

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47077; File No. SR-NASD-2002-115]

Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding an Amendment to Nasdaq's Transaction Credit Program for Exchange-Listed Securities to Allocate Credits to Liquidity Providers

December 20, 2002.

On August 19, 2002, the National Association of Securities Dealers, Inc. ("NASD"), 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")¹ and Rule 19b-4 thereunder,² a proposed rule change to modify Nasdaq's transaction credit program for exchange-listed securities³ to allocate credits to liquidity providers. The proposed rule change was published for notice and comment in the **Federal Register** on November 19, 2002.⁴

The Commission received one comment on the proposed rule change.⁵ This order approves the proposed rule change.

As set forth in its July 2, 2002 Order of Summary Abrogation ("Abrogation Order"),⁶ the Commission will continue to examine the issues surrounding market data fees, the distribution of market data rebates, and the impact of

market data revenue sharing programs on both the accuracy of market data and on the regulatory functions of self-regulatory organizations. In the interim, the Commission believes it is reasonable to allow Nasdaq to amend its transaction credit program for exchange-listed securities to allocate credits to liquidity providers. To the extent that the Abrogation Order was prompted by evidence that entities were engaging in conduct with no economic benefit other than to capture market data fees, Nasdaq's proposal to allocate credits to liquidity providers may remove some of the incentives for engaging in such behavior.

The Commission has reviewed carefully the proposed rule change and the comment letter, and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association⁷ and, in particular, the requirements of Section 15A of the Act.⁸ Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(5) of the Act⁹ which requires the rules of a national securities association to provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which the NASD operates or controls.

The decision to allow Nasdaq to make these adjustments to its transaction credit program for exchange-listed securities, however, is narrowly drawn, and should not be construed as resolving the issues raised in the Abrogation Order, and does not suggest what, if any, future actions the Commission may take with regard to market data revenue sharing programs.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-NASD-2002-115) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,

Deputy Secretary.

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⁷ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78o-3.

⁹ 15 U.S.C. 78o-3(b)(5).

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47080; File No. SR-NASD-2002-134]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Exemptions From Options Position and Exercise Limits

December 23, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 1, 2002, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by 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

NASD is proposing to amend Rule 2860(b)(3)(A) of the Conduct Rules of NASD, relating to options position and exercise limits for positions entered into under certain enumerated hedge strategies.

Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

2860. Options

- (a) No Change
- (b) Requirements
- (1) and (2) (No Change)
- (3) Position Limits³

(A) Stock Options—Except in highly unusual circumstances, and with the prior written approval of [the Association] *NASD* pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, non-member broker, or non-

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Commission notes that it made typographical changes to the rule text submitted in the proposed rule change. NASD has committed to submitting an amendment reflecting those changes. Telephone conversation between Gary Goldsholle, Office of General Counsel, NASD and Tim Fox, Law Clerk, Division of Market Regulation ("Division"), Commission on December 20, 2002.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Nasdaq's transaction credit program for exchange-listed securities was a pilot at the time Nasdaq filed the instant proposed rule change. The program is now permanent. See Securities Exchange Act Release No. 46938 (December 3, 2002), 67 FR 72993 (December 10, 2002) (SR-NASD-2002-149) (approving proposal to make permanent Nasdaq's transaction credit pilot program for exchange-listed securities, and to increase the percentage of revenue available for distribution from 40% to 50%).

⁴ See Securities Exchange Act Release No. 46806 (November 8, 2002), 67 FR 69780.

⁵ See December 10, 2002 letter from Darla C. Stuckey, Corporate Secretary, New York Stock Exchange, Inc. ("NYSE") to Jonathan G. Katz, Secretary, Commission ("NYSE Letter"). The NYSE Letter does not specifically address the instant proposed rule change, but instead expresses the NYSE's general opposition to market data revenue sharing programs. Therefore, the Commission has not included a detailed summary of comments in this order. The NYSE Letter is available at the Commission. The Commission did not ask Nasdaq to respond to the NYSE Letter.

⁶ Securities Exchange Act Release No. 46159 (July 2, 2002), 67 FR 45775 (July 10, 2002) (File Nos. SR-NASD-2002-61, SR-NASD-2002-68, SR-CSE-2002-06, and SR-PCX-2002-37) (Order of Summary Abrogation).

member dealer, an opening transaction through Nasdaq, the over-the-counter market or on any exchange in a stock option contract of any class of stock options if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, non-member broker, or non-member dealer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate equity options position in excess of:

(i) 13,500 option contracts of the put class and the call class on the same side of the market covering the same underlying security, combining for purposes of this position limit long positions in put options with short positions in call options, and short positions in put options with long positions in call options; or

(ii) 22,500 option[s] contracts of the put class and the call class on the same side of the market covering the same underlying security, providing that the 22,500 contract position limit shall only be available for option contracts on securities [which] *that* underlie Nasdaq or exchange-traded options qualifying under applicable rules for a position limit of 22,500 option contracts; or

(iii) 31,500 option contracts of the put class and the call class on the same side of the market covering the same underlying security providing that the 31,500 contract position limit shall only be available for option contracts on securities [which] *that* underlie Nasdaq or exchange-traded options qualifying under applicable rules for a position limit of 31,500 option contracts; or

(iv) 60,000 option[s] contracts of the put and the call class on the same side of the market covering the same underlying security, providing that the 60,000 contract position limit shall only be available for option contracts on securities [which] *that* underlie Nasdaq or exchange-traded options qualifying under applicable rules for a position limit of 60,000 option contracts; or

(v) 75,000 option[s] contracts of the put and the call class on the same side of the market covering the same underlying security, providing that the 75,000 contract position limit shall only be available for option contracts on securities [which] *that* underlie Nasdaq or exchange-traded options qualifying under applicable rules for a position limit of 75,000 option contracts; or

(vi) such other number of stock option[s] contracts as may be fixed from time to time by [the Association] NASD as the position limit for one or more classes or series of options provided that reasonable notice shall be given of each

new position limit fixed by [the Association] NASD.

(vii) Equity Option Hedge Exemptions
a. *The following qualified hedge strategies and positions described in subparagraphs 1. through 5. below shall be exempt from the established position limits under this rule for standardized options. Hedge strategies and positions described in subparagraphs 6. and 7. below in which one of the option components consists of a conventional option, shall be subject to a position limit of five times the established position limits contained in subparagraphs (i) through (vi) above. Hedge strategies and positions in conventional options as described in subparagraphs 1. through 5. below shall be subject to a position limit of five times the established limits contained in subparagraphs (i) through (vi) above. Options positions limits established under this subparagraph shall be separate from limits established in other provisions of this rule.*

1. *Where each option contract is "hedged" or "covered" by 100 shares of the underlying security or securities convertible into the underlying security, or, in the case of an adjusted option, the same number of shares represented by the adjusted contract: (a) Long call and short stock; (b) short call and long stock; (c) long put and long stock; or (d) short put and short stock.*

2. *Reverse Conversions—A long call position accompanied by a short put position, where the long call expires with the short put, and the strike price of the long call and short put is equal, and where each long call and short put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.*

3. *Conversions—A short call position accompanied by a long put position where the short call expires with the long put, and the strike price of the short call and long put is equal, and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.*

4. *Collars—A short call position accompanied by a long put position, where the short call expires with the long put, and the strike price of the short call equals or exceeds the strike price of the long put position and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying*

security. Neither side of the short call/long put position can be in-the-money at the time the position is established.

5. *Box Spreads—A long call position accompanied by a short put position with the same strike price and a short call position accompanied by a long put position with a different strike price.*

6. *Back-to-Back Options—A listed option position hedged on a one-for-one basis with an over-the-counter (OTC) option position on the same underlying security. The strike price of the listed option position and corresponding OTC option position must be within one strike price interval of each other and no more than one expiration month apart.*

7. *For reverse conversion, conversion and collar strategies set forth above in subparagraphs 2., 3. and 4., one of the option components can be an OTC option guaranteed or endorsed by the firm maintaining the proprietary position or carrying the customer account.*

[a. The following positions, where each option contract is "hedged" by 100 shares of stock or securities readily convertible into or economically equivalent to such stock, or, in the case of an adjusted option contract, the same number of shares represented by the adjusted contract, shall be exempted from established limits contained in paragraphs (i) through (vi) above:]

- [1. long call and short stock;]
- [2. short call and long stock;]
- [3. long put and long stock;]
- [4. short put and short stock.]

[b. Except as provided under OTC Collar Exemption contained in subparagraph (b)(3)(A)(viii), in no event may the maximum allowable position, inclusive of options contracts hedged pursuant to the equity option position limit hedge exemption in subparagraph a. above, exceed three times the applicable position limit established in subparagraph (b)(3)(A)(i) through (v) with respect to standardized equity options, or paragraph (b)(3)(A)(ix) with respect to conventional equity options.]

[(viii) OTC Collar Aggregation Exemption]

[a. For purposes of this paragraph (b), the term OTC collar shall mean a conventional equity option position comprised of short (long) calls and long (short) puts overlying the same security that hedge a corresponding long (short) position in that security.]

[b. Notwithstanding the aggregation provisions for short (long) call positions and long (short) put positions contained in subparagraphs (b)(3)(A)(i) through (v) above, the conventional options positions involved in a particular OTC collar transaction need not be

aggregated for position limit purposes, provided the following conditions are satisfied:]

[1. the conventional options can only be exercised if they are in-the-money;]

[2. neither conventional option can be sold, assigned, or transferred by the holder without the prior written consent of the writer;]

[3. the conventional options must be European-style (*i.e.*, only exercisable upon expiration) and expire on the same date;]

[4. the strike price of the short call can never be less than the strike price of the long put; and]

[5. neither side of any particular OTC collar transaction can be in-the-money when that particular OTC collar is established.]

[6. the size of the conventional options in excess of the applicable basic position limit for the options established pursuant to subparagraph (b)(3)(A)(ix) must be hedged on a one-to-one basis with the requisite long or short stock position for the duration of the collar, although the same long or short stock position can be used to hedge both legs of the collar.]

[c. For multiple OTC collars on the same security meeting the conditions set forth in subparagraph b. above, all of the short (long) call options that are part of such collars must be aggregated and all of the long (short) put options that are part of such collars must be aggregated, but the short (long) calls need not be aggregated with the long (short) puts.]

[d. Except as provided above in subparagraphs b. and c., in no event may a member fail to aggregate any conventional options contract of the put class and the call class overlying the same equity security on the same side of the market with conventional option positions established in connection with an OTC collar.]

[e. Nothing in this subparagraph (b)(3)(A)(viii) changes the applicable position limit for a particular equity security.]

[(ix)](viii) Conventional Equity Options

a. For purposes of [sub]paragraph (b), standardized equity option[s] contracts of the put class and call class on the same side of the market overlying the same security shall not be aggregated with conventional equity option[s] contracts or FLEX Equity Option[s] contracts overlying the same security on the same side of the market.

Conventional equity option[s] contracts of the put class and call class on the same side of the market overlying the same security shall be subject to a position limit equal to the greater of:

1. the basic limit of 13,500 contracts, or

2. any standardized equity options position limit as set forth in [sub]paragraphs (b)(3)(A)(ii) through (v) for which the underlying security qualifies or would be able to qualify.

a. In order for a security not subject to standardized equity options trading to qualify for an options position limit of more than 13,500 contracts, a member must first demonstrate to NASD's [the Association's] Market Regulation Department that the underlying security meets the standards for such higher options position limit and the initial listing standards for standardized options trading.

(B) No Change

(4) through (24) No Change

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

In its filing with the Commission, NASD included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD 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 proposed rule change amends NASD's options position and exercise limits. Earlier this year, the Commission approved changes to the rules of the options exchanges that eliminated standardized equity option⁴ position and exercise limits for certain qualified hedge strategies and established position and exercise limits of *five* times the standard limit for certain of those strategies when they include an over-the-counter (OTC) option contract.⁵

⁴ A standardized equity option contract is any equity options contract issued, or subject to issuance by, the Options Clearing Corporation that is not a FLEX Equity Option. NASD Rule 2860(b)(2)(vv).

⁵ See Securities Exchange Act Release No. 45603 (March 20, 2002), 67 FR 14751 (March 27, 2002) (CBOE-2000-12); Securities Exchange Act Release No. 45650 (March 26, 2002), 67 FR 15638 (Apr. 2, 2002) (AMEX-2001-71); Securities Exchange Act Release No. 45737 (April 11, 2002), 67 FR 18975 (Apr. 17, 2002) (PCX-2000-45); Securities Exchange Act Release No. 45899 (May 9, 2002), 67 FR 34980 (May 16, 2002) (PHLX-2002-33); and Securities Exchange Act Release No. 46228 (July 18, 2002), 67 FR 48689 (July 25, 2002) (ISE-2002-15).

NASD is proposing changes to substantially conform its rules to those of the options exchanges.

The proposed rule change establishes six qualified hedge strategies:

1. Where each option contract is "hedged" or "covered" by 100 shares of the underlying⁶ security or securities convertible into the underlying security, or, in the case of an adjusted option, the same number of shares represented by the adjusted contract: (a) long call and short stock; (b) short call and long stock; (c) long put and long stock; or (d) short put and short stock.

2. Reverse Conversions—A long call position accompanied by a short put position, where the long call expires with the short put, and the strike price of the long call and short put is equal, and where each long call and short put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.

3. Conversions—A short call position accompanied by a long put position where the short call expires with the long put, and the strike price of the short call and long put is equal, and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.

4. Collars—A short call position accompanied by a long put position, where the short call expires with the long put and the strike price of the short call equals or exceeds the strike price of the long put position and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of such the underlying security or securities convertible into such underlying security. Neither side of the short call/long put position can be in-the-money at the time the position is established.

5. Box Spreads—A long call position accompanied by a short put position with the same strike price and a short call position accompanied by a long put position with a different strike price.

6. Back-to-Back Options—A listed option position hedged on a one-for-one basis with an OTC option position on the same underlying security. The strike price of the listed option position and corresponding OTC option position must be within one strike price interval

⁶ NASD represents that the phrase "securities convertible into the underlying security" does not include single stock futures products. Telephone Conversation between Gary Goldsholle, Office of General Counsel, NASD and Tim Fox, Law Clerk, Division, Commission on December 6, 2002.

of each other and no more than one expiration month apart.

Under the proposed rule change, there would be no position and exercise limits when such qualified hedge strategies are effected solely with standardized equity options. In addition, the proposed rule change establishes standardized equity option position and exercise limits of five times the standard limit when one component of such strategies is an OTC option contract.

Further, within the list of proposed hedge strategies, NASD proposes that the option component of a reversal, a conversion or a collar position can be treated as one contract rather than as two contracts. NASD believes that all three strategies serve to hedge a related stock portfolio. Because these strategies require the contemporaneous purchase/sale of both a call and put component, against the appropriate number of shares underlying the option (generally 100 shares), NASD believes, like the options exchanges, that the position should be treated as one contract for hedging purposes.

NASD currently establishes position and exercise limits on conventional⁷ equity options.⁸ The NASD's position limits for conventional equity options are identical to those for standardized options.⁹ Moreover, like position and exercise limits for standardized equity options, NASD recognizes certain hedge strategies under which persons can establish greater options positions. NASD currently has an equity option hedge exemption¹⁰ and an OTC collar aggregation exemption.¹¹ Under the current equity option hedge exemption, a person can establish a conventional equity options position of three times the standard position limit. Under the OTC collar aggregation exemption, a person can establish a conventional equity options position of *three* times the standard position limit for each side of the OTC collar.

The proposed rule change modifies the conventional equity options position and exercise limits in several respects. First, the proposed rule change expands the hedge exemption for conventional

options to include all of the qualified hedge strategies. NASD believes that covered stock positions, conversions, reverse conversions, collars,¹² and box spreads may all be effected with conventional options. Moreover, NASD believes that having one set of hedge strategies applicable to standardized and conventional options will simplify members' compliance burdens.

Second, the proposed rule change increases the conventional equity options position and exercise limits for such qualified hedge strategies to five times the standard limits. NASD believes that this change makes NASD's conventional equity options position limits consistent with the limits for OTC options under the options exchange's hedge exemptions. NASD's increased conventional options position limits also will apply when not part of a standardized option hedge. According to NASD, this change avoids having different conventional equity options position and exercise limits apply depending on whether a position is hedged by a standardized or conventional option.

Third, the proposed rule change provides that conventional equity options positions under the hedge strategies not be aggregated with other options positions similar to the way that positions under the current equity option hedge exemption and OTC collar aggregation exemption are not aggregated with other options positions.

NASD believes that rationales articulated by the Commission in its prior approval of similar rule changes by the options exchanges apply equally to the proposed rule change.¹³ It is NASD's view that position and exercise limits serve as a regulatory tool designed to address potential manipulative schemes and adverse market impact surrounding the use of options. According to NASD, the Commission has taken a gradual, evolutionary approach toward expansion of position and exercise limits. NASD believes that the Commission has been careful to balance two competing concerns when considering the appropriate level at which to set position and exercise limits. According to NASD, the Commission has recognized that the limits must be sufficient to prevent investors from disrupting the market in the underlying securities. At the same time, it is NASD's view that the

Commission has determined that limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs. NASD believes that the proposed rule change is consistent with these Commission policies.

Under the proposed rule change, the standard position and exercise limits will remain in place for unhedged equity options positions. Once an account reaches the standard limit, positions identified as a qualified hedge strategy would be subject to the increased position limits, or exempted from position limit calculations, as appropriate. The exemption would be automatic (*i.e.*, it will not require pre-approval from NASD) to the extent that a member identifies that a pre-existing qualified strategy is in place or is employed from the point that an account's position reaches the standard limit and provides the required supporting documentation to NASD.¹⁴ The exemption would remain in effect to the extent that the exempted position remains intact and NASD is provided with any required supporting documentation.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,¹⁵ in general and with Section 15A(b)(6) of the Act,¹⁶ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD also believes that the proposed rule change is necessary to keep NASD's rules consistent with similar rules of Options Exchanges approved by the Commission.

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

NASD 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.

⁷ A "conventional option" is any option contract not issued, or subject to issuance, by the Options Clearing Corporation. NASD Rule 2860(b)(2)(N).

⁸ NASD notes that the terms "conventional" and "OTC" options have identical meanings for the purposes of this proposed rule change. Telephone conference among Gary Goldsholle, Office of General Counsel, NASD, Susie Cho, Special Counsel, Division, Commission, and Tim Fox, Law Clerk, Division, Commission on November 14, 2002.

⁹ NASD Rule 2860(b)(3)(A)(ix).

¹⁰ NASD Rule 2860(b)(3)(A)(vii).

¹¹ NASD Rule 2860(b)(3)(A)(viii).

¹² NASD Rule 2860(b)(3)(viii) currently provides for a collar exemption. For purposes of clarity and consistency, NASD proposes adopting the collar exemption developed by the Options Exchanges in place of its existing collar exemption.

¹³ See *supra* note 4.

¹⁴ Under the proposed rule change, the existing reporting procedures that serve to identify and document hedged positions above a certain threshold continue to apply. Paragraph (b)(5) of NASD Rule 2860 requires reporting to NASD of aggregate positions of 200 more contracts of the put class and the call class on the same side of the market covering the same underlying security.

¹⁵ 15 U.S.C. 78o-3.

¹⁶ 15 U.S.C. 78o-3(b)(6).

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

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 NASD 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 filings will also be available for inspection and copying at the principal office of the NASD.

All submissions should refer to File No. SR-NASD-2002-134 and should be submitted by January 21, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47076; File No. SR-NYSE-2002-65]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc. Regarding the Extension of the Pilot Programs for Mediation and Administrative Conferences

December 20, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 19, 2002, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") 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 the NYSE. 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 Exchange proposes to extend its pilot programs for mediation and administrative conferences (NYSE Rules 638 and 639) that expire on December 31, 2002. The Exchange has separately requested that the rules for Mediation and Administrative Conferences, as amended, ("the amended pilots") be adopted by way of its filing SR-NYSE-2002-59. An extension of the present pilots is needed pending the Commission's action on the amended rules.

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 NYSE included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The NYSE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

On November 19, 1998, the Commission approved a two-year pilot program for mediation and administrative conferences in the Exchange's arbitration facility.³ On December 20, 2000, the Commission approved amendments to the two pilot rules and granted a 2-year extension.⁴ The pilot mediation program is intended to allow parties to settle cases earlier with lower costs. The administrative conference allows arbitrators to intervene early in the case to set deadlines and resolve preliminary procedural issues. On November 4, 2002, the Exchange filed a proposal with the Commission to adopt as amended the rules for mediation and administrative conferences.⁵ The Exchange proposes to extend through January 31, 2003, its pilot program for mediation and administrative conferences (Rules 638 and 639) currently scheduled to expire on December 31, 2002. The Exchange has separately proposed in SR-NYSE-2002-59 to amend and revise Rules 638 (Mediation) and 639 (Administrative Conferences). An extension of the present pilot is needed pending the Commission's actions on its request.

While the Exchange believes it is appropriate to replace the pilot programs with the Rules proposed in SR-NYSE-2002-59, to maintain continuity pending the Commission's action an extension of the pilots to January 31, 2003 is warranted. By this filing, the Exchange is not seeking to modify the present pilot programs.

2. Statutory Basis

The Exchange believes that proposed changes are consistent with Section 6(b)(5) of the Act in that they promote just and equitable principles of trade by insuring that members and member organizations and the public have a fair and impartial forum for the resolution of their disputes.

³ See Securities Exchange Act Release No. 34-40695 (November 19, 1998); 63 FR 65834 (November 30, 2000), (SR-NYSE-98-27).

⁴ See Securities Exchange Act Release No. 34-43785 (December 29, 2000); 66 FR 1710 (January 9, 2001), (SR-NYSE-00-39).

⁵ See Securities Exchange Act Release No. 34-47025 (December 18, 2002) (File No. SR-NYSE-2002-59).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

¹⁷ 17 CFR 200.30-3(a)(12).