

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45954; File No. SR-NASD-2002-12]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to a Proposed Rule Change and Amendment No. 1 Thereto Relating to the Establishment of a Subordination Agreement Investor Disclosure Document

May 17, 2002.

On January 17, 2002, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly-owned subsidiary NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to require, as part of a subordination agreement, the execution of a Subordination Agreement Investor Disclosure Document ("Disclosure Document"). On March 21, 2002, NASD Regulation filed Amendment No. 1 to the proposed rule change with the Commission.³ The proposed rule change, as amended by Amendment No. 1, was published for comment in the *Federal Register* on April 16, 2002.⁴ The Commission received no comment letters on the proposal. This order approves the proposed rule change, as amended.

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association and, in particular, the requirements of section 15A of the Act⁵ and the rules and regulations thereunder. Specifically, the Commission believes that the proposed rule change is consistent with section 15A(b)(6) of the Act,⁶ which, among other things, requires that NASD's rules 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. The Commission believes that the Disclosure Document should provide investors with an understanding of the key risks associated with loaning money or securities to a broker-dealer under a subordination agreements.⁷

It is therefore ordered, pursuant to section 19(b)(2) of the Act,⁸ that the proposed rule change and Amendment No. 1 thereto (File No. SR-NASD-2002-12) are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland

Deputy Secretary

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45930; File No. SR-PCX-2001-13]

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. Relating to its Auto-Ex System

May 15, 2002.

I. Introduction

On January 30, 2002, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change³ relating to disengagement of the Exchange's Automatic Execution System for

⁷ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Exchange filed this proposed rule change pursuant to the requirements of Section IV.B.h.(i)(bb) of the Commission's September 11, 2000 Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Act, which required the PCX (as well as the other floor-based options exchanges) to adopt new, or amend existing rules concerning automatic quotation and execution systems which specify the circumstances, if any, by which automated execution systems would be disengaged or operated in any manner other than the normal manner set forth in the exchange's rules; and, requires the documentation of the reasons for each decision to disengage an automatic execution system or operate it in any manner other than the normal manner. See Securities Exchange Act Release No. 43268 (September 11, 2000), Administrative Proceeding File No. 3-10282.

Options ("Auto-Ex"), increasing or decreasing Auto-Ex order size, and declaring quotes from away markets unreliable. PCX submitted Amendment No. 1 to the proposed rule change on April 9, 2002.⁴ The proposed rule change, as amended by Amendment No. 1, was published for comment in the *Federal Register* on April 15, 2002.⁵ The Commission received no comments on the amended proposal. This order approves the proposed rule change, as amended by Amendment No. 1.

II. Description of the Proposal

The Exchange proposes to modify PCX's Automatic Execution System Rule (Rule 6.87) to include provisions regarding: (1) Disengaging Auto-Ex and increasing or decreasing the Auto-Ex eligible order size, (2) declaring quotes from away markets unreliable, and (3) documenting these actions. The Exchange also proposes to clarify PCX Rule 6.28.

Disengaging Auto-Ex and Increasing or Decreasing the Auto-Ex Eligible Order Size

The Exchange proposes to define the unusual market conditions that may permit suspending Auto-Ex or increasing or decreasing the size of orders that may be automatically executed over the Auto-Ex as follows: (1) High volatility (when a stock or the entire market is experiencing rapid and extreme price fluctuations usually accompanied by doublewide spreads); (2) large influx of orders (when volume is two or more times the average daily volume in an issue, or when an extraordinarily large options order is executed on the PCX and reported); or (3) unreliable quote feed (when the Exchange is unable to accurately collect, process and/or disseminate quotation data). Such unusual market conditions may be caused by news announcements (e.g., announcements relating to earnings speculation, economic news, reports of mergers or takeovers, or disasters).

The Exchange's current Rules 6.87(h)(1) and (2) permit suspension of Auto-Ex in the event of floor-wide and non-floor wide Pacific Options Exchange Trading System ("POETS")⁶

⁴ See letter from Cindy Sink, Senior Attorney, Regulatory Policy, PCX, to Deborah L. Flynn, Assistant Director, Division of Market Regulation, Commission, dated April 8, 2002 ("Amendment No. 1").

⁵ See Securities Exchange Act Release No. 45712 (April 9, 2002), 67 FR 18285 (April 15, 2002).

⁶ POETS is the Exchange's automated trading system comprised of an options order routing system, an automatic execution system, an on-line

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, NASD Regulation made certain clarifications to the Disclosure Document ("Amendment No. 1"). Letter from Patrice M. Cliniecki, Vice President and Acting General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated March 21, 2002.

⁴ Securities Exchange Act Release No. 45721 (April 10, 2002), 67 FR 18661.

⁵ 15 U.S.C. 78o-3.

⁶ 15 U.S.C. 78o-3(b)(6).