

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"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action <input type="checkbox"/>	Date Expires <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<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).

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 Rule 2860(b)(23) (Tendering Procedures for Exercise of Options) to: (1) simplify the manner in which a Contrary Exercise Advice (“CEA”) is submitted; (2) extend by one hour the cut-off time by which members must submit CEA notices; (3) add procedures for exercising a standardized equity option when a modified close of trading is announced; and (4) consolidate all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) instead of having additional and overlapping provisions in Rule 11850 (Tendering Procedures for Exercise of Options) as is currently the case. 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) through (22) No Change.

¹ 15 U.S.C. 78s(b)(1).

(23) Tendering Procedures for Exercise of Options

(A) Exercise of Options Contracts

(i) Subject to the restrictions established pursuant to paragraph (b)(4) and (b)(8) hereof and such other restrictions that may be imposed by [the Association]NASD, The Options Clearing Corporation or an options exchange pursuant to appropriate rules, an outstanding option contract issued by The Options Clearing Corporation may be exercised during the time period specified in the rules of The Options Clearing Corporation by the tender to The Options Clearing Corporation of an exercise notice in accordance with rules of The Options Clearing Corporation. An exercise notice may be tendered to The Options Clearing Corporation only by the clearing member in whose account the option contract is carried. [Exercise instructions of their customers relating to exchange listed option contracts shall not be accepted by members after 5:30 p.m. (Eastern Time) on the business day immediately prior to the expiration date of any option contract. Exercise instructions in respect of such option contracts carried in any proprietary account of a member shall similarly not be accepted by any other member with which such member maintains an account after 5:30 p.m. (Eastern Time) on the business day immediately prior to the expiration date of any option contract.]Members may

establish fixed procedures as to the latest time they will accept exercise instructions from customers.

[(ii) Notwithstanding the provisions of subparagraph (A)(i) hereof, members may receive and act on exercise instructions after the cut-off time for the acceptance of exercise instructions but prior to 5:00 p.m. (Eastern Time) on the expiration date of an option contract:]

[a. in the case of option contracts carried in an account maintained for another member in which only positions of customers of such other member are carried;]

[b. in order to remedy mistakes or errors made in good faith;]

[c. to take appropriate action as the result of a failure to reconcile unmatched option transactions; or]

[d. where extraordinary circumstances relating to a public customer's ability to communicate exercise instructions to the member (or the member's ability to receive exercise instructions) prior to such cut-off time warrant such action.]

[(iii) This subparagraph (A) is intended as a means of providing for relatively uniform procedures in respect of exercise instructions and not to alter or affect in any way the expiration times for an option which are fixed in accordance with the rules of

The Options Clearing Corporation or any other provisions of an options contract, and the exercise prior to expiration of an option contract in contravention of this subparagraph (A) shall neither affect the validity of such exercise nor modify or otherwise affect any right or obligation of any holder or writer of any option contract of such series of options.]

(ii) Final exercise decisions of options holders to either exercise or not to exercise an expiring standardized equity option must be indicated to an options exchange that is a national securities exchange (national options exchange) that lists and trades the option, either directly to such national options exchange or via a member of such national options exchange if it is not a member of such exchange, by the respective member no later than 5:30 p.m. Eastern time (“ET”) on the business day immediately prior to the expiration date. For customer accounts, members may not accept exercise instructions after 5:30 p.m. ET but have until 6:30 p.m. ET to submit a Contrary Exercise Advice (as defined below). For non-customer accounts, members may not accept exercise instructions after 5:30 p.m. ET but have until 6:30 p.m. ET to submit a Contrary Exercise Advice if such member employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Members are required to submit a Contrary Exercise Advice by 5:30 p.m. ET

for non-customer accounts if such members do not employ an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Each member shall establish fixed procedures to ensure secure time stamps in connection with their electronic systems employed for the recording of submissions to exercise or not exercise expiring options. For purposes of this Rule 2860(b)(23)(A), the terms “customer account” and non-customer account” shall have the meanings as defined in The Options Clearing Corporation By-laws.

(iii) Special procedures apply to the exercise of standardized equity options on the last business day before their expiration (“expiring options”). Unless waived by The Options Clearing Corporation, expiring standardized equity options are subject to the Exercise-by-Exception (“Ex-by-Ex”) procedure under The Options Clearing Corporation Rule 805. This rule provides that, unless contrary instructions are given, standardized equity option contracts that are in-the-money by specified amounts shall be automatically exercised. In addition to The Options Clearing Corporation rules, the following NASD requirements apply with respect to expiring standardized equity options. Option holders desiring to exercise or not exercise expiring standardized equity options must either:

- a. take no action and allow exercise determinations to be made in accordance with The Options Clearing Corporation's Ex-by-Ex procedure where applicable; or
- b. submit a "Contrary Exercise Advice" by the deadline specified in paragraph (ii) above. A Contrary Exercise Advice is a form approved by the national options exchanges, NASD or The Options Clearing Corporation for use by a member to submit a final exercise decision committing an options holder to either: (1) not exercise an option position which would automatically be exercised pursuant to The Options Clearing Corporation's Ex-by-Ex procedure; or (2) to exercise a standardized equity option position which would not automatically be exercised pursuant to The Options Clearing Corporation's Ex-by-Ex procedure. A Contrary Exercise Advice may be canceled by filing an "Advice Cancel" or resubmitted at any time up to the submission cut-off times specified in paragraph (ii) above. Contrary Exercise Advices and/or Advice Cancels may be submitted by any member to:

1. a place designated for that purpose by any national options exchange of which it is a member and where the standardized equity option is listed;

2. a place designated for that purpose by any national options exchange that lists and trades the standardized equity option via a member of such exchange if the member is not a member of such exchange;

3. any national options exchange of which it is a member and where the standardized equity option is listed via The Options Clearing Corporation in a form prescribed by The Options Clearing Corporation; or

4. any national options exchange where the standardized equity option is listed via The Options Clearing Corporation in a form prescribed by The Options Clearing Corporation, provided the member is a member of The Options Clearing Corporation.

(iv) In those instances when The Options Clearing Corporation has waived the Ex-by-Ex procedure for an options class, members must either:

a. submit to any of the places listed in paragraphs (iii)b.1. through 4. above, a Contrary Exercise Advice, within the time limits specified in paragraph (ii) above if the holder intends to exercise the standardized equity option, or

b. take no action and allow the standardized equity option to expire without being exercised.

The applicable underlying security price in such instances will be as described in The Options Clearing Corporation Rule 805(1), which is normally the last sale price in the primary market for the underlying security. In cases where the Ex-by-Ex procedure has been waived for an options class, The Options Clearing Corporation rules require that members wanting to exercise such options must submit an affirmative Exercise Notice to The Options Clearing Corporation, whether or not a Contrary Exercise Advice has been filed.

(v) Members that maintain proprietary or public customer positions in expiring standardized equity options shall take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. Members that have accepted the responsibility to indicate final exercise decisions on behalf of another member also shall take necessary steps to ensure that such decisions are

properly indicated to the relevant national options exchange.

Members may establish a processing cut-off time prior to NASD's exercise cut-off time at which they will no longer accept final exercise decisions in expiring standardized equity options from customers.

(vi) Members may effect or amend exercise decisions for standardized equity options after the exercise cut-off time (but prior to expiration) under the following circumstances:

a. in order to remedy mistakes or errors made in good faith;

b. to take appropriate action as the result of a failure to reconcile unmatched option transactions; or

c. where extraordinary circumstances restricted a customer's or member's ability to inform the respective member of such decisions (or a member's ability to receive such decisions) by the cut-off time.

The burden of establishing an exception for a proprietary or customer account of a member rests solely on the member seeking to rely on such exception.

(vii) In the event a national options exchange or The Options Clearing Corporation provides advance notice on or before 5:30 p.m. ET on the business day immediately prior to the last business day before the expiration date indicating that a

modified time for the close of trading in standardized equity options on such last business day before expiration will occur, then the deadline to make a final decision to exercise or not exercise an expiring option shall be 1 hour 28 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. ET deadline found in paragraph (ii) above. However, members may deliver a Contrary Exercise Advice or Advice Cancel to the places specified in paragraphs (iii)b.1. through 4. above within 2 hours 28 minutes following the time announced for the close of trading in standardized equity options on that day instead of the 6:30 p.m. ET deadline found in paragraph (ii) above for customer accounts and non-customer accounts where such member firm employs an electronic submission procedure with time stamp for the submission of exercise instructions. For non-customer accounts, members that do not employ an electronic procedure with time stamp for the submission of exercise instructions are required to deliver a Contrary Exercise Advice or Advice Cancel within 1 hour and 28 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. ET deadline found in paragraph (ii) above.

(viii) The filing of a final exercise decision, exercise instruction, exercise advice, Contrary Exercise Advice or Advice Cancel required by paragraph (A) hereof does not serve as a

substitute to the effective notice required to be submitted to The Options Clearing Corporation for the exercise or non-exercise of expiring standardized equity options.

(ix) Submitting or preparing an exercise instruction after the exercise cut-off time in any expiring standardized equity option on the basis of material information released after the exercise cut-off time is activity inconsistent with just and equitable principles of trade.

(x) The exercise cut-off requirements contained in this paragraph (A) do not apply to any currency option or standardized index option products listed on a national options exchange.

(B) [Each member shall prepare a memorandum of every exercise instruction received from a customer showing the time such instruction was received. Such memoranda shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b) under the Act.] In the event a member receives and acts on an exercise instruction (for its own proprietary account or on behalf of a customer's account) pursuant to an exception set forth in subparagraphs a, b., or c. of subparagraph (A)[(ii)](vi) hereof, the member shall maintain a memorandum setting forth the circumstances giving rise to such exception and shall file a copy of the memorandum with the Market Regulation Department of the national options exchange trading the option, if it is a member of such exchange, or NASD's Market Regulation Department if it is not a member

of such exchange, no later than 12:00 p.m., ET on the business day following that expiration. Such memorandum must additionally include the time when such final exercise decision was made or, in the case of a customer, received, and shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b). [If the member is relying on subparagraph b. or subparagraph d. as the basis for an exception, it shall promptly file a copy of the memorandum with the Association.]

(C) through (D) No Change.

(24) No Change.

* * * * *

[11850. Tendering Procedures for Exercise of Options]

[(a) Exercise of Option Contracts]

[(1) Subject to the restrictions established pursuant to Rule 2860 of the Association's Rules, and such other restrictions which may be imposed by the Association, the Options Clearing Corporation (OCC) or an options exchange pursuant to appropriate rules, an outstanding exchange listed option contract may be exercised during the time period specified in the OCC rules by the tender to OCC of an exercise notice in accordance with OCC rules. An exercise notice may be tendered to OCC only by the clearing member in whose account the option contract is carried. Members may establish fixed procedures as to the latest time at which they will accept exercise notices from their customers.]

[(b) Exercise Cut-Off for Expiring Equity Options]

[(1)(A) Final exercise decisions of options holders to either

exercise or not to exercise an expiring equity option must be indicated to an options exchange that is a national securities exchange (national options exchange) that lists and trades the option, either directly to such national options exchange or via a member of such national options exchange if it is not a member of such exchange, by the respective member no later than 5:30 p.m., Eastern Time on the business day immediately prior to the expiration date (“the exercise cut-off time”) in either of the following manners:]

[(i) take no action and allow exercise determinations to be made in accordance with OCC’s Rule 805 exercise-by-exception procedure where applicable; or]

[(ii) submit a Contrary Exercise Advice. A Contrary Exercise Advice is a form approved by the national options exchanges and the Association for use by a member to submit a final exercise decision committing an options holder to not exercise an option position which would automatically be exercised pursuant to OCC’s exercise-by-exception procedure, or to exercise an equity option position which would not automatically be exercised pursuant to OCC’s exercise-by-exception procedure. Contrary Exercise Advices may be submitted by any member:]

[a. to a place designated for that purpose by any national options exchange of which they are a member and

where the equity option is listed;]

[b. to a place designated for that purpose by any national options exchange that lists and trades the equity option via a member of the such exchange if the member is not a member of such exchange;]

[c. to any national options exchange of which they are a member and where the equity option is listed via OCC in a form prescribed by OCC; or]

[d. to any national options exchange where the equity option is listed via OCC in a form prescribed by OCC, provided the member is a member of OCC.]

[(B) In those instances when OCC has waived the exercise-by-exception procedure, a Contrary Exercise Advice is still required to be submitted by members wanting to exercise an option that would not have been automatically exercised, or not to exercise an option that would have been automatically exercised, had the exercise-by-exception procedure been in effect. The applicable underlying security price in such instances will be as described in OCC Rule 805(1), which is normally the last sale price in the primary market for the underlying security. In cases where the exercise-by-exception procedure has been waived for an options class, OCC rules require that OCC members and member organizations wanting to exercise such options must submit an affirmative Exercise Notice to OCC, whether or not a Contrary Exercise Advice has been filed.]

[(C) Members that maintain proprietary or public customer positions in expiring options shall take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. Members who have accepted the responsibility to indicate final exercise decisions on behalf of another member also shall take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange. Members may establish a processing cut-off time prior to the Association's exercise cut-off time at which they will no longer accept final exercise decisions in expiring options from customers.]

[(2) Members may effect or amend exercise decisions for standardized equity options after the exercise cut-off time (but prior to expiration) under the following circumstances:]

[(A) in order to remedy mistakes or errors made in good faith;]

[(B) to take appropriate action as the result of a failure to reconcile unmatched option transactions; or]

[(C) where extraordinary circumstances restricted a customer's or member's ability to inform the respective member of such decisions (or a member's ability to receive such decisions) by the cut-off time.]

[The burden of establishing an exception for a proprietary or customer account of a member rests solely on the member seeking to rely on such exception.]

[(3) In the event a member makes a final exercise decision (for its own

proprietary account or on behalf of a customer's account) after the exercise cut-off time pursuant to an exception set forth in clauses (A), (B), or (C) of paragraph (b)(2) hereof, the member shall maintain a memorandum setting forth the circumstances regarding such exception and shall file a copy of the memorandum with the Market Regulation Department of the national options exchange trading the option, if it is a member of such exchange, or the Association's Market Regulation Department if it is not a member of such exchange, no later than 12:00 p.m., Eastern Time on the business day following that expiration. Such memorandum must additionally include the time when such final exercise decision was made or, in the case of a customer, received, and shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b).]

[(4) The filing of a final exercise decision required by paragraph (b)(1) hereof does not serve as a substitute to the effective notice required to be submitted to OCC for the exercise or non-exercise of expiring options.]

[(5) Submitting or preparing an exercise instruction after the exercise cut-off time in any expiring option on the basis of material information released after the exercise cut-off time is activity inconsistent with just and equitable principles of trade.]

[(6) The exercise cut-off requirements contained in this paragraph (b) do not apply to any currency option or standardized index option products listed on a national options exchange.]

[(c) Allocation of Exercise Assignment Notices]

[(1) Each member shall establish fixed procedures for the allocation to

customers of exercise notices assigned in respect of a short position in option contracts in such member's customer accounts. Such allocation shall be on a "first in – first out" or automated random selection basis that has been approved by the Association or on a manual random selection basis that has been specified by the Association. Each member shall inform its customers in writing of the method it uses to allocate exercise notices to its customer's accounts, explaining its manner of operation and the consequences of that system.]

[(2) Each member shall report its proposed method of allocation to the Association and obtain the Association's prior approval thereof, and no member shall change its method of allocation unless the change has been reported to and been approved by the Association. The requirements of this paragraph shall not be applicable to allocation procedures submitted to and approved by another self-regulatory organization having comparable standards pertaining to methods of allocation.]

[(3) Each member shall preserve for a three-year period sufficient workpapers and other documentary materials relating to the allocation of exercise assignment notices to establish the manner in which allocation of such exercise assignment notices is in fact being accomplished.]

[(d) Delivery and Payment]

[Delivery of the shares of an underlying security upon the exercise of an option contract and payment of the aggregate exercise price in respect thereto, shall be effected in accordance with the rules of the Options Clearing Corporation. As promptly as practicable after the exercise of an option contract by a customer, the member shall

require the customer to make full cash payment of the aggregate exercise price in the case of a call option contract or to deposit the underlying stock in the case of a put option contract, or, in either case, to make the required margin deposit in respect thereto if such transaction is effected in a margin account, in accordance with the applicable regulations of the Federal Reserve Board and Rule 2520 of the Association's Conduct Rules. As promptly as practicable after the assignment to a customer of an exercise notice, the member shall require the customer to deposit the underlying stock in the case of a call option contract if the shares of the underlying security are not carried in the customer's account, or to make full cash payment of the aggregate exercise price in the case of a put option contract, or, in either case, to make the required margin deposit in respect thereof, if such transaction is effected in a margin account, in accordance with Rule 2520 and the applicable regulations of the Federal Reserve Board.]

* * * * *

(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 January 23, 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, administrative, technical, conforming, and non-substantive changes to NASD rules. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution were 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 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 has filed the proposed rule change for immediate effectiveness. NASD will announce the implementation date of the proposed rule change in a Notice to Members to be published no later than 60 days following the filing of the rule change with the Commission for immediate effectiveness. The implementation date will be 30 days after the date of the Notice to Members.

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

(a) Purpose

NASD is proposing to amend Rule 2860(b)(23) (Tendering Procedures for Exercise of Options) to conform to recent changes to the substantially similar rules of the Options Exchanges.² The proposed rule change presents no novel issues. The proposed rule change simplifies the manner in which a Contrary Exercise Advice (“CEA”) is submitted, extends by one hour the cut-off time by which members must submit CEA notices, and adds procedures for exercising a standardized equity option when a modified

² See Rule 980 of the AMEX; Rule 1042 of the PHLX; Rule 6.24 of the NYSE Arca (formerly the PCX); Rule 11.1 and related Regulatory Circulars RG03-41 and RG 03-54 of the CBOE; Rule 1100 of the ISE; and Chapter VII Section 1 of the BOX (collectively referred to as the “Options Exchanges”).

close of trading is announced. The proposed rule change also consolidates all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) instead of having additional and overlapping provisions in Rule 11850 (Tendering Procedures for Exercise of Options) as is currently the case.

The provisions in Rule 2860(b)(23) apply only to members that are not also members of the exchange on which the option is listed and traded, so-called “access firms.”³ Inasmuch as access firms are not members of an options exchange, it is necessary that the NASD rule subject such firms and customers of such firms to the same requirements for CEAs as customers and firms that are members of an options exchange.

³ See Rule 2860(b)(1)(A)(ii).

Currently, Rule 2860(b)(23)(A) generally requires that members cannot accept instructions to exercise a standardized option from the account of any customer or any other member after 5:30 p.m. Eastern Time (“ET”) on the business day immediately prior the expiration date of an option contract. Rule 2860(b)(23)(A) also provides for an exception to this exercise cut-off time for specified reasons. Rule 2860(b)(23)(B) requires that members maintain records for each exercise instruction. Additional procedures with respect to exercise of standardized options contracts that are not included in Rule 2860 are provided in Rule 11850 of the Uniform Practice Code and address The Options Clearing Corporation’s (“OCC”) exercise-by-exception procedures (“Ex-by-Ex”). The Ex-by-Ex procedures set forth in OCC Rule 805 provide for the automatic exercise of certain options that are in-the-money by a specified amount. Under the Ex-by-Ex procedures, option holders holding an option contract that is in-the-money by a requisite amount and who wish to have their contracts automatically exercised need to take no further action.

However, under OCC Rule 805, option holders who do not want their options automatically exercised or who want their options to be exercised under different parameters than that of the Ex-by-Ex procedure must file a CEA with a national options exchange of which they are a member or where the equity option is listed in accordance with Rule 11850 and instruct the OCC of their “contrary intention.” Rule 11850 is designed, in part, to deter individuals from taking improper advantage of late breaking news by requiring evidence of an options holders’ intention to exercise or not exercise expiring equity options via the submission of a CEA. Members satisfy the filing requirement by manually submitting a CEA form or by electronically submitting the

CEA through OCC's electronic communications system.

If the OCC has waived the Ex-by-Ex procedures for an options class, a member is still required to submit a CEA if the member wants to exercise a standardized equity option that would not have been automatically exercised, or not to exercise a standardized equity option that would have been automatically exercised, had the Ex-by-Ex procedure been in effect.

The Ex-by-Ex procedures contained in the rules of Options Exchanges have recently been amended.⁴ In addition, the Options Exchanges' rules contain provisions for exercising an equity option in the event of a modified close of trading. NASD proposes to (1) amend its rules to conform to the changes to the similar rules of the Options Exchanges, and (2) consolidate the provisions pertaining to the procedures for exercising standardized options set forth in Rule 11850 into Rule 2860(b)(23).

Specifically, Rule 2860(b)(23)(A)(i) would be amended to mirror the provisions of Rule 11850(a)(1) and provide that members may establish fixed procedures as to the latest time they will accept exercise instructions from customers for tender to the OCC.

Rule 2860(b)(23)(A)(ii) would be amended to integrate the provisions of Rule

⁴ See Exchange Act Release No. 47885 (May 16, 2003), 68 FR 28309 (May 23, 2003) (Approval Order of SR-AMEX-2001-92); Exchange Act Release No. 48639 (October 16, 2003), 68 FR 60764 (October 23, 2003) (Notice of Filing and Immediate Effectiveness of SR-PHLX-2003-65); Exchange Act Release No. 48640 (October 16, 2003), 68 FR 60757 (October 23, 2003) (Notice of Filing and Immediate Effectiveness of SR-PCX-2003-47); Exchange Act Release No. 49275 (February 18, 2004), 69 FR 8713 (February 25, 2004) (Notice of Filing and Immediate Effectiveness of SR-CBOE-2003-47); Exchange Act Release No. 48505 (September 17, 2003), 68 FR 55680 (September 26, 2003) (Notice of Filing and Immediate Effectiveness of SR-ISE-2003-20) and Exchange Act Release No. 49191 (February 4, 2004), 69 FR 7055 (February 12, 2004) (Notice of Filing and Immediate Effectiveness of SR-BSE-2004-04).

11850(b)(1)(A) regarding the cut-off time to submit final exercise decisions. In addition, to conform to the similar amendments to the rules of the Options Exchanges, NASD proposes to extend the cut-off time to 6:30 p.m. ET for members to submit CEAs for customer accounts. NASD further proposes to allow members to submit CEAs for non-customer accounts by 6:30 p.m. ET, but only if such member employs an electronic procedure with time stamp recording for the submission of exercise instructions by options holders. Members would have to establish fixed procedures to ensure secure time stamps in connection with the utilization of the electronic stamp provision. If a member does not employ an electronic time stamp and appropriate procedures to ensure secure time stamps, the member would have to submit CEAs for non-customer accounts by 5:30 p.m. ET.

NASD believes that granting members additional time to submit CEAs or Advice Cancels is necessary to address a concern that a 5:30 p.m. ET cut-off time is problematic for customer accounts due to logistical difficulties in the time required to receive customer exercise instructions, and, subsequently, to process them through retail branch systems and back offices before submitting them. NASD believes that extending the cut-off times for CEAs and Advice Cancels for non-customer accounts, if electronically time stamped, is fair and provides for consistent regulation. NASD does not propose to extend the submission cut-off time for members that manually submit CEA and Advice Cancels due to difficulties involved in monitoring manual procedures.

Rule 2860(b)(23)(A)(iii) would be amended to incorporate the provisions of Rule 11850(b)(1)(A) regarding the Ex-by-Ex procedures together with conforming language and definitional changes to harmonize the rule with the rules of the Options Exchanges.

A new subparagraph (iv) would be added to Rule 2860(b)(23)(A) to parallel the provisions of Rule 11850(b)(1)(B) for cases in which the Ex-by-Ex procedure has been waived. New subparagraph (iv) also would track the amended rules of the Options Exchanges that provide that no CEA is required to be filed if the option holder does not wish to exercise the expiring standardized equity option.

Rule 2860(b)(23)(A)(v) would provide (as currently provided in Rule 11850(b)(1)(C)) that members that maintain proprietary or public customer positions in expiring standardized equity options must take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. In addition, members that have accepted the responsibility to indicate final exercise decisions on behalf of another member also must take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange.

Rule 2860(b)(23)(A)(vi) would retain the provision (as currently provided in Rule 2860(b)(23)(A)(ii) and Rule 11850(b)(2)) that would allow members to make final exercise decisions after the exercise cut-off time, but before expiration of the standardized equity option subject to the same exceptions as Rule 11850 currently provides which are also consistent with the rules of the Options Exchanges.⁵ Rule

⁵ See Exchange Act Release No. 35389 (February 16, 1995) 60 FR 10135 (February 23, 1995) (SR-NASD-94-78) regarding the Commission's approval of

2860(b)(23)(B) would also retain the requirements for reporting and record keeping obligations when a member relies on these exceptions as amended by incorporating provisions from Rule 11850(b)(3).

NASD also proposes to add to Rule 2860 a similar provision as found in the rules of the Options Exchanges that address when a national options exchange or the OCC establishes a different exercise cut-off time.⁶ Specifically, proposed Rule 2860(b)(23)(A)(vii) would apply when a different or modified close of trading is announced. In such cases, the option exchange or the OCC would have forewarning of the event and would be required to provide notice of the change in the exercise cut-off time by 5:30 p.m. ET on the business day prior to the last trading day before expiration. Under such circumstances, the deadline for making a final decision to exercise or not exercise would be 1 hour and 28 minutes following the time announced for the close of trading on that day. With respect to the submission of a CEA by members, the cut-off time would be 2 hours and 28 minutes after the close of trading for customer accounts and non-customer accounts where the member firm employs an electronic procedure with time stamp for the submission of exercise instructions. Members that do not employ an electronic submission procedure for exercise instructions would be required to submit a CEA within 1 hour and 28 minutes after the close of trading for its non-customer accounts.

NASD's deletion of the exemption in Rule 11850 that applies "in the case of options contracts carried in an account maintained for another member in which only positions of customers of such other member are carried" in order to conform to the rules of the Options Exchanges.

⁶ See supra note 2.

Proposed subparagraphs (viii), (ix) and (x) of Rule 2860(b)(23)(A), wholly incorporate the provisions of Rule 11850(b)(4) through (6), respectively. As noted above, Rule 2860(b)(23)(B) requiring recordkeeping of instructions would be retained and amended by incorporating provisions from Rule 11850(b)(3).

Finally, paragraphs (C) and (D) of Rule 2860(b)(23) govern the allocation of exercise assignment notices and delivery and payment, respectively. Rule 11850(c) and (d) of the Uniform Practice Code have the same provisions as Rule 2860(b)(23) with regard to these provisions. Accordingly, these provisions are deleted from Rule 11850 as they are covered in Rule 2860(b)(23)(C) and (D).

NASD believes that the proposed rule change is necessary to provide its members that are not members of an options exchange with the same treatment as members of the Options Exchanges. Furthermore, as noted above, the proposed rule change will streamline and simplify the NASD rules as well as harmonize NASD's rule with those of the Options Exchanges.

As noted in Item 2 of this filing, NASD has filed the proposed rule change for immediate effectiveness. NASD will announce the implementation date of the proposed rule change in a Notice to Members to be published no later than 60 days following the filing of the rule change with the Commission for immediate effectiveness. The implementation date will be 30 days after the date of the Notice to Members.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁷ 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 the proposed rule will streamline and simplify the NASD rules by consolidating overlapping provisions. In addition, NASD believes the proposed rule change will promote consistent regulation by harmonizing NASD's rule with those of the Options Exchanges.

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,⁸ in that the proposed rule change

⁷ 15 U.S.C. 78o-3(b)(6).

⁸ 17 CFR 240.19b-4.

does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days after filing. In accordance with Rule 19b-4,⁹ 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 will announce the implementation date of the proposed rule change in a Notice to Members to be published no later than 60 days following the filing of the rule change with the Commission for immediate effectiveness. The implementation date will be 30 days after the date of the Notice to Members.

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

The proposed rule change is being made to harmonize NASD's rule for exercise of options with those of the Options Exchanges.

9. Exhibits

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

⁹ 17 CFR 240.19b-4.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2006-099)

Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendments to Procedures for Exercise of Options

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 Rule 2860(b)(23) (Tendering Procedures for Exercise of Options) to: (1) simplify the manner in which a Contrary Exercise Advice (“CEA”) is submitted; (2) extend by one hour the cut-off time by which members must

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4.

submit CEA notices; (3) add procedures for exercising a standardized equity option when a modified close of trading is announced; and (4) consolidate all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) instead of having additional and overlapping provisions in Rule 11850 (Tendering Procedures for Exercise of Options) as is currently the case. Below is the text of the proposed rule change.

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

* * * * *

2860. Options

(a) No Change.

(b) Requirements

(1) through (22) No Change.

(23) Tendering Procedures for Exercise of Options

(A) Exercise of Options Contracts

(i) Subject to the restrictions established pursuant to paragraph (b)(4) and (b)(8) hereof and such other restrictions that may be imposed by [the Association]NASD, The Options Clearing Corporation or an options exchange pursuant to appropriate rules, an outstanding option contract issued by The Options Clearing Corporation may be exercised during the time period specified in the rules of The Options Clearing Corporation by the tender to The Options Clearing Corporation of an exercise notice in accordance with rules of The Options Clearing Corporation. An exercise

notice may be tendered to The Options Clearing Corporation only by the clearing member in whose account the option contract is carried. [Exercise instructions of their customers relating to exchange listed option contracts shall not be accepted by members after 5:30 p.m. (Eastern Time) on the business day immediately prior to the expiration date of any option contract. Exercise instructions in respect of such option contracts carried in any proprietary account of a member shall similarly not be accepted by any other member with which such member maintains an account after 5:30 p.m. (Eastern Time) on the business day immediately prior to the expiration date of any option contract.]Members may establish fixed procedures as to the latest time they will accept exercise instructions from customers.

[(ii) Notwithstanding the provisions of subparagraph (A)(i) hereof, members may receive and act on exercise instructions after the cut-off time for the acceptance of exercise instructions but prior to 5:00 p.m. (Eastern Time) on the expiration date of an option contract:]

[a. in the case of option contracts carried in an account maintained for another member in which only positions of customers of such other member are carried;]

[b. in order to remedy mistakes or errors made in

good faith;]

[c. to take appropriate action as the result of a failure to reconcile unmatched option transactions; or]

[d. where extraordinary circumstances relating to a public customer's ability to communicate exercise instructions to the member (or the member's ability to receive exercise instructions) prior to such cut-off time warrant such action.]

[(iii) This subparagraph (A) is intended as a means of providing for relatively uniform procedures in respect of exercise instructions and not to alter or affect in any way the expiration times for an option which are fixed in accordance with the rules of The Options Clearing Corporation or any other provisions of an options contract, and the exercise prior to expiration of an option contract in contravention of this subparagraph (A) shall neither affect the validity of such exercise nor modify or otherwise affect any right or obligation of any holder or writer of any option contract of such series of options.]

(ii) Final exercise decisions of options holders to either exercise or not to exercise an expiring standardized equity option must be indicated to an options exchange that is a national securities exchange (national options exchange) that lists and

trades the option, either directly to such national options exchange or via a member of such national options exchange if it is not a member of such exchange, by the respective member no later than 5:30 p.m. Eastern time (“ET”) on the business day immediately prior to the expiration date. For customer accounts, members may not accept exercise instructions after 5:30 p.m. ET but have until 6:30 p.m. ET to submit a Contrary Exercise Advice (as defined below). For non-customer accounts, members may not accept exercise instructions after 5:30 p.m. ET but have until 6:30 p.m. ET to submit a Contrary Exercise Advice if such member employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Members are required to submit a Contrary Exercise Advice by 5:30 p.m. ET for non-customer accounts if such members do not employ an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Each member shall establish fixed procedures to ensure secure time stamps in connection with their electronic systems employed for the recording of submissions to exercise or not exercise expiring options. For purposes of this Rule 2860(b)(23)(A), the terms “customer account” and non-customer account” shall have the

meanings as defined in The Options Clearing Corporation By-laws.

(iii) Special procedures apply to the exercise of standardized equity options on the last business day before their expiration (“expiring options”). Unless waived by The Options Clearing Corporation, expiring standardized equity options are subject to the Exercise-by-Exception (“Ex-by-Ex”) procedure under The Options Clearing Corporation Rule 805. This rule provides that, unless contrary instructions are given, standardized equity option contracts that are in-the-money by specified amounts shall be automatically exercised. In addition to The Options Clearing Corporation rules, the following NASD requirements apply with respect to expiring standardized equity options. Option holders desiring to exercise or not exercise expiring standardized equity options must either:

a. take no action and allow exercise determinations to be made in accordance with The Options Clearing Corporation’s Ex-by-Ex procedure where applicable; or

b. submit a “Contrary Exercise Advice” by the deadline specified in paragraph (ii) above. A Contrary Exercise Advice is a form approved by the national options exchanges, NASD or The Options Clearing Corporation for

use by a member to submit a final exercise decision committing an options holder to either: (1) not exercise an option position which would automatically be exercised pursuant to The Options Clearing Corporation's Ex-by-Ex procedure; or (2) to exercise a standardized equity option position which would not automatically be exercised pursuant to The Options Clearing Corporation's Ex-by-Ex procedure. A Contrary Exercise Advice may be canceled by filing an "Advice Cancel" or resubmitted at any time up to the submission cut-off times specified in paragraph (ii) above. Contrary Exercise Advices and/or Advice Cancels may be submitted by any member to:

1. a place designated for that purpose by any national options exchange of which it is a member and where the standardized equity option is listed;

2. a place designated for that purpose by any national options exchange that lists and trades the standardized equity option via a member of such exchange if the member is not a member of such exchange;

3. any national options exchange of which it is a member and where the standardized equity option is listed via The Options Clearing Corporation in a form prescribed by The Options Clearing Corporation; or

4. any national options exchange where the standardized equity option is listed via The Options Clearing Corporation in a form prescribed by The Options Clearing Corporation, provided the member is a member of The Options Clearing Corporation.

(iv) In those instances when The Options Clearing Corporation has waived the Ex-by-Ex procedure for an options class, members must either:

a. submit to any of the places listed in paragraphs (iii)b.1. through 4. above, a Contrary Exercise Advice, within the time limits specified in paragraph (ii) above if the holder intends to exercise the standardized equity option, or

b. take no action and allow the standardized equity option to expire without being exercised.

The applicable underlying security price in such instances will be as described in The Options Clearing Corporation Rule

805(1), which is normally the last sale price in the primary market for the underlying security. In cases where the Ex-by-Ex procedure has been waived for an options class, The Options Clearing Corporation rules require that members wanting to exercise such options must submit an affirmative Exercise Notice to The Options Clearing Corporation, whether or not a Contrary Exercise Advice has been filed.

(v) Members that maintain proprietary or public customer positions in expiring standardized equity options shall take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. Members that have accepted the responsibility to indicate final exercise decisions on behalf of another member also shall take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange. Members may establish a processing cut-off time prior to NASD's exercise cut-off time at which they will no longer accept final exercise decisions in expiring standardized equity options from customers.

(vi) Members may effect or amend exercise decisions for standardized equity options after the exercise cut-off time (but prior to expiration) under the following circumstances:

a. in order to remedy mistakes or errors made in good faith;

b. to take appropriate action as the result of a failure to reconcile unmatched option transactions; or

c. where extraordinary circumstances restricted a customer's or member's ability to inform the respective member of such decisions (or a member's ability to receive such decisions) by the cut-off time.

The burden of establishing an exception for a proprietary or customer account of a member rests solely on the member seeking to rely on such exception.

(vii) In the event a national options exchange or The Options Clearing Corporation provides advance notice on or before 5:30 p.m. ET on the business day immediately prior to the last business day before the expiration date indicating that a modified time for the close of trading in standardized equity options on such last business day before expiration will occur, then the deadline to make a final decision to exercise or not exercise an expiring option shall be 1 hour 28 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. ET deadline found in paragraph (ii) above. However, members may deliver a Contrary Exercise Advice or Advice Cancel to the places specified

in paragraphs (iii)b.1. through 4. above within 2 hours 28 minutes following the time announced for the close of trading in standardized equity options on that day instead of the 6:30 p.m. ET deadline found in paragraph (ii) above for customer accounts and non-customer accounts where such member firm employs an electronic submission procedure with time stamp for the submission of exercise instructions. For non-customer accounts, members that do not employ an electronic procedure with time stamp for the submission of exercise instructions are required to deliver a Contrary Exercise Advice or Advice Cancel within 1 hour and 28 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. ET deadline found in paragraph (ii) above.

(viii) The filing of a final exercise decision, exercise instruction, exercise advice, Contrary Exercise Advice or Advice Cancel required by paragraph (A) hereof does not serve as a substitute to the effective notice required to be submitted to The Options Clearing Corporation for the exercise or non-exercise of expiring standardized equity options.

(ix) Submitting or preparing an exercise instruction after the exercise cut-off time in any expiring standardized equity option on the basis of material information released after the exercise cut-

off time is activity inconsistent with just and equitable principles of trade.

(x) The exercise cut-off requirements contained in this paragraph (A) do not apply to any currency option or standardized index option products listed on a national options exchange.

(B) [Each member shall prepare a memorandum of every exercise instruction received from a customer showing the time such instruction was received. Such memoranda shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b) under the Act.] In the event a member receives and acts on an exercise instruction (for its own proprietary account or on behalf of a customer's account) pursuant to an exception set forth in subparagraphs a, b., or c. of subparagraph (A)[(ii)](vi) hereof, the member shall maintain a memorandum setting forth the circumstances giving rise to such exception and shall file a copy of the memorandum with the Market Regulation Department of the national options exchange trading the option, if it is a member of such exchange, or NASD's Market Regulation Department if it is not a member of such exchange, no later than 12:00 p.m., ET on the business day following that expiration. Such memorandum must additionally include the time when such final exercise decision was made or, in the case of a customer, received, and shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b). [If the member is relying on subparagraph b. or

subparagraph d. as the basis for an exception, it shall promptly file a copy of the memorandum with the Association.]

(C) through (D) No Change.

(24) No Change.

* * * * *

[11850. Tendering Procedures for Exercise of Options]

[(a) Exercise of Option Contracts]

[(1) Subject to the restrictions established pursuant to Rule 2860 of the Association's Rules, and such other restrictions which may be imposed by the Association, the Options Clearing Corporation (OCC) or an options exchange pursuant to appropriate rules, an outstanding exchange listed option contract may be exercised during the time period specified in the OCC rules by the tender to OCC of an exercise notice in accordance with OCC rules. An exercise notice may be tendered to OCC only by the clearing member in whose account the option contract is carried. Members may establish fixed procedures as to the latest time at which they will accept exercise notices from their customers.]

[(b) Exercise Cut-Off for Expiring Equity Options]

[(1)(A) Final exercise decisions of options holders to either exercise or not to exercise an expiring equity option must be indicated to an options exchange that is a national securities exchange (national options exchange) that lists and trades the option, either directly to such national options exchange or via a member of such national options

exchange if it is not a member of such exchange, by the respective member no later than 5:30 p.m., Eastern Time on the business day immediately prior to the expiration date (“the exercise cut-off time”) in either of the following manners:]

[(i) take no action and allow exercise determinations to be made in accordance with OCC’s Rule 805 exercise-by-exception procedure where applicable; or]

[(ii) submit a Contrary Exercise Advice. A Contrary Exercise Advice is a form approved by the national options exchanges and the Association for use by a member to submit a final exercise decision committing an options holder to not exercise an option position which would automatically be exercised pursuant to OCC’s exercise-by-exception procedure, or to exercise an equity option position which would not automatically be exercised pursuant to OCC’s exercise-by-exception procedure. Contrary Exercise Advices may be submitted by any member:]

[a. to a place designated for that purpose by any national options exchange of which they are a member and where the equity option is listed;]

[b. to a place designated for that purpose by any national options exchange that lists and trades the equity

option via a member of the such exchange if the member is not a member of such exchange;]

[c. to any national options exchange of which they are a member and where the equity option is listed via OCC in a form prescribed by OCC; or]

[d. to any national options exchange where the equity option is listed via OCC in a form prescribed by OCC, provided the member is a member of OCC.]

[(B) In those instances when OCC has waived the exercise-by-exception procedure, a Contrary Exercise Advice is still required to be submitted by members wanting to exercise an option that would not have been automatically exercised, or not to exercise an option that would have been automatically exercised, had the exercise-by-exception procedure been in effect. The applicable underlying security price in such instances will be as described in OCC Rule 805(1), which is normally the last sale price in the primary market for the underlying security. In cases where the exercise-by-exception procedure has been waived for an options class, OCC rules require that OCC members and member organizations wanting to exercise such options must submit an affirmative Exercise Notice to OCC, whether or not a Contrary Exercise Advice has been filed.]

[(C) Members that maintain proprietary or public customer positions in expiring options shall take necessary steps to ensure that final

exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. Members who have accepted the responsibility to indicate final exercise decisions on behalf of another member also shall take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange. Members may establish a processing cut-off time prior to the Association's exercise cut-off time at which they will no longer accept final exercise decisions in expiring options from customers.]

[(2) Members may effect or amend exercise decisions for standardized equity options after the exercise cut-off time (but prior to expiration) under the following circumstances:]

[(A) in order to remedy mistakes or errors made in good faith;]

[(B) to take appropriate action as the result of a failure to reconcile unmatched option transactions; or]

[(C) where extraordinary circumstances restricted a customer's or member's ability to inform the respective member of such decisions (or a member's ability to receive such decisions) by the cut-off time.]

[The burden of establishing an exception for a proprietary or customer account of a member rests solely on the member seeking to rely on such exception.]

[(3) In the event a member makes a final exercise decision (for its own proprietary account or on behalf of a customer's account) after the exercise cut-

off time pursuant to an exception set forth in clauses (A), (B), or (C) of paragraph (b)(2) hereof, the member shall maintain a memorandum setting forth the circumstances regarding such exception and shall file a copy of the memorandum with the Market Regulation Department of the national options exchange trading the option, if it is a member of such exchange, or the Association's Market Regulation Department if it is not a member of such exchange, no later than 12:00 p.m., Eastern Time on the business day following that expiration. Such memorandum must additionally include the time when such final exercise decision was made or, in the case of a customer, received, and shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b).]

[(4) The filing of a final exercise decision required by paragraph (b)(1) hereof does not serve as a substitute to the effective notice required to be submitted to OCC for the exercise or non-exercise of expiring options.]

[(5) Submitting or preparing an exercise instruction after the exercise cut-off time in any expiring option on the basis of material information released after the exercise cut-off time is activity inconsistent with just and equitable principles of trade.]

[(6) The exercise cut-off requirements contained in this paragraph (b) do not apply to any currency option or standardized index option products listed on a national options exchange.]

[(c) Allocation of Exercise Assignment Notices]

[(1) Each member shall establish fixed procedures for the allocation to customers of exercise notices assigned in respect of a short position in option contracts in such member's customer accounts. Such allocation shall be on a "first in – first out" or automated random selection basis that has been approved by the Association or on a manual random selection basis that has been specified by the Association. Each member shall inform its customers in writing of the method it uses to allocate exercise notices to its customer's accounts, explaining its manner of operation and the consequences of that system.]

[(2) Each member shall report its proposed method of allocation to the Association and obtain the Association's prior approval thereof, and no member shall change its method of allocation unless the change has been reported to and been approved by the Association. The requirements of this paragraph shall not be applicable to allocation procedures submitted to and approved by another self-regulatory organization having comparable standards pertaining to methods of allocation.]

[(3) Each member shall preserve for a three-year period sufficient workpapers and other documentary materials relating to the allocation of exercise assignment notices to establish the manner in which allocation of such exercise assignment notices is in fact being accomplished.]

[(d) Delivery and Payment]

[Delivery of the shares of an underlying security upon the exercise of an option contract and payment of the aggregate exercise price in respect thereto, shall be effected in accordance with the rules of the Options Clearing Corporation. As promptly as practicable after the exercise of an option contract by a customer, the member shall require the customer to make full cash payment of the aggregate exercise price in the case of a call option contract or to deposit the underlying stock in the case of a put option contract, or, in either case, to make the required margin deposit in respect thereto if such transaction is effected in a margin account, in accordance with the applicable regulations of the Federal Reserve Board and Rule 2520 of the Association's Conduct Rules. As promptly as practicable after the assignment to a customer of an exercise notice, the member shall require the customer to deposit the underlying stock in the case of a call option contract if the shares of the underlying security are not carried in the customer's account, or to make full cash payment of the aggregate exercise price in the case of a put option contract, or, in either case, to make the required margin deposit in respect thereof, if such transaction is effected in a margin account, in accordance with Rule 2520 and the applicable regulations of the Federal Reserve Board.]

* * * * *

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

NASD is proposing to amend Rule 2860(b)(23) (Tendering Procedures for Exercise of Options) to conform to recent changes to the substantially similar rules of the Options Exchanges.⁴ The proposed rule change presents no novel issues. The proposed rule change simplifies the manner in which a Contrary Exercise Advice (“CEA”) is submitted, extends by one hour the cut-off time by which members must submit CEA notices, and adds procedures for exercising a standardized equity option when a modified close of trading is announced. The proposed rule change also consolidates all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) instead of having additional and overlapping provisions in Rule 11850 (Tendering Procedures for Exercise of Options) as is currently the case.

The provisions in Rule 2860(b)(23) apply only to members that are not also members of the exchange on which the option is listed and traded, so-called “access firms.”⁵ Inasmuch as access firms are not members of an options exchange, it is necessary that the NASD rule subject such firms and customers of such firms to the same requirements for CEAs as customers and firms that are members of an options exchange.

⁴ See Rule 980 of the AMEX; Rule 1042 of the PHLX; Rule 6.24 of the NYSE Arca (formerly the PCX); Rule 11.1 and related Regulatory Circulars RG03-41 and RG 03-54 of the CBOE; Rule 1100 of the ISE; and Chapter VII Section 1 of the BOX (collectively referred to as the “Options Exchanges”).

⁵ See Rule 2860(b)(1)(A)(ii).

Currently, Rule 2860(b)(23)(A) generally requires that members cannot accept instructions to exercise a standardized option from the account of any customer or any other member after 5:30 p.m. Eastern Time (“ET”) on the business day immediately prior the expiration date of an option contract. Rule 2860(b)(23)(A) also provides for an exception to this exercise cut-off time for specified reasons. Rule 2860(b)(23)(B) requires that members maintain records for each exercise instruction. Additional procedures with respect to exercise of standardized options contracts that are not included in Rule 2860 are provided in Rule 11850 of the Uniform Practice Code and address The Options Clearing Corporation’s (“OCC”) exercise-by-exception procedures (“Ex-by-Ex”). The Ex-by-Ex procedures set forth in OCC Rule 805 provide for the automatic exercise of certain options that are in-the-money by a specified amount. Under the Ex-by-Ex procedures, option holders holding an option contract that is in-the-money by a requisite amount and who wish to have their contracts automatically exercised need to take no further action.

However, under OCC Rule 805, option holders who do not want their options automatically exercised or who want their options to be exercised under different parameters than that of the Ex-by-Ex procedure must file a CEA with a national options exchange of which they are a member or where the equity option is listed in accordance with Rule 11850 and instruct the OCC of their “contrary intention.” Rule 11850 is designed, in part, to deter individuals from taking improper advantage of late breaking news by requiring evidence of an options holders’ intention to exercise or not exercise expiring equity options via the submission of a CEA. Members satisfy the filing

requirement by manually submitting a CEA form or by electronically submitting the CEA through OCC's electronic communications system.

If the OCC has waived the Ex-by-Ex procedures for an options class, a member is still required to submit a CEA if the member wants to exercise a standardized equity option that would not have been automatically exercised, or not to exercise a standardized equity option that would have been automatically exercised, had the Ex-by-Ex procedure been in effect.

The Ex-by-Ex procedures contained in the rules of Options Exchanges have recently been amended.⁶ In addition, the Options Exchanges' rules contain provisions for exercising an equity option in the event of a modified close of trading. NASD proposes to (1) amend its rules to conform to the changes to the similar rules of the Options Exchanges, and (2) consolidate the provisions pertaining to the procedures for exercising standardized options set forth in Rule 11850 into Rule 2860(b)(23).

Specifically, Rule 2860(b)(23)(A)(i) would be amended to mirror the provisions of Rule 11850(a)(1) and provide that members may establish fixed procedures as to the latest time they will accept exercise instructions from customers for tender to the OCC.

⁶ See Exchange Act Release No. 47885 (May 16, 2003), 68 FR 28309 (May 23, 2003) (Approval Order of SR-AMEX-2001-92); Exchange Act Release No. 48639 (October 16, 2003), 68 FR 60764 (October 23, 2003) (Notice of Filing and Immediate Effectiveness of SR-PHLX-2003-65); Exchange Act Release No. 48640 (October 16, 2003), 68 FR 60757 (October 23, 2003) (Notice of Filing and Immediate Effectiveness of SR-PCX-2003-47); Exchange Act Release No. 49275 (February 18, 2004), 69 FR 8713 (February 25, 2004) (Notice of Filing and Immediate Effectiveness of SR-CBOE-2003-47); Exchange Act Release No. 48505 (September 17, 2003), 68 FR 55680 (September 26, 2003) (Notice of Filing and Immediate Effectiveness of SR-ISE-2003-20) and Exchange Act Release No. 49191 (February 4, 2004), 69 FR 7055 (February 12, 2004) (Notice of Filing and Immediate Effectiveness of SR-BSE-2004-04).

Rule 2860(b)(23)(A)(ii) would be amended to integrate the provisions of Rule 11850(b)(1)(A) regarding the cut-off time to submit final exercise decisions. In addition, to conform to the similar amendments to the rules of the Options Exchanges, NASD proposes to extend the cut-off time to 6:30 p.m. ET for members to submit CEAs for customer accounts. NASD further proposes to allow members to submit CEAs for non-customer accounts by 6:30 p.m. ET, but only if such member employs an electronic procedure with time stamp recording for the submission of exercise instructions by options holders. Members would have to establish fixed procedures to ensure secure time stamps in connection with the utilization of the electronic stamp provision. If a member does not employ an electronic time stamp and appropriate procedures to ensure secure time stamps, the member would have to submit CEAs for non-customer accounts by 5:30 p.m. ET.

NASD believes that granting members additional time to submit CEAs or Advice Cancels is necessary to address a concern that a 5:30 p.m. ET cut-off time is problematic for customer accounts due to logistical difficulties in the time required to receive customer exercise instructions, and, subsequently, to process them through retail branch systems and back offices before submitting them. NASD believes that extending the cut-off times for CEAs and Advice Cancels for non-customer accounts, if electronically time stamped, is fair and provides for consistent regulation. NASD does not propose to extend the submission cut-off time for members that manually submit CEA and Advice Cancels due to difficulties involved in monitoring manual procedures.

Rule 2860(b)(23)(A)(iii) would be amended to incorporate the provisions of Rule 11850(b)(1)(A) regarding the Ex-by-Ex procedures together with conforming language and definitional changes to harmonize the rule with the rules of the Options Exchanges.

A new subparagraph (iv) would be added to Rule 2860(b)(23)(A) to parallel the provisions of Rule 11850(b)(1)(B) for cases in which the Ex-by-Ex procedure has been waived. New subparagraph (iv) also would track the amended rules of the Options Exchanges that provide that no CEA is required to be filed if the option holder does not wish to exercise the expiring standardized equity option.

Rule 2860(b)(23)(A)(v) would provide (as currently provided in Rule 11850(b)(1)(C)) that members that maintain proprietary or public customer positions in expiring standardized equity options must take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. In addition, members that have accepted the responsibility to indicate final exercise decisions on behalf of another member also must take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange.

Rule 2860(b)(23)(A)(vi) would retain the provision (as currently provided in Rule 2860(b)(23)(A)(ii) and Rule 11850(b)(2)) that would allow members to make final exercise decisions after the exercise cut-off time, but before expiration of the standardized equity option subject to the same exceptions as Rule 11850 currently

provides which are also consistent with the rules of the Options Exchanges.⁷ Rule 2860(b)(23)(B) would also retain the requirements for reporting and record keeping obligations when a member relies on these exceptions as amended by incorporating provisions from Rule 11850(b)(3).

NASD also proposes to add to Rule 2860 a similar provision as found in the rules of the Options Exchanges that address when a national options exchange or the OCC establishes a different exercise cut-off time.⁸ Specifically, proposed Rule 2860(b)(23)(A)(vii) would apply when a different or modified close of trading is announced. In such cases, the option exchange or the OCC would have forewarning of the event and would be required to provide notice of the change in the exercise cut-off time by 5:30 p.m. ET on the business day prior to the last trading day before expiration. Under such circumstances, the deadline for making a final decision to exercise or not exercise would be 1 hour and 28 minutes following the time announced for the close of trading on that day. With respect to the submission of a CEA by members, the cut-off time would be 2 hours and 28 minutes after the close of trading for customer accounts and non-customer accounts where the member firm employs an electronic procedure with time stamp for the submission of exercise instructions. Members that do not employ an electronic submission procedure for exercise instructions would be required to submit a

⁷ See Exchange Act Release No. 35389 (February 16, 1995) 60 FR 10135 (February 23, 1995) (SR-NASD-94-78) regarding the Commission's approval of NASD's deletion of the exemption in Rule 11850 that applies "in the case of options contracts carried in an account maintained for another member in which only positions of customers of such other member are carried" in order to conform to the rules of the Options Exchanges.

⁸ See supra note 4.

CEA within 1 hour and 28 minutes after the close of trading for its non-customer accounts.

Proposed subparagraphs (viii), (ix) and (x) of Rule 2860(b)(23)(A), wholly incorporate the provisions of Rule 11850(b)(4) through (6), respectively. As noted above, Rule 2860(b)(23)(B) requiring recordkeeping of instructions would be retained and amended by incorporating provisions from Rule 11850(b)(3).

Finally, paragraphs (C) and (D) of Rule 2860(b)(23) govern the allocation of exercise assignment notices and delivery and payment, respectively. Rule 11850(c) and (d) of the Uniform Practice Code have the same provisions as Rule 2860(b)(23) with regard to these provisions. Accordingly, these provisions are deleted from Rule 11850 as they are covered in Rule 2860(b)(23)(C) and (D).

NASD believes that the proposed rule change is necessary to provide its members that are not members of an options exchange with the same treatment as members of the Options Exchanges. Furthermore, as noted above, the proposed rule change will streamline and simplify the NASD rules as well as harmonize NASD's rule with those of the Options Exchanges.

NASD has filed the proposed rule change for immediate effectiveness. NASD will announce the implementation date of the proposed rule change in a Notice to Members to be published no later than 60 days following the filing of the rule change with the Commission for immediate effectiveness. The implementation date will be 30 days after the date of the Notice to Members.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁹ 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 the proposed rule will streamline and simplify the NASD rules by consolidating overlapping provisions. In addition, NASD believes the proposed rule change will promote consistent regulation by harmonizing NASD's rule with those of the Options Exchanges.

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;
- (ii) impose any significant burden on competition; and

⁹ 15 U.S.C. 78o-3(b)(6).

(iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.¹⁰

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.

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- 2006-099 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.

¹⁰ 17 CFR 240.19b-4(f)(6).

All submissions should refer to File Number SR-NASD- 2006-099. 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-2006-099 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.¹¹

Nancy M. Morris

Secretary

¹¹ 17 CFR 200.30-3(a)(12).