permitting Exchange rules applicable to the trading of broad-based index options to apply to MidCap 400 options is appropriate. Specifically, the Commission believes it is consistent with the Act to designate the Index as broad-based because the MidCap 400 reflects a substantial segment of the U.S. equities market, in general, and mid-level capitalized U.S. securities, in particular. The Index consists of 400 of the most actively traded middle-capitalized securities in the United States.[21] In addition, as of January 6, 2004, the total capitalization of the Index was approximately $962.075 billion. The MidCap 400 also includes stocks of companies from ten market sectors, no one of which dominates the Index.[22] Moreover, the Index represents a broad cross-section of domestic mid-level capitalized stocks, with no single stock comprising more than 1.23% of the Index's total value (as of January 6, 2004). The percentage weighting of the five largest components in the Index also accounts for only 4.66% of the Index's value. Finally, 344 (86%) of the 400 stocks included in the Index, representing 88.1% of the total weight of the Index, are the subject of standardized options trading, and many of the other Index component stocks are eligible for options trading (as of January 6, 2004).

B. Index Design and Structure

The broad diversification, large capitalization, and liquid markets of the Index's component stocks significantly minimizes the potential for manipulation of the Index. First, as discussed above, the Index represents a broad cross-section of domestic mid-level capitalized stocks, with no single industry group or stock dominating the Index. Second, the overwhelming majority of the stocks that comprise the Index are actively traded, with a mean and median average daily trading volume of 437,107 and 724,445 shares, respectively.[23]

Third, S&P has developed procedures and criteria designed to ensure that the Index maintains its broad representative sample of stocks in the middle-capitalization range of securities.[24] Accordingly, the Commission believes it is unlikely that attempted manipulations of the prices of a small number of issues would affect significantly the Index's value.

C. Surveillance

The Exchange represents that it has an adequate surveillance program in place for the Exchange's other index options (at present, options on the S&P SmallCap 600 Index) and intends to apply those same program procedures to the options on the Index. Additionally, the Exchange is a member of the Intermarket Surveillance Group (''ISG''), which allows for the sharing of surveillance information for potential intermarket trading abuses pursuant to the Intermarket Surveillance Group Agreement (the ''Agreement'').[25] The members of the ISG include all of the U.S. registered stock and options markets. The Commission believes that a surveillance sharing agreement between an exchange proposing to list a stock index derivative product and the exchanges trading the stocks underlying the derivative product is an important measure for surveillance of the derivative and underlying securities markets. Such agreements ensure the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the stock index product less readily susceptible to manipulation.

D. Market Impact

The Commission believes that the listing and trading of MidCap 400 options, including LEAPS and reduced-value LEAPS, on the Exchange will not adversely impact the underlying securities markets. First, as described above, the Index is broad-based and no one stock or industry group dominates the Index. Second, as noted above, the stocks contained in the Index have large capitalizations and are actively traded. Third, existing ISE stock index options rules and surveillance procedures will apply to MidCap 400 options. Fourth, the Exchange has established position and exercise limits for the MidCap 400 options that will serve to minimize potential manipulation and market impact concerns. Fifth, the risk to investors of contra-party non-performance will be minimized because the Index options and Index LEAPS will be issued and guaranteed by the Options Clearing Corporation just like other standardized options traded in the United States.

Finally, the Commission believes that the ISE's other proposed rule changes to accommodate the trading of S&P MidCap 400 options, such as strike price intervals, are consistent with the Act. Based on representations from the ISE, the Commission also believes that the Exchange will have sufficient capacity to accommodate the anticipated order flow. The Commission also believes the Amex's proposed expiration cycle for the S&P MidCap 400 options is reasonable because it provides investors sufficient flexibility to establish their desired options positions.

V. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[26] that the proposed rule change, as amended, (SR–ISE–2004–08) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[27]

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 04–11308 Filed 5–18–04; 8:45 am]

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[21] Specifically, the mean and median capitalization for the 400 companies, as of January 6, 2004, was $ 2.4 billion and $ 2.1 billion, respectively.

[22] Specifically, as of February 26, 2004, the ten market sectors along with their respective weighting in the Index was as follows: (1) energy, 5.5%; (2) materials, 6.3%; (3) industrials, 14.5%; (4) consumer discretionary, 16.3%; (5) consumer staples, 4.5%; (6) health care, 9.5%; (7) financials, 16.5%; (8) information technology, 19%; (9) telecommunications services, 0.8%; and (10) utilities, 7.3%.

[23] For the six-month period ending January 2004, 398 of the 400 (99.5%) companies within the Index had an average daily trading volume greater than 30,000 shares per day. Those companies represent 99.25% of the market capitalization of the Index. The average daily trading volume of the 20 most heavily traded companies in the Index, representing 7.51% of the market capitalization of the Index, was 3,784,032 shares per day.

[24] *See supra* notes 11–14 and accompanying text.

[25] ISG was formed on July 14, 1983, among other things, to coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets. *See* Intermarket Surveillance Group Agreement, July 14, 1983. The participation of exchanges within the ISG and their sharing of surveillance information is governed by the Agreement. The most recent amendment to the Agreement, which incorporates the original agreement and all amendments made thereafter, was signed by members January 29, 1990. *See* Second Amendment to Intermarket Surveillance Group Agreement, January 29, 1990.

[26] 15 U.S.C. 78*o*–3(b)(6) and 78s(b)(2).

[27] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49688; File No. SR–NASD–2003–163]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Voluntary Direct Communication Between Parties and Arbitrators

May 12, 2004.

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 October 31, 2003, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association''), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (''NASD Dispute Resolution'') 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 Dispute Resolution. On February 23, 2004, NASD filed Amendment No. 1 to the proposed rule change.[3] 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 Dispute Resolution is proposing a new rule of the NASD to permit parties in an arbitration to communicate directly with the arbitrators if all parties and arbitrators agree, and to establish guidelines for such direct communication. Below is the text of the proposed rule change. Proposed new language is in italics.

10334. Direct Communication Between Parties and Arbitrators

(a) This rule provides procedures under which parties and arbitrators may communicate directly.

(b) Only parties that are represented by counsel may use direct communication under this Rule. If, during the proceeding, a party chooses to appear pro se (without counsel), this Rule shall no longer apply.

(c) All arbitrators and all parties must agree to the use of direct communication during the Initial Prehearing Conference or a later conference or hearing before it can be used.

(d) Parties may send the arbitrators only items that are listed in an order.

(e) Parties may send items by regular mail, overnight courier, facsimile, or email. All the arbitrators and parties must have facsimile or email capability before such a delivery method may be used.

(f) Copies of all materials sent to arbitrators must also be sent at the same time and in the same manner to all parties and the Director. Materials that exceed 15 pages, however, shall be sent to the Director only by regular mail or overnight courier.

(g) The Director must receive copies of any orders and decisions made as a result of direct communications among the parties and the arbitrators.

(h) Parties may not communicate orally with the arbitrators outside the presence of all parties.

(i) Any party or arbitrator may terminate the direct communication order at any time, after giving written notice to the other arbitrators and the parties.

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 Dispute Resolution 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 Dispute Resolution 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 proposes a rule that would permit direct communication with the arbitrators where all parties and arbitrators agree. The rule also would establish guidelines for direct communication.

Background. Under normal procedures, parties may exchange certain documents among themselves (such as those relating to discovery), but must address all communications intended for the arbitrators to NASD staff, who then forward the communications to the arbitrators. If the communication includes a motion or similar request, staff members customarily solicit a response from the other parties before forwarding the motion or request. Similarly, the arbitrators transmit their orders and any other communications through the staff.

In response to a recommendation of the NASD National Arbitration and Mediation Committee, the Chicago Office of NASD Dispute Resolution began a pilot project in June 2001 to determine whether direct communication between parties and arbitrators would enhance the arbitration process. The Chicago Office developed the parameters governing whether a case would be eligible for inclusion in the pilot and changed the script used by the panel chairperson at the Initial Prehearing Conference (''IPHC'') on those cases. A modified IPHC Order also was given to the panel chairperson to memorialize all direct communication matters agreed to by the parties and the arbitrators.

In total, 839 cases were eligible for inclusion in the project. Of these cases, parties and arbitrators in 255 cases (30%) participated in the program. At the end of the one-year pilot period, staff formulated a survey for those arbitrators and party representatives who participated in the pilot project. NASD Dispute Resolution sent out 850 surveys and obtained 268 responses (32%). Although attempts were made to limit duplication, certain arbitrators and party representatives who participated in more than one eligible case in the pilot might have sent in multiple survey responses.

Of the responses NASD received, 193 came from arbitrators and 75 from party representatives. Overall, 73% of party representatives and 69% of the arbitrators who responded to the survey favored continuing direct communication with the arbitrators. Favorable comments reflected the opinion that direct communication expedited the arbitration process and was more convenient than the normal method of communicating through staff.

In light of the success of the Chicago pilot, NASD has developed a nationwide rule that would permit direct communication with the arbitrators where all parties and arbitrators agree. The rule also would establish guidelines for direct communication.

On October 2, 2002, the Securities Industry Conference on Arbitration (''SICA'')[4] adopted an amendment to Rule 23 of the Uniform Code of Arbitration that provides for joint administration of arbitrations by the arbitrators and the parties.[5] Like the

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] See letter from Jean Feeney, Vice President and Chief Counsel, Dispute Resolution, NASD to Katherine England, Assistant Director, Division of Market Regulation, Commission, dated February 20, 2004.

[4] SICA's voting members include representatives of the self-regulatory organizations that administer arbitration forums, the Securities Industry Association, and three members of the public. In addition, staff of the SEC, the Commodity Futures Trading Commission, the American Arbitration Association, the North American Securities Administrators Association, and the former public members of SICA are invited to attend meetings.

[5] The joint administration amendment is found in section 23(e) of the Uniform Code, which is included in the Twelfth Report of the Securities Industry Conference on Arbitration (October 2003), available on the NASD Dispute Resolution Web site, under both Resources for Parties and Resources for Neutrals.

NASD proposal, the SICA rule would apply only to matters in which all parties are represented by counsel, and in which the arbitrators and all parties agree to proceed under the rule; terminates if a party chooses to appear without counsel; prohibits oral communication between parties and arbitrators unless all parties are present; and requires parties to send written materials to the arbitrators and the director at the same time and in the same manner. Unlike the NASD proposal, the SICA rule would allow the arbitrators, without the assistance of the sponsoring self-regulatory organization, to ''schedule all pre-hearing and hearing dates, the timing of the service and filing of appropriate papers, all discovery matters and all other matters relevant to the expeditious handling of the case.'' The SICA rule allows the parties or the arbitrators to initiate conference calls under certain conditions; requires that parties send the director proof of service of written materials; and provides that the arbitrators may terminate or modify any joint administration order. The NASD rule, unlike the SICA rule, provides that parties may send the arbitrators only items that are listed in an arbitrator order; that materials that exceed 15 pages may only be sent to the director by regular mail or overnight courier; and that any party or any arbitrator may terminate the direct communication order. NASD understands that the SICA rule change has not been adopted by any self-regulatory organization. The National Arbitration and Mediation Committee and the Board were apprised of the SICA amendment, but determined to model the NASD proposal on the successful Chicago pilot described above.

Proposed Rule Change. The proposed rule is based largely on procedures used in the Chicago pilot, with a few changes to reflect staff's experience with the pilot and to provide for possible issues that might occur in a larger-scale application of the rule. Only parties that are represented by counsel may use direct communication under the proposed rule. If, during the proceeding, a party chooses to appear pro se (without counsel), the rule will no longer apply. All arbitrators and all parties must agree to the use of direct communication before it can be used. The scope of direct communication will be set forth in an arbitrator order, and parties may send the arbitrators only the types of items that are listed in the order.

The proposed rule provides that either an arbitrator or a party may rescind his or her agreement at any time if direct communication is no longer working well. Materials must be sent at the same time and in the same manner to all parties and the Director (through the assigned staff member), and staff must receive copies of any orders and decisions made as a result of direct communications among the parties and the arbitrators. As requested by staff of NASD Dispute Resolution, however, the rule contains a provision stating that materials more than 15 pages long shall be sent to the Director only by mail or courier, to avoid tying up busy fax machines and printers. Arbitrators (or parties) with similar concerns could include a similar provision as to themselves in the direct communication order. NASD will prepare a template for direct communication orders to guide the arbitrators and parties in considering these issues.

2. Statutory Basis

NASD Dispute Resolution believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[6] which requires, among other things, that the Association'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. NASD believes that permitting direct communication with the arbitrators where all parties and arbitrators agree, and where specific guidelines are followed, will protect investors and the public interest by expediting the arbitration process and giving parties more control over their arbitration cases.

B. Self-Regulatory Organization's Statement on Burden on Competition

NASD Dispute Resolution 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, as amended.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

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–2003–163

Paper comments:

• Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609.

All submissions should refer to File Number SR–NASD–2003–163. 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the 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–

[6] 15 U.S.C. 78o–3(b)(6).

2003–163 and should be submitted on or before June 9, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[7]

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 04–11258 Filed 5–18–04; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49682; File No. SR–NYSE–2004–09]

Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the New York Stock Exchange, Inc., and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 To Amend NYSE Rule 123C Relating to Market-on-Close Policy and Expiration Procedures

May 11, 2004.

I. Introduction

On February 19, 2004, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') 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 amend NYSE Rule 123C relating to Market-on-Close Policy and Expiration Procedures. The proposed rule change was published for comment in the **Federal Register** on April 1, 2004.[3] The Commission received no comments on the proposal.

On April 26, 2004, the Exchange amended the proposed rule change.[4] Amendment No. 1 adds ''LOC'' to the first sentence of section (3)(B) of NYSE Rule 123C, which was inadvertently excluded from the rule text of the Exchange's original filing.

This order approves the proposed rule change. Simultaneously, the Commission provides notice of filing of Amendment No. 1 and grants accelerated approval of Amendment No. 1.

II. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.[5] Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[6] in that it is designed to, among other things, prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system; and in general, to protect investors and the public interest.

The Commission believes the electronic entry of all market-on-close (''MOC'') and limit-on-close (''LOC'') orders may allow market participants greater control in active trading crowds, and may enhance the dissemination of accurate information to all participants, because publications will be systematically generated. Furthermore, the Commission believes that moving the MOC and LOC deadline from 3:40 p.m. to 3:50 p.m. may allow traders and floor brokers greater control over the execution of customer orders and greater participation in active markets. The Exchange stated that its electronic entry systems for MOC and LOC order processing would require technology upgrades. Accordingly, the Exchange has represented that it will notify the Exchange membership and the Commission of the timing and implementation of such electronic entry systems.

For these reasons, the Commission finds that the proposed rule change is consistent with the Act.[7]

The Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 1 added ''LOC'' to the first sentence of section (3)(B) of NYSE Rule 123C. Since Amendment No. 1 makes only a technical change to the proposed rule text, the Commission finds good cause to accelerate approval of Amendment No. 1 to the proposed rule change.[8]

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 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 e-mail to *rule-comments@sec.gov.* Please include File Number SR–NYSE–2004–09 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609.

All submissions should refer to File Number SR–NYSE–2004–09. 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the NYSE. 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–NYSE–2004–09 and should be submitted on or before June 9, 2004.

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[7] 17 CFR 200.30–3(a)(12)

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 49476 (March 25, 2004), 69 FR 17255.

[4] *See* letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated April 26, 2004 (''Amendment No. 1''). In Amendment No. 1, the NYSE corrected a typographical error. Additionally, the NYSE confirmed that by making this correction to paragraph (3)(B) of the proposed rule language, the NYSE clarifies what is established NYSE practice where there is no order imbalance. Amendment No. 1 does not expand the scope of the proposed rule change, but instead only clarifies rule language that represents existing practices at the NYSE. *See,* telephone conversation between Donald Siemer, Director, Market Surveillance, NYSE, and Joseph P. Morra, Special Counsel, Division, Commission, dated May 10, 2004.

[5] 15 U.S.C. 78f.

[6] 15 U.S.C. 78f(b)(5).

[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] *See* footnote 4, *supra.*