended to provide you with some basic facts about the most common features of corporate bonds, and to alert you to some of the risks associated with buying, selling, and holding corporate bonds.

As with any investment, before buying a corporate bond, you should analyze the bond on its own merits, weighing its risks, costs, and rewards. Consult with your firm about any questions you may have about investing in a particular bond.

#### Corporate Bond Basics

##### What Is a Corporate Bond?

Corporate bonds are, at their simplest, loans that investors make to public and private corporations. Consequently, bonds are referred to as debt securities. Corporations generally issue corporate bonds to raise money for capital expenditures, operations, and acquisitions.

Typically, bondholders receive interest payments during the term of a bond (or, for as long as a bondholder owns a bond), at the stated interest rate—also called the coupon rate. In addition, if bondholders hold bonds until maturity, they also are repaid the principal amount, called par value or face amount.

##### Bond Price and Yield

###### Price

If you sell a bond before it matures, you may not receive the full principal amount of the bond. This is because a bond's price is not based on the par value of the bond. Rather, it is set in the secondary market and is established by the current market values of such bonds, which may be more or less than the amount of principal the issuer would be required to pay the bondholder at maturity. Therefore, it is

impossible to predict in advance the price that a bondholder will receive if the bondholder purchases a bond and later sells the bond before maturity.

The price of a bond is often above or below its par value because the price is adjusted according to current interest rates in the whole market for the same debt security and comparable debt securities. For example, if the bond you desire to purchase has a coupon rate of 8 percent, and similar quality new bonds available for sale have a coupon rate of 5 percent, you will have to pay more than the par amount of the bond that you intend to purchase, because you will receive more interest income than the current coupon rate (5 percent) being attached to similar bonds. (A bond's coupon rate is the rate of interest paid periodically on the face amount of the obligation.)

##### Yield

Yield is the overall return on the capital you invest in the bond. Yield is similar to, but different from, a bond's coupon rate. This distinction is important, because as is explained above, while a bond's face amount or par value is fixed, its market value almost always changes over time. Because bond prices fluctuate continually in the market, the yield your bond investment will provide if it is sold prior to maturity also changes constantly. A bond's price is inversely related to its yield. As a bond's price increases, its associated yield decreases; as the price of a bond decreases, the associated yield increases.

For example, a bond that sells today for \$1,000 and has a coupon rate of 8 percent has a current yield of 8 percent. Because the "price" equals the face amount of the bond, the current yield of 8 percent equals the 8 percent coupon rate. However, usually after the first sale of a bond, the price of a bond differs from the face amount. For example, if the same bond sells tomorrow for \$990, the current yield would be slightly higher than 8 percent.

##### Yield to Maturity and Yield to Call: What's the Difference?

Yield to maturity is calculated by taking into account the total amount of interest you will receive over time, your purchase price (the amount of capital you invested), the face amount (or other amount you will be paid when the issuer "redeems" the bond), the time between interest payments, and the time remaining until the bond matures.

If you hold a callable bond, another type of yield calculation, yield to call, also is important for you to understand. This calculation takes into account the

impact on a bond's yield if it is called prior to maturity and is often done using the first date on which the issuer could call the bond. (Other call dates may be used in specified circumstances.) A bond's yield to call may be lower than its yield to maturity.

To get a more accurate picture of what a bond will cost you or what you received for it, you should also ask your broker to calculate the yield adjusting the purchase price up (when you purchase) or down (when you sell) by the amount of the mark-up or commission (when you purchase) or mark-down or commission (when you sell) and other fees or charges that you are charged by your broker for its services. This is called yield reflecting broker compensation.

#### Corporate Bond Risks

Like virtually all investments, corporate bonds carry risk. It is important that you fully understand the risks of investing in corporate bonds. These risks include:

##### Interest Rate Risk

When interest rates rise, bond prices fall, and when interest rates fall, bond prices rise. Interest rate risk is the risk that changes in interest rates generally in the U.S. or the world economy may reduce (or increase) the market value of a bond you hold. Interest rate risk increases the longer that you hold a bond. For example, if interest rates rise throughout the economy, bond issuers, along with other borrowers, will need to offer potential bondholders higher rates to compete with the higher interest rates available elsewhere.

Any bonds issued in a period of rising interest rates generally will carry higher coupon rates, which will be more attractive to potential bondholders than the coupon rate paid by bonds issued before the rise in interest rates. This decreased appetite for older bonds that pay lower interest depresses their price in the secondary market, which would translate into your receiving a lower price for your bonds if you chose to resell them in a period of rising interest rates. The opposite holds true as well, and the market value of older bonds that pay higher than current interest rates tends to rise in periods where interest rates are generally declining.

##### Call and Reinvestment Risk

Bonds with a call provision can be redeemed or "called" by the bond issuers, requiring bondholders to redeem their bonds at the call price well before their maturity dates. Bonds often are called when market interest rates are falling, because bond issuers want to

refinance their debt at lower interest rates (similar to when a home owner seeks to refinance a mortgage at a lower rate when mortgage interest rates decrease). This is known as call risk.

With a callable bond, a bondholder might not receive the bond's coupon rate for the entire term of the bond, and it might be difficult or impossible to find an equivalent investment paying rates as high as the called bond. This is known as reinvestment risk.

Additionally, at any given point in time, the period that a callable bond will generate cash flow is uncertain. This risk will be reflected in a lower market value for the bond because any appreciation in the value of the bond's periodic interest payments may not be fully realized if it is "called away" by its issuer.

##### Refunding Risk and Sinking Funds Provisions

A sinking fund provision, which often is a term included in bonds issued by industrial and utility companies, requires a bond's issuer to retire a certain number of bonds periodically. This can be accomplished in a variety of ways, including through purchases in the secondary market or forced purchases directly from bondholders at a pre-determined price.

Holder of bonds subject to sinking fund redemptions should understand that they risk having their bonds called (or redeemed) prior to maturity. Unlike other bonds subject to call, depending on the sinking fund provision, there may be a relatively high likelihood that the issuer will redeem some or many of the bonds prior to maturity, even if market-wide interest rates do not change.

It is important to understand that there is no guarantee that an issuer of these bonds will be able to comply strictly with any redemption requirements. In certain cases, an issuer may need to borrow funds or issue additional debt to refinance an outstanding bond issue subject to a sinking fund provision when it matures. If the issuer is unable to raise adequate funds to refinance the outstanding issue, the issuer could default and the bondholder could lose all or most of his/her investment.

##### Default and Credit Risk

If you ever loaned money to someone, chances are you gave some thought to the likelihood of being repaid. Some loans are riskier than others. The same is true when you invest in bonds. You are taking a risk that the issuer's promise to repay both principal and interest will not be upheld. In the case of Treasuries and other government-

issued bonds backed by the "full faith and credit of the U.S. government," that risk is almost zero. However, there is some risk of default with corporate bonds. This means the corporations issuing them may either be late paying bondholders or—in worst-case scenarios—be unable to pay at all.

Bond ratings are a way of measuring default and credit risk. Bond ratings are issued by private companies called credit rating agencies. In issuing a credit rating, a credit rating agency reviews relevant information supplied to it by the issuer or its agents, and from sources the credit rating agency considers reliable, including financial information such as the issuer's financial statements, and assigns a rating (for example, AAA (or Aaa) to D).

Generally, bonds are categorized in two broad categories—investment grade and non-investment grade. Bonds that are rated BBB (or Baa) or higher are considered investment grade. Bonds that are rated BB (or Ba) or lower are non-investment grade. Non-investment grade bonds are also referred to as high-yield or junk bonds, and in some cases, distressed bonds. These bonds are considered riskier investments because the issuer's general financial condition is less sound, and the issuer may default—(may not be able to pay the interest and principal to bondholders when they are due).

Many bondholders heavily weigh the rating of a particular corporate bond in determining if the corporate bond is an appropriate and suitable investment for them. Although credit ratings are an important indicator of creditworthiness, you should also consider that the value of the bond might change depending on changes in the company's business and profitability. The credit rating could be revised downward. In the worst scenario, if you own a bond and the company that issues it defaults you could lose all of your investment. Finally, some bonds are not rated. In such cases, an individual bondholder may find it difficult to assess the overall creditworthiness of the issuer of the bond.

##### Liquidity Risk

You should determine whether the bond in which you are interested has traded frequently, infrequently, or not at all in recent months, and if your broker regularly buys and sells the bond. While certain bonds are very actively traded and are relatively "liquid," other bonds, including many high-yield bonds, are traded much less frequently or not at all and may not be easy to sell. If you think you might need to sell the bonds you are purchasing prior to their maturity, you

should carefully consider the likelihood of your being able to do so, and whether your broker will be able and willing to assist you in liquidating your investment at a fair price reasonably related to then current market prices. It is possible that you may be able to resell a bond only at a heavy discount to the price you paid (loss of some principal) or not at all. Additionally, bonds that are less frequently traded may be subject to wider "spreads" in the secondary market, which means that you would receive less for your bond if selling, or pay more if buying, than otherwise would be the case.

#### Corporate Bonds with Special Features

It also is important to understand any special features a bond may have before you buy, since these features may affect risk.

#### Floating Rate Bonds

Floating-rate bonds have a floating or variable interest rate that is adjusted periodically, or floats, using an external value or measure (for example, the prime rate or a stock index). Such bonds offer protection against interest rate risk, but their coupon rate is usually lower than those of fixed-rate bonds.

#### Zero-Coupon Bonds

Zero-coupon bonds, unlike other bonds, don't make regular interest payments. Instead, the bondholder buys the bond at a discount from the face value of the bond, and, when the bond matures, the issuer repays the bondholder the face amount. The difference between the discounted amount the bondholder pays upon purchase and the face amount later received is the imputed interest. Because zero-coupon bonds don't pay any interest until maturity, their prices may be more volatile than other bonds with similar maturities that pay interest periodically.

#### Secured Bonds

Secured bonds are backed by collateral that the bond's issuer has agreed to sell if it otherwise is unable to meet its obligation when the bond matures. For example, a bond might be backed by a specific factory or industrial equipment. However, any such backing is only as good as the value of the asset being used as collateral, the value of which can decrease during the term of the bond.

Bonds that are not backed by any collateral are unsecured and are sometimes called debentures. Debentures are backed solely by an issuer's promise to repay you. Most corporate bonds are debentures.

#### Guaranteed and Insured Bonds

Certain bonds may be referred to as guaranteed or insured. This means that a third party has agreed to make the bond's interest and principal payments if the issuer is unable to make these payments. You should keep in mind that such guarantees only are as valuable as the creditworthiness of the third party making the guarantee or providing the insurance.

#### Convertible Bonds

Convertible bonds may be converted into the stock of the bond's issuer. A bondholder should be careful to understand the conditions under which the bonds may be converted, as this right often is contingent upon the issuer's stock reaching a certain price level, among other things. Bond investors also should ask their broker or financial adviser whether there is any charge or fee associated with making a conversion.

#### Junior or Subordinated Bonds

The more junior bonds issued by a company typically are referred to as subordinated debt, because a junior bondholder's claim for repayment of the principal of such bonds has a lower priority than the claims of a bondholder holding an issuer's more senior debt. Therefore, in the event of a bankruptcy, junior bondholders receive payment only after senior debt claims are paid in full. Additionally, other types of claims also may have priority on the issuer's remaining assets over the claims of all bondholders (e.g., certain supplier or customer claims). Therefore, although bondholders generally are paid prior to stockholders in a bankruptcy proceeding, this doesn't mean the bondholder will get any money back because the issuer's assets could be reduced to zero by other creditors that have the right to be paid before bondholders.

#### Broker Compensation for Selling Bonds

No Commission does not Mean No Charge.

You should understand that your broker is being compensated for performing services for you, even if you are not charged a commission when you buy or sell a bond. In most bond transactions, brokers are compensated, even though a commission charge is not disclosed, because the transaction is structured as a principal transaction (i.e., your broker sells you a bond it already owns). This is because when a dealer sells you a bond in a principal capacity, the dealer increases or marks up the price you pay over the price the dealer paid to acquire the bond. The

mark-up is the dealer's compensation and is similar to a commission. Similarly, if you sell a bond, a dealer will offer you a price that includes a mark-down from the price that the dealer believes he can sell the bond to another dealer or another buyer. You should understand that the firm has charged you a fee for its services.

#### Would a Similar Bond Cost Less?

Finally, it is important to consider the potential conflicts that your broker might have when it sells you a bond. Bonds issued by different issuers often have very similar risk profiles and carry similar coupon rates. Before you buy a bond, you should shop around and consider if there are other bonds that you could buy at a cheaper price than the one recommended by your broker. You should consider whether there are other bonds available with similar risk/return profiles that might be available at lower cost. You also should try and understand how your broker is being compensated for any bond transaction, particularly those that are recommended to you where similar bonds may be available.

\* \* \* \* \*

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

In its filing with the Commission, FINRA 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. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

#### 1. Purpose

##### Background

With the implementation of FINRA's Trade Reporting and Compliance Engine ("TRACE") in 2002 and the subsequent availability of a consolidated view of transaction information in the U.S. corporate bond market, a number of trends have emerged that have implications for the regulatory framework of the corporate debt market. For example, approximately 65% of TRACE transactions are for amounts of less than \$100,000, indicating significant individual investor participation in the corporate bond

market.<sup>5</sup> FINRA believes that helping investors to understand some of the key characteristics of particular bonds that they are buying or selling as well as the key risks associated with bond investing is an important element of its efforts to enhance transparency in the corporate debt market. FINRA also believes that the proposed rule change will further efficiency, competition, and capital formation in the market for corporate debt securities. In particular, FINRA anticipates that the proposed rule change, by providing greater transparency to debt securities transactions, will result in greater efficiency in pricing and further competition in the market for corporate debt securities. FINRA believes the proposed rule change also will enhance capital formation to the extent that investors are better able to assess the risks and benefits related to investing in corporate debt securities.<sup>6</sup>

#### Proposed Disclosures

Proposed NASD Rule 2231 would require members, subject to certain exceptions,<sup>7</sup> to provide customers in

<sup>5</sup> See NASD Notice to Members 05–21 (April 2005); see also *Report of the Corporate Debt Market Panel*, September 2004, [http://www.finra.org/web/groups/reg\\_systems/documents/regulatory\\_systems/p011445.pdf](http://www.finra.org/web/groups/reg_systems/documents/regulatory_systems/p011445.pdf) (“Panel Report”). The Corporate Debt Market Panel (“Panel”) was a group of twelve experts in the fixed income area appointed by the NASD Board of Governors to make recommendations to NASD regarding how best to ensure market integrity and investor protection in the corporate bond market. The Panel reviewed information showing significant levels of participation by individual investors in the corporate bond market. For example, the Panel Report notes that information obtained from TRACE shows that approximately “two thirds of corporate bond transactions reported to TRACE are in quantities of \$100,000 or less in value, a size widely viewed as representative of individual investor activity.” Panel Report at 4. The Panel also reviewed NASD surveys showing that individual investors often do not understand certain key structural aspects of specific bonds or the market in which bonds are traded. For example, 34% of individuals surveyed did not believe that they were paying a fee for buying or selling a bond and approximately 60% of investors surveyed did not understand that bond prices generally fall as interest rates rise. Panel Report at 4. The Panel concluded that individual investors would benefit from additional guidance and information disclosure, and recommended, among other things, that investors obtain improved access to information on bonds and receive increased disclosures regarding their bond transactions. The proposed rule change is based on the Panel’s recommendations and also reflects significant input from other NASD advisory committees, such as NASD’s Fixed Income Committee.

<sup>6</sup> See generally Panel Report.

<sup>7</sup> Proposed NASD Rule 2231’s disclosures would not be required to be provided to institutional accounts, and proposed NASD Rule 2231 would not apply to transactions in asset-backed or exempted securities. “Institutional account” would have the same meaning it has in NASD Rule 3110(c)(4). “Asset-backed security” would have the same meaning it has in Rule 10b–10(d)(10) under the Act.

TRACE-eligible securities transactions,<sup>8</sup> with additional transaction-specific disclosures relating to applicable charges, credit ratings, the availability of last-sale transaction information, and certain interest, yield and call provisions.<sup>9</sup> These disclosures would have to be provided in the same manner and at the same time in which a broker-dealer discloses information under Rule 10b–10.<sup>10</sup>

FINRA believes that the information in the proposed disclosures generally is of the type that currently is included in confirmations of transactions in various types of securities (e.g., municipal securities). While the disclosures proposed by FINRA are narrowly

See 17 CFR 240.10b–10. “Exempted security” would have the same meaning it has in Section 3(a)(12) of the Act (15 U.S.C. 78c(a)(12)). See paragraphs (a)(2)(A), (a)(2)(D) and (a)(2)(C) of proposed NASD Rule 2231, respectively.

<sup>8</sup> Proposed NASD Rule 2231 only would apply to a transaction in a “debt security” that also is a “TRACE-eligible security,” which would have the same meaning it has in NASD Rule 6210(a). See proposed NASD Rule 2231(a)(2)(H). Debt security would have the same meaning it has under Rule 10b–10 under the Act except that it would not include any asset-backed security or exempted security. See Proposed NASD Rule 2231(a)(2)(B).

<sup>9</sup> Under proposed NASD Rule 2231(a) members would not be required to make any of the disclosures, which are specified in proposed paragraph (b), that are duplicative of disclosures already required under SEC Rule 10b–10 for that transaction. Proposed NASD Rule 2231(a)(1). Also, under proposed NASD Rule 2231(a), unless otherwise provided, the information would be required to be disclosed in the same manner (e.g., frequency) and at the same time in which the member discloses information to the customer about the specific debt transaction pursuant to SEC Rule 10b–10. *Id.* For example, the Commission has provided exemptive relief to broker-dealer sponsors of “wrap fee programs” to permit those broker-dealers to confirm transactions in their wrap fee programs through periodic statements, not less often than quarterly (subject to several conditions), in lieu of immediate trade confirmations that otherwise would be required under SEC Rule 10b–10. *Money Management Institute, Securities Industry Association, SEC No-Action Letter*, 1999 SEC No-Act Lexis 934 (August 23, 1999). FINRA would defer to SEC and SEC staff interpretations of SEC Rule 10b–10 when interpreting proposed NASD Rule 2231’s delivery requirements, and members properly relying upon such interpretations for purposes of satisfying SEC Rule 10b–10’s delivery requirements also would be deemed to satisfy proposed NASD Rule 2231’s delivery requirements. If the SEC approves the proposed Rule, FINRA would provide guidance in this area only in instances where the SEC or its staff has not already addressed a particular issue.

<sup>10</sup> Proposed NASD Rule 2231(a)(1). However, FINRA would not interpret proposed NASD Rule 2231 as requiring members to provide the required supplemental disclosures on the same piece of paper or in the same electronic document (if the confirmation is provided electronically) as that containing the SEC Rule 10b–10 confirmation, because FINRA believes such requirements could be unwieldy without materially enhancing investor protection. Nevertheless, FINRA anticipates that the supplemental disclosures of proposed NASD Rule 2231 and the confirmation disclosures required by SEC Rule 10b–10 would be delivered simultaneously.

tailored to the specific concerns that have been raised regarding confirmation disclosure in TRACE-eligible securities transactions, FINRA has identified where analogous disclosures are today required. The specific additional disclosures would include the security’s CUSIP<sup>11</sup> number and its TRACE symbol<sup>12</sup> to assure that the transaction is identified as clearly as possible. A member acting as principal would be required to disclose, if applicable, a statement relating to transaction charges.<sup>13</sup> This standard disclosure is intended to clarify for investors who are dealing with a member acting as a principal, in the capacity of either a dealer or market maker, whether the member has obtained any remuneration in connection with the customer’s debt securities transaction. FINRA is not proposing to require that the amount of the member’s mark-up or mark-down be

<sup>11</sup> Proposed NASD Rule 2231(b)(1). “CUSIP” stands for Committee on Uniform Securities Identification Procedures. According to FINRA, CUSIP numbers belong to Standard and Poor’s, a division of the McGraw-Hill Companies, Inc. (“S&P”). S&P licenses to FINRA the use of the terms “Committee on Uniform Securities Identification Procedures” and “CUSIP.” See Municipal Securities Rulemaking Board (“MSRB”) Rule G–15(a)(i)(B)(2) (requires disclosure of a security’s CUSIP number); cf. SEC Rule 10b–10(a)(1) (requires disclosure of a security’s “identity”).

<sup>12</sup> Proposed NASD Rule 2231(b)(1). The TRACE symbol allows retail investors to more easily identify the TRACE-eligible security as to the issuer. See SEC Rule 10b–10(a)(1) (requires disclosure of a security’s “identity”); cf. MSRB Rule G–15(a)(i)(B)(1)(a) (for stripped coupon securities, requires confirmation disclosure of a security’s “trade name and series designation”); MSRB Rule G–15(a)(i)(B)(1)(b) (for municipal fund securities, requires confirmation disclosure of “the name used by the issuer to identify such securities and, to the extent necessary to differentiate the securities from other municipal fund securities of the issuer, any separate program series, portfolio or fund designation for such securities must be shown.”).

<sup>13</sup> Proposed NASD Rule 2231(b)(2). The required disclosure for principal transactions, if applicable, would be “the broker-dealer’s remuneration on this transaction has been added to the price in the case of a purchase or deducted from the price in the case of a sale.” *Id.*; cf. SEC Rule 10b–10(e)(1)(ii) (a broker or dealer that effects “any transaction” for a customer in security futures products in a futures account must disclose “the source and amount of any remuneration received or to be received \* \* \* including, but not limited to, markups, commissions, costs, fees, and other charges incurred in connection with a transaction \* \* \*.”); SEC Rule 10b–10(a)(2)(ii) (in certain circumstances a non-market maker acting as principal for its own account is required to disclose the “difference between the price to the customer and the dealer’s contemporaneous purchase (for customer purchases) or sale price (for customer sales)”; SEC Rule 10b–10(a)(2)(i) (must disclose capacity, and, when acting as agent for the customer, some other person, or for both the customer and some other person, the “amount of any remuneration received or to be received \* \* \*.” under SEC Rule 10b–10(a)(2)(i)(B)); MSRB Rule G–15(a)(i)(A)(1)(e) (requires, in certain cases, certain disclosures regarding the broker-dealer’s remuneration in the transaction).

disclosed because, under SEC Rule 10b-10, in debt securities transactions, an agency commission is required to be disclosed, but a principal's mark-up or mark-down is not. Under certain circumstances a member would be required to disclose the credit rating of the security and the Nationally Recognized Statistical Rating Organization ("NRSRO") assigning it the rating.<sup>14</sup> A member that subscribes to more than one NRSRO (or otherwise is provided credit ratings as described previously) and has more than one credit rating for a security, would be required to provide the lowest of such credit ratings to the customer.<sup>15</sup> A member would be required to disclose the credit rating if it, or the clearing firm or service bureau providing confirmation services to the member on the transaction, has entered into a written agreement with a rating agency to receive such credit ratings, and, in the case of a clearing firm or service bureau, those ratings are made available to the member for inclusion on the transaction confirmation at no additional cost.<sup>16</sup> A member would be

<sup>14</sup> Proposed NASD Rule 2231(b)(3); *cf.* SEC Rule 10b-10(a)(8) (requires disclosure that a debt security is unrated by an NRSRO, if applicable); MSRB Rule G-15(a)(i)(C)(3)(f) (requires disclosure that a debt security is unrated by an NRSRO, if applicable). Pursuant to the Credit Rating Agency Reform Act of 2006 and Commission rules thereunder, on June 28, 2007, the Commission announced that seven credit rating agencies applied to be registered with the Commission as NRSROs and could continue to represent themselves or act as NRSROs during Commission consideration of their applications. See SEC Press Release 2007-124 (June 28, 2007). The seven credit agencies are: A.M. Best Company, Inc., Dominion Bond Rating Service Limited, Fitch, Inc., Japan Credit Rating Agency, Ltd., Moody's Investors Service, Rating and Investment Information, Inc., and Standard and Poor's Rating Services. In issuing a credit rating, these organizations review relevant information supplied to them by the issuer or its agents, and from sources they consider reliable, including financial information such as the issuer's financial statements, and assign a rating, for example AAA (Aaa) to D.

<sup>15</sup> Proposed NASD Rule 2231(b)(3).

<sup>16</sup> It is FINRA's understanding that certain large clearing firms offer to disclose on a correspondent firm's transaction confirmation a "menu" of items for a fixed fee and that credit rating information typically is included as one of these menu items. FINRA noted in NASD *Notice to Members* 05-21 that, if the current proposal were adopted, FINRA would monitor the percentage of firms that subscribe to and disclose NRSRO ratings and would consider the advisability of mandating at least one subscription to an NRSRO if a uniform practice of disclosing NRSRO ratings did not arise. For example, FINRA might consider such an approach if the proposed Rule were adopted and FINRA became aware that member firms were seeking to avoid disclosing NRSRO ratings by paying their clearing firms or service bureaus a separate, nominal charge to receive such ratings to circumvent the requirement in proposed NASD Rule 2231(b)(3)(B) and (C) that requires a member to make such disclosures only if the member receives NRSRO ratings from its clearing firm "at

required to disclose the credit rating it has received at the time the transaction confirmation is generated<sup>17</sup> as well as the date applicable to the credit rating. A member also would be required to disclose that transaction price information is publicly available for the security, and that a customer may obtain such information at the FINRA internet web site <http://www.bondinfo.com> for the customer's non-commercial use at no charge, or at other sources that provide such information, such as the Web site, [investinginbonds.com](http://investinginbonds.com).<sup>18</sup>

For customer purchases only, members would be required to provide the frequency of interest and/or principal payments as applicable, if either are paid on a periodic, fixed schedule.<sup>19</sup> If the debt security does not pay interest or principal on a regular schedule, the member must disclose the following: "This security does not pay interest or principal on a regular schedule. Information regarding the frequency of interest or principal payments for this security will be furnished to you upon written request."<sup>20</sup> Yield to maturity would be required to be disclosed and, if the debt security is subject to call prior to maturity through any means, a notation of "callable" also would be required to be included.<sup>21</sup> The date and price of the

no additional cost." Finally, a member that receives credit rating information and whose clearing firm also receives credit rating information would be permitted to choose which credit ratings to disclose so long as the credit rating was the lowest of the ratings it receives.

<sup>17</sup> Proposed NASD Rule 2231(b)(3). This provision has been revised in response to SEC staff comments and industry feedback and is intended to minimize the costs and operational burdens faced by members complying with this requirement. Members now would be permitted to use the lowest credit rating they have received or may receive as part of the confirmation preparation process. Members would not be required to disclose the credit rating available at the time a transaction is executed, which was initially proposed by FINRA in SR-NASD-2005-100.

<sup>18</sup> Proposed NASD Rule 2231(b)(4). Most transactions in TRACE-eligible securities, as well as other debt securities, are executed in the over-the-counter market; the proposed disclosure is intended to direct investors to a primary source of market data for TRACE-eligible securities transactions. In NYSE Rule 409(f), FINRA requires that broker-dealers disclose on confirmations the name of the securities market on which the confirmed transaction was made. The New York Stock Exchange granted temporary relief from this requirement in conjunction with the implementation of Regulation NMS. See NYSE Information Memorandum 07-28 (March 20, 2007). In *Regulatory Notice* 07-35 (August 2007) FINRA extended this relief until January 1, 2008.

<sup>19</sup> Proposed NASD Rule 2231(b)(5)(A); *cf.* MSRB Rule G-15(a)(i)(C)(2)(e) (must disclose "the basis on which interest is paid," if the security pays interest on other than a semi-annual basis).

<sup>20</sup> Proposed NASD Rule 2231(b)(5)(A).

<sup>21</sup> Proposed NASD Rule 2231(b)(5)(B); *cf.* SEC Rule 10b-10(a)(5) (must disclose yield to maturity);

next pricing call would be required to be included and so designated.<sup>22</sup> If the debt security is continuously callable (*i.e.*, callable on any date after the first call date) a member would be required to disclose, "This security is continuously callable."<sup>23</sup> If there are any call features in addition to the next pricing call, disclosure must be made that: "Additional call features exist that may affect yield; additional information will be furnished to you upon written request."<sup>24</sup> For variable rate debt securities, the member would be required to inform the customer that the coupon rate may vary and that the member will provide additional information<sup>25</sup> in writing about the variable debt upon a customer's written request.<sup>26</sup> Finally, when a member sells to a customer a debt security that is callable and, at the time of issuance, is not structured to include scheduled interest payments (*e.g.*, "zero coupon bonds"), the member would be required to provide to the customer the dollar equivalent of the debt security's

SEC Rule 10b-10(a)(6) (must disclose yield to maturity, type of call, call date and call price); MSRB Rule G-15(a)(i)(C)(2)(a) (must disclose if securities are callable, if callable through any means prior to maturity, must disclose date and price of next pricing call, and must disclose other call features, or in certain cases, provide notice that other call features exist and additional information will be provided upon request).

<sup>22</sup> Proposed NASD Rule 2231(b)(5)(B).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> Proposed NASD Rule 2231(b)(5)(C). The additional information required to be provided upon written request would be: (i) *The amount of the next interest payment based on the current coupon rate*, (ii) *a statement that this amount will change if the coupon rate changes*, (iii) *how often the coupon rate may be recalculated*, (iv) *an explanation of the event(s) that may trigger the recalculation*, and (v) *the formula for recalculating such coupon rate*. *Id.*; *cf.* MSRB Rule G-15(a)(i)(D)(2) (for municipal collateralized mortgage obligations, must include a statement that the actual yield of such security may vary according to certain variables and a statement that information concerning the factors that affect yield will be furnished upon written request); MSRB Rule G-15(a)(i)(C)(2)(a) (for callable securities if there are any call features in addition to the next pricing call, must provide a statement that "additional call features exist that may affect yield; complete information will be provided upon request"). FINRA also notes that in registered offerings much of this information would be set forth in the prospectus and the indenture concerning the debt security, which would be publicly available to investors.

<sup>26</sup> Proposed NASD Rule 2231(b)(5)(C); *cf.* SEC Rule 10b-10(a)(4) (for transactions in debt securities subject to redemption, must provide "a statement to the effect that such debt security may be redeemed in whole or in part before maturity, that such redemption could affect the yield represented and the fact that additional information is available upon request\* \* \*"); SEC Rule 10b-10(a)(7) (for transactions in certain asset-backed securities, must disclose that the actual yield may vary depending upon certain factors and that additional information is available upon request).

imputed interest until the next occurring call date (assuming that the price at which the debt security may be called is paid to the holder).<sup>27</sup> Additionally, customers would have the right to make a written request for certain additional cash flow information as well as the disclosure document (see discussion below of proposed disclosure document).<sup>28</sup> Members would have three business days to provide a written response to such requests, unless the request were made more than six months after the settlement of a transaction, in which case a member would have ten business days to respond.<sup>29</sup>

#### Proposed Disclosure Document

A member that has provided a customer disclosure under proposed NASD Rule 2231 during the period since it last sent an account statement to its customer also would be required to notify that customer of the location and availability of a FINRA-authored disclosure document that discusses investing in bonds, titled "Important Information You Need to Know About Investing in Bonds."<sup>30</sup>

<sup>27</sup> Proposed NASD Rule 2231(b)(5)(D); cf. SEC Rule 10b-10(a)(6) (for debt security transactions effected on the basis of yield, must disclose the "dollar price calculated from the yield at which the transaction was affected"); MSRB Rule G-15(a)(i)(A)(5)(a)(ii) ("dollar price shall be computed"). This disclosure is intended to provide investors with an easily understood figure reflecting information similar to that considered by many institutional investors who consider a security's compound accreted value ("CAV") when investing in certain bonds. CAV is, as of a particular date, a computation of the aggregate of a security's principal and interest.

<sup>28</sup> See proposed NASD Rule 2231(b)(5)(A)-(C) and proposed NASD Rule 2340(e)(1).

<sup>29</sup> See proposed NASD Rule 2231(b)(5)(A)-(C) and proposed NASD Rule 2340(e)(3).

<sup>30</sup> Proposed NASD Rule 2340(e). The proposed rule change would redesignate current NASD Rule 2340(e), which governs FINRA's exemptive authority with respect to its customer account statement rule, as NASD Rule 2340(f). The proposed disclosure document describes various types of corporate bonds and their common features or provisions (e.g., coupon rate, face value, and maturity), as well as risks investors should consider before investing in debt securities, such as interest rate risk, call and reinvestment risk, refunding risk (and sinking fund provisions), and default and credit risk (including the differences between subordinated and non-subordinated debt). The document also addresses other topics, including bond pricing, the relationship between price and yield, and the difference between a bond's yield to maturity and its yield to call. FINRA believes the disclosure document should aid investors in determining whether a bond is an appropriate investment given the investor's investment objectives. Members would be permitted to provide customers with the FINRA internet web site address where this disclosure document is located, or the member's own internet web site address, provided that this disclosure document, or an internet hyperlink directly thereto, is easily accessible from the internet address that is provided to customers. Members would be required to provide a paper

#### Effective Date

FINRA would announce the effective date of the proposed rule change in a *Regulatory Notice* to be published no later than 60 days following Commission approval. As proposed, the effective date would not be later than nine months following publication of the *Regulatory Notice* announcing Commission approval.

#### 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A of the Act in general, and Section 15A(b)(6) of the Act<sup>31</sup> in particular, which requires, among other things, that FINRA's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change is consistent with these requirements in that it would provide investors with information with which they might better assess the quality of their executions in debt securities transactions, the fees charged, and whether the security purchased fits their investment goals.

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

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

FINRA's statement on comments received from members, participants, or others is set forth in Exhibit 1a to Amendment No. 1 to SR-NASD-2005-100. At the Commission staff's request, FINRA staff has agreed to extend the comment period for the proposed rule change from 21 days to 45 days from its publication in the **Federal Register**.

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

Within 35 days of the date of publication of this notice in the **Federal**

copy of this disclosure document upon request, but would be permitted to provide this disclosure document in electronic form (e.g., as an attachment to an e-mail) if the customer requests that it be delivered in electronic form.

<sup>31</sup> 15 U.S.C. 78o-3(b)(6)

**Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

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

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

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-100 on the subject line.

##### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2005-100. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does



not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2005-100 and should be submitted on or before December 3, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>32</sup>

Nancy M. Morris,

Secretary.

[FR Doc. E7-20601 Filed 10-18-07; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56656; File No. SR-NYSEArca-2007-94]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto To Eliminate Position and Exercise Limits for Options on the Russell 2000 Index, and To Specify That Certain Reduced-Value Options on Broad-Based Security Indexes Have No Position and Exercise Limits

October 12, 2007.

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 September 14, 2007, NYSE Arca, Inc. (“NYSE Arca” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by NYSE Arca. On October 1, 2007, NYSE Arca submitted Amendment No. 1 to the proposed rule change. The Exchange has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders it effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

NYSE Arca proposes to amend its rules to eliminate the position and

exercise limits for options on the Russell 2000 Index (“RUT”), and to specify that reduced-value options on broad-based security indexes for which full-value options have no position and exercise limits will similarly have no position and exercise limits. The text of the proposed rule change is available at NYSE Arca, the Commission’s Public Reference Room, and <http://www.nysearca.com>.

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

In its filing with the Commission, NYSE Arca 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. NYSE Arca has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

###### 1. Purpose

NYSE Arca proposes to amend Rules 5.15(a) and 5.17(a)(13) in order to: (1) Eliminate position and exercise limits for options on RUT, a multiply listed and heavily traded broad-based security index; and (2) specify that reduced-value options on broad-based security indexes for which full-value options have no position limits will similarly have no position limits.

##### *Eliminate Position and Exercise Limits for RUT Options*

NYSE Arca presently trades options on one broad-based index, RUT. However, the Exchange believes that the circumstances and considerations that the Commission relied upon in approving the elimination of position and exercise limits for another heavily traded broad-based index options (e.g., NASDAQ-100 Index (“NDX”), listed on the Chicago Board Options Exchange (“CBOE”))<sup>5</sup> equally apply to NYSE Arca’s proposal to eliminate position and exercise limits for options on RUT. In addition, the Commission recently approved similar proposals by CBOE and the American Stock Exchange LLC

(“Amex”) to eliminate position and exercise limits for RUT options.<sup>6</sup>

In approving the elimination of position and exercise limits for NDX options on CBOE, the Commission considered the capitalization of this index and the deep and liquid markets for the securities underlying the index that significantly reduced the concerns of market manipulation or disruption in the underlying markets.<sup>7</sup> The Commission also noted the active trading volume for options on the index. The Exchange believes that RUT shares these factors in common with NDX. As of July 31, 2007, the approximate market capitalization of NDX was \$2.28 trillion, the average daily trading volume (“ADTV”) for the component of NDX was 572 million shares and the ADTV for options on NDX was approximately 64,000 contracts per day. NYSE Arca believes that RUT has comparable characteristics. The market capitalization for RUT is \$1.73 trillion, the ADTV for the underlying securities is 535 million shares, and the ADTV for the option is approximately 79,000 contracts.

In approving the elimination of position and exercise limits for NDX, the Commission also noted that financial requirements imposed by the options exchanges and the Commission serve to address concerns that an exchange member, an Options Trading Permit (“OTP”) Holder<sup>8</sup> in the case of NYSE Arca, or its customer, may try to maintain an inordinately large unhedged position in NDX options. These same financial requirements also apply to RUT options. Under NYSE Arca rules, the Exchange also has the authority to impose additional margin upon accounts maintaining underhedged positions, and is further able to monitor accounts to determine when such action is warranted. As noted in the Exchange’s rules, the clearing firm carrying such an account would be subject to capital charges under Rule 15c3-1 under the Act<sup>9</sup> to the extent of any resulting margin deficiency.<sup>10</sup>

In approving the elimination of position and exercise limits for NDX, the Commission relied heavily on

<sup>6</sup> See Securities Exchange Act Release Nos. 56351 (September 4, 2007), 72 FR 51875 (September 11, 2007) (SR-Amex-2007-81); and 56350 (September 4, 2007), 72 FR 51878 (September 11, 2007) (SR-CBOE-2007-79) (collectively, “RUT Approval Orders”).

<sup>7</sup> See NDX Approval Order, *supra* note 5.

<sup>8</sup> OTP Holder is defined in NYSE Arca Rule 1.1(q). OTP Holders have the status of a “member” of the Exchange as that term is defined in Section 3 of the Act. See 15 U.S.C. 78c.

<sup>9</sup> 17 CFR 240.15c3-1.

<sup>10</sup> See NYSE Arca Rule 5.17(a)(14).

<sup>32</sup> 32 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> See Securities Exchange Act Release No. 52650 (October 21, 2005), 70 FR 62147 (October 28, 2005) (SR-CBOE-2005-41) (“NDX Approval Order”).