OMB APPROVAL	
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Estimated average burden hours per response...........38	

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2006 - 007
Amendment No.

Proposed Rule Change by National Association of Securities Dealers

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☑	☐	☐	☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Amendments to Rule 2860 to revise the definition of the term underlying index and allow members to calculate position limits for certain conventional equity options in accordance with volume and float criteria specified by the options exchanges.

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: Kathryn
Last Name: Moore
Title: Assistant General Counsel
E-mail: kathryn.moore@nasd.com
Telephone: (202) 974-2974
Fax: (202) 728-8264

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: 01/23/2006

By: Patrice Gliniecki
(Name)

Senior Vice President and Deputy General Counsel
(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.

PATRICE GLINIECKI,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information Add Remove View	The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.
Exhibit 1 - Notice of Proposed Rule Change Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications Add Remove View Exhibit Sent As Paper Document ☐	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.
Exhibit 3 - Form, Report, or Questionnaire Add Remove View Exhibit Sent As Paper Document ☐	Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.
Exhibit 4 - Marked Copies Add Remove View	The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.
Exhibit 5 - Proposed Rule Text Add Remove View	The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 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 to: (a) revise the definition of the term "underlying index" to include all indexes underlying standardized index options and other indexes that meet certain specified criteria; and (b) allow members to calculate the position limits, in accordance with volume and float criteria specified by the options exchanges, for conventional equity options overlying securities that are part of the FTSE World Index Series. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

2800. SPECIAL PRODUCTS

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2860. Options

(a) No Change.

(b) Requirements

(1) No Change.

(2) Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

(A) through (M) No Change.

(N) Conventional Index Option — The term "conventional index option" means any options contract not issued, or subject to issuance, by The Options Clearing Corporation that is based upon an index:

(i) The options are designated as A.M.-settled index options;

(ii) The index is capitalization-weighted, price-weighted, equal dollar-weighted, or modified capitalization-weighted, and consists of ten or more component securities;

(iii) Each component security has a market capitalization of at least $75 million, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, the market capitalization is at least $50 million;

(iv) Trading volume of each component security has been at least one million shares for each of the last six months, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, trading volume has been at least 500,000 shares for each of the last six months;

(v) In a capitalization-weighted index or modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of component securities in the index each have had an average monthly trading volume of at least 2,000,000 shares over the past six months;

(vi) No single component security represents more than 25% of the weight of the index, and the five highest weighted component securities in the index do not in the aggregate account for more than 50% (60% for an index consisting of fewer than 25 component securities) of the weight of the index;

(vii) All component securities are "NMS securities" as defined in Section 240.600;

(viii) Non-U.S. component securities (stocks or ADRs) that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 20% of the weight of the index;

(ix) An equal dollar-weighted index will be rebalanced at least once every calendar quarter; and

(x) If an underlying index is maintained by a broker-dealer, the index is calculated by a third party who is not a broker-dealer, and the broker-dealer has erected a "Chinese Wall" around its personnel who have access to information concerning changes in and adjustments to the index.

(N) through (XX) renumbered as (O) through (YY).

(ZZ) Standardized Index Option — The term "standardized index option" means any options contract issued, or subject to issuance, by The Options Clearing Corporation that is based upon an index.

(YY) through (AAA) renumbered as (AAA) through (CCC).

[(BBB)] (DDD) Underlying Index — The term "underlying index" means an index underlying a Standardized Index Option or a Conventional Index Option. [an index upon which a Nasdaq index option contract is based.]

(CCC) through (DDD) renumbered as (EEE) through (FFF).

(3) Position Limits

(A) Stock Options — Except in highly unusual circumstances, and with the prior written approval of NASD pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, non-member broker, or non-member dealer, an opening transaction through Nasdaq, the over-the-counter market or on any exchange in a stock option contract of any class of stock options if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, non-member broker, or non-member dealer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate equity options position in excess of:

(i) through (vii) No Change.

(viii) Conventional Equity Options

a. No Change.

b. In order for a security not subject to standardized equity options trading to qualify for an options position limit of more than 13,500 contracts (or 25,000 contracts during the Pilot Period), a member must first demonstrate to NASD's Market Regulation Department that the underlying security meets the standards for such higher options position limit and the initial listing standards for standardized options trading.

<u>Provided, however, that for certain securities in an index designated by NASD, a member may claim such higher position limit as permitted in accordance with the volume and float criteria specified by NASD; provided further, that a member claiming a higher position limit under this subparagraph must notify NASD's Market Regulation Department in writing in such form as may be prescribed by NASD and shall be filed no later than the close of business day on the next business day following the day on which</u>

the transaction or transactions requiring such limits occurred; and provided further, that the member must agree to reduce its position in the event that NASD staff determines different position limits should apply.

(B) through (D) No Change.

(4) through (24) No Change.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on November 12, 2003, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on November 13, 2003. No other action by NASD is necessary for the filing of the 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 will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

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

(a) Purpose

Amendment to Definition of "Underlying Index"

NASD Rule 2860 governs the activities of members in standardized and conventional options contracts. Paragraph (b)(5) imposes a position-reporting obligation on members when they or their customers establish options positions that exceed certain thresholds. Specifically, members are required to file, or cause to be filed, a report with NASD with respect to each account that establishes an aggregate position of 200 or more contracts on the same side of the market covering the same underlying security or index. The current definition of "underlying index" is limited to an index upon which a Nasdaq index option is based.[1] Since there are no longer any Nasdaq index options, this definition fails to require members to report positions in conventional index options.[2] In addition, in

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1 Nasdaq briefly traded stock index options in the mid-1980s.

2 As noted in Notice to Members 01-01, the options position reporting requirements are applicable to all standardized options positions established by "access" firms or their customers and all conventional options positions established by members or their customers. Access firms are defined as NASD members that conduct a business in standardized options but are not themselves members of the options exchange or which such options are listed and traded. The proposed rule change also would require access firms to report position limits in standardized index options.

connection with NASD's proposed rule changes to reflect Nasdaq's separation from NASD upon Nasdaq's anticipated approval as a national securities exchanges,[3] Rule 2860 will be amended to remove all references to Nasdaq.

To require members to report members' and customers' positions in conventional index options, NASD staff proposes amending the definition of "underlying index" to mean an index underlying a "standardized index option" or "conventional index option." In addition, the proposed rule change would define the terms "standardized index option" and "conventional index option."

Under the proposed rule change, the definition of "underlying index" would include conventional index options contracts on such indexes as the S&P 500, Dow Jones Industrial Average, and the NASDAQ 100, because these indexes underlie standardized index options that are issued, or subject to issuance, by The Options Clearing Corporation.

The proposed rule change also amends the definition of "underlying index" to include certain indexes that do not underlie standardized index options but that meet specified criteria. The proposed criteria for customized indexes are based upon the standards in place at the options exchanges for listing narrow-based or industry indexes.[4] The purpose of these criteria is to exclude from the definition of "underlying index," indexes that are so narrowly constructed that they are the economic equivalent of, or have

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[3] See File No. SR-NASD-2005-087, Securities Exchange Act Release No. 52049 (July 15, 2005), 70 FR 42398 (July 22, 2005).

[4] See, *e.g.,* Chicago Board Options Exchange Rule 24.2(b).

attributes of, an equity option on common stock. These criteria also serve to prevent the creation of a narrow index to subvert position limit requirements, which do not apply to conventional index options.[5]

Under the proposed rule change, a member has the burden of demonstrating that an index meets the specified criteria before it would be considered a "conventional index option." Thus, members should maintain detailed records to be able to demonstrate promptly, upon a request from NASD, that a particular "conventional index option" meets the necessary criteria. Members also should be aware that options that are based on a security that does not meet the definition of "conventional index option" continue to be subject to position limits and position reporting requirements as if the non-conforming index was deconstructed into its equity security components.

Position Limits for Conventional Equity Options Overlying Certain Foreign Securities

The proposed rule change also addresses the need for members to identify position limits for conventional equity options on securities that do not underlie a standardized equity option.

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5 See NASD Notice to Members 94-46 at 256 (June 1994).

Under Rule 2860(b)(3)(viii), the position limits for conventional equity options are the same as the limits for the standardized equity options overlying the same security. For example, if standardized equity options on ABC have a position limit of 75,000 contracts, then conventional equity options on ABC also have a position limit of 75,000 contracts. On the other hand, for an equally liquid foreign security such as DEF, for which there are no standardized equity options, a member must obtain prior approval from NASD staff for any position limit in excess of 13,500 contracts (the base limit in the absence of a Pilot Program). This process of prior approval places a significant burden on a member's ability to execute transactions with customers given the time difference between the foreign market and the U.S. market and the time frame in which customers typically desire to trade.

The proposed rule change would allow members to calculate on their own the position limits for conventional equity options overlying securities that are part of the FTSE World Index Series[6] using the volume and float criteria established by the options

[6] The Financial Times and the London Stock Exchange operate the FTSE World Index Series. The FTSE World Index Series covers 30 different countries and over 1900 stocks.

contracts.[7] NASD has chosen the FTSE World Index Series[8] in part because the SEC staff has deemed securities in the predecessor to this index of foreign securities to receive comparable treatment to U.S. equity securities under the securities haircut provisions of the SEC's net capital rule as set forth in Rule 15c3-1 of the Act,[9] and the Federal Reserve Board recognizes this index for determining whether stocks are eligible for margin treatment.[10] Under the proposed rule change, a member would make a post-trade notice filing—within one business day—to NASD staff providing the necessary trade data

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7 See CBOE Rule 4.11.02; AMEX Rule 904.07; Phil. Stock Exchange Rule 1001.05; Pac. Stock Exchange Rule 6.8.06; and ISE Rule 412(d).

Options Position Limit	**Criteria***
22,500 (or 50,000 during the pilot period from August 24, 2004 through February 23, 2006 (the "Pilot Period"))	Trading volume of 20,000,000 shares; or Trading volume of 15,000,000 shares, and 40,000,000 shares currently outstanding.
31,500 (or 75,000 during the Pilot Period)	Trading volume of 40,000,000 shares; or Trading volume of 30,000,000 shares, and 120,000,000 shares currently outstanding.
60,000 (or 200,000 during the Pilot Period)	Trading volume of 80,000,000 shares; or Trading volume of 60,000,000 shares, and 240,000,000 shares currently outstanding.
75,000 (or 250,000 during the Pilot Period)	Trading volume of 100,000,000 shares; or Trading volume of 75,000,000 shares, and 300,000,000 shares currently outstanding.

* Each as measured during the most recent six-month period.

8 In the event NASD changes the designated index from the FTSE World Index Series, NASD will publish the designation of the new applicable index in a Notice to Members and provide members at least 30 days written notice of the change.

9 1993 SEC No-Act LEXIS 967 (Aug. 13, 1993).

10 12 CFR Part 220.11(c) and (d) and 69 FR 10601.

and/or current float data to support the member's position limit calculation. Thus, in the example above, a conventional equity option on DEF would have a position limit of 75,000 contracts rather than 13,500 contracts because its volume and float data meet the criteria for 75,000 contracts, provided the member makes the necessary filing within the prescribed time.

Under the proposed rule change, NASD staff would review the member's notice filing, and, if it determines that a member incorrectly assigned a position limit, it would notify the firm and instruct it to promptly reduce its position to fall below the appropriate limits determined by the staff.

As noted in Item 2 of this filing, NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that amending the definition of "underlying index" will ensure more complete reporting of options positions. NASD also believes that permitting members to calculate position limits for certain foreign securities will enable members to effect options transaction in such securities without unnecessary delay.

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, as amended.

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

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

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

Not applicable.

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

Not applicable.

9. Exhibits

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

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2006-007)
SELF REGULATORY ORGANIZATIONS

Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Options Rules

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. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. <u>Self-Regulatory Organization's S Statement of the Terms of Substance of the Proposed Rule Change</u>

NASD is proposing to amend Rule 2860 to: (a) revise the definition of the term "underlying index" to include all indexes underlying standardized index options and other indexes that meet certain specified criteria; and (b) allow members to calculate the position limits, in accordance with volume and float criteria specified by the options exchanges, for conventional equity options overlying securities that are part of the FTSE World Index Series. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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

2 17 CFR 240.19b-4.

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2800. SPECIAL PRODUCTS

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2860. Options

(a) No Change.

(b) Requirements

(1) No Change.

(2) Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

(A) through (M) No Change.

<u>(N) Conventional Index Option — The term “conventional index option” means any options contract not issued, or subject to issuance, by The Options Clearing Corporation that is based upon an index:</u>

<u>(i) The options are designated as A.M.-settled index options;</u>

<u>(ii) The index is capitalization-weighted, price-weighted, equal dollar-weighted, or modified capitalization-weighted, and consists of ten or more component securities;</u>

<u>(iii) Each component security has a market capitalization of at least $75 million, except that for each of the lowest weighted</u>

component securities in the index that in the aggregate account for no more than 10% of the weight of the index, the market capitalization is at least $50 million;

(iv) Trading volume of each component security has been at least one million shares for each of the last six months, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, trading volume has been at least 500,000 shares for each of the last six months;

(v) In a capitalization-weighted index or modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of component securities in the index each have had an average monthly trading volume of at least 2,000,000 shares over the past six months;

(vi) No single component security represents more than 25% of the weight of the index, and the five highest weighted component securities in the index do not in the aggregate account for more than 50% (60% for an index consisting of fewer than 25 component securities) of the weight of the index;

(vii) All component securities are "NMS securities" as defined in Section 240.600;

(viii) Non-U.S. component securities (stocks or ADRs) that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 20% of the weight of the index;

(ix) An equal dollar-weighted index will be rebalanced at least once every calendar quarter; and

(x) If an underlying index is maintained by a broker-dealer, the index is calculated by a third party who is not a broker-dealer, and the broker-dealer has erected a "Chinese Wall" around its personnel who have access to information concerning changes in and adjustments to the index.

(N) through (XX) renumbered as (O) through (YY).

(ZZ) Standardized Index Option — The term "standardized index option" means any options contract issued, or subject to issuance, by The Options Clearing Corporation that is based upon an index.

(YY) through (AAA) renumbered as (AAA) through (CCC).

[(BBB)] (DDD) Underlying Index — The term "underlying index" means an index underlying a Standardized Index Option or a

<u>Conventional Index Option.</u> [an index upon which a Nasdaq index option contract is based.]

(CCC) through (DDD) renumbered as (EEE) through (FFF).

(3) Position Limits

(A) Stock Options — Except in highly unusual circumstances, and with the prior written approval of NASD pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, non-member broker, or non-member dealer, an opening transaction through Nasdaq, the over-the-counter market or on any exchange in a stock option contract of any class of stock options if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, non-member broker, or non-member dealer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate equity options position in excess of:

(i) through (vii) No Change.

(viii) Conventional Equity Options

a. No Change.

b. In order for a security not subject to standardized equity options trading to qualify for an options position limit of more than

13,500 contracts (or 25,000 contracts during the Pilot Period), a member must first demonstrate to NASD's Market Regulation Department that the underlying security meets the standards for such higher options position limit and the initial listing standards for standardized options trading.

Provided, however, that for certain securities in an index designated by NASD, a member may claim such higher position limit as permitted in accordance with the volume and float criteria specified by NASD; provided further, that a member claiming a higher position limit under this subparagraph must notify NASD's Market Regulation Department in writing in such form as may be prescribed by NASD and shall be filed no later than the close of business day on the next business day following the day on which the transaction or transactions requiring such limits occurred; and provided further, that the member must agree to reduce its position in the event that NASD staff determines different position limits should apply.

(B) through (D) No Change.

(4) through (24) No Change.

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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

Amendment to Definition of "Underlying Index"

NASD Rule 2860 governs the activities of members in standardized and conventional options contracts. Paragraph (b)(5) imposes a position-reporting obligation on members when they or their customers establish options positions that exceed certain thresholds. Specifically, members are required to file, or cause to be filed, a report with NASD with respect to each account that establishes an aggregate position of 200 or more contracts on the same side of the market covering the same underlying security or index. The current definition of "underlying index" is limited to an index upon which a Nasdaq index option is based.[3] Since there are no longer any Nasdaq index options, this

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[3] Nasdaq briefly traded stock index options in the mid-1980s.

definition fails to require members to report positions in conventional index options.[4] In addition, in connection with NASD's proposed rule changes to reflect Nasdaq's separation from NASD upon Nasdaq's anticipated approval as a national securities exchange,[5] Rule 2860 will be amended to remove all references to Nasdaq.

To require members to report members' and customers' positions in conventional index options, NASD staff proposes amending the definition of "underlying index" to mean an index underlying a "standardized index option" or "conventional index option." In addition, the proposed rule change would define the terms "standardized index option" and "conventional index option."

Under the proposed rule change, the definition of "underlying index" would include conventional index options contracts on such indexes as the S&P 500, Dow Jones Industrial Average, and the NASDAQ 100, because these indexes underlie standardized index options that are issued, or subject to issuance, by The Options Clearing Corporation.

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4 As noted in Notice to Members 01-01, the options position reporting requirements are applicable to all standardized options positions established by "access" firms or their customers and all conventional options positions established by members or their customers. Access firms are defined as NASD members that conduct a business in standardized options but are not themselves members of the options exchange or which such options are listed and traded. The proposed rule change also would require access firms to report position limits in standardized index options.

5 See File No. SR-NASD-2005-087, Securities Exchange Act Release No. 52049 (July 15, 2005), 70 FR 42398 (July 22, 2005).

The proposed rule change also amends the definition of "underlying index" to include certain indexes that do not underlie standardized index options but that meet specified criteria. The proposed criteria for customized indexes are based upon the standards in place at the options exchanges for listing narrow-based or industry indexes.[6] The purpose of these criteria is to exclude from the definition of "underlying index," indexes that are so narrowly constructed that they are the economic equivalent of, or have attributes of, an equity option on common stock. These criteria also serve to prevent the creation of a narrow index to subvert position limit requirements, which do not apply to conventional index options.[7]

Under the proposed rule change, a member has the burden of demonstrating that an index meets the specified criteria before it would be considered a "conventional index option." Thus, members should maintain detailed records to be able to demonstrate promptly, upon a request from NASD, that a particular "conventional index option" meets the necessary criteria. Members also should be aware that options that are based on a security that does not meet the definition of "conventional index option" continue to be subject to position limits and position reporting requirements as if the non-conforming index was deconstructed into its equity security components.

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[6] See, *e.g.,* Chicago Board Options Exchange Rule 24.2(b).

[7] See NASD Notice to Members 94-46 at 256 (June 1994).

Position Limits for Conventional Equity Options Overlying Certain Foreign Securities

The proposed rule change also addresses the need for members to identify position limits for conventional equity options on securities that do not underlie a standardized equity option. Under Rule 2860(b)(3)(viii), the position limits for conventional equity options are the same as the limits for the standardized equity options overlying the same security. For example, if standardized equity options on ABC have a position limit of 75,000 contracts, then conventional equity options on ABC also have a position limit of 75,000 contracts. On the other hand, for an equally liquid foreign security such as DEF, for which there are no standardized equity options, a member must obtain prior approval from NASD staff for any position limit in excess of 13,500 contracts (the base limit in the absence of a Pilot Program). This process of prior approval places a significant burden on a member's ability to execute transactions with customers given the time difference between the foreign market and the U.S. market and the time frame in which customers typically desire to trade. The proposed rule change would allow members to calculate on their own the position limits for conventional equity options overlying securities that are part of the FTSE World Index Series[8] using the volume and float criteria established by the options exchanges for their listed options

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8 The Financial Times and the London Stock Exchange operate the FTSE World Index Series. The FTSE World Index Series covers 30 different countries and over 1900 stocks.

contracts.[9] NASD has chosen the FTSE World Index Series[10] in part because the SEC staff has deemed securities in the predecessor to this index of foreign securities to receive comparable treatment to U.S. equity securities under the securities haircut provisions of the SEC's net capital rule as set forth in Rule 15c3-1 of the Act,[11] and the Federal Reserve Board recognizes this index for determining whether stocks are eligible for margin treatment.[12] Under the proposed rule change, a member would make a post-trade notice filing—within one business day—to NASD staff providing the necessary trade

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9 See CBOE Rule 4.11.02; AMEX Rule 904.07; Phil. Stock Exchange Rule 1001.05; Pac. Stock Exchange Rule 6.8.06; and ISE Rule 412(d).

Options Position Limit	**Criteria***
22,500 (or 50,000 during the pilot period from August 24, 2004 through February 23, 2006 (the "Pilot Period"))	Trading volume of 20,000,000 shares; or Trading volume of 15,000,000 shares, and 40,000,000 shares currently outstanding.
31,500 (or 75,000 during the Pilot Period)	Trading volume of 40,000,000 shares; or Trading volume of 30,000,000 shares, and 120,000,000 shares currently outstanding.
60,000 (or 200,000 during the Pilot Period)	Trading volume of 80,000,000 shares; or Trading volume of 60,000,000 shares, and 240,000,000 shares currently outstanding.
75,000 (or 250,000 during the Pilot Period)	Trading volume of 100,000,000 shares; or Trading volume of 75,000,000 shares, and 300,000,000 shares currently outstanding.

* Each as measured during the most recent six-month period.

10 In the event NASD changes the designated index from the FTSE World Index Series, NASD will publish the designation of the new applicable index in a Notice to Members and provide members at least 30 days written notice of the change.

11 1993 SEC No-Act LEXIS 967 (Aug. 13, 1993).

12 12 CFR Part 220.11(c) and (d) and 69 FR 10601.

data and/or current float data to support the member's position limit calculation. Thus, in the example above, a conventional equity option on DEF would have a position limit of 75,000 contracts rather than 13,500 contracts because its volume and float data meet the criteria for 75,000 contracts, provided the member makes the necessary filing within the prescribed time.

Under the proposed rule change, NASD staff would review the member's notice filing, and, if it determines that a member incorrectly assigned a position limit, it would notify the firm and instruct it to promptly reduce its position to fall below the appropriate limits determined by the staff.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that amending the definition of "underlying index" will ensure more complete reporting of options positions. NASD also believes that permitting members to calculate position limits for certain foreign securities will enable members to effect options transaction in such securities without unnecessary delay.

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, 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-2006-007 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2006-007. 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, 100 F Street, NE, Washington, DC 20549. 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 the File Number SR-NASD-2006-007 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.[13]

Secretary

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13 17 CFR 200.30-3(a)(12).