

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 NYSE. All submissions should refer to File No. SR-NYSE-2001-08 and should be submitted by August 24, 2001.

## V. Conclusion

for the foregoing reasons, the Commission finds that the NYSE's proposal to amend its rules and policies to accommodate the trading of certain ETFs on a UTP basis, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-NYSE-2001-08), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>25</sup>

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44608; File No. SR-OCC-2001-02]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to Deposits of Nasdaq SmallCap Securities as Margin Collateral Pursuant to Rule 604(d)

July 27, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> notice is hereby given that on April 11, 2001, The Options Clearing Corporation ("OCC") 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 primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The proposed rule change would amend OCC Rule 604(d) to allow Nasdaq SmallCap Market Securities to be deposited as margin collateral. The rule change also makes certain other technical changes to the rule.<sup>2</sup>

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

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>3</sup>

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

The primary purpose of this rule change is to allow securities traded in the Nasdaq SmallCap market to be deposited as collateral pursuant to Rule 604(d). The rule change also makes certain other technical changes to the rule.

#### Nasdaq SmallCap Securities

In 1984, OCC received Commission approval to amend Rule 604(d) to allow the deposit of securities traded in the Nasdaq National Market System ("NMS") as a form of margin collateral.<sup>4</sup> Nasdaq formed the NMS market in 1982 to distinguish NMS securities as those securities that met its highest listing standards and that were subject to real-time sale price and volume reporting. Securities that did not meet NMS standards were termed "regular Nasdaq securities." While the eligibility criteria found in Rule 604(d) have remained relatively unchanged since 1984, the structure of the Nasdaq market has evolved substantially since then.

The Nasdaq market structure has had many notable changes. For example, in

1992, all Nasdaq securities became subject to real-time last sale price and volume reporting requirements, increasing the transparency for all Nasdaq issues (*i.e.*, NMS and regular Nasdaq securities).<sup>5</sup> Then, in 1994, the Nasdaq Stock Market was created with two distinct tiers: The Nasdaq National Market® ("NNM," formerly the NMS market) and the SmallCap market (formally the regular Nasdaq securities).<sup>6</sup> Later, in 1997, the qualification standards of both the NNM and the SmallCap market tiers were substantially upgraded.<sup>7</sup>

The upgraded qualification standards applicable to Nasdaq SmallCap issuers set forth minimum and ongoing financial criteria (*e.g.*, assets, capitalization, and income), share float and price criteria, corporate governance (*e.g.*, independent directors, audit committee formation and activities, auditor peer review, and voting rights), and public disclosure (*e.g.*, timely filing and distribution of annual and interim financial reports and annual meeting of shareholders).<sup>8</sup> These qualification criteria exceed the standards that governed the Nasdaq NMS securities at the time those securities were approved for margin purposes in 1984. The Nasdaq SmallCap qualification standards approximate American Stock Exchange ("Amex") listing criteria applicable to equity securities.<sup>9</sup> Such Amex listed equity securities are accepted by OCC for margin purposes. OCC therefore believes that the qualification standards that are applicable to SmallCap issues provide sufficient safeguards to address concerns about the quality of securities trade in that market tier.

The ten dollar minimum price per share requirement and concentration limit (*i.e.*, the securities of any one issuer cannot exceed 10% of the margin requirement for any one clearing member account) of Rule 604(d) also provide additional safeguards to

<sup>5</sup> Securities Exchange Act Release No. 30569 (April 16, 1992), 57 FR 13396 [File No. SR-NASD-91-50] (order approving a rule change requiring real-time trade reporting of transactions in Nasdaq securities, except convertible debt, and allowing the NASD to publicly disseminate the information).

<sup>6</sup> Securities Exchange Act Release No. 34928 (November 9, 1994), 59 FR 55906 [File No. SR-NASD-94-48] (order clarifying the two tiers of the Nasdaq Stock Market as the Nasdaq SmallCap Market and the Nasdaq National Market).

<sup>7</sup> Securities Exchange Act Release No. 38961 (August 29, 1997), 62 FR 45895 [File No. SR-NASD-97-16] (order revising the listing and maintenance standards to increase the quality of companies listed on Nasdaq and raising the level of investor protection).

<sup>8</sup> NASD Rules 4310 and 4350.

<sup>9</sup> American Stock Exchange Company Guide, Sections 101, 102, and 120-132.

<sup>24</sup> 15 U.S.C. 78s(b)(2).

<sup>25</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> A copy of OCC's proposed rule change is available at the Commission's Public Reference Section or through OCC.

<sup>3</sup> The Commission has modified the text of the summaries prepared by OCC.

<sup>4</sup> Securities Exchange Act Release No. 20558 (January 18, 1984), 49 FR 2183 [File No. SR-OCC-83-17] (order approving an OCC rule change allowing clearing members to deposit certain common stocks not underlying options to satisfy their margin obligations).

minimize issuer quality concerns. OCC has analyzed the market and liquidity risks associated with accepting SmallCap securities for margin purposes by utilizing daily returns and volume statistics for the last four years. Average

daily returns and standard deviation of average daily returns for the entire population of SmallCap securities as well as a subset of the population having a price of greater than ten dollars per share were computed. For

comparison, a similar computation was performed for NNM securities. A summary of this analysis is outlined below:

| Class                  | Average range minimum (in percent) | Average range maximum (in percent) | Average move* (in percent) | Average standard deviation (in percent) |
|------------------------|------------------------------------|------------------------------------|----------------------------|---|
| NNM (All) .....        | -24.5                              | +86.2                              | 3.6                        | 7.5                                     |
| NNM (>\$10) .....      | -21.3                              | +29.9                              | 3.2                        | 4.8                                     |
| SmallCap (>All) .....  | -33.9                              | +128.2                             | 5.0                        | 10.7                                    |
| SmallCap (>\$10) ..... | -21.1                              | +51.4                              | 2.6                        | 5.3                                     |

\*Computed on the basis of the absolute value daily returns.

Based on this analysis, OCC has concluded that the average SmallCap security presents market risks similar to that of NNM securities, especially for those securities that trade at a price greater than ten dollars per share.<sup>10</sup> This analysis also confirms that the current 70% valuation rate provides a sufficient cushion to protect against adverse market moves in SmallCap securities.

Finally, OCC performed a volume analysis to assess the liquidity of SmallCap securities over the same four-year period which confirmed that SmallCap securities are not as liquid as NNM securities.<sup>11</sup> However, the analysis also showed that a material portion of this average share volume is concentrated in a relatively small number of NNM issuers. For example, 20% of the NNM average share volume is attributable to the shares of five issuers. However, there are over 2,150 additional NNM securities that may be deposited for margin purposes. In light of the concentration within the NNM, OCC believes that there is sufficient liquidity in SmallCap issues over ten dollars to support their acceptance for margin purposes.

#### Conforming Changes

Certain changes are also being proposed for Rule 604(d) to conform its terms to similar changes elsewhere in OCC's By-Laws and Rules that were previously approved by the Commission. Rule 604(d) currently provides that no security that has been suspended from trading or is subject to special margin requirements by its "primary market" may be deposited as margin. The rule also defines the current market value of a stock or bond

to be its closing price on the "primary market" for such stock or bond.

OCC is proposing to delete the term "primary market" from certain OCC rules.<sup>12</sup> Removing the term "primary market" was prompted by recognition that the equity markets were becoming increasingly fragmented. OCC desired the discretion to designate the market whose closing price would serve as the benchmark in order to avoid disputes over which market is a stock's primary market. OCC believes that it is appropriate to make this same change for Rule 604(d) purposes. For purposes of determining whether a security has been suspended from trading or subject to special margin requirements, OCC would use its discretion as to which of the markets that listed or otherwise qualified the security for trading would be followed.

Another conforming change concerns the time when a "closing price" is determined. To address any questions that may arise with the growth of after-hours trading, OCC is proposing to amend Rule 604(d) to provide that the closing price will be determined at the close of "regular trading hours (as defined by the Corporation) \* \* \*." This change allows OCC to avoid potential disputes by (i) eliminating any basis for arguing that the closing price should be determined based on after-hours trading and (ii) giving OCC the discretion to determine when "regular trading hours" end.

Finally, OCC is proposing to eliminate those provisions of Rule 604(d) that require stocks that are deposited as margin to be subject to last sales reporting. It is OCC's understanding that all exchange traded Nasdaq Stock

Market securities are now subject to last sales reporting, making the requirement unnecessary.

The proposed rule change is consistent with Section 17A of the Act because it enables clearing members to use additional securities as margin collateral without adversely affecting the safekeeping of securities that are in OCC's possession, custody, or control.

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

OCC does not believe that the proposed rule change would 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 were not and are not intended to be solicited with respect to the proposed rule change, and none have been received.

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

Within thirty-five 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 ninety 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.

<sup>10</sup> Approximately 12% of SmallCap securities trade at over ten dollars per share.

<sup>11</sup> Average daily share volume of NNM securities trading over ten dollars per share was 594,632 while the average daily share volume of SmallCap securities trading above ten dollars was 15,005 shares.

<sup>12</sup> Securities Exchange Act Release Nos. 43782 (January 9, 2001), 66 FR 1712 [File No. SR-OCC-00-04] (notice of proposed rule change revising OCC's price determination rules); and 41089 (March 1, 1999), 64 FR 10051 [File No. SR-OCC-98-14] (order approving the revision of OCC Rule 805 with respect to closing prices in expiration processing).

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 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 Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing also will be available for inspection and copying at the principal office of OCC. All submissions should refer to File No. SR-OCC-2001-02 and should be submitted by August 24, 2001.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44610; File No. SR-OCC-2001-07]

### Self-Regulatory Organizations; Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Clearing Security Futures

July 27, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on June 29, 2001, The Options Clearing Corporation ("OCC") 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 primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

OCC is proposing rule changes to permit OCC to clear and settle security futures.

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

In its filing with the Commission, OCC included states 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>2</sup>

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

###### 1. Introduction

In SR-OCC-2001-05, OCC filed with the Commission proposed amendments to its By-Laws specifying the types of markets for which OCC would clear security futures and describing the general terms on which it would clear for those markets. That rule change was approved by order of the Commission dated June 15, 2001.<sup>3</sup> The purpose of this rule filing is to submit a full set of rule changes that will permit OCC to clear and settle transactions in security futures.

These rules are intended to be as generic as possible to cover any security futures product that may be developed by the markets clearing through OCC. Nevertheless, it may be necessary in the future to amend or supplement these rules to accommodate specific products that are developed by the markets.

###### 2. Overview of Security Futures Rules

Amendments to the By-Laws and Rules are in the same general format that has previously been used for new products. The proposed rules would provide for clearance and settlement of nearly the full range of security futures products that can be traded under the Commodity Futures Modernization Act. These include physically-settled futures on individual stocks as well as cash-settled futures on individual stocks and narrow-based stock indices. A further rule change would be required in order for OCC to clear options on security futures.

The security futures provided for in this rule filing will have the same basic terms as futures contracts trading in the traditional futures markets under the jurisdiction of the Commodity Futures

Trading Commission ("CFTC"). A futures contract is entered into at a contract price" agreed upon between the buyer and seller in the futures market. The contract price represents the notional price or value at which the underlying stock or index will be purchased and sold at "maturity" of the contract if the contract has not been offset through an earlier closing transaction. The contracts will be marked to the daily closing price of the futures contract through "variation payments" that are passed through OCC from the buyer to the seller or vice versa depending upon the direction of the market movement. Intraday variation settlements are also provided for although it is OCC's present intention to effect intraday variation settlements only on an exception basis when market conditions or other factors make such settlements necessary or desirable. A deposit of "original" or "risk" margin will be required from both purchasers and sellers to cover the maximum anticipated variation payment that would likely be required (within usual confidence intervals) based on the clearing member's positions. This calculation will be made based upon all of the positions in the particular account of the clearing member using OCC's TIMS system for portfolio margining.

A maturity of the contract, a "final variation payment" will be determined based on a "final settlement price." The final settlement price will be the price or level of the underlying security at a specified point or interval in time, which could be either the closing price or a volume-weighted average price on the last day of trading of the futures contract or an opening price on the following day. In the case of cash-settled futures, all rights and obligations under the contract would be satisfied by the final variation payment. In the case of physically-settled security futures, delivery of and payment for the underlying stock would be effected pursuant to the same basic rules currently applicable to settlement of stock option exercises. The price to be paid by the purchaser is referred to as the "aggregate purchase price" and is equal to the final settlement price times the number of shares to be delivered. Effectively, delivery occurs at the current market price of the stock, but the net of the variation payments paid and received over the period that the futures contract was held puts the buyer and seller in the economic position of having purchased and sold the security at the original contract price.

Because a security future is both a "security" as defined in the Act and a

<sup>2</sup> The Commission has modified parts of these statements.

<sup>3</sup> Securities Exchange Act Release No. 44434 (June 15, 2001), 66 FR 33283.

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