

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 type="checkbox"/>	Section 19(b)(3)(A) <input checked="" 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 checked="" 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).

Amendments to Rules 2520 and 2522 to recognize additional complex option spread strategies and amend provisions for permitted offsets

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 Senior Vice President and Deputy 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

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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 Rules 2520 and 2522 that will revise the margin requirements to (1) recognize specific additional complex option spread strategies for purposes of determining required margin and (2) amend the provisions relating to “permitted offsets” for certain listed option transactions.

The text of the proposed rule change is attached as Exhibit 5 to this rule filing. Proposed new language is underlined; proposed deletions are in brackets.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on February 1, 2006, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The Board of Governors of NASD had an opportunity to review the proposed rule change at its meeting on February 2, 2006. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the

¹ 15 U.S.C. 78s(b)(1).

NASD By-Laws permits the Board of Governors of NASD to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD has filed the proposed rule change for immediate effectiveness. The effective date and the implementation date will be the date of filing.

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

(a) Purpose

Background

The proposed rule change is consistent with recent margin rule amendments by the New York Stock Exchange (“NYSE”) and the Chicago Board Options Exchange (“CBOE”), which were recently approved by the Commission.² Specifically, NASD is proposing to amend Rule 2520 to (1) recognize specific additional complex option spread strategies for purposes of determining required margin and (2) amend the provisions relating to “permitted offsets” for certain listed option transactions. In addition, NASD is proposing to amend Rule 2522 to include definitions relating to the proposed rule change described above as well as certain other conforming definitional and language changes.

1. Complex Option Spread Strategies

NASD proposes to amend Rule 2520 and the corresponding definitions in Rule 2522 to recognize specific additional complex option spread strategies and set margin requirements commensurate with the risk of such spread strategies. These complex option spread strategies are the net result of combining two or more spread strategies

² See Exchange Act Release No. 52951 (December 14, 2005), 70 FR 75523 (December 20, 2005) (SR-NYSE-2004-39); Exchange Act Release No. 52950 (December 14, 2005), 70 FR 75512 (December 20, 2005) (SR-CBOE-2004-053).

that are currently recognized in NASD's margin rules. The netting of contracts in option series common to each of the currently recognized spreads in an aggregation reduces it to the complex spread strategies noted below.

Basic option spreads can be paired in such ways that they offset each other in terms of risk. The total risk of the combined spreads is less than the sum of the risk of both spread positions if viewed as stand-alone strategies. The specific complex option spread strategies listed below are structured using the same principles as, and are essentially expansions of, the advanced spreads currently allowed in Rule 2520 and as defined in Rule 2522. Currently, Rule 2520 recognizes and prescribes margin requirements for advanced spread strategies known as the "butterfly spread" and the "box spread." However, these option spreads are limited in scope. The proposed rule change seeks to expand on the types of pairings that would qualify for butterfly spread and box spread margin treatment. In addition, Rule 2520 recognizes a "calendar spread," also known as a "time spread," yet it is not identified as such. NASD proposes to define this term as "the sale of one option and the simultaneous purchase of another option of the same type, both specifying the same underlying component with the same exercise price or different exercise prices, where the 'long' option expires after the 'short' option," in Rule 2522 since some of the complex spreads NASD seeks to recognize in the proposed rule change will include this component of spread strategies.

To be eligible for the margin requirements set forth below, a complex spread must be consistent with one of the seven patterns specified below. The expiration months and the sequence of the exercise prices must correspond to the same pattern, and the intervals between the exercise prices must be equal.

Members will be required to obtain initial and maintenance margin for the subject complex spreads, whether established outright or through netting, of not less than the sum of the margin required on each basic spread in the equivalent aggregation.

The basic requirements are as follows: (a) the complex option spreads must be carried in a margin account; and (b) European-style³ options are prohibited for complex spread combinations having a long option series that expires after the other option series (i.e., those that involve a time spread such as items 5, 6, and 7 below). Only American-style options⁴ may be used in these combinations. Additionally, the intervals between exercise prices must be equal, and each complex spread must comprise four option series, with the exception of item 4 below, which must comprise three option series.

The sum of the margin required on each currently recognized spread in each of the applicable aggregations renders margin requirements for the subject complex spread strategies as stated below. The additional complex option spread strategies and maintenance margin requirements are as follows:

(1) A Long Condor Spread is comprised of two long Butterfly Spreads. The proposal requires initial and maintenance margin of full cash payment of the net debit incurred when this spread strategy is established. Full payment of the net debit incurred will cover any potential risk to the carrying broker-dealer.

(2) A Short Iron Butterfly Spread is comprised of one long Butterfly Spread and

³ A European-style option is an option contract that can be exercised only on its expiration date.

⁴ An American-style option is an option contract that can be exercised at any time between the date of purchase and its expiration date.

one short Box Spread. The establishment of a long Butterfly Spread results in a margin requirement equal to the net debit incurred. The establishment of a short Box Spread requires margin equal to the aggregate difference between the exercise prices. The net proceeds from the sale of short option components may be applied to the margin requirement. Accordingly, to cover the risk to the carrying broker-dealer, the proposal requires a deposit of the aggregate exercise price differential. The net credit received may be applied to the deposit required.

(3) A Short Iron Condor Spread is comprised of two long Butterfly Spreads and one short Box Spread. The establishment of long Butterfly Spreads results in a margin requirement equal to the net debit incurred. The establishment of a short Box Spread requires margin equal to the difference in the strike price. Accordingly, to cover the risk to the carrying broker-dealer, the proposal requires a deposit of the aggregate exercise price differential. The net credit received may be applied to the deposit required.

(4) A Long Calendar Butterfly Spread is comprised of one long Calendar Spread and one long Butterfly Spread. The proposal requires initial and maintenance margin of full cash payment of the net debit incurred when this spread strategy is established. Full payment of the net debit incurred will cover any potential risk to the carrying broker-dealer.

(5) A Long Calendar Condor Spread is comprised of one long Calendar Spread and two long Butterfly Spreads. The proposal requires initial and maintenance margin of full cash payment of the net debit incurred when this spread strategy is established. Full payment of the net debit incurred will cover any potential risk to the carrying broker-dealer.

(6) A Short Calendar Iron Butterfly Spread is comprised of one long Calendar Spread plus one long Butterfly Spread and one short Box Spread. To cover the risk to the carrying broker-dealer, the proposal requires a deposit of the aggregate exercise price differential. The net credit received may be applied to the deposit required.

(7) A Short Calendar Iron Condor Spread is comprised of one Long Calendar Spread plus two long Butterfly Spreads and one short Box Spread. To cover the risk to the carrying broker-dealer, the proposal requires a deposit of the aggregate exercise price differential. The net credit received may be applied to the deposit required.

As noted above, the purpose and benefit is to set levels of margin that more precisely represent actual net risk of the option positions in the account and enable customers to implement these strategies more efficiently.

2. Permitted Offsets

Rule 2520(f)(2)(J) addresses margin requirements for members that clear and carry the listed options transactions of registered specialists, registered market makers or registered traders in options, and recognizes certain offset positions in establishing the margin requirements. The rule currently limits permitted offsets for these parties to options series that are “in or at the money,” which is defined to mean “the current market price of the underlying security is not more than two standard exercise intervals below (with respect to a call option) or above (with respect to a put option) the exercise price of the option.”

Recently, various option exchanges have provided for the listing of options with one-dollar strike intervals in a number of classes. As a result, the use of securities to hedge options series that have one-dollar strike intervals has unintentionally become

more restrictive. The proposed rule change will eliminate the definition of “in or at the money,” thereby eliminating the two standard exercise interval limitation for listed options. In addition, the proposed rule change will require permitted offset transactions to be effected for specialist or market-making purposes such as hedging, risk reduction, rebalancing of positions, liquidation, or accommodation of customer orders, or other similar specialist or market-making purposes.

Since clearing firms have risk monitoring systems that alert them to unhedged positions and haircut requirements pursuant to Rule 15c3-1 of the Act,⁵ which perform a similar function as NASD margin requirements relative to providing adequate risk coverage to broker-dealers, elimination of the two-dollar standard exercise price limitation and definition of “in or at the money” will not diminish the “safety and soundness” provisions that the margin rules provide.

As noted in Item 2 of this filing, NASD has filed the proposed rule change for immediate effectiveness. The effective date and the implementation date will be the date of filing.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁶ 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

⁵ 17 CFR 240.15c3-1.

⁶ 15 U.S.C. 78o-3(b)(6).

interest. NASD believes that the proposed rule change will set margin requirements commensurate with the risk of the identified options spread strategies and will further promote consistent margin requirements among the self-regulatory organizations.

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.

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

Not applicable.

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

The proposed rule change is effective upon filing pursuant to Section 19(b)(3) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder,⁷ in that the proposed rule change does not significantly affect the protection of investors or the public interest and does not impose any significant burden on competition. In accordance with Rule 19b-4, NASD submitted written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing. NASD has requested that the Commission waive the 30-day period for the proposed rule change to become operative, in order to conform with rule changes by the NYSE and CBOE that were approved by the SEC and to avoid subjecting firms to

⁷ 17 CFR 240.19b-4.

conflicting margin requirements.

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

The proposed rule change is substantially similar to the New York Stock Exchange Rule 431(f) (Margin Requirements) and Chicago Board Options Exchange Rule 12.3 (Margin Requirements).

9. Exhibits

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

Exhibit 5. Revised text of the proposed rule change to Rules 2520 and 2522 marked to show additions to and deletions from the current rule language.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2006-045)

Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendments to Rule 2520 (Margin Requirements)

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. NASD has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. 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 Rules 2520 and 2522 that will revise the margin requirements to (1) recognize specific additional complex option spread strategies for purposes of determining required margin and (2) amend the provisions relating to “permitted offsets” for certain listed option transactions.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4.

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

Proposed new language is in italics; proposed deletions are in brackets.

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

The proposed rule change is consistent with recent margin rule amendments by the New York Stock Exchange (“NYSE”) and the Chicago Board Options Exchange (“CBOE”), which were recently approved by the Commission.⁴ Specifically, NASD is proposing to amend Rule 2520 to (1) recognize specific additional complex option spread strategies for purposes of determining required margin and (2) amend the provisions relating to “permitted offsets” for certain listed option transactions. In addition, NASD is proposing to amend Rule 2522 to include definitions relating to the proposed rule change described above as well as certain other conforming definitional and language changes.

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1. Complex Option Spread Strategies

NASD proposes to amend Rule 2520 and the corresponding definitions in Rule 2522 to recognize specific additional complex option spread strategies and set margin requirements commensurate with the risk of such spread strategies. These complex option spread strategies are the net result of combining two or more spread strategies that are currently recognized in NASD's margin rules. The netting of contracts in option series common to each of the currently recognized spreads in an aggregation reduces it to the complex spread strategies noted below.

Basic option spreads can be paired in such ways that they offset each other in terms of risk. The total risk of the combined spreads is less than the sum of the risk of both spread positions if viewed as stand-alone strategies. The specific complex option spread strategies listed below are structured using the same principles as, and are essentially expansions of, the advanced spreads currently allowed in Rule 2520 and as defined in Rule 2522. Currently, Rule 2520 recognizes and prescribes margin requirements for advanced spread strategies known as the "butterfly spread" and the "box spread." However, these option spreads are limited in scope. The proposed rule change seeks to expand on the types of pairings that would qualify for butterfly spread and box spread margin treatment. In addition, Rule 2520 recognizes a "calendar spread," also known as a "time spread," yet it is not identified as such. NASD proposes to define this term as "the sale of one option and the simultaneous purchase of another option of the same type, both specifying the same underlying component with the same exercise price or different exercise prices, where the 'long' option expires after the 'short' option," in Rule 2522 since some of the complex spreads NASD seeks to recognize in the proposed rule change will include this component of spread strategies.

To be eligible for the margin requirements set forth below, a complex spread must be consistent with one of the seven patterns specified below. The expiration months and the sequence of the exercise prices must correspond to the same pattern, and the intervals between the exercise prices must be equal.

Members will be required to obtain initial and maintenance margin for the subject complex spreads, whether established outright or through netting, of not less than the sum of the margin required on each basic spread in the equivalent aggregation.

The basic requirements are as follows: (a) the complex option spreads must be carried in a margin account; and (b) European-style⁵ options are prohibited for complex spread combinations having a long option series that expires after the other option series (i.e., those that involve a time spread such as items 5, 6, and 7 below). Only American-style options⁶ may be used in these combinations. Additionally, the intervals between exercise prices must be equal, and each complex spread must comprise four option series, with the exception of item 4 below, which must comprise three option series.

The sum of the margin required on each currently recognized spread in each of the applicable aggregations renders margin requirements for the subject complex spread strategies as stated below. The additional complex option spread strategies and maintenance margin requirements are as follows:

(1) A Long Condor Spread is comprised of two long Butterfly Spreads. The proposal requires initial and maintenance margin of full cash payment of the net debit incurred when

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⁶ An American-style option is an option contract that can be exercised at any time between the date of purchase and its expiration date.

this spread strategy is established. Full payment of the net debit incurred will cover any potential risk to the carrying broker-dealer.

(2) A Short Iron Butterfly Spread is comprised of one long Butterfly Spread and one short Box Spread. The establishment of a long Butterfly Spread results in a margin requirement equal to the net debit incurred. The establishment of a short Box Spread requires margin equal to the aggregate difference between the exercise prices. The net proceeds from the sale of short option components may be applied to the margin requirement. Accordingly, to cover the risk to the carrying broker-dealer, the proposal requires a deposit of the aggregate exercise price differential. The net credit received may be applied to the deposit required.

(3) A Short Iron Condor Spread is comprised of two long Butterfly Spreads and one short Box Spread. The establishment of long Butterfly Spreads results in a margin requirement equal to the net debit incurred. The establishment of a short Box Spread requires margin equal to the difference in the strike price. Accordingly, to cover the risk to the carrying broker-dealer, the proposal requires a deposit of the aggregate exercise price differential. The net credit received may be applied to the deposit required.

(4) A Long Calendar Butterfly Spread is comprised of one long Calendar Spread and one long Butterfly Spread. The proposal requires initial and maintenance margin of full cash payment of the net debit incurred when this spread strategy is established. Full payment of the net debit incurred will cover any potential risk to the carrying broker-dealer.

(5) A Long Calendar Condor Spread is comprised of one long Calendar Spread and two long Butterfly Spreads. The proposal requires initial and maintenance margin of full

cash payment of the net debit incurred when this spread strategy is established. Full payment of the net debit incurred will cover any potential risk to the carrying broker-dealer.

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(7) A Short Calendar Iron Condor Spread is comprised of one Long Calendar Spread plus two long Butterfly Spreads and one short Box Spread. To cover the risk to the carrying broker-dealer, the proposal requires a deposit of the aggregate exercise price differential. The net credit received may be applied to the deposit required.

As noted above, the purpose and benefit is to set levels of margin that more precisely represent actual net risk of the option positions in the account and enable customers to implement these strategies more efficiently.

2. Permitted Offsets

Rule 2520(f)(2)(J) addresses margin requirements for members that clear and carry the listed options transactions of registered specialists, registered market makers or registered traders in options, and recognizes certain offset positions in establishing the margin requirements. The rule currently limits permitted offsets for these parties to options series that are “in or at the money,” which is defined to mean “the current market price of the underlying security is not more than two standard exercise intervals below (with respect to a call option) or above (with respect to a put option) the exercise price of the option.”

Recently, various option exchanges have provided for the listing of options with one-dollar strike intervals in a number of classes. As a result, the use of securities to hedge

options series that have one-dollar strike intervals has unintentionally become more restrictive. The proposed rule change will eliminate the definition of “in or at the money,” thereby eliminating the two standard exercise interval limitation for listed options. In addition, the proposed rule change will require permitted offset transactions to be effected for specialist or market-making purposes such as hedging, risk reduction, rebalancing of positions, liquidation, or accommodation of customer orders, or other similar specialist or market-making purposes.

Since clearing firms have risk monitoring systems that alert them to unhedged positions and haircut requirements pursuant to Rule 15c3-1 of the Act,⁷ which perform a similar function as NASD margin requirements relative to providing adequate risk coverage to broker-dealers, elimination of the two-dollar standard exercise price limitation and definition of “in or at the money” will not diminish the “safety and soundness” provisions that the margin rules provide.

NASD has filed the proposed rule change for immediate effectiveness. The effective date and the implementation date will be the date of filing.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁸ 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 the proposed rule change will set margin requirements commensurate

⁷ 17 CFR 240.15c3-1.

⁸ 15 U.S.C. 78o-3(b)(6).

with the risk of the identified options spread strategies and will further promote consistent margin requirements among the self-regulatory organizations.

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.

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

Because the foregoing proposed rule change does not:

- (i) significantly affect the protection of investors or the public interest; and
- (ii) impose any significant burden on competition;

it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.⁹ Because the Commission has waived the requirement that the rule change cannot become operative for 30 days from the date on which it was filed, the rule change has become operative on the filing date.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

⁹ 17 CFR 240.19b-4(f)(6).

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-2006-045 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-2006-045. 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-2006-045 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.¹⁰

Nancy M. Morris

Secretary

¹⁰ 17 CFR 200.30-3(a)(12).

Exhibit 5

The text of proposed rule change is. Proposed new language is underlined; proposed deletions are in [brackets].

* * * * *

2520. Margin Requirements

(a) through (e) No Change.

(f) Other Provisions

(1) No Change.

(2) Puts, Calls and Other Options, Currency Warrants, Currency

Index Warrants and Stock Index Warrants

(A) through (B) No Change.

(C) For purposes of this subparagraph (f)(2), obligations issued by the United States Government shall be referred to as United States Government obligations. Mortgage pass-through obligations guaranteed as to timely payment of principal and interest by the Government National Mortgage Association shall be referred to as GNMA obligations.

In the case of any put, call, currency warrant, currency index warrant, or stock index warrant carried "long" in a customer's account that expires in nine months or less, initial margin must be deposited and maintained equal to at least 100% of the purchase price of the option or warrant.

Long Listed Option or Warrant With An Expiration

Exceeding Nine Months. In the case of a put, call, index stock group

option, or stock index warrant that is issued by a registered clearing agency, margin must be deposited and maintained equal to at least 75% of the current market value of the option or warrant; provided that the option or warrant has a remaining period to expiration exceeding nine months.

Long OTC Option or Warrant With An Expiration Exceeding Nine Months. In the case of a[n OTC] put, [or]call, index stock group option, [on a stock or stock index, and a] or stock index warrant[,] carried long that is not issued by a registered clearing agency[with an expiration exceeding 9 months], margin must be deposited and maintained equal to at least 75% of the option's or warrant's “in-the-money” amount plus 100% of the amount, if any, by which the current market value of the option or warrant exceeds its “in-the-money” amount provided the option or warrant:[. Options or warrants margined pursuant to this paragraph must:]

(i) [be valued at all times for margin purposes at an amount not to exceed, the in-the-money amount,]

[(ii) be]is guaranteed by the carrying broker-dealer, [and]

(ii) [(iii) have]has an American-style exercise provision,

and

(iii) has a remaining period to expiration exceeding nine months.

(D) through (F) No Change.

(G) (i) through (iv) No Change.

(v) The following requirements set forth the minimum

amount of margin that must be maintained in margin accounts of customers having positions in components underlying options, and stock index warrants, when such components are held in conjunction with certain positions in the overlying option or warrant. The option or warrant must be issued by a registered clearing agency or guaranteed by the carrying broker/dealer. In the case of a call or warrant carried in a short position, a related long position in the underlying component shall be valued at no more than the call/warrant exercise price for margin equity purposes.

a. Long Option or Warrant Offset. When a component underlying an option or warrant is carried long (short) in an account in which there is also carried a long put (call) or warrant specifying equivalent units of the underlying component, the minimum amount of margin that must be maintained on the underlying component is 10% of the [aggregate] option/warrant exercise price plus the "out-of-the-money" amount, not to exceed the minimum maintenance required pursuant to paragraph (c) of this Rule.

b. Conversions. When a call or warrant carried in a short position is covered by a long position in equivalent units of the underlying component and [there] is also carried with a long put or warrant specifying equivalent

units of the same underlying component and having the same exercise price and expiration date as the short call or warrant, the minimum amount of margin that must be maintained for the underlying component shall be 10% of the [aggregate] exercise price.

c. Reverse Conversions. When a put or warrant carried in a short position is covered by a short position in equivalent units of the underlying component and is also carried with a long call or warrant specifying equivalent units of the same underlying component and having the same exercise price and expiration date as the short put or warrant, the minimum amount of margin that must be maintained for the underlying component shall be 10% of the [aggregate] exercise price plus the amount by which the exercise price of the put exceeds the current market value of the underlying, if any.

d. Collars. When a call or warrant carried in a short position is covered by a long position in equivalent units of the underlying component and is also carried with a long put or warrant specifying equivalent units of the same underlying component and having a lower exercise price and the same expiration date as the short call/warrant, the minimum amount of margin that must be maintained for

the underlying component shall be the lesser of 10% of the [aggregate] exercise price of the put plus the put "out-of-the-money" amount or 25% of the call aggregate exercise price.

e. Butterfly Spread. This subparagraph applies to a butterfly spread as defined in Rule 2522 where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer.

1. No Change.

2. With respect to a short butterfly spread as defined in Rule 2522, margin must be deposited and maintained equal to at least the amount of the [aggregate] difference between the two lowest exercise prices with respect to short butterfly spreads comprised of calls or the [aggregate] difference between the two highest exercise prices with respect to short butterfly spreads comprised of puts. The net proceeds from the sale of short option components may be applied to the requirement.

f. Box Spread. This subparagraph applies to box spreads as defined in Rule 2522, where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer.

1. With respect to a long box spread as defined in Rule 2522, the net debit must be paid in full.

2. With respect to a short box spread as defined in Rule 2522, margin must be deposited and maintained equal to at least the amount of the [aggregate] difference between the exercise prices. The net proceeds from the sale of the short option components may be applied to the requirement.

g. Long Box Spread in European-Style Options.

With respect to a long box spread as defined in Rule 2522, in which all component options have a European-style exercise provision and are issued by a registered clearing agency or guaranteed by the carrying broker/dealer, margin must be deposited and maintained equal to at least 50% of the [aggregate] difference in the exercise prices. The net proceeds from the sale of short option components may be applied to the requirement. For margin purposes, the long box spread may be valued at an amount not to exceed 100% of the [aggregate] difference in the exercise prices.

h. Long Condor Spread. This subparagraph applies to a long condor spread as defined in Rule 2522 where all option positions are issued by a registered clearing agency

or guaranteed by the carrying broker/dealer. With respect to a long condor spread as defined in Rule 2522, the net debit must be paid in full.

i. Short Iron Butterfly Spread. This subparagraph applies to a short iron butterfly spread as defined in Rule 2522 where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer. With respect to a short iron butterfly spread as defined in Rule 2522, margin must be deposited and maintained equal to at least the amount of the exercise price interval. The net proceeds from the sale of short option components may be applied to the requirement.

j. Short Iron Condor Spread. This subparagraph applies to a short iron condor spread as defined in Rule 2522 where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer. With respect to a short iron condor spread as defined in Rule 2522, margin must be deposited and maintained equal to at least the amount of the exercise price interval. The net proceeds from the sale of short option components may be applied to the requirement.

k. Long Calendar Butterfly Spread. This subparagraph applies to a long calendar butterfly spread as

defined in Rule 2522 where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer. With respect to a long calendar butterfly spread as defined in Rule 2522, the net debit must be paid in full.

l. Long Calendar Condor Spread. This subparagraph applies to a long calendar condor spread as defined in Rule 2522 where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer. With respect to a long calendar condor spread as defined in Rule 2522, the net debit must be paid in full.

m. Short Calendar Iron Butterfly Spread. This subparagraph applies to a short calendar iron butterfly spread as defined in Rule 2522 where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer. With respect to a short calendar iron butterfly spread as defined in Rule 2522, margin must be deposited and maintained equal to at least the amount of the exercise price interval. The net proceeds from the sale of short option components may be applied to the requirement.

n. Short Calendar Iron Condor Spread. This subparagraph applies to a short calendar iron condor spread as defined in Rule 2522 where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer. With respect to a short calendar iron condor spread as defined in Rule 2522, margin must be deposited and maintained equal to at least the amount of the exercise price interval. The net proceeds from the sale of short option components may be applied to the requirement.

(H) through (I) No Change.

(J) (i) Registered specialists, market makers or traders — Notwithstanding the other provisions of this subparagraph (f)(2), a member may clear and carry the listed option transactions of one or more registered specialists, registered market makers or registered traders in options (whereby[which] registered traders are deemed specialists for all purposes under the Act, pursuant to the rules of a national securities exchange) (hereinafter referred to as "specialist(s)"), upon a "Good Faith" margin basis satisfactory to the concerned parties, provided the "Good Faith" margin requirement[s] is not less than the Net Capital haircut deduction of the member [organization] carrying the transaction pursuant to SEC Rule 15c3-1 under the Act. In lieu of collecting the "Good

Faith" margin requirement, a carrying member [organization] may elect to deduct in computing its Net Capital the amount of any deficiency between the equity maintained in the account and the "Good Faith" margin required.

For purposes of this paragraph (f)(2)(J), a permitted offset position means, in the case of an option in which a specialist or market maker makes a market, a position in the underlying asset or other related assets, and in the case of other securities in which a specialist or market maker makes a market, a position in options overlying the securities in which a specialist or market maker makes a market. Accordingly, a specialist or market maker in options may establish, on a share-for-share basis, a long or short position in the securities underlying the options in which the specialist or market maker makes a market, and a specialist or market maker in securities other than options may purchase or write options overlying the securities in which the specialist or market maker makes a market, if the account holds the following permitted offset positions:

- a. A short option position which[is "in or at the money" and] is not offset by a long or short option position for an equal or greater number of shares of the same underlying security which is "in the money";

b. A long option position which[is "in or at the money" and] is not offset by a long or short option position for an equal or greater number of shares of the same underlying security which is "in the money";

c. A short option position against which an exercise notice was tendered;

d. A long option position which was exercised;

e. A net long position in a security (other than an option) in which a specialist or market maker makes a market;

f. A net short position in a security (other than an option) in which the specialist or market maker makes a market; or

g. A specified portfolio type as referred to in SEC Rule 15c3-1, including its appendices, or any applicable SEC staff interpretation or no-action position.

Permitted offset transactions must be effected for specialist or market making purposes such as hedging, risk reduction, rebalancing of positions, liquidation, or accommodation[s] of customer orders, or other similar [market making]specialist or market maker purpose. The specialist or market maker must be able to demonstrate compliance with this provision.

For purposes of this paragraph (f)(2)(J),[the term "in or at the money" means the current market price of the underlying security is not more than two standard exercise intervals below (with respect to a call option) or above (with respect to a put option) the exercise price of the option;] the term "in the money" means the current market price of the underlying asset or index is not below (with respect to a call option) or above (with respect to a put option) the exercise price of the option; and, the term "overlying option" means a put option purchased or a call option written against a long position in an underlying asset; or a call option purchased or a put option written against a short position in an underlying asset.

(ii) Securities, including options, in such accounts shall be valued conservatively in the light of current market prices and the amount which might be realized upon liquidation. Substantial additional margin must be required or excess [n]Net [c]Capital maintained in all cases where the securities carried:

a. through b. No Change.

c. in one or more or all accounts, including proprietary accounts combined, are such that they cannot be liquidated promptly or represent undue concentration of risk in view of the carrying member's [n]Net [c]Capital and its overall exposure to material loss.

(K) through (L) No Change.

(M) Cash account transactions — A member may make option transactions in a customer's cash account, provided that:

(i) No Change.

(ii) Spreads. A European-style cash-settled index stock group option or stock index warrant carried in a short position is deemed a covered position, and eligible for the cash account, provided a long position in a European-style cash-settled stock group index option, or stock index warrant having the same underlying component or index that is based on the same aggregate current underlying value, is held in or purchased for the account on the same day, provided that:

a. through b. No Change.

c. there is held in the account at the time the positions are established, or received into the account promptly thereafter:

1. cash or cash equivalents of not less than any amount by which the [aggregate] exercise price of the long call or call warrant (short put or put warrant) exceeds the [aggregate] exercise price of the short call or call warrant (long put or put warrant), to which [requirement of] net proceeds

from the sale of the short position may be applied,

or

2. an escrow agreement.

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement i. cash, ii. cash equivalents, or iii. a combination thereof having an aggregate market value at the time the positions are established of not less than any amount by which the [aggregate] exercise price of the long call or call warrant (short put or put warrant) exceeds the [aggregate] exercise price of a short call or call warrant (long put or put warrant) and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice or that the bank will promptly pay the member funds sufficient to purchase a warrant sold short in the event of a buy-in.

- d. No Change.

(iii) **Long Butterfly Spreads, Short Butterfly Spreads, Long Condor Spreads, Short Iron Butterfly Spreads, or Short Iron Condor Spreads.** Put or call options carried in a short position are deemed covered positions and eligible for the cash

account provided that the account contains long positions of the same type which in conjunction with the short options, constitute a long butterfly spread, short butterfly spread, long condor spread, short iron butterfly spread, or short iron condor spread as defined in Rule 2522 and provided that:

a. through d. No Change.

e. all components options expire concurrently;

[e]f. with respect to a long butterfly spread or long condor spread as defined in Rule 2522, the net debit is paid in full; and

[f]g. with respect to a short butterfly spread, short iron butterfly spread or short iron condor spread as defined in Rule 2522, there is held in the account at the time the positions are established or received into the account promptly thereafter:

1. cash or cash equivalents of not less than the amount of the [aggregate] difference between the two lowest exercise prices with respect to short butterfly spreads comprised of call options or the [aggregate] difference between the two highest exercise prices with respect to short butterfly spreads comprised [or] of put options, to which

[requirement] the net proceeds from the sale of short option components may be applied; or

2. an escrow agreement.

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement i. cash, ii. cash equivalents or iii. a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the [aggregate] difference between the two lowest exercise prices with respect to short butterfly spreads comprised of calls or the [aggregate] difference between the two highest exercise prices with respect to short butterfly spreads comprised of puts and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice on the call (put) with the lowest (highest) exercise price.

(iv) **Box Spreads.** Puts and calls carried in a short position are deemed covered positions and eligible for the cash account provided that the account contains long positions which in conjunction with the short options constitute a box spread as defined in Rule 2522 provided that:

a. through d. No Change.

e. all component options expire concurrently;

[e]f. with respect to a long box spread as defined in Rule 2522, the net debit is paid in full; and

[f]g. with respect to a short box spread as defined in Rule 2522, there is held in the account at the time the positions are established, or received into the account promptly thereafter:

1. cash or cash equivalents of not less than the amount of the [aggregate] difference between the exercise prices, to which [requirement] the net proceeds from the sale of short option components may be applied; or

2. an escrow agreement.

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement i. cash, ii. cash equivalents or iii. a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the [aggregate] difference between the exercise prices and that the bank will promptly pay the member

such amount in the event the account is assigned an exercise notice on either short option.

(3) through (11) No Change.

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2522. Definitions Related to Options, Currency Warrants, Currency Index

Warrants and Stock Index Warrants Transactions.

(a) The following definitions shall apply to the margin requirements for options, currency warrants, currency index warrants and stock index warrants transactions:

(1) through (5) No Change.

(6) Box Spread

The term "box spread" means an aggregation of positions in a long call and short put with the same exercise price ("buy side") coupled with a long put and short call with the same exercise price ("sell side") [all of which have the same underlying component or index and time of expirations, and are based on the same aggregate current underlying value, and are] structured as[;]; (A) a "long box spread" in which the sell side exercise price exceeds the buy side exercise price or (B) a "short box spread" in which the buy side exercise price exceeds the sell side exercise price[.], all of which have the same contract size, underlying component or index and time of expiration, and are based on the same aggregate current underlying value.

(7) through (8) No Change.

(9) Butterfly Spread

The term "butterfly spread" means an aggregation of positions in three series of either puts or calls, [all having the same underlying component or index, and time of expiration, and based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, which positions are] structured as either: (A) a "long butterfly spread" in which two short options in the same series are offset by one long option with a higher exercise price and one long option with a lower exercise price or (B) a "short butterfly spread" in which two long options in the same series offset one short option with a higher exercise price and one short option with a lower exercise price[.], all of which have the same contract size, underlying component or index and time of expiration, are based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, and the exercise prices are in ascending order.

(10) Calendar Spread

The term "calendar spread" or "time spread" means the sale of one option and the simultaneous purchase of another option of the same type, both specifying the same underlying component with the same exercise price or different exercise prices, where the "long" option expires after the "short" option.

(10) through (22) renumbered as (11) through (23).

[(23)](24) Escrow Agreement

The term "escrow agreement," when used in connection with cash settled calls, puts, currency warrants, currency index warrants, or stock index warrants carried short, means any agreement issued in a form acceptable to [the

Association]NASD under which a bank holding cash, cash equivalents, one or more qualified equity securities or a combination thereof in the case of a call [option] or warrant or cash, cash equivalents or a combination thereof in the case of a put [option] or warrant is obligated (in the case of an option) to pay the creditor the exercise settlement amount in the event an option is assigned an exercise notice or, (in the case of a warrant) the funds sufficient to purchase a warrant sold short in the event of a buy-in.

[The term "escrow agreement" when used in connection with non cash settled call or put options carried short, means any agreement issued in a form acceptable to the Association under which a bank holding the underlying security (in the case of a call option) or required cash or cash equivalents or a combination thereof (in the case of a put option) is obligated to deliver to the creditor (in the case of a call option) or accept from the creditor (in the case of a put option) the underlying security against payment of the exercise price in the event of the call or put is assigned an exercise notice.]

(24) through (40) renumbered as (25) through (41).

(42) Long Calendar Butterfly Spread

The term "long calendar butterfly spread" means an aggregation of positions in three series of either puts or calls, structured as two short options with the same exercise price, offset by a long option with a lower exercise price and a long option with a higher exercise price, all of which have the same contract size, underlying component or index, are based on the same aggregate current underlying value, where the interval between the exercise price of each series is

equal, the exercise prices are in consecutive order, and one long option expires after the other three options expire concurrently. However, a long calendar butterfly spread cannot be composed of cash-settled, European-style index options. This strategy can also be considered a combination of one long calendar spread and one long butterfly spread, as defined in this rule.

(43) Long Calendar Condor Spread

The term “long calendar condor spread” means an aggregation of positions in four series of either puts or calls, structured as a long option with the lowest exercise price, two short options with the next two consecutively higher exercise prices and a long option with the highest exercise price, all of which have the same contract size, underlying component or index, are based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, the exercise prices are in consecutive order, and one long option expires after the other three options expire concurrently. However, a long calendar condor spread cannot be composed of cash-settled, European-style index options. This strategy can also be considered a combination of one long calendar spread and two long butterfly spreads, as defined in this rule.

(44) Long Condor Spread

The term “long condor spread” means an aggregation of positions in four series of either puts or calls, structured as a long option with the lowest exercise price, two short options with the next two consecutively higher exercise prices and a long option with the highest exercise price, all of which have the same contract size, underlying component or index and time of expiration, are based on

the same aggregate current underlying value, where the interval between the exercise price of each series is equal, and the exercise prices are in consecutive order. This strategy can also be considered a combination of two long butterfly spreads, as defined in this rule.

(41) through (60) renumbered as (45) through (64).

(65) Short Calendar Iron Butterfly Spread

The term “short calendar iron butterfly spread” means an aggregation of positions in two series of puts and two series of calls, structured as a short put and a short call with the same exercise price, offset by a long put with a lower exercise price and a long call with a higher exercise price, all of which have the same contract size, underlying component or index, are based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, the exercise prices are in consecutive order, and one long option expires after the other three options expire concurrently. However, a short calendar iron butterfly spread cannot be composed of cash-settled, European-style index options. This strategy can also be considered a combination of one long calendar spread, one long butterfly spread, and one short box spread, as defined in this rule.

(66) Short Calendar Iron Condor Spread

The term “short calendar iron condor spread” means an aggregation of positions in two series of puts and two series of calls, structured as a long put with the lowest exercise price, a short put and a short call with the next two consecutively higher exercise prices and a long call with the highest exercise

price, all of which have the same contract size, underlying component or index, are based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, the exercise prices are in consecutive order, and one long option expires after the other three options expire concurrently. However, a short calendar iron condor spread cannot be composed of cash-settled, European-style index options. This strategy can also be considered a combination of one long calendar spread, two long butterfly spreads, and one short box spread, as defined in this rule

(67) Short Iron Butterfly Spread

The term “short iron butterfly spread” means an aggregation of positions in two series of puts and two series of calls, structured as a short put and a short call with the same exercise price, offset by a long put with a lower exercise price and a long call with a higher exercise price, all of which have the same contract size, underlying component or index and time of expiration, are based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, and the exercise prices are in consecutive order. This strategy can also be considered a combination of one long butterfly spread and one short box spread, as defined in this rule.

(68) Short Iron Condor Spread

The term “short iron condor spread” means an aggregation of positions in two series of puts and two series of calls, structured as a long put with the lowest exercise price, a short put and a short call with the next two consecutively higher exercise prices, and a long call with the highest exercise price, all of which have

the same contract size, underlying component or index and time of expiration, are based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, and the exercise prices are in consecutive order. This strategy can also be considered a combination of two long butterfly spreads and one short box spread, as defined in this rule.

(61) through (77) renumbered as (69) through (85).