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August 13, 2002

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-1001

Re: **File No. SR-NASD-2001-47**
Rules 3115 and 3340 – Audit Trail and Trading Halt Requirements for
Security Futures, Amendment No. 1

Dear Ms. England:

On July 30, 2001, the Securities and Exchange Commission (“SEC” or “Commission”) published for comment proposed new Rule 3115 (Requirements for Alternative Trading Systems to Record and Transmit Order And Execution Information for Security Futures) and amendments to Rule 3340 (Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts). The proposed rule changes were filed by NASD to fulfill its obligations under the Commodity Futures Modernization Act (“CFMA”) to have rules in place that require Alternative Trading Systems (“ATs”) that trade security futures products (“SFPs”) to: (1) have audit trails necessary to facilitate coordinated surveillance; and (2) coordinate trading halts with markets trading the underlying securities and markets trading related securities.

The SEC received one comment on the proposed rule change, a letter from Island ECN, Inc. (“Island”) dated August 20, 2001.¹ NASD has reviewed Island’s letter and for the reasons set forth below, believes that the Commission should approve the proposed rule change with only several minor changes described below.

A. Audit Trail

Island’s letter raises two basic points. First, Island suggests that the proposed audit trail requirements are beyond the scope of what is contemplated by the CFMA. NASD has reviewed the items required by proposed Rule 3115 and the information provided by other SFP markets for coordinated surveillance by the Intermarket Surveillance Group (“ISG”), and does not believe that the requirements of Rule 3115 are unnecessarily broad or burdensome. Moreover, we note that Island has registered an

¹ Letter from Chris Concannon, Vice President, Island, to Jonathan Katz, Secretary, SEC, dated August 20, 2001.

affiliate, Island Futures Exchange, as a designated contract market with the Commodity Futures Trading Commission (“CFTC”) to trade security futures. This affiliate would not be subject to NASD Rule 3115.

NASD has reviewed the items required by proposed Rule 3115 and believes that one additional item is necessary. In particular, NASD believes that the audit trail should in addition include an account identifier relating the order back to the account owner. The account identification number provides a means to track a trade back to the beneficial owner of an account. The account identifier has traditionally been a key component of a futures market audit trail. In addition, NASD has made a correction to subparagraph (b)(3) suggested by Island to replace the word “contracts” for the word “share.”

The changes to Rule 3115 should be made as follows. On pages 3 and 14 of the original rule filing, amend subparagraph (b) as follows. (New text is double underlined, deleted text is in [brackets].)

(3) Number of [share] ~~contracts~~ to which the order applies.

* * *

(13) Size of the order executed; [and]

(14) Identity of the alternative trading system’s subscribers that were intermediaries or parties in the transaction[.]; and

(15) An account identifier that relates the order back to the account owner(s).

B. Trading Halts

Second, Island believes that the proposed amendments to Rule 3340 regarding security futures should not take effect “while the exact same rule for equities was recently delayed.” Island’s concerns over Rule 3340 are no longer valid. The amendments to Rule 3340 that Island’s letter addressed have been approved by the SEC and have been in effect since October 9, 2001. The proposed rule change is thus substantially similar to existing trading halt provisions and should, with the one change noted below, be approved. We further note that in view of Island’s decision to trade security futures through Island Futures Exchange, the proposed rule change would not affect Island.

The amendments to NASD Rule 3340 were developed based upon similar proposed rules by the SEC and CFTC applicable to securities exchanges and contract markets.² Based upon comments received, the SEC and CFTC increased the percentage

² Cash Settlement and Regulatory Halt Requirements for Security Futures Products, Joint Proposed Rule of CFTC and SEC, 66 Fed. Reg. 45904 (Aug. 30, 2001).

Katherine A. England

August 13, 2002

Page 3 of 3

of the market capitalization of underlying securities – from 30% or more to 50% or more – for triggering a trading halt in a narrow-based security index.³ NASD has made a corresponding change in the proposed rule change.

The changes to Rule 3340 should be made as follows. On pages 5 and 16 of the original rule filing, amend subparagraph (b)(2) as follows:

(2) a future on a narrow-based security index when one or more underlying securities that constitute [30]50% or more of the market capitalization of the index has a regulatory trading halt that is currently in effect.

If the SEC has any questions concerning this amendment, please contact the undersigned at (202) 728-8104.

Very truly yours,

Gary L. Goldsholle
Associate General Counsel

³ Cash Settlement and Regulatory Halt Requirements for Security Futures Products, Joint Final Rule of CFTC and SEC, 67 Fed. Reg. 36741 (May 24, 2002).