

Proposed Rule Change by National Association of Securities Dealers
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input checked="" type="checkbox"/>	Amendment <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input checked="" type="checkbox"/>	Section 19(b)(3)(A) <input type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
Pilot <input type="checkbox"/>			Rule		
Extension of Time Period for Commission Action <input type="checkbox"/>			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
Date Expires <input type="text"/>			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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Description
Provide a brief description of the proposed rule change (limit 250 characters).

Rule change to expand the class of entities permitted to use the delta hedging exemption from equity options position limits

Contact Information
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
 Title
 E-mail
 Telephone Fax

Signature
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date
 By Vice President and Associate General Counsel
 (Name) (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD Rule 2860 to expand the class of entities permitted to use the delta hedging exemption from equity options position limits. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

2860. Options

(a) No Change.

(b) Requirements

(1) No Change.

(2) Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

(A) through (R) No Change.

¹ 15 U.S.C. 78s(b)(1).

(S) Delta Neutral — The term “delta neutral” describes an equity [stock] options position that has been fully hedged, in accordance with [an SEC-approved pricing model,] a Permitted Pricing Model as defined in paragraph (b)(3)(A)(vii)b. with a portfolio of instruments including or relating to the same underlying security[stock] to offset the risk that the value of the equity options position will change with incremental changes in the price of the [stock] security underlying the options position.

(T) through (FF) No Change.

(GG) Net Delta – the term “net delta” means the number of shares that must be maintained (either long or short) to offset the risk that the value of an equity [stock] options position will change with incremental changes in the price of the security underlying the options position.

(HH) through (KK) No Change.

(LL) Options Contract Equivalent of the Net Delta – the term “options contract equivalent of the net delta” means the net delta divided by the number of shares underlying the options contract.

(LL) through (CCC) renumbered as (MM) through (DDD).

(3) Position Limits

(A) Stock Options—Except in highly unusual circumstances, and with the prior written approval of 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-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) through (vi) No Change.

(vii) Equity Options Hedge Exemptions

a. No Change.

[b. Delta Hedging Exemption for OTC Derivatives

Dealers]

[A stock options position of an OTC Derivatives Dealer (as that term is defined in Rule 3b-12 under the Act) affiliated with a member, in standardized or conventional options that is delta neutral, shall be exempt from position limits under this rule if the following conditions are satisfied:]

[1. The member has obtained a written representation from its affiliated OTC Derivatives Dealer that such entity is hedging its stock options positions in

accordance with its internal risk management control systems and pricing models approved by the SEC pursuant to Rules 15c3-1(a)(5) and 15c3-1f under the Act, and that if it ceases to hedge stock options positions in accordance with such systems and models, that it will provide immediate written notice to the member.]

[2. The member must report in accordance with paragraph (b)(5), all stock options positions (including those that are delta neutral) of 200 or more contracts (whether long or short) on the same side of the market covering the same underlying stock that are effected by the member.]

[3. Any stock options position of an OTC Derivatives Dealer that is not delta neutral shall be subject to position limits in accordance with this section (subject, however, to the availability of other exemptions). For these purposes, only the option contract equivalent of the net delta of such positions is subject to position limits. The options contract equivalent of the net delta is the net delta divided by 100.]

b. Delta Hedging Exemption For Members and Non-

Member Affiliates

An equity options position of a member or non-member affiliate in standardized and/or conventional equity options that is delta neutral under a Permitted Pricing Model shall be exempt from position limits under this rule. Any equity options position of such member or non-member affiliate that is not delta neutral shall be subject to position limits, subject to the availability of other options position limit exemptions. The number of options contracts attributable to a position that is not delta neutral shall be the options contract equivalent of the net delta.

1. Permitted Pricing Model shall mean:

A. A pricing model maintained and operated by the Options Clearing Corporation (“OCC Model”) when used by a member, or non-member affiliate permitted to rely on subparagraphs B or C;

B. A pricing model maintained and used by a member subject to consolidated supervision by the Commission pursuant to Appendix E of Commission Rule 15c3-1, or by an affiliate that is part of such member’s consolidated supervised holding company group, in accordance with its internal risk management control system and

consistent with the requirements of Appendices E or G, as applicable, to Commission Rule 15c3-1 and Commission Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital or capital allowances for market risk thereunder, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such member's consolidated supervised holding company group:

C. A pricing model maintained and used by a financial holding company ("FHC") or a company treated as an FHC under the Bank Holding Company Act of 1956, or by an affiliate that is part of either such company's consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with:

i. the requirements of the Board of Governors of the Federal Reserve System, as amended from time to time, in connection

with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Board of Governors of the Federal Reserve System, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company's consolidated supervised holding company group; or

ii. the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company's principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where "principal regulator" means a member of the Basel Committee on Banking Supervision that is the home country consolidated

supervisor of such company – provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company’s consolidated supervised holding company group;

D. A pricing model maintained and used by an OTC derivatives dealer registered with the Commission pursuant to SEC Rule 15c3-1(a)(5) in accordance with its internal risk management control system and consistent with the requirements of Appendix F to SEC Rule 15c3-1 and SEC Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder, provided that only such OTC derivatives dealer and no other affiliated entity (including a member) may rely on this subparagraph D.; or

E. A pricing model used by a national bank under the National Bank Act maintained and used in accordance with its internal risk management

control system and consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency, provided that only such national bank and no other affiliated entity (including a member) may rely on this exemption.

2. Effect on Aggregation of Account Positions

A. Members and non-member affiliates

who rely on this exemption must ensure that the Permitted Pricing Model is applied to all positions in or relating to the security(ies) underlying the relevant options position that are owned or controlled by such member or non-member affiliate.

B. Notwithstanding subparagraph b.2.A. of this Rule, the Net Delta of an options position held by an entity entitled to rely on this exemption, or by a separate and distinct trading unit of such entity, may be calculated without regard to positions in or relating to the security(ies) underlying the options

position held by an affiliated entity or by another trading unit within the same entity, provided that:

i. the entity demonstrates to NASD's satisfaction that no control relationship, as defined in Notice to Members 07-03, exists between such affiliates or trading units;* and

ii. the entity has provided NASD written notice in advance that it intends to be considered separate and distinct from any affiliate, or – as applicable – which trading units within the entity are to be considered separate and distinct from each other for purposes of this exemption.

* Note: NASD has set forth, in Notice to Members 07-03, the conditions under which it will deem no control relationship to exist between affiliates and between separate and distinct trading units within the same entity.

C. Notwithstanding subparagraph b.2.A. or b.2.B. of this Rule, a member or non-member affiliate who relies on this exemption shall

designate, by prior written notice to NASD, each trading unit or entity whose options positions are required under NASD Rules to be aggregated with the option positions of such member or non-member affiliate that is relying on this exemption for purposes of compliance with NASD position limits or exercise limits. In any such case:

i. the Permitted Pricing Model shall be applied, for purposes of calculating such member's or affiliate's net delta, only to the positions in or relating to the security(ies) underlying any relevant option position owned and controlled by those entities and trading units who are relying on this exemption; and

ii. the net delta of the positions owned or controlled by the entities and trading units who are relying on this exemption shall be aggregated with the non-exempt option positions of all other entities and trading units whose options positions are required under NASD Rules to be

aggregated with the option positions of such member or affiliate.

3. Obligations of Members and Affiliates

A member that relies, or whose affiliate relies, upon this exemption must provide a written certification to NASD that it and/or its affiliates are using a Permitted Pricing Model pursuant to subparagraph 1. above and that if the affiliate ceases to hedge stock options positions in accordance with such Permitted Pricing Model, it will provide immediate written notice to the member.

The options positions of a non-member relying on this exemption must be carried by a member with which it is affiliated.

4. Reporting

A. Each member must report in accordance with paragraph (b)(5), all equity option positions (including those that are delta neutral) of 200 or more contracts (whether long or short) on the same side of the market covering the same underlying security that are effected by the member.

B. In addition, each member on its own behalf or on behalf of a designated aggregation unit

pursuant to subparagraph (b)(3)(A)(vii)b.2. shall report in a manner specified by NASD the options contract equivalent of the net delta of each position that represents 200 or more contracts (whether long or short) on the same side of the market covering the same underlying security that are effected by the member.

(viii) No Change.

(B) through (D) No Change.

(4) through (24) No Change.

(c) No Change.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Governors of NASD (“Board”) and authorized for filing with the SEC pursuant to a delegation of authority granted by the Board at its meeting on July 31, 2003, to the General Counsel of NASD Regulatory Policy and Oversight (or his officer designee) (“Delegation of Authority”) to file, without further specific board authorization, rule changes as may be necessary to effectuate current provisions within existing rules that allow NASD staff to grant

exemptions or to amend rules and rule proposals to provide for exemptions. The staff will advise the Board of any action taken pursuant to the Delegation of Authority. No other action by NASD is necessary for the filing of this proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be no later than 30 days following publication of the Notice to Members announcing Commission approval.

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

(a) Purpose

Background

Over the past several years, NASD has increased in absolute terms the size of the options position and exercise limits as well as the size and scope of available exemptions for "hedged" positions.² The exemptions for hedged positions generally required a one-to-one hedge, i.e., one stock option contract must be hedged by the number of shares

² See Securities Exchange Act Release No. 47307 (February 3, 2003), 68 FR 6977 (February 11, 2003) (SR-NASD-2002-134); Securities Exchange Act Release No. 40932 (January 11, 1999), 64 FR 2930 (January 19, 1999) (SR-NASD-98-92); Securities Exchange Act Release No. 40087 (June 12, 1998), 63 FR 33746 (June 19, 1998) (SR-NASD-98-23); Securities Exchange Act Release No. 39771 (March 19, 1998), 63 FR 14743 (March 26, 1998) (SR-NASD-98-15).

covered by the options contract, typically 100 shares. In practice, however, many firms do not hedge their options positions in this way. Rather, these firms engage in what is known as “delta hedging,” which varies the number of shares of stock used to hedge an options position based upon the relative sensitivity of the value of the option contract to a change in the price of the underlying stock.³ Delta hedging is widely accepted for net capital and risk management purposes.

In 2004, the SEC approved amendments to Rule 2860 that provide a delta hedging exemption from stock options position and exercise limits⁴ for positions held by affiliates of NASD members approved by the SEC as “OTC Derivatives Dealers.”⁵ At that time, the SEC reiterated its “support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.”⁶

Broadening the Scope of NASD’s Delta Hedging Exemption

³ For example, an option with a delta of .5 will move \$0.50 for every \$1.00 move in the underlying stock.

⁴ The proposed rule change does not expressly amend NASD’s options exercise limits in Rule 2860(b)(4) because such exercise limits apply only to the extent Rule 2860(b)(3) imposes position limits. Thus, as delta neutral positions would be exempt from position limits under the proposed rule change, such positions also would be exempt from exercise limits. See NASD Notice to Members 94-46 (June 1994) at 2 (“... exercise limits correspond to position limits, such that investors in options classes on the same side of the market are allowed to exercise ... only the number of options contracts set forth as the applicable position limit for those options classes.”). Similarly, for positions held that are not delta neutral, only the option contract equivalent of the net delta of such positions would be subject to exercise limits.

⁵ See Securities Exchange Act Release No. 50748 (November 29, 2004), 69 FR 70485 (December 6, 2004) (SR-NASD-2004-153).

⁶ See 69 FR 70485, 70486 (December 6, 2004).

In the proposed rule change, NASD is expanding the delta hedging exemption beyond OTC Derivatives Dealers to include broker-dealers and certain other financial institutions (“Exemption”). Specifically, the proposed rule change would permit any member, or non-member affiliate permitted to rely on subparagraph (B) or (C) of Rule 2860(b)(3)(A)(vii)b.1., to apply the delta model developed by the Options Clearing Corporation (“OCC Model”).

In addition, certain other broker-dealers and affiliated entities, described below, would be permitted to use a proprietary model(s) to calculate options position net deltas provided that the use of such models were in accordance with the entity’s internal risk management control systems. The options contract equivalent of the net delta⁷ of a hedged options position still would be subject to the position limits in Rule 2860 (subject to the availability of any other position limit exemptions).

For example, if a member is short 20,000 call contracts (each representing 100 shares of stock) with a delta of .5, the member would need to be long 1,000,000 shares of stock to hedge that position. Assume that the member was long 600,000 shares and had another permitted offset (e.g., a swap or futures contract) representing another 200,000

⁷ “Net delta” is defined in Rule 2860(b)(2)(GG) to mean “the number of shares that must be maintained (either long or short) to offset the risk that the value of a stock options position will change with incremental changes in the price of the stock underlying the options position.” The following terms shall, unless the context otherwise requires, have the stated meanings:

“Options Contract Equivalent of the Net Delta” is defined in Rule 2860(b)(2)(LL) to mean the net delta divided by the number of shares underlying the options contract.

shares of stock. In that case, the net delta of that position would be 200,000 shares (1,000,000 – 600,000 long shares – 200,000 swap or future); and the number of contracts attributable to that position would be 2,000 contracts (200,000 shares / 100 shares per contract) on the short side of the market.

Permitted Pricing Models are pricing models used by: (1) a member or its affiliate subject to consolidated supervision by the Commission pursuant to Appendix E of SEC Rule 15c3-1, (2) a financial holding company (“FHC”) or a company treated as an FHC under the Bank Holding Company Act of 1956, or its affiliate subject to consolidated holding company group supervision,⁸ (3) an SEC registered OTC derivatives dealer,⁹ (4)

⁸ An FHC’s affiliate that is part of the FHC’s consolidated supervised holding company group would be eligible to use this part of the Exemption. An FHC’s (or an affiliate’s) use of a proprietary model would have to be consistent with either: (i) the requirements of the Board of Governors of the Federal Reserve System, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Board of Governors of the Federal Reserve System; or (ii) the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company’s principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where “principal regulator” means a member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company. It is important to note that the U.S. activities of entities subject to the Basel standards still are overseen by the Federal Reserve Board, and NASD would be relying upon that oversight in extending exemptive relief to such entities.

⁹ This part of the Exemption would replace in its entirety current Rule 2860(b)(3)(a)vii.b. An OTC Derivative Dealer’s use of a proprietary model would be required to be consistent with the requirements of Appendix F to Commission Rule 15c3-1 and SEC Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder. Only an OTC Derivatives Dealer and no other

a national bank under the National Bank Act,¹⁰ and (5) a member, or non-member affiliate as permitted by subparagraph (B) or (C) of Rule 2860(b)(3)(A)(vii)b.1., using a pricing model maintained and operated by the Options Clearing Corporation.

Irrespective of the features of any proprietary pricing model, only financial instruments relating to the security underlying an equity options position may be included in any determination of an equity options position's net delta or whether the options position is delta neutral. For example, a short position in XYZ calls may be hedged with a long position in XYZ warrants. However, a short position in XYZ calls may not be hedged with any financial instrument relating to a security other than XYZ stock. In addition, firms may not use the same equity or other financial instrument position in connection with more than one hedge exemption. Thus, a stock position used as part of a delta hedge must not also serve as the basis for any other equity option hedge exemption.

Obligations of Members and Affiliates

A member that intends to employ, or whose non-member affiliate intends to employ, the Exemption must provide a written certification to NASD stating that the member and/or its affiliate will use a Permitted Pricing Model as defined in the Rule and

affiliated entity (including a member) would be able to rely upon this particular part of the Exemption.

¹⁰ The use of a proprietary model by a national bank would be required to be consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency. An affiliate of a national bank (including an NASD member) would not be permitted to rely on this part of the Exemption.

that if an affiliate ceases to hedge stock options positions in accordance with such systems and models, it will provide immediate written notice to the member.

Any options position that is not delta neutral would remain subject to position and exercise limits (subject, however, to the availability of other exemptions). While delta hedging generally is employed as part of an overall risk management program, firms do not necessarily hedge every position to be delta neutral, i.e., having a net delta of zero. In such cases, only the options contract equivalent of the net delta of any such options position would be subject to position limits.

Impact on “Aggregation” Guidance

NASD recently issued guidance on when certain options accounts may be “disaggregated.”¹¹ The proposed rule change would impact this guidance in the following way. Generally, an entity that relies on the proposed rule change would be required to ensure that a Permitted Pricing Model is applied to all positions in or relating to the security or securities underlying the relevant options position that are owned or controlled by the entity, or its affiliates. However, the net delta of an options position held by an entity entitled to rely on this Exemption, or by a separate and distinct trading unit of such entity, would be permitted to be calculated without regard to positions in or relating to the security or securities underlying the option held by an affiliated entity or by another trading unit within the same entity, provided that: (i) the entity demonstrates to NASD’s satisfaction that no control relationship, as defined in Notice to Members 07-

¹¹ See NASD Notice to Members 07-03 (January 2007).

03, exists between such affiliates or trading units, and (ii) the entity has provided NASD written notice in advance that it intends to be considered separate and distinct from any affiliate, or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of this Exemption.¹²

Position Reporting

Today, under paragraph (b)(5), a broker-dealer must report any options position in which the member has an interest, and each customer, non-member broker or non-member dealer account, which has established an aggregate position of 200 or more options contracts (whether long or short) of the put class and the call class on the same side of the market. Under the proposed rule change, NASD would retain these reporting thresholds even with respect to options position of any member or designated aggregation unit that are delta neutral. In addition, however, each member, or designated aggregation unit pursuant to subparagraph (b)(3)(A)(vii)b.2., also shall report the options equivalent of the net delta of a position if such position represents 200 or more contracts (whether long or short) on the same side of the market covering the same underlying stock that are effected by the member. Referring to the example above, a member who is short 20,000 call contracts with a delta of .5 and long 600,000 shares of stock and long 200,000 shares through a SWAP or futures contract, would report (a) its options position as short 20,000 contracts and (b) its options equivalent of the net delta as short 2,000 contracts.

¹² NASD has set forth, in Notice to Members 07-03, the conditions under which it will deem no control relationship to exist between affiliates and between separate and distinct trading units within the same entity.

NASD and other SROs are working on modifying the Large Options Position Reporting (“LOPR”) system and/or The Options Clearing Corporation (“OCC”) reports to allow a member to indicate that an equity options position is being delta hedged.

Reliance on Federal Oversight

NASD notes that when NASD provided exemptive relief for OTC Derivatives Dealers in 2004, NASD indicated that it believed that the rigor of the SEC’s OTC Derivatives Dealer approval process and the ongoing oversight by the SEC staff provided an appropriate basis for exempting delta neutral positions in options held by such entities from position and exercise limits.¹³ The proposed rule change’s extension of exemptive relief to additional users of proprietary models similarly relies upon the rigorous approval processes and ongoing oversight of a federal financial regulator.

In an effort to leverage the existing federal oversight in this area, NASD has developed procedures to monitor members’ compliance with the proposed delta-hedging position limit rules. Specifically, NASD would employ a narrowly circumscribed program around the employment of delta hedging by eligible broker-dealers. NASD would examine to the extent of: (a) reviewing that the eligible broker-dealers have policies and procedures to determine their net positions in ascertaining any option holdings in respect of position limits including the reduction from any such net positions any positions subject to delta hedging or allowable equity option hedges; and (b) determining that the eligible broker-dealers represent that they have made any reduction

¹³ See SR-NASD-2004-153 (filed on October 12, 2004), at 8.

from such net option positions pursuant to and in accordance with a model, or the processes that develop a model, for delta hedging that have been approved by an applicable federal regulator. It is important to note that NASD is not under any obligation to test: (a) the integrity of a model, its processes or methodology; or (b) the employment of such models by eligible broker-dealers as to any data inputs, calculations or any other utilization of the model.

As noted in Item 2 above, NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be no later than 30 days following publication of the Notice to Members announcing Commission approval.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁴ which requires, among other things, that NASD rules must be 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 believes that it is appropriate, subject to certain conditions, to exempt options positions of entities subject to an extensive regulatory framework of a federal financial regulator from position limits and require that only the option contract equivalent of the net delta of a stock options position be subject to position limits.

¹⁴ 15 U.S.C. 78o-3(b)(6).

4. 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.¹⁵

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

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.¹⁶

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

¹⁵ 15 U.S.C. 78a.

¹⁶ 15 U.S.C. 78s(b)(2).

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2007-044)

Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Relating to Expanding the Class of Entities Permitted to Use the Delta Hedging Exemption from Equity Options Position Limits

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 , the National Association of Securities Dealers, Inc. (“NASD”) 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 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 NASD Rule 2860 to expand the class of entities permitted to use the delta hedging exemption from equity options position limits. 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(b) Requirements

(1) No Change.

(2) Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

(A) through (R) No Change.

(S) Delta Neutral — The term “delta neutral” describes an equity [stock] options position that has been fully hedged, in accordance with [an SEC-approved pricing model,] a Permitted Pricing Model as defined in paragraph (b)(3)(A)(vii)b. with a portfolio of instruments including or relating to the same underlying security [stock] to offset the risk that the value of the equity options position will change with incremental changes in the price of the [stock] security underlying the options position.

(T) through (FF) No Change.

(GG) Net Delta – the term “net delta” means the number of shares that must be maintained (either long or short) to offset the risk that the value of an equity [stock] options position will change with incremental changes in the price of the security underlying the options position.

(HH) through (KK) No Change.

(LL) Options Contract Equivalent of the Net Delta – the term “options contract equivalent of the net delta” means the net delta divided by the number of shares underlying the options contract.

(LL) through (CCC) renumbered as (MM) through (DDD).

(3) Position Limits

(A) Stock Options—Except in highly unusual circumstances, and with the prior written approval of 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-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) through (vi) No Change.

(vii) Equity Options Hedge Exemptions

a. No Change.

[b. Delta Hedging Exemption for OTC Derivatives

Dealers]

[A stock options position of an OTC Derivatives Dealer (as that term is defined in Rule 3b-12 under the Act) affiliated with a member, in standardized or conventional options that is delta neutral, shall be exempt from position limits under this rule if the following conditions are satisfied:]

[1. The member has obtained a written representation from its affiliated OTC Derivatives Dealer that such entity is hedging its stock options positions in accordance with its internal risk management control systems and pricing models approved by the SEC pursuant to Rules 15c3-1(a)(5) and 15c3-1f under the Act, and that if it ceases to hedge stock options positions in accordance with such systems and models, that it will provide immediate written notice to the member.]

[2. The member must report in accordance with paragraph (b)(5), all stock options positions (including those that are delta neutral) of 200 or more contracts (whether long or short) on the same side of the market covering the same underlying stock that are effected by the member.]

[3. Any stock options position of an OTC Derivatives Dealer that is not delta neutral shall be subject to position limits in accordance with this section (subject, however, to the availability of other exemptions). For these purposes, only the option contract equivalent of the net delta of such positions is subject to position limits. The options contract equivalent of the net delta is the net delta divided by 100.]

b. Delta Hedging Exemption For Members and Non-Member Affiliates

An equity options position of a member or non-member affiliate in standardized and/or conventional equity options that is delta neutral under a Permitted Pricing Model shall be exempt from position limits under this rule. Any equity options position of such member or non-member affiliate that is not delta neutral shall be subject to position limits, subject to the availability of other options position limit exemptions. The number of options contracts attributable to a position that is not delta neutral shall be the options contract equivalent of the net delta.

1. Permitted Pricing Model shall mean:

A. A pricing model maintained and operated by the Options Clearing Corporation (“OCC Model”) when used by a member, or non-member affiliate permitted to rely on subparagraphs B or C;

B. A pricing model maintained and used by a member subject to consolidated supervision by the Commission pursuant to Appendix E of Commission Rule 15c3-1, or by an affiliate that is part of such member’s consolidated supervised holding company group, in accordance with its

internal risk management control system and consistent with the requirements of Appendices E or G, as applicable, to Commission Rule 15c3-1 and Commission Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital or capital allowances for market risk thereunder, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such member's consolidated supervised holding company group:

C. A pricing model maintained and used by a financial holding company ("FHC") or a company treated as an FHC under the Bank Holding Company Act of 1956, or by an affiliate that is part of either such company's consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with:

i. the requirements of the Board of Governors of the Federal Reserve System, as amended from time to time, in connection

with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Board of Governors of the Federal Reserve System, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company's consolidated supervised holding company group; or

ii. the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company's principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where "principal regulator" means a member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company – provided that

the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company's consolidated supervised holding company group;

D. A pricing model maintained and used by an OTC derivatives dealer registered with the Commission pursuant to SEC Rule 15c3-1(a)(5) in accordance with its internal risk management control system and consistent with the requirements of Appendix F to SEC Rule 15c3-1 and SEC Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder, provided that only such OTC derivatives dealer and no other affiliated entity (including a member) may rely on this subparagraph D.; or

E. A pricing model used by a national bank under the National Bank Act maintained and used in accordance with its internal risk management control system and consistent with the requirements of the Office of the Comptroller of the Currency, as

amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency, provided that only such national bank and no other affiliated entity (including a member) may rely on this exemption.

2. Effect on Aggregation of Account Positions

A. Members and non-member affiliates

who rely on this exemption must ensure that the Permitted Pricing Model is applied to all positions in or relating to the security(ies) underlying the relevant options position that are owned or controlled by such member or non-member affiliate.

B. Notwithstanding subparagraph b.2.A. of this Rule, the Net Delta of an options position held by an entity entitled to rely on this exemption, or by a separate and distinct trading unit of such entity, may be calculated without regard to positions in or relating to the security(ies) underlying the options position held by an affiliated entity or by another trading unit within the same entity, provided that:

i. the entity demonstrates to NASD's satisfaction that no control relationship, as defined in Notice to Members 07-03, exists between such affiliates or trading units;* and

ii. the entity has provided NASD written notice in advance that it intends to be considered separate and distinct from any affiliate, or – as applicable – which trading units within the entity are to be considered separate and distinct from each other for purposes of this exemption.

* Note: NASD has set forth, in Notice to Members 07-03, the conditions under which it will deem no control relationship to exist between affiliates and between separate and distinct trading units within the same entity.

C. Notwithstanding subparagraph b.2.A. or b.2.B. of this Rule, a member or non-member affiliate who relies on this exemption shall designate, by prior written notice to NASD, each trading unit or entity whose options positions are required under NASD Rules to be aggregated with

the option positions of such member or non-member affiliate that is relying on this exemption for purposes of compliance with NASD position limits or exercise limits. In any such case:

i. the Permitted Pricing Model shall be applied, for purposes of calculating such member's or affiliate's net delta, only to the positions in or relating to the security(ies) underlying any relevant option position owned and controlled by those entities and trading units who are relying on this exemption; and

ii. the net delta of the positions owned or controlled by the entities and trading units who are relying on this exemption shall be aggregated with the non-exempt option positions of all other entities and trading units whose options positions are required under NASD Rules to be aggregated with the option positions of such member or affiliate.

3. Obligations of Members and Affiliates

A member that relies, or whose affiliate relies, upon this exemption must provide a written certification to NASD that it and/or its affiliates are using a Permitted Pricing Model pursuant to subparagraph 1. above and that if the affiliate ceases to hedge stock options positions in accordance with such Permitted Pricing Model, it will provide immediate written notice to the member.

The options positions of a non-member relying on this exemption must be carried by a member with which it is affiliated.

4. Reporting

A. Each member must report in accordance with paragraph (b)(5), all equity option positions (including those that are delta neutral) of 200 or more contracts (whether long or short) on the same side of the market covering the same underlying security that are effected by the member.

B. In addition, each member on its own behalf or on behalf of a designated aggregation unit pursuant to subparagraph (b)(3)(A)(vii)b.2. shall report in a manner specified by NASD the options contract equivalent of the net delta of each position

that represents 200 or more contracts (whether long or short) on the same side of the market covering the same underlying security that are effected by the member.

(viii) No Change.

(B) through (D) No Change.

(4) through (24) No Change.

(c) No Change.

* * * * *

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

Background

Over the past several years, NASD has increased in absolute terms the size of the options position and exercise limits as well as the size and scope of available exemptions

for “hedged” positions.³ The exemptions for hedged positions generally required a one-to-one hedge, i.e., one stock option contract must be hedged by the number of shares covered by the options contract, typically 100 shares. In practice, however, many firms do not hedge their options positions in this way. Rather, these firms engage in what is known as “delta hedging,” which varies the number of shares of stock used to hedge an options position based upon the relative sensitivity of the value of the option contract to a change in the price of the underlying stock.⁴ Delta hedging is widely accepted for net capital and risk management purposes.

In 2004, the SEC approved amendments to Rule 2860 that provide a delta hedging exemption from stock options position and exercise limits⁵ for positions held by affiliates of NASD members approved by the SEC as “OTC Derivatives Dealers.”⁶ At that time,

³ See Securities Exchange Act Release No. 47307 (February 3, 2003), 68 FR 6977 (February 11, 2003) (SR-NASD-2002-134); Securities Exchange Act Release No. 40932 (January 11, 1999), 64 FR 2930 (January 19, 1999) (SR-NASD-98-92); Securities Exchange Act Release No. 40087 (June 12, 1998), 63 FR 33746 (June 19, 1998) (SR-NASD-98-23); Securities Exchange Act Release No. 39771 (March 19, 1998), 63 FR 14743 (March 26, 1998) (SR-NASD-98-15).

⁴ For example, an option with a delta of .5 will move \$0.50 for every \$1.00 move in the underlying stock.

⁵ The proposed rule change does not expressly amend NASD’s options exercise limits in Rule 2860(b)(4) because such exercise limits apply only to the extent Rule 2860(b)(3) imposes position limits. Thus, as delta neutral positions would be exempt from position limits under the proposed rule change, such positions also would be exempt from exercise limits. See NASD Notice to Members 94-46 (June 1994) at 2 (“... exercise limits correspond to position limits, such that investors in options classes on the same side of the market are allowed to exercise ... only the number of options contracts set forth as the applicable position limit for those options classes.”). Similarly, for positions held that are not delta neutral, only the option contract equivalent of the net delta of such positions would be subject to exercise limits.

⁶ See Securities Exchange Act Release No. 50748 (November 29, 2004), 69 FR 70485 (December 6, 2004) (SR-NASD-2004-153).

the SEC reiterated its “support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.”⁷

Broadening the Scope of NASD’s Delta Hedging Exemption

In the proposed rule change, NASD is expanding the delta hedging exemption beyond OTC Derivatives Dealers to include broker-dealers and certain other financial institutions (“Exemption”). Specifically, the proposed rule change would permit any member, or non-member affiliate permitted to rely on subparagraph (B) or (C) of Rule 2860(b)(3)(A)(vii)b.1., to apply the delta model developed by the Options Clearing Corporation (“OCC Model”).

In addition, certain other broker-dealers and affiliated entities, described below, would be permitted to use a proprietary model(s) to calculate options position net deltas provided that the use of such models were in accordance with the entity’s internal risk management control systems. The options contract equivalent of the net delta⁸ of a hedged options position still would be subject to the position limits in Rule 2860 (subject to the availability of any other position limit exemptions).

For example, if a member is short 20,000 call contracts (each representing 100 shares of stock) with a delta of .5, the member would need to be long 1,000,000 shares of

⁷ See 69 FR 70485, 70486 (December 6, 2004).

⁸ “Net delta” is defined in Rule 2860(b)(2)(GG) to mean “the number of shares that must be maintained (either long or short) to offset the risk that the value of a stock options position will change with incremental changes in the price of the stock underlying the options position.” The following terms shall, unless the context otherwise requires, have the stated meanings:

“Options Contract Equivalent of the Net Delta” is defined in Rule 2860(b)(2)(LL) to mean the net delta divided by the number of shares underlying the options contract.

stock to hedge that position. Assume that the member was long 600,000 shares and had another permitted offset (e.g., a swap or futures contract) representing another 200,000 shares of stock. In that case, the net delta of that position would be 200,000 shares (1,000,000 – 600,000 long shares – 200,000 swap or future); and the number of contracts attributable to that position would be 2,000 contracts (200,000 shares / 100 shares per contract) on the short side of the market.

Permitted Pricing Models are pricing models used by: (1) a member or its affiliate subject to consolidated supervision by the Commission pursuant to Appendix E of SEC Rule 15c3-1, (2) a financial holding company (“FHC”) or a company treated as an FHC under the Bank Holding Company Act of 1956, or its affiliate subject to consolidated holding company group supervision,⁹ (3) an SEC registered OTC derivatives dealer,¹⁰ (4)

⁹ An FHC’s affiliate that is part of the FHC’s consolidated supervised holding company group would be eligible to use this part of the Exemption. An FHC’s (or an affiliate’s) use of a proprietary model would have to be consistent with either: (i) the requirements of the Board of Governors of the Federal Reserve System, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Board of Governors of the Federal Reserve System; or (ii) the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company’s principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where “principal regulator” means a member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company. It is important to note that the U.S. activities of entities subject to the Basel standards still are overseen by the Federal Reserve Board, and NASD would be relying upon that oversight in extending exemptive relief to such entities.

¹⁰ This part of the Exemption would replace in its entirety current Rule 2860(b)(3)(a)vii.b. An OTC Derivative Dealer’s use of a proprietary model would be required to be consistent with the requirements of Appendix F to Commission Rule 15c3-1 and SEC Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder. Only an OTC Derivatives Dealer and no other

a national bank under the National Bank Act,¹¹ and (5) a member, or non-member affiliate as permitted by subparagraph (B) or (C) of Rule 2860(b)(3)(A)(vii)b.1., using a pricing model maintained and operated by the Options Clearing Corporation.

Irrespective of the features of any proprietary pricing model, only financial instruments relating to the security underlying an equity options position may be included in any determination of an equity options position's net delta or whether the options position is delta neutral. For example, a short position in XYZ calls may be hedged with a long position in XYZ warrants. However, a short position in XYZ calls may not be hedged with any financial instrument relating to a security other than XYZ stock. In addition, firms may not use the same equity or other financial instrument position in connection with more than one hedge exemption. Thus, a stock position used as part of a delta hedge must not also serve as the basis for any other equity option hedge exemption.

Obligations of Members and Affiliates

A member that intends to employ, or whose non-member affiliate intends to employ, the Exemption must provide a written certification to NASD stating that the member and/or its affiliate will use a Permitted Pricing Model as defined in the Rule and that if an affiliate ceases to hedge stock options positions in accordance with such systems and models, it will provide immediate written notice to the member.

affiliated entity (including a member) would be able to rely upon this particular part of the Exemption.

¹¹ The use of a proprietary model by a national bank would be required to be consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency. An affiliate of a national bank (including an NASD member) would not be permitted to rely on this part of the Exemption.

Any options position that is not delta neutral would remain subject to position and exercise limits (subject, however, to the availability of other exemptions). While delta hedging generally is employed as part of an overall risk management program, firms do not necessarily hedge every position to be delta neutral, i.e., having a net delta of zero. In such cases, only the options contract equivalent of the net delta of any such options position would be subject to position limits.

Impact on “Aggregation” Guidance

NASD recently issued guidance on when certain options accounts may be “disaggregated.”¹² The proposed rule change would impact this guidance in the following way. Generally, an entity that relies on the proposed rule change would be required to ensure that a Permitted Pricing Model is applied to all positions in or relating to the security or securities underlying the relevant options position that are owned or controlled by the entity, or its affiliates. However, the net delta of an options position held by an entity entitled to rely on this Exemption, or by a separate and distinct trading unit of such entity, would be permitted to be calculated without regard to positions in or relating to the security or securities underlying the option held by an affiliated entity or by another trading unit within the same entity, provided that: (i) the entity demonstrates to NASD’s satisfaction that no control relationship, as defined in Notice to Members 07-03, exists between such affiliates or trading units, and (ii) the entity has provided NASD written notice in advance that it intends to be considered separate and distinct from any

¹² See NASD Notice to Members 07-03 (January 2007).

affiliate, or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of this Exemption.¹³

Position Reporting

Today, under paragraph (b)(5), a broker-dealer must report any options position in which the member has an interest, and each customer, non-member broker or non-member dealer account, which has established an aggregate position of 200 or more options contracts (whether long or short) of the put class and the call class on the same side of the market. Under the proposed rule change, NASD would retain these reporting thresholds even with respect to options position of any member or designated aggregation unit that are delta neutral. In addition, however, each member, or designated aggregation unit pursuant to subparagraph (b)(3)(A)(vii)b.2., also shall report the options equivalent of the net delta of a position if such position represents 200 or more contracts (whether long or short) on the same side of the market covering the same underlying stock that are effected by the member. Referring to the example above, a member who is short 20,000 call contracts with a delta of .5 and long 600,000 shares of stock and long 200,000 shares through a SWAP or futures contract, would report (a) its options position as short 20,000 contracts and (b) its options equivalent of the net delta as short 2,000 contracts.

NASD and other SROs are working on modifying the Large Options Position Reporting (“LOPR”) system and/or The Options Clearing Corporation (“OCC”) reports to allow a member to indicate that an equity options position is being delta hedged.

¹³ NASD has set forth, in Notice to Members 07-03, the conditions under which it will deem no control relationship to exist between affiliates and between separate and distinct trading units within the same entity.

Reliance on Federal Oversight

NASD notes that when NASD provided exemptive relief for OTC Derivatives Dealers in 2004, NASD indicated that it believed that the rigor of the SEC's OTC Derivatives Dealer approval process and the ongoing oversight by the SEC staff provided an appropriate basis for exempting delta neutral positions in options held by such entities from position and exercise limits.¹⁴ The proposed rule change's extension of exemptive relief to additional users of proprietary models similarly relies upon the rigorous approval processes and ongoing oversight of a federal financial regulator.

In an effort to leverage the existing federal oversight in this area, NASD has developed procedures to monitor members' compliance with the proposed delta-hedging position limit rules. Specifically, NASD would employ a narrowly circumscribed program around the employment of delta hedging by eligible broker-dealers. NASD would examine to the extent of: (a) reviewing that the eligible broker-dealers have policies and procedures to determine their net positions in ascertaining any option holdings in respect of position limits including the reduction from any such net positions any positions subject to delta hedging or allowable equity option hedges; and (b) determining that the eligible broker-dealers represent that they have made any reduction from such net option positions pursuant to and in accordance with a model, or the processes that develop a model, for delta hedging that have been approved by an applicable federal regulator. It is important to note that NASD is not under any obligation to test: (a) the integrity of a model, its processes or methodology; or (b) the

¹⁴ See SR-NASD-2004-153 (filed on October 12, 2004), at 8.

employment of such models by eligible broker-dealers as to any data inputs, calculations or any other utilization of the model.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be no later than 30 days following publication of the Notice to Members announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁵ which requires, among other things, that NASD rules must be 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 believes that it is appropriate, subject to certain conditions, to exempt options positions of entities subject to an extensive regulatory framework of a federal financial regulator from position limits and require that only the option contract equivalent of the net delta of a stock options position be subject to position limits.

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.

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

Written comments were neither solicited nor received.

¹⁵ 15 U.S.C. 78o-3(b)(6).

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 self-regulatory organization consents, the Commission will:

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

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

IV. Solicitation of Comments

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2007-044 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-NASD-2007-044. This file number should be included on the subject line if e-mail is used. To help the Commission

process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of NASD.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2007-044 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Nancy M. Morris

Secretary

¹⁶ 17 CFR 200.30-3(a)(12).