

Packard. We have determined to include these particular options in the Pilot based on recommendations by our market makers.

In all other respects, except one, the Pilot will remain unchanged. For Primary Market Makers ("PMMs"), the minimum size for quotes will continue to be 100 contracts for customers and 50 contracts for broker-dealers, although this enhanced quotation size requirement will not affect the PMM's obligation under ISE Rule 803(c)(1) to disseminate a quotation of at least 10 contracts when the quotation consists, in part, of a customer order for less than 10 contracts. For Competitive Market Makers, the size requirements will continue to be half of the PMM requirement: 50 contracts for customers, 25 contracts for broker-dealers. The enhanced broker-dealer size will not apply to executions against other market makers, where the minimum size would continue to be one contract.

These enhanced size requirements will apply only to the options series in the three months closest to expiration. Moreover, the pilot will not apply to "deep-in-the-money" options, or an option in the last three days of that option's trading (that is, the pilot will not apply for the last three days of trading during an option series' expiry week). In the one change to the Pilot, ISE proposes to amend the definition of "deep-in-the-money." Currently, the rule excludes options that are deep-in-the-money, with the definition based on the number of pricing intervals a strike is from the at-the-money strike. ISE proposes to change this by defining "deep-in-the-money" to mean options with strike prices that are in the money by 12 percent or more in relation to the price of the underlying stock. This change to the definition is based on market makers' experience trading under the Pilot today, and ISE believes that this amended definition will reduce market makers' exposure to risk, while continuing to apply the Pilot to options representing over two-thirds of all trading volume.

## 2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)<sup>4</sup> that an exchange have rules that are designed 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 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*

No written comments were solicited or received with respect to the proposed rule change.

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

Because the foregoing rule change: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; (iii) does not become operative for 30 days from the date of filing; and (iv) the Exchange provided the Commission with notice of its intent to file the proposed rule change at least five days prior to the filing date, the proposed rule change has become effective pursuant to section 19(b)(3)(A) of the Act<sup>5</sup> and Rule 19b-4(f)(6)<sup>6</sup> thereunder.

## 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 also will be available for inspection and copying at the principal office of the ISE. All submissions should refer to File No. SR-ISE-2002-17 and should be submitted by July 26, 2002.

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. 34-46141; File No. SR-NASD-2002-01]

### **Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 thereto and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Automatic Refreshing of Quotations in Nasdaq's SuperMontage System and the Withdrawal of Market Makers That Fail to Maintain a Clearing Relationship**

June 28, 2002.

On January 3, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to amend NASD Rules 4710(b)(5) and 4619(c) to modify the procedures for refreshing exhausted market maker quotes in, and withdrawing market makers that fail to maintain proper clearing arrangements from, Nasdaq's future Order Display and Collector Facility ("NNMS" or "SuperMontage").

Specifically, Nasdaq proposes to reduce from 3 minutes to 30 seconds the amount of time that a market maker can leave its bid or offer quotation at zero before SuperMontage begins its automatic quote refresh process. The process would only operate against the single bid or offer side of a quotation that has been reduced to zero through executions. If there are no available quotes from which to determine a refresh price, SuperMontage would refresh the exhausted side of a quote to a normal unit of trading at a price level that is one penny inferior to the lesser of either: (a) The last valid displayed inside bid/offer in the security before all

<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.

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

<sup>5</sup> 15 U.S.C. 78s(b)(3)(A).

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

such bids/offers were exhausted, or (b) the market maker's last displayed bid/offer. If the resulting bid/offer quote would create a locked or crossed market, NNMS would instead re-open the market maker's bid/offer quote at a price that is one penny inferior to the unexchanged contra side of the market. Finally, Nasdaq proposes to suspend from trading on SuperMontage market makers that fail to maintain a clearing relationship. Once the market maker regains a clearing relationship, the suspend status would be lifted, and the market maker would be free to participate again.

Nasdaq submitted Amendment No. 1 on March 5, 2002.<sup>3</sup> The proposed rule change and Amendment No. 1 thereto were published for comment in the **Federal Register** on April 8, 2002.<sup>4</sup> The Commission received no comments on the proposal. Nasdaq submitted Amendment No. 2 on June 13, 2002.<sup>5</sup>

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association<sup>6</sup> and, in particular, the requirements of section 15A of the Act<sup>7</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change, as amended, is consistent with section 15A(b)(6) of the Act,<sup>8</sup> which requires, among other things, that the rules of an association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities,

and, in general, to protect investors and the public interest.

The Commission believes that the proposed rule change, as amended, should assist market makers in maintaining two-sided quotes and facilitate their continued participation in Nasdaq. By reducing the amount of time, from 3 minutes to 30 seconds, that a quote is in a closed state and by only closing out the side of the quote that has been zeroed out, the revised procedures should help ensure the presence of liquidity providers, while preserving priority for orders that may be represented by the unexhausted side of the quote. Further, Nasdaq, by establishing procedures for refreshing an exhausted quote where there are no available quotes, has addressed any potential instance in which trading interest is not being displayed. This should ensure that quotes may be refreshed in all instances. Finally, Nasdaq's proposal to suspend market makers who fail to maintain clearing relationships from participating in the SuperMontage should encourage market makers to maintain appropriate clearing relationships at all times.

The Commission finds good cause for accelerating approval of Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication in the **Federal Register**, pursuant to section 19(b)(2) of the Act.<sup>9</sup> The Commission finds that Amendment No. 2 merely clarifies the proposed rule change by explaining that references to automatic adjustment of quotes at "inferior" prices refer to both bid and offer prices, with an inferior price adjustment on the bid side of the quote resulting in a higher offer price, and that references to a "clearing relationship" refer to a clearing relationship between a firm and a registered clearing agency or, alternatively, with a member of such an agency. Accordingly, the Commission believes that granting accelerated approval of Amendment No. 2 is appropriate and consistent with section 15A(b)(6)<sup>10</sup> and 19(b)(2) of the Act<sup>11</sup> in that it should prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, and, in general, protect investors and the public interest.

As stated previously in the order approving SuperMontage, the Commission wishes to again emphasize that it fully expects that the NASD will

monitor the use of the system defaults by market makers to ensure that they do not become a surrogate for meaningful market making, and that the NASD will reevaluate the penalties against market makers for failure to properly maintain two-sided quotes if there is a decline in the overall quality of market making, particularly during market volatility.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>12</sup> that the proposed rule change, as amended (File No. SR-NASD-2002-01) be, and it hereby is, approved.

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

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46144; File No. SR-NASD-2002-46]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 to the Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Rule 6200 Series or the TRACE Rules

June 28, 2002

#### I. Introduction

On April 3, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change 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> to amend the Rule 6200 Series of the Rules of the NASD, which provides for the reporting and dissemination of transaction information in eligible corporate debt securities ("TRACE Rules"). The NASD submitted Amendment No. 1 to the proposed rule change on May 13, 2002.<sup>3</sup>

<sup>12</sup> 15 U.S.C. 78s(b)(2).

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

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

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

<sup>3</sup> In Amendment No. 1, the NASD revised the language of the proposed rule change regarding the time frame in which the managing underwriter must deliver CUSIP information to the TRACE Operations Center, and a member's obligations in instances in which the member is not required to report yield data to the NASD. See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 13, 2002 ("Amendment No. 1").

<sup>3</sup> See Letter from Thomas P. Moran, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 4, 2002 ("Amendment No. 1").

<sup>4</sup> See Securities Exchange Act Release No. 45671 (March 28, 2002), 67 FR 16784.

<sup>5</sup> See Letter from Thomas P. Moran, Associate General Counsel, Nasdaq, to Marc F. McKayle, Special Counsel, Division, Commission, dated June 13, 2002 ("Amendment No. 2"). In Amendment No. 2, Nasdaq made two points of clarification: (1) References to automatic adjustment of quotes at "inferior" prices refer to both bid and offer prices, with an inferior price adjustment on the bid side of the quote resulting in a lower bid price, and an inferior price adjustment on the offer price resulting in a higher offer price, (2) references to a "clearing relationship" refer to a clearing relationship between a firm and a registered clearing agency or, alternatively, with a member of such an agency.

<sup>6</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78o-3.

<sup>8</sup> 15 U.S.C. 78o-3 (b)(6).

<sup>9</sup> 15 U.S.C. 78s(b)(2).

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

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