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September 5, 2002

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-2002-40, Amendment No. 2 – Security Futures Rules**

Dear Ms. England:

NASD hereby submits Amendment No. 2 to SR-NASD-2002-40 (the “rule filing”). The amendment, in part, addresses issues raised in the two comment letters received by the Securities and Exchange Commission (“SEC”).¹ After evaluating all of the points expressed in the comment letters, NASD believes that it should retain the provisions of the rule filing, except for the amendments noted in this letter.

Specifically, NASD has addressed the comments made by SIA, FIA, and CBOE on confirmations of security futures transactions by eliminating NASD’s confirmation requirement. NASD has also addressed SIA and FIA comments regarding customer account statements by eliminating subparagraph (B) of Rule 2865(b)(15). Rule 2865(b)(15)(B) pertained to margin equity requirements that are more appropriately addressed in other rules.

NASD does not agree to make the changes concerning discretionary accounts requested by CBOE at this time. The “Discretionary Accounts” section of Rule 2865(b)(18) tracks the requirements for options. Although CBOE has proposed to amend its options rules, the SEC has not approved CBOE’s rules. NASD, therefore, will consider amending both its options and security futures rules once CBOE’s proposed rules have been approved. In addition, SIA and FIA have requested that the requirement in subparagraph (A) of Rule 2865(b)(15) that members show “the market value of each securities futures position” as well as the “total market value of all positions” be deleted or replaced with other language. Based upon further

¹ Letter to Jonathan Katz, Secretary, SEC, from Jonathan Barton, Chairman, Steering Committee on Security Futures of the Futures Industry Association (“FIA”) and Securities Industry Association (“SIA”) (August 9, 2002); Letter to Jonathan G. Katz, Secretary, SEC, from Richard G. DuFour, Executive Vice President, Chicago Board Options Exchange, Inc. (“CBOE”) (August 21, 2002).

conversations with the SIA and FIA, we have made certain changes to the customer account statement requirements. We have stated that for customer account statements involving security futures, members should provide the market price, mark-to-market value and nominal value.

Several of the SIA and FIA comments called for NASD to change its rule filing to ease restrictive aspects of the proposed rules. NASD believes that its proposed rules further the goal of investor protection by using the NASD's options rules as the basis for the majority of its security futures rules. This approach also is consistent with the requirements outlined in the Commodity Futures Modernization Act of 2000. Accordingly, NASD intends to retain the following rules as proposed: the registration and qualification requirements in Rule 1022; the front-running interpretation - IM-2110-3; the advertising rules - Rules 2210 and IM-2210-7; the application of NASD's by-laws, rules, and other interpretations to security futures trading - Rule 2865(b)(1)(C); diligence in opening accounts - Rule 2865(b)(16); recordkeeping - Rule 2865(b)(17); and security futures transactions and reports - Rule 2865(b)(24).

The SIA and FIA comment letter raises several issues regarding how existing NASD rules will apply to security futures and seeks clarification on certain aspects of NASD's proposed rules. NASD agrees that addressing many of these points will be helpful to NASD members. NASD will address the following issues in a *Notice to Members*: the application of NASD's best execution rule, Rule 2320, to security futures; that the Series 55 qualification will not be needed for associated persons to trade security futures; that NASD intends to recognize the Series 30 qualification as acceptable for an associated person in a firm registered as a broker/dealer and either a futures commission merchant or introducing broker to supervise security futures; that the suitability obligations to institutional customers interpretation, IM-2310-3, will apply to security futures; and when the trading ahead of customer orders requirement, Rule 2865(b)(25), will apply.

Accordingly, NASD hereby amends the rule filing as follows:²

1. The "Registered Options and Security Futures Principals" section in proposed Rule 1022(f)(6) beginning on pages five and sixty-four of the rule filing should be revised to read as follows (new language is underlined and deleted text is [bracketed]):

(5) Any person who is registered with NASD as a Registered Options and Security Futures Principal, or who becomes registered as a Registered Options and Security Futures Principal before a revised examination that

² The changes made in Amendment No. 2 to the rule filing assume that the changes made in Amendment No. 1 have been approved, and therefore, are not indicated in this Amendment. Only current changes to the language made pursuant to this Amendment are shown.

includes security futures products is offered, [may not supervise security futures activities unless such person has, prior to December 31, 2008,] must complete [ed] a firm-element continuing education program [requirement] that addresses security futures and a principal's responsibilities for security futures before such person can supervise security futures activities. After a revised examination that includes security futures products is offered, a person associated with a member [that] who passes such a revised Qualification Examination for Registered Options and Security Futures Principal (or any other examination covering security futures that is acceptable to NASD) is not required to complete a firm-element continuing education program [requirement] that addresses security futures and a principal's responsibilities for security futures to supervise activities in such products, except as otherwise required by Rule 1120 generally or by the member firm. Any Registered Options and Securities Futures Principal who intends to qualify to supervise security futures activities by completing a firm-element continuing education program must complete such a program by December 31, 2006. Any Registered Options and Securities Futures Principal who has not completed a firm-element continuing education program by that date will be required to pass an appropriate qualification examination covering security futures to supervise security futures activities.

2. Rule 1022(g)(3) beginning on pages five and sixty-five of the rule filing should be revised to read as follows (new language is underlined and deleted text is [bracketed]):

(g)(3) Any person who is registered with NASD as a Limited Principal—General Securities Sales Supervisor, or who becomes registered as a Limited Principal – General Securities Sales Supervisor before a revised examination that includes security futures products is offered, [may not act in a limited principal capacity with regard to security futures products unless such person has, prior to December 31, 2008,] must complete [ed] a firm-element continuing education program [requirement] that addresses security futures and a principal's responsibilities for security futures before such person can supervise security futures activities. After a revised examination that includes security futures products is offered, a person associated with a member [that] who passes such a revised Qualification Examination for Limited Principal—General Securities Sales Supervisor (or any other examination covering security futures that is acceptable to NASD) is not required to complete a firm-element continuing education program [requirement] that addresses security futures and a principal's responsibilities for security futures to supervise such products, except as otherwise required by Rule 1120 generally or by the member firm. Any Limited Principal—General Securities Sales Supervisor who intends to qualify to supervise security futures activities by completing a firm-element continuing education program must complete such a program by December 31, 2006. Any Limited Principal—General Security Sales Supervisor

who has not completed a firm-element continuing education program by that date will be required to pass an appropriate qualification examination covering security futures to supervise security futures activities.

3. The “General Securities Representative” section in proposed Rule 1032(a)(2)(E) beginning on pages 8 and sixty-eight of the rule filing should be revised to read as follows (new language is underlined and deleted text is [bracketed]):

(2)(E) A person who is registered with NASD as a General Securities Representative, or who becomes registered as a General Securities Representative before a new examination that includes security futures is offered, [may not act as a General Securities Representative with regard to security futures products unless such person has, prior to December 31, 2008,] must complete [ed] a firm-element continuing education program [requirement] that addresses security futures products before such person can act as a General Securities Representative with regard to security futures products. After a new examination that includes security futures products is offered, a person associated with a member who passes such a new [revised] Qualification Examination for General Securities Representative (or any other examination covering security futures that is acceptable to NASD) is not required to complete a firm-element continuing education program [requirement] that addresses security futures to act as a General Securities Representative with regard to such products, except as otherwise required by Rule 1120 generally or by the member firm. Once the new examination that includes security futures becomes available, persons seeking to become a General Securities Representative will be required to pass such new [revised] examination (or any other examination covering security futures that is acceptable to NASD) to act as a General Securities Representative with regard to security futures products. Only persons registered as General Securities Representatives prior to the time that the new examination is available (“eligible General Securities Representatives”) will be eligible to use a firm-element continuing education program in lieu of passing the new examination to engage in security futures activities. Any eligible General Securities Representative who intends to qualify as a General Securities Representative with regard to security futures products by completing a firm-element continuing education program must complete such a program by December 31, 2006. Any eligible General Securities Representative who has not completed a firm-element continuing education program by that date will be required to pass an appropriate qualification examination to engage in security futures activities.

4. The Limited Representative—Options and Security Futures section in proposed Rule 1032(d)(4) beginning on pages ten and sixty-nine of the rule filing should be revised to read as follows (new language is underlined and deleted text is [bracketed]):

(d)(4) Any person who is registered with NASD as a Limited Representative—Options and Security Futures, or who becomes registered as a Limited Representative—Options and Security Futures before a revised examination that includes security futures is offered, [may not act as a limited representative with regard to security futures products unless such person has, prior to December 31, 2008,] must complete [ed] a firm-element continuing education program [requirement] that addresses security futures. After a revised examination that includes security futures products is offered, a person associated with a member who passes such a revised Qualification Examination for Limited Representative—Options and Security Futures (or any other examination covering security futures that is acceptable to NASD) is not required to complete a firm-element continuing education program [requirement] that addresses security futures to act as a Limited Representative with regard to such products, except as otherwise required by Rule 1120 generally or by the member firm. Any Limited Representative—Options and Security Futures who intends to qualify as a Limited Representative with regard to security futures products by completing a firm-element continuing education program must complete such a program by December 31, 2006. Any Limited Representative—Options and Security Futures who has not completed a firm-element continuing education program by that date will be required to pass an appropriate qualification examination covering security futures to engage in security futures activities.

5. The Approval and Recordkeeping section in Rule 2210 beginning on pages twelve and seventy-two of the rule filing should be revised to read as follows (new language is underlined and deleted text is [bracketed]):

(b)(1) Each item of advertising and sales literature shall be approved by signature or initial, prior to use or filing with [the Association] NASD, by a registered principal of the member. This requirement may be met, only with respect to corporate debt and equity securities that are the subject of research reports as the term is defined in Rule 472 of the New York Stock Exchange, by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock Exchange. This requirement may be met, only with respect to advertising and sales literature concerning security futures, by the signature or initial of a [Registered Options and Security Futures Principal] principal qualified to supervise security futures activities.

6. In light of the SEC's proposed rule on the confirmation requirements of security futures products and comments received from SIA, FIA, and CBOE, we believe that the "Confirmations" section in Rule 2865(b)(12) beginning on pages twenty-three and eighty-three setting forth the requirements for confirmations of security futures products should be deleted in its entirety and that Section 12 should be reserved for future rulemaking. For the same reason, we believe that the language

setting forth the purpose of Rule 2865 beginning on pages forty-five and 104 of the rule filing that discusses “Confirmations” should also be deleted in its entirety.

7. The Statements of Account section in Rule 2865(b)(15) beginning on pages twenty-four and eighty-three of the rule filing should be revised to read as follows (new language is underlined and deleted text is [bracketed]):

(A) Statements of account showing security and money positions, entries, interest charges, and any special charges that have been assessed against such account during the period covered by the statement shall be sent no less frequently than once every month to each customer in whose account there has been an entry during the preceding month with respect to a security futures contract and quarterly to all customers having an open security futures position or money balance. Interest charges and any special charges assessed during the period covered by the statement need not be specifically delineated if they are otherwise accounted for on the statement and have been itemized on transaction confirmations. With respect to security futures customers having a general (margin) account, such statements shall also provide the [mark-to-]market price, [and] mark-to-market value and nominal value of each security futures position and mark-to-market price and market value of other security positions in the general (margin) account, the total [market] value of all positions in the account (i.e., the mark-to-market value of all security futures positions and the market value of all other security positions), the outstanding debit or credit balance in the account, and the general (margin) account equity. The statements shall bear a legend stating that further information with respect to commissions and other charges related to the execution of security futures transactions has been included in confirmations of such transactions previously furnished to the customer, and that such information will be made available to the customer promptly upon request. The statements shall also bear a legend requesting the customer promptly to advise the member of any material change in the customer’s investment objectives or financial situation.

[(B) For purposes of this subparagraph (15), general (margin) account equity shall be computed by subtracting the total of the “short” security values and any debit balance from the total of the “long” security values and any credit balance.]

8. Because we have not proposed rules on the liquidation of positions and restrictions on access for security futures, the language setting forth the purpose of Rule 2865 beginning on pages forty-four and 103 that discusses “Liquidation of Positions and Restrictions on Access” should be deleted in its entirety.

If you have any questions concerning this amendment, please contact the undersigned at (202) 728-8104; e-mail gary.goldsholle@nasd.com or Patricia Albrecht,

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Office of General Counsel, NASD, at (202) 728-8026; e-mail patricia.m.albrecht@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

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cc: T.R. Lazo, Division of Market Regulation