

in Item IV below. GSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

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

GSCC's Schedule of Timeframes ("Schedule") contains two deadlines that are applicable to requests for repo collateral substitutions: (i) A deadline of noon (12:00 p.m.) after which a member that initiated the substitution will be subject to a late fee of five hundred dollars (\$500.00) per substitution imposed and (ii) an absolute deadline of 12:30 p.m. after which GSCC will reject the substitution request.<sup>2</sup> The Schedule provides that GSCC may extend these deadlines by one hour on days that The Bond Market Association ("BMA") announces in advance will be "high volume days."<sup>3</sup>

Given the unpredictable occurrence of days on which a large number of collateral substitution requests occur, the BMA recently supplemented its guidelines to provide a process for the same-day designation of high volume days and extension of repo collateral substitution deadlines.<sup>4</sup> Specifically, the BMA has recommended that prior to 10:05 a.m. on each day on which the markets are open for trading, GSCC's inter-dealer broker netting members should notify GSCC of the number of collateral substitution requests they have received for that trading day. If the number of such collateral substitution requests exceeds 150 in the aggregate, GSCC will extend its repo collateral substitution deadlines by one hour and will notify the BMA which will issue a notice to market participants.<sup>5</sup> In effect, under the new trading practice

<sup>2</sup> All times in GSCC's rules are New York time. GSCC's repo substitution notification deadlines were based upon guidelines issued by The Bond Market Association ("BMA") that provide that on each business day market participants should notify their inter-dealer broker of any collateral substitutions by 9:55 a.m. and should provide such brokers with the description of the substituted collateral by 11:00 a.m. GSCC provides members with an additional hour in which to send the request to GSCC.

<sup>3</sup> Pursuant to BMA's trading practices guidelines, high volume days are the first and last business day of each calendar quarter on which markets are open for trading and such other days as the BMA may announce no later than 24 hours prior to the occurrence of such day.

<sup>4</sup> The BMA issued this supplement on an interim basis pending the approval of this rule change.

<sup>5</sup> GSCC, the BMA, and industry representatives have established 150 as the number of requests that will trigger GSCC's determination that a trading day is a high volume day. This will be incorporated into the BMA's trading practice guidelines. Should this change, GSCC will file a proposed rule change under Section 19(b)(3)(A) with the Commission.

guidelines, it will be GSCC that determines when a trading day is a high volume day.

The Schedule currently permits GSCC to extend its repo collateral substitution deadlines only after the BMA has designated a high volume day. The proposed rule change would permit GSCC to determine when a trading day is a high volume day and therefore to institute a same-day extension of its deadlines without having the BMA designation.

The proposed rule change is consistent with the requirements of Section 17A of the Act and the rules and regulations thereunder because it will provide members with additional time to submit their repo collateral notification requests on days that develop into high volume days.

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

GSCC does not believe that the proposed rule change will have any impact or impose any burden on competition.

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

Written comments relating to the proposed rule change have not yet been solicited or received. GSCC will notify the Commission of any written comment received by GSCC.

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

The Commission finds that the proposal, which allows GSCC to react in a timely manner to volume increases by extending submission deadlines for repo collateral substitution requests by GSCC members, is consistent with Section 17A(b)(3)(F) because it should help perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions. Allowing GSCC to designate high volume days independently of the BMA will enable GSCC to better serve its members because GSCC will be able to respond in real-time to market conditions affecting its clearance and settlement of repos.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of the filing because approval prior to the thirtieth day of publication will give GSCC the ability to immediately handle any high volume day that might occur.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of GSCC. All submissions should refer to File No. SR-GSCC-2002-12 and should be submitted by December 18, 2002.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>6</sup> that the proposed rule change is hereby approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-46860; File No. SR-ISE-2001-15]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the International Securities Exchange LLC, Relating to a Pilot Program for Quotation Spreads**

November 20, 2002.

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 May 25, 2001, the International Securities Exchange LLC ("ISE" or "Exchange")

<sup>6</sup> 15 U.S.C. 78s(b)(2).

<sup>7</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.

filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in items I, II, and III below, which items have been prepared by the ISE. 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**

The ISE proposes to amend Supplementary Material .01 to ISE Rule 803, "Obligations of Market Makers," to establish a six-month pilot program in which the allowable quotation spread for options on up to 50 underlying securities will be \$5, regardless of the price of the bid.

The text of the proposed rule change is available at the ISE and at the Commission.

### **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 ISE 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 ISE 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

The purpose of the proposed rule change is to establish a six-month pilot program to substantially relax the quotation spread requirements on the ISE in options on up to 50 underlying securities. Currently, the ISE's rules contain maximum quotation spread requirements that vary from \$.25 to \$1, depending on the price of the option. Each ISE market maker independently is subject to these requirements. According to the ISE, although the primary purpose of the spread requirements is to help to maintain narrow spreads, the spread requirements also result in individual market makers sometimes quoting at prices that they believe are unnecessarily narrow, potentially exposing them to greater risk if markets move quickly. The ISE believes that, due to its unique electronic competitive market making system, the quotation

spread requirements may not be necessary to ensure tight and competitive quotations on the ISE.

In this regard, the ISE states that its market structure creates strong incentives for competing market makers and other market participants to disseminate competitive prices. In the ISE's trading system, each market maker quotes independently and customers and professional traders can enter limit orders on the ISE's book. The ISE automatically collects this trading interest, calculates an ISE best bid and offer ("BBO"), and disseminates the BBO to the investing public. Furthermore, the ISE allocates trading interest based upon the price and size of trading interest. Under the ISE's trading algorithm, the ISE allocates volume to trading interest at the best price. The larger the size of a person's quote or order at the best price, the more trading interest that person receives. The ISE believes that this provides strong incentives for market makers and other market participants to enter quotes and orders that improve the price and depth of the market. The ISE believes that in this model, market forces provide sufficient discipline to maintain narrow and competitive quotation spreads.

Accordingly, the ISE proposes to expand the allowable spread in a pilot group of up to 50 options (up to five per each of the ISE's ten groups of options) to \$5.<sup>3</sup> The ISE states that it will monitor the quotation quality of the selected options for a six-month pilot period and, based on the results, recommend either relaxing the spread requirements for all options, ending the pilot, or adjusting the spread requirements.

##### (2) Basis

The ISE believes that the proposed rule change is consistent with the requirement under section 6(b)(5)<sup>4</sup> of the Act that an exchange have rules that are 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 for a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

The ISE believes that the proposed rule change does not impose any burden

<sup>3</sup> At this point, the ISE does not propose to eliminate the spread requirements entirely to avoid perception issues about extremely wide spreads.

<sup>4</sup> 15 U.S.C. 78f(b)(5).

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*

The ISE has not solicited, and does not intend to solicit, comments on the proposed rule change. The ISE has not received any unsolicited written comments from members or other interested parties.

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

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

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

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

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to file number SR-ISE-2001-15 and should be submitted by December 18, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46859; File No. SR-NASD-2002-162]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Relating to Supervisory Control Amendments

November 20, 2002.

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 November 4, 2002, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change. The proposed rule change is described in Items I, II, and III below, which Items have been prepared by the NASD. 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

The NASD is proposing to adopt new NASD Rule 3012 and amend other rules regarding the supervisory and supervisory control procedures of member firms. Specifically, new NASD Rule 3012 would require members to develop general and specific supervisory control procedures that independently test and verify and modify, where necessary, the members' supervisory procedures. In addition, proposed amendments to (1) NASD Rule 3010(c) would require that office inspections be conducted by independent persons and include, at a minimum, the testing and verification of certain supervisory procedures; (2) NASD Rule 3110 would expand upon a member's supervisory and recordkeeping requirements with respect to changes in customer account name or designation in connection with order executions; (3) NASD IM-3110 would provide guidance as to when a member may hold mail for a customer

who will be absent for a period of time; (4) NASD Rule 2510(d) would clarify the time limit on time-and-price discretionary authority; and (5) NASD Rule 9610 would incorporate into NASD Procedural Rules the ability of members to request an exemption from amended NASD Rule 3010(c). Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

\* \* \* \* \*

#### 2510. Discretionary Accounts

(a) through (c) No Change.

(d) Exceptions

This Rule shall not apply to:

(1) discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a specified shall be executed, *except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent a specific, written, contrary indication signed and dated by the customer;*

(2) No Change.

*Any exercise of time and price discretion must be reflected on the customer order ticket.*

\* \* \* \* \*

#### 3010. Supervision

(a) through (b) No Change.

(c) Internal Inspections

(1) Each member shall conduct a review, at least annually, of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with *applicable NASD rules* [the Rules of this Association]. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction. Each branch office of the member shall be inspected according to a cycle which shall be set forth in the firm's written supervisory and inspection procedures. In establishing such cycle, the firm shall give consideration to the nature and complexity of the securities activities for which the location is responsible, the volume of business done, and the number of associated persons assigned to the location. Each member shall retain a written record of the dates upon which each review and inspection is conducted.

(2) *Office inspections by members pursuant to paragraph (c)(1) must be conducted by a person who is independent from the activities being performed at the office and those persons providing supervision to that office. The independence requirements in connection with office inspections may be satisfied by reasonable means based on the size and resources of the firm and the scope and nature of its activities. Written reports of these inspections are to be kept on file by the member for a minimum of three years.*

*An office inspection and review must include, but is not limited to, testing and verification of the member's policies and procedures, including supervisory policies and procedures in the following areas:*

(A) *Safeguarding of customer funds and securities;*

(B) *Maintaining books and records;*

(C) *Supervision of customer accounts serviced by branch office managers;*

(D) *Transmittal of funds between customers and registered representatives and between customers and third parties;*

(E) *Validation of customer address changes; and*

(F) *Validation of changes in customer account information.*

(3) *Pursuant to the Rule 9600 Series, NASD may exempt any member unconditionally or on specified terms and conditions from the independence requirement in the inspection of a member's offices as set forth in paragraph (c)(2) upon a satisfactory showing that complying with the requirements would be unduly burdensome on the member and that the member's internal inspection procedures are reasonably designed to achieve compliance with applicable securities laws and regulations and applicable NASD rules.*

\* \* \* \* \*

#### 3012. Supervisory Controls

(a) *General Requirements*

(1) *Each member shall establish and maintain a system of supervisory control policies and procedures that (A) test and verify that the member's supervisory procedures are reasonably designed with respect to the activities of the member and its registered representatives and associated persons, to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules and (B) create additional or amend supervisory procedures where the need is identified by such testing and verification. The member's supervisory controls must be performed by persons who are*

<sup>5</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.