approved collections of information discussed below.

Rule 17Ad–4(b) & (c) Notices Regarding Exempt Transfer Agent Status

Rule 17Ad–4(b) & (c) is used to document when transfer agents are exempt, or no longer exempt, from the minimum performance standards and certain recordkeeping provisions of the Commission's transfer agent rules. Rule 17Ad–4(c) sets forth the conditions under which a registered transfer agent loses it exempt status. Once the conditions for exemption no longer exist, the transfer agent, to keep the appropriate regulatory authority (''ARA'' apprised of its current status, must prepare, and file if the ARA for the transfer agent is the Board of Governors of the Federal Reserve System (''BGFRS'') or the Federal Deposit Insurance Corporation (''FDIC''), a notice of loss of exempt status under paragraph (c). The transfer agent then cannot claim exempt status under Rule 17Ad–4(b) again until it remains subject to the minimum performance standards for non-exempt transfer agents for six consecutive months. The ARAs use the information contained in the notice to determine whether a registered transfer agent qualifies for the exemption, to determine when a registered transfer agent no longer qualifies for the exemption, and to determine the extent to which the transfer agent is subject to regulation.

The BGFRS receives approximately twelve notices of exempt status and six notices of loss of exempt status annually. The FDIC receives approximately eighteen notices of exempt status and three notices of loss of exempt status annually. The Commission and the Office of the Comptroller of the Currency (''OCC'') do not require transfer agents to file notice of exempt status or loss of exempt status. Instead, transfer agents whose ARA is the Commission or OCC need only to prepare and maintain these notices. The Commission estimates that approximately sixteen notices of exempt status and loss of exempt status are prepared annually by transfer agents whose ARA is the Commission. Similarly, the OCC estimates that the transfer agents for which it is the ARA, prepare and maintain approximately fifteen notices of exempt status and loss of exempt status annually. Thus, a total of approximately seventy notices of exempt status and loss of exempt status are prepared and maintained by transfer agents annually. Of these seventy notices, approximately forty are filed with an ARA. Any additional costs associated with filing such notices would be limited primarily to postage, which would be minimal. Since the Commission estimates that no more than one-half hour is required to prepare each notice, the total annual burden to transfer agents is approximately thirty-five hours. The average cost per hour is approximately $30. Therefore, the total cost of compliance to the transfer agent community is $1,050.

Rule 17Ad–15 Signature Guarantees

Rule 17Ad–15 requires approximately 1,093 transfer agents to establish written standards for accepting and rejecting guarantees of securities transfers from eligible guarantor institutions. Transfer agents are also required to establish procedures to ensure that those standards are used by the transfer agent to determine whether to accept or reject guarantees from eligible guarantor institutions. Transfer agents must maintain, for a period of three years following the date of a rejection of transfer, a record of all transfers rejected, along with the reason for the rejection, identification of the guarantor, and whether the guarantor filed to meet the transfer agent's guaranteed standard. These recordkeeping requirements assist the Commission and other regulatory agencies with monitoring transfer agents and ensuring compliance with the rule.

There are approximately 1,093 registered transfer agents. Of the 1,093 registered transfer agents, approximately 120 will receive fewer than 100 items for transfer. The staff expects that more small transfer agents will have few, if any, rejections. The average number of hours necessary for every transfer agents agent to comply with the Rule 17Ad–15 is about forty hours annually. The total burden is 43,720 hours for all transfer agents. The average cost per hour is approximately $30. Therefore, the total cost of compliance for all transfer agents is about $1,311,600.

The retention period for the recordkeeping requirement under Rule 17Ad–15 is three years following the date of a rejection of transfer. The recordkeeping requirement under the rule is mandatory to assist the Commission and other regulatory agencies with monitoring transfer agents and ensuring compliance with the rule. This rule does not involve the collection of confidential information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

General comments regarding the estimated burden hours should be directed to the following persons: (i) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 3208, New Executive Office Building, Washington, D.C. 20503. and (ii) Micheal E. Bartell, Associate Executive Director, Office of Information Technology, Securities and Exchange Commission, 450 Fifth Street, Washington, D.C. 20549. Comments must be submitted to OMB within 30 days of this notice.

Dated: July 10, 2000.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00–18006 Filed 7–14–00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–43021; File No. SR–NASD–99–41]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 Relating to the Opening of Day-Trading Accounts

July 10, 2000.

I. Introduction

On August 20, 1999, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association''), through its wholly owned subsidiary, NASD Regulation, Inc. (''NASD Regulation''), filed with the Securities and Exchange Commission (''SEC'' or ''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 relating to the opening of day-trading accounts.

The proposed rule change was published for comment in the **Federal Register** on September 21, 1999.[3] The Commission received three comment letters on the proposed rule change.[4] On

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

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 41432 (September 14, 1999), 64 FR 51165.

[4] *See* Letters from James H. Lee, President, Electronic Traders Association (''ETA''), to Jonathan G. Katz, Secretary, SEC, dated October 11, 1999; Bradley W. Skolnik, President, Indiana Securities Commissioner, North American Securities Administrators Association (''NASAA''), to Jonathan G. Katz, Secretary, SEC, dated October 12, 1999; and Lee B. Spencer, Jr., Chairman, Federal Regulation Committee, Everett Lang, Co-Chairman, Discount Brokerage Committee, Michael L. Michael, Chairman, Ad-Hoc Committee on Technology and

February 18, 2000, NASD Regulation submitted Amendment No. 1 to the proposed rule change.[5] Amendment No. 1 was published for comment in the **Federal Register** on March 2, 2000.[6] The Commission received four comment letters on the proposed rule change in Amemdment No. 1.[7] On June 21, 2000, NASD Regulation submitted Amendment No. 2 to the proposed rule change.[8] In this notice and order, the Commission is seeking comment from interested persons on Amendment No. 2 and approving the proposed rule change and Amendment No. 1, and is approving Amendment No. 2 on an accelerated basis.

II. Description of the Proposal

The NASD, through NASD Regulation, proposes to add two new rules to its Rule 2300 series.[9] New Rules 2360, approval Procedures for Day-Trading Accounts, and 2361, Day-Trading Risk Disclosure Statement, only apply to firms that are ''promoting a day-trading strategy.''

The proposal focuses on disclosing the basis risks of engaging in a day-trading strategy and assessing the appropriateness of day-trading strategies for individuals. In particular, the proposal would require a firm that is ''promoting a day-trading strategy,'' directly or indirectly, to deliver a specified risk disclosure statement to a non-institutional customer prior to opening an account for the customer. In addition to delivering the risk disclosure statement, the proposal would require a firm to either: (1) Approve the customer's account for day trading; or (2) obtain a written agreement from the customer stating that the customer does not intend to use the account for day-trading activities. A firm would not be permitted to rely on the written agreement from the customer if the firm knows that the customer intends to use the account for day trading. In addition, if a firm knows that a customer who provided such an agreement is engaging in a day-trading strategy, the firm would be required to approve the account for day trading.

As part of approving an account for day trading, a firm would be required to have reasonable grounds for believing that the day-trading strategy is appropriate for the customer. In making this determination, the firm would be required to exercise reasonable diligence to ascertain the essential facts about the customer, including his or her financial situation, tax status, prior investment and trading experience, and investment objectives. The firm also would be required to prepare a record setting forth the basis on which the firm has approved the customer's account for day trading. Any record or written statement prepared or obtained by the firm pursuant to the proposed rule change would have to be preserved in accordance with NASD Rule 3110(a).

A. Scope of Proposal

1. Firms ''Promoting a Day-Trading Strategy''

As discussed below, the proposed new rules only apply to firms that are ''promoting a day-trading strategy'' and to new accounts opened by all non-institutional customers at those firms.[10] While the proposal does not expressly define ''promoting a day-trading strategy,'' it does state that none of the following actions alone would trigger the proposed rule's requirements: (1) The promotion by a member of efficient execution services or lower execution costs based on multiple trades; (2) providing general investment research or advertising the high quality or prompt availability of such general research; and (3) having a web site that provides general financial information or news or that allows the multiple entry of intra-day purchases and sales of the same securities.[11]

The proposal would apply to a member that affirmatively promotes day-trading activities or strategies through advertising, training seminars, or direct outreach programs. The proposal would only be triggered by the firm's general promotional efforts or by firm-sponsored promotional efforts.[12] For instance, a firm generally would be subject to the proposed rule if its advertisements address the benefits of day trading, rapid-fire trading, or momentum trading, or encourage persons to trade or profit like a professional trader. A firm also would be subject to the proposed rule if it promotes its day-trading services through a third party. Moreover, the fact that many of a firm's customers are engaging in a day-trading strategy would be relevant in determining whether a firm has promoted itself in this way. Firms may not, however, promote day trading through individuals in an effort to circumvent the proposed rule. In addition, if a principal or officer of the firm is aware that brokers in the firm are soliciting customers for day trading, then firm will be deemed to be promoting day trading.[13]

While the proposal does not define the term ''promoting a day-trading strategy,'' NASD Regulation represents that firms could submit their advertisements to NASD Regulation's Advertising/Investment Companies Regulation Department for review and guidance on whether the content of the

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Regulation, and Michael Anderson, Co-Chairman, Discount Brokerage Committee, Securities Industry Association (''SiA''), to Margaret H. McFarland, Deputy Secretary, SEC, dated October 22, 1999.

[5] In Amendment No. 1, NASD Regulation responded to issues raised in the initial three comment letters by revising the proposed rule change and the proposed rule text with respect to: modifying the disclosure statement; revising the method for delivering the disclosure statement; describing certain activities that will not trigger application of the proposed day-trading rules; and clarifying information-gathering requirements. *See* Letter from Alden S. Adkins, Sr. Vice President and General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation (''Division''), SEC, dated February 10, 1999 (''Amendment No. 1'').

[6] Securities Exchange Act Release No. 42452 (February 23. 2000), 65 FR 11353.

[7] *See* Letters from The Honorable Susan M. Collins, Chairman, Permanent Subcommittee on Investigations, The Honorable Carl Levin, Ranking Minority Member, Permanent Subcommittee on Investigations, and The Honorable Richard J. Durbin, Committee on Governmental Affairs, U.S. Senate, to Jonathan G. Katz, Secretary, SEC, dated March 17, 2000 (''Senators''); Linda Lerner, General Counsel, All-Tech Direct, Inc., to Jonathan G. Katz, Secretary, SEC, dated March 20, 2000 (''All-Tech''); Bradley W. Skolnik, President, Indiana Securities Commissioner, NASAA, to Jonathan G. Katz, Secretary, SEC, dated March 23, 2000; and Robert P. Mazzarella, Chairman, Discount Brokerage Committee, and Michael L. Michael, Chairman, Ad Hoc Committee on Technology and Regulation, SIA, to Jonathan G. Katz, Secretary, SEC, dated March 23, 2000.

[8] In Amendment No. 2, NASD Regulation responded to the comment letters submitted on Amendment No. 1 and incorporated several recommendations from the letters into the proposed disclosure statement. *See* Letter from Joan Conley, Senior Vice President and Corporate Secretary, NASD Regulations, to Nancy Sanow, Assistant Director, Division, SEC, dated June 21, 2000 (''Amendment No. 2'').

[9] NASD's 2300 series of rules covers *Transactions With Customers.*

[10] As proposed, ''day-trading strategy'' is defined as ''an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities.'' The proposed definition would include those instances where an individual regularly transmits one or more purchase and sale (*i.e.,* ''round-trip'') transactions in a single day. The proposed definition of ''day-trading strategy'' also includes orders transmitted by non-electronic means, such as by telephone.

[11] In the original filing, activities that would not alone trigger application of the rule were described in the proposed rule change but were not part of the proposed rule text. In Amendment No. 1, NASD Regulation added these provisions to the proposed rule text. *See* Amendment No., *supra* note 5.

[12] *See* amendment Nos. 1 and 2, *supra* notes 5 and 8.

[13] *Id.* In Amendment No. 2, NASD Regulation noted that NASD Rule 3010(a) requires that firms maintain a system to supervise the activities of each registered representative that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with NASD rules.

advertisement constitutes such activity for purposes of the proposal.[14]

2. Accounts Covered by the Proposed Rule

The term ''non-institutional customer'' would mean a customer that does not qualify as an ''institutional account'' to mean the account of: (1) A bank, savings and loan association, insurance company, or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or agency or office performing similar functions); or (3) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.[15] The proposal would not apply to an existing customer unless the customer opens a new account at a firm that is promoting a day-trading strategy.

B. Requirements for New Customer Accounts of Firms Promoting a Day-Trading Strategy

Before opening a new account for a customer, a firm that is promoting a day-trading strategy must deliver a risk disclosure document and either approve the account for day trading or obtain a written agreement from the customer stating that the customer does not intend to use the account for day-trading activities. Each of these requirements is described below.

1. Requirement to Provide a Day-Trading Risk Disclosure Statement

As discussed above, the proposal would require a firm that is promoting a day-trading strategy to deliver a risk disclosure statement, discussing the unique risks posed by day trading, to all non-institutional customers prior to opening an account for such customers.[16] The disclosure statement would include several factors that a customer should consider before engaging in day trading, including that: The customer should be prepared to lose all of the funds that he or she uses for day trading; day trading generally requires significant resource; [17] and day trading on margin or short selling may result in losses beyond the initial investment.

The disclosure statement also would include a provision stating that day trading generally is not appropriate for persons of limited resources and limited investment or trading experience and low risk tolerance. Another provision would explain that a day trader should know its firm's business practices [18] because under certain market conditions, a day trader may find it difficult or impossible to liquidate a position quickly at a reasonable price, such as when the market for a stock suddenly drops, or if trading is halted due to recent news events or unusual trading activity. The provision would further state that the more volatile a stock is, the greater the likelihood that problems may be encountered in executing a transaction.[19]

The disclosure statement would further explain that, because a day-trading strategy requires frequent trades, payment of commissions will add to losses or significantly decrease earnings. The disclosure document also would provide an example of how much annual profit a day trader would need to generate just to cover commission costs.[20] The disclosure statement would conclude with a provision that informs investors of the potential need to register as an investment adviser or as a broker or dealer under federal and state registration requirements.[21]

The firm would be permitted to develop an alternative risk disclosure statement, provided that the alternative statement was substantially similar to the mandated statement and was filed with, and approved, by NASD Regulation's Advertising/Investment Companies Regulation Department. In addition, NASD Regulation encourages all firms, particularly firms that provide on-line trading capability, to provide the mandated risk disclosure statement or a substantially similar disclosure statement to their customers. The proposed risk disclosure statement, as amended, follows. Proposed additions from Amendment No. 2 are in italics and proposed deletions are in brackets.[22]

Rule 2361. Day-Trading Risk Disclosure Statement

(a) Except as provided in paragraph (b), no member that is promoting a day-trading strategy, directly or indirectly, shall open an account for or on behalf of a non-institutional customer unless, prior to opening the account, the member has furnished to each customer, individually, in writing or electronically, the following disclosure statement:

You should consider the following points before engaging in a day-trading strategy. For purposes of this notice, a ''day-trading strategy'' means an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities.

Day trading can be extremely risky. Day trading generally is not appropriate for someone of limited resources and limited investment or trading experience and low risk tolerance. You should be prepared to lose all of the funds that you use for day trading. In particular, you should not fund day-trading activities with retirement savings, student loans, second mortgages, emergency funds, funds set aside for purposes such as education or home ownership, or funds required to meet your living expenses. *Further, certain evidence indicates that an investment of less than $50,000 will significantly impair the ability of a day trader to make a profit. Of course, an investment of $50,000 or more will in no way guarantee success.*

Be cautious of claims of large profits from day trading. You should be wary of advertisements or other statements that emphasize the potential for large profits in day trading. Day trading can also lead to large and immediate financial losses.

Day trading requires knowledge of securities markets. Day trading requires in-depth knowledge of the securities markets and trading techniques and strategies. In attempting to profit through day trading, you must compete with professional, licensed traders employed by securities firms. You should have appropriate experience before engaging in day trading.

Day trading requires knowledge of a firm's operations. *You should be familiar with a securities firm's business practices, including the operation of the firm's order execution systems and procedures.* Under certain market conditions, you may find it difficult or impossible to liquidate a position quickly at a reasonable price. This can occur, for example, when the market for a stock suddenly drops, or if trading is halted due to recent news events or unusual trading activity. The more volatile a stock is, the greater the likelihood that problems may be

[14] As a result, NASD Regulation believes that the proposal should both limit concerns about any effect of the proposal on the NASD's general suitability rule and allow firms to better determine whether a particular advertisement would trigger the rule prior to publication or distribution of the advertisement.

[15] NASD Regulation believes that applying the proposed rule change to non-institutional customers would ensure that most individuals would be covered by the proposal, regardless of whether they engage in day-trading activities in their own name or in the name of a corporation or partnership.

[16] NASD Regulation did not recommend that all firms, whether or not they promote day trading, be required to disseminate the disclosure statement to all new customers because the benefits of such a requirement are unclear. However, NASD Regulation advised that it will continue to monitor the growth of day-trading activities to determine whether, in the future, such a requirement might be justified. *See* Amendment No. 1, *supra* note 5.

[17] In Amendment No. 2, NASD Regulation adopted the Senators' suggestion to include in the risk disclosure statement a warning that investors with less than $50,000 in risk capital are not likely to succeed as day traders. *See* Amendment No. 2, *supra* note 8.

[18] *See* Amendment No. 2, *supra* note 8.

[19] *See* Amendment No. 1, *supra* note 5.

[20] *See* Amendment No. 2, *supra* note 8.

[21] *Id.*

[22] Proposed NASD Rule 2360, pertaining to approval procedures for day trading accounts, remains unchanged from Amendment No. 1 and therefore its text is not set forth in this release.

encountered in executing a transaction. In addition to normal market risks, you may experience losses due to system failures.

Day trading will generate substantial commissions, even if the per trade cost is low. [Day trading may result in your paying large commissions.] Day trading *involves* [may require you to trade your account] aggressive[ly] *trading,* and *generally* you *will* [may] pay commissions on each trade. The total daily commissions that you pay on your trades *will* [may] add to your losses or significantly reduce your earnings. *For instance, assuming that a trade cost $16 and an average of 29 transactions are conducted per day, an investor would need to generate an annual profit of $111,360 just to cover commission expenses.*

Day trading on margin or short selling may result in losses beyond your initial investment. When you day trade with funds borrowed from a firm or someone else, you can lose more than the funds you originally placed at risk. A decline in the value of the securities that are purchased may require you to provide additional funds to the firm to avoid the forced sale of those securities or other securities in your account. Short selling as part of your day-trading strategy also may lead to extraordinary losses, because you may have to purchase a stock at a very high price in order to cover a short position.

Potential Registration Requirements. *Persons providing investment advice for others or managing the securities accounts for others may need to register as either an ''Investment Advisor'' under the Investment Advisors Act of 1940 or as a ''Broker'' or ''Dealer'' under the Securities Exchange Act of 1934. Such activities may also trigger state registration requirements.*

(b) In lieu of providing the disclosure statement specified in paragraph (a), a member that is promoting a day-trading strategy may provide to the customer, individually, in writing or electronically, prior to opening the account, an alternative disclosure statement, provided that:

(1) The alternative disclosure statement shall be substantially similar to the disclosure statement specified in paragraph (a); and

(2) The alternative disclosure statement shall be filed with the Association's Advertising Department (Department) for review at least 10 days prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changes are recommended by the Association, shall be withheld from use until any changes specified by the Association have been made or, if expressly disapproved, until the alternative disclosure statement has been refiled for, and has received, Association approval. The member must provide with each filing the anticipated date of first use.

(c) For purposes of this rule, the term ''day-trading strategy'' shall have the meaning provided in Rule 2360(e).

(d) For purposes of this *R*[r]ule, the term ''non-institutional customer'' means a customer that does not qualify as an ''institutional account'' under Rule 3110(c)(4).

* * * * *

2. Customer Acknowledgment

The proposal would require firms to deliver the disclosure statement to each customer individually, by mail or electronic means, prior to opening the account. A firm would not satisfy the proposal's requirements by posting the disclosure statement in a remote location on its web site, and claiming that it was delivered to all customers in such manner. The proposal would not require customers to sign the disclosure statements.[23]

3. Approving Customer Accounts for Day Trading

In addition to delivering a risk disclosure document. A firm must approve a customer's account for a day-trading strategy in accordance with certain procedures. Specifically, to approve a customer's account for a day-trading strategy, a firm must have reasonable grounds for believing that the strategy is appropriate for the customer and to exercise reasonable diligence to ascertain the essential facts relative to the customer. The proposal would expressly require a firm to review a customer's investment objectives, investment and trading experience and knowledge, financial situation (including estimated annual income from all sources, estimated net worth exclusive of family residence, and estimated liquid net worth), tax status, employment status (name of employer, self-employed or retired, marital status, number of dependents, and age.[24] The proposal would not required firms to determine the source of funds, primarily because of concerns with defining the scope of any such obligation and the risks of imposing disproportionate burdens on firms.[25]

4. Accounts Used for Purposes Other Than Day-Trading Activities

As an alternative to approving an account for a day-trading strategy, the proposal would permit a firm that is promoting a day-trading strategy to obtain from the customer a written agreement that the customer does not intend to use the account for the purposes of day trading (''other-use agreement''). [26] A firm would not be permitted to rely on an other-use agreement if it knows that the customer intends to use the account for day trading. Moreover, if a firm opens an account for a customer in reliance on an other-use agreement, but later knows that the customer is using the account for day-trading activities, then the firm would be required to approve the customer's account for day trading in accordance with the rule as soon as practicable, but in no event later than ten days from the date of discovery. The standard of knowledge is one of actual knowledge.[27]

III. Summary of Comments

After the original publication of the proposed rule change in the **Federal Register,**[28] the Commission received comment letters form the ETA, NASAA, and the SIA, [29] generally supporting aspects of the proposed rule change but recommending numerous significant changes to the proposal itself. NASD Regulation responded to these letters in Amendment No. 1.[30] The Commission then published Amendment No. 1 for comment,[31] and, in response, the commission received comments letters form All-Tech, the SIA, NASAA, and the Senators, again generally supporting features of the proposal but recommending various modifications.[32]

A. Issues Raised in Comment Letters to Amendment No. 1

1. Application of the Rule

In its comment letter to Amendment No. 1, the SIA restated its concern that individual solicitations by a broker or brokers of a day-trading strategy could cause an entire firm to be deemed to be promoting a day-trading strategy. In Amendment No. 1, NASD Regulation stated that if a broker targeted, for example, five customers for day trading without the firm's knowledge, the firm would not be deemed to be promoting day trading. However, if a principal or officer of the firm knew that the firm's brokers were promoting a day-trading strategy, the firm would be deemed to

[23] NASD Regulation added the ''individual'' delivery requirement in Amendment No. 1. NASD Regulation believes that any abuses of the delivery requirement could be detected during routine examinations. *See* Amendment No. 1, *supra* note 5.

[24] The proposed rule change originally included only an evaluation of the investment objectives, investment and trading experience and knowledge, financial situation and tax status. The additional factors were added in Amendment No. 1. *See* Amendment No. 1, *supra* note 5.

[25] *See* Amendment No. 2, *supra* note 8.

[26] The firm would be required to provide a risk disclosure statement to the customer even if the firm obtains an other-use agreement

[27] *See* Amendment No. 1, *supra* note 5. NASD Regulation believes that it is proper to hold a firm accountable for facts known to the firm. *See* Amendment No. 2, *supra* note 8.

[28] *See supra* note 3.

[29] *See supra* note 4.

[30] *See* Amendment No. 1 *supra* note 5. A summary of comments received on the original filing is included in Securities Exchange Act Release No. 42452 (February 23, 2000), 65 FR 11353 (March 2, 2000).

[31] *See supra* note 6.

[32] *See supra* note 7.

be promoting day trading. The SIA argued that knowing the strategies employed by its brokers is a good supervisory practice and should not trigger application of the day-trading rules to the entire firm. Alternatively, the SIA argued that the commentary accompanying the proposal should state that a number of the firm's brokers would need to be individually soliciting customers to day trade for these solicitations to cause the firm itself to be considered to be promoting a day-trading strategy. In response, NASD Regulation stated that, while solicitations by individual brokers would not alone cause a firm to be considered to be promoting a day-trading strategy, when an officer or a principal has knowledge of brokers soliciting accounts for day trading, the firm would be deemed to be promoting day trading and thus subject to the day-trading rules.[33]

The SIA also suggested that the proposal unfairly assigns the firm the responsibility for customers changing their minds with respect to the ''other use'' agreement. The SIA stated that because firms maintain records of customers' trades, it can be argued that firms always have actual knowledge. The NASD responded that, on balance, it believes the provision is appropriate and not overly burdensome, and that it is proper to hold a firm accountable for facts known to the firm.[34]

On the other hand, NASAA expressed concern that the proposal could be read narrowly so as to not cover certain firms promoting day-trading activities. Accordingly, NASAA recommended that the NASD clarify that although the enumerated activities would not by themselves be deemed to be promoting a day-trading strategy, they could nevertheless still be considered part of a plan to promote day trading when combined with other acts. NASD Regulation stated that it believes that the proposed rule, as amended, addresses NASAA's concerns and pointed out that the proposed rule language specifies that firms would not be deemed to be promoting day trading activities *solely* by engaging in one of the listed activities, and that therefore such activities may be considered part of a plan to promote day-trading activities when combined with other acts.[35]

Finally, All-Tech argued that the risk disclosure requirements were ''hypocritical'' because they would impose additional regulatory requirements on day-trading firms and not on other firms that facilitate online trading. Citing findings by the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs, the NASD responded that it believes day-trading strategies present unique investor protection concerns that do not necessarily translate to other forms of trading. Thus, the NASD determined that there is no reason to change its position on this issue.[36]

Risk Disclosure Statement

The Senators recommended that the risk disclosure statement warn customers that investors with less than $50,000 in risk capital are not likely to succeed as day traders. NASD Regulation adopted this recommendation in Amendment No. 2, and qualified the warning by stating that risking capital of $50,000 or more does not, however, guarantee successful day trading. The Senators also recommended a provision explaining that there is substantial evidence that most day traders would need to generate at least $100,000 per year just to cover commission costs and trading fees. NASD Regulation incorporated this suggestion into the risk disclosure statement by supplementing the statement with a mathematical example highlighting the need to generate substantial earnings to cover day-trading costs.

In addition, NASAA recommended changing the provision, captioned ''Day trading requires knowledge of a firm's operations,'' to include the language removed by NASD Regulation in Amendment No. 1. NASD Regulation, in Amendment No. 1, replaced language in the original proposal with language suggested in a comment letter. NASAA stated that it believes that the deleted language better explained the need for customers to understand their own firm's execution systems and evaluate potential problems for themselves. Agreeing with the suggestion, NASD Regulation reinserted the removed text into the risk disclosure document.[37]

Appropriateness Determination

As mentioned above, the Senators suggested establishing a ''rebuttable presumption'' that if an investor has less than $50,000 of risk capital, day trading is not appropriate for the customer. This presumption could be rebutted by other factors that the firm concludes outweigh the inadequate risk capital. The Senators further suggested that where a firm determines that day trading is an appropriate strategy for customers who do not possess $50,000 for investment purposes, the firm would be required to prepare and maintain a record setting forth the reasons that it deemed day trading to be appropriate for the customers. NASD Regulation chose not to incorporate this presumption into Amendment No. 2 for several reasons. First, NASD Regulation stated its belief that the $50,000 threshold may make sense for many investors, but it arguably is too low for very active day traders and too high for less active day traders. Second, imposing such a presumption could encourage individuals to misrepresent the value of their assets. Finally, NASD Regulation noted that the current proposal already requires a firm to document the basis on which it approves an account for a day-trading strategy.[38]

NASAA again recommended that the proposal incorporate some additional recordkeeping requirements included in the NASD options rules. Noting that it had considered this issue in preparing Amendment No. 1, NASD Regulation disagreed with this suggestion because it believes that many of these requirements are duplicative of obligations currently imposed on firms.[39]

4. Sources of Customer funds

The Senators suggested modifying the proposal to require broker-dealers that are promoting day-trading strategies to inquire whether parties opening accounts plan to trade for others, and if so, to require firms to determine if parties need to be registered as investment advisors. In Amendment No. 2, NASD Regulation responded to this comment by stating that it believes that it would ''be difficult, if not impossible'' for firms to make this determination. However, NASD Regulation stated that customers should be informed of potential registration requirements and therefore amended the risk disclosure statement to include such a warning.

[33] *See* Amendment Nos. 1 and 2, *supra* notes 5 and 8.

[34] *See* Amendment No. 1, *supra* note 5.

[36] *Id.*

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] *See* Amendment Nos. 1 and 2, *supra* notes 5 and 8.

NASAA recommended that the proposal require firms to obtain information on the sources of customer funds invested because of the prevalence of day traders using borrowed money to fund their accounts. NASD Regulation represented in Amendment No. 2 that is it considering a separate response to address this concern.[40]

B. Issues Raised in Comment Letters to Amendment No. 2

Although Amendment No. 2 was not yet published, the Commission received one comment letter regarding the amendment.[41] The SIA reiterated its concern that the proposed rule language may undermine what the SIA refers to as the safe harbor provision of the proposed rule. The SIA is concerned that, under the proposed rule, a firm could engage in the activities listed in proposed Rule 2360(g) and have the fact that they engage in those activities—activities that are specifically enumerated in the Rule as not deemed to be promoting a day-trading strategy—used in the determination that the firm is promoting a day-trading strategy.

IV. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act[42] and the rules and regulations thereunder applicable to a national securities association. In particular, the Commission finds the proposal is consistent with the requirements of Section15A(b)(6) of the Act,[43] because the proposed rule change is 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.

During the past few years, the problems and risks associated with day trading have received widespread attention by regulators, legislators, the media, and the public. For example, on February 25 of this year, the Commission's staff issued a report providing the results of its examination of 47 registered broker-dealers providing day-trading facilities to the general public.[44] In addition, earlier this year, the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs held a series of hearings detailing day trading practices.[45] The NASD Regulation proposal, as amended, is intended to provide a measured regulatory response to assure that firms promoting a day-trading strategy check to make certain that day trading is an appropriate investment strategy for a customer opening a day-trading account and that the customer is aware of its risks.

Certain brokerage firms focus primarily, or even exclusively, on promoting day-trading strategies to individuals. These firms generally advertise on the Internet and elsewhere as ''day-trading'' firms or otherwise highlight their execution and other services as desirable for ''serious'' or ''professional'' traders. In addition, many of these firms offer training on day-trading techniques, as well as provide computer facilities and software packages specifically designed to support and accommodate day trading.

Day trading, however, raises unique investor protection concerns. In general, day traders seek to profit from very small movements in the price of a security. Such a strategy often requires aggressive trading of a brokerage account and the use of strategies including margin trading and short selling. As a result, day trading generally requires a significant amount of capital, a sophisticated understanding of securities markets and trading techniques, and a high tolerance for risk. Even experienced day traders with in-depth knowledge of the securities markets may suffer severe and unexpected financial losses.

The Commission finds that requiring a member firm to disclose the risks of day trading to non-institutional customers when the firm promotes a day-trading strategy should help alert individuals who are new to day trading to the risks associated with that strategy. In addition, requiring a member firm to determine whether a day-trading strategy is appropriate for a customer should help to assure that individuals who are unable to bear the risks of day trading, or who have investment objectives incompatible with day trading, are not approved for day trading. In summary, the Commission finds that the risk disclosure statement and appropriateness review mandated by the proposed NASD rules are thoughtfully designed and tailored to address investor protection concerns raised by the increasingly popular trading strategy referred to as day trading.

The Commission notes that the proposed rule change focuses on the promotion of trading strategies that can present high risks to individuals that do not have the investing experience or financial means to sustain those risks and, as revised, the proposed NASD rules should not be unduly burdensome for firms to apply. Firms that are actively promoting a day-trading strategy should be responsible for assessing whether the strategy is appropriate for an individual who opens a day-trading account at that firm. These firms also should be required to disclose the risks of engaging in a day-trading strategy to an individual prior to opening an account for that individual.

While the commenters generally favored the concept of providing greater disclosure of day-trading risks, they also suggested various modifications to the proposal. The Commission believes that NASD Regulation has responded adequately to commenters' concerns and suggestions by incorporating some recommendations into the proposal and explaining why it was not incorporating others. In particular, in response to comments submitted on the original proposed rule change, NASD Regulation: (1) Refined the definition of ''day-trading strategy,'' (2) added more detail regarding the information that a firm must obtain at a minimum from a customer before approving the account for a day-trading strategy; (3) incorporated into the rule those activities that would not be deemed to be ''promoting a day-trading strategy,'' and (4) revised the disclosure statement to discuss the risks associated with trade executions during volatile market conditions and systems failures, among other revisions.

Amendment No. 2 further refines the risk disclosure document to take into account various comments and suggestions submitted regarding Amendment No.1. Amendment No.2 amends the risk disclosure document to: (1) Indicate that an investment of less than $50,000 will impair the ability of a day trader to profit, while an investment of $50,000 or more does not guarantee success; (2) provide an example of the annual profits needed to cover commission costs; (3) encourage investors to become familiar with the firm's business practices, including its order execution systems and procedures; and (4) inform investors

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[40] *See* Amendment No. 2, *supra* note 8.

[41] *See* Letter from Michael L. Michael, Chairman, Technology and Regulation Committee, and Michael Hogan, Chairman, Ad-hoc Online Brokerage Legal Committee, SIA, to Nancy Sanow, Assistant Director, SEC, dated June 30, 2000 (''June 30 SIA Letter'').

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

[43] 15 U.S.C. 78*o*–3(b)(6).

[44] This study, *Report of Examinations of Day-Trading Broker-Dealers,* is available on the internet at http://www.sec.gov/news/studies/daytrep.htm.

[45] Staff of the Permanent Subcommittee on Investigations, Senate Comm. On Governmental Affairs. 106th Cong., 2d Sess., Memorandum on Day Trading (February 24, 2000).

about the potential need to register as an investment advisor or broker-dealer under certain conditions.

As noted above, the SIA expressed concern about a statement in Amendment No. 2 advising firms that the activities specified in Rule 2360(g) may be considered part of a plan to promote day trading when combined with other acts.[46] Rule 2360(g) provides that firms will not be deemed to be promoting a day-trading strategy *solely* by engaging in one of the listed activities. The Commission believes that NASD Regulation addressed this concern in its Amendment No. 2 by correctly noting that Rule 2360(g) would not subject a firm to the new rules *solely* by engaging in the activities listed in that rule. The Commission finds that, in making the determination of whether a firm is promoting a day-trading strategy, it is reasonable for NASD Regulation to consider all of the firm's activities, including those listed in Rule 2360(g).

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

The Commission finds good cause for approving Amendment No. 2 prior to the thirtieth day after the date of publication of notice in the **Federal Register**. The Commission finds that the additional disclosures noted in Amendment No. 2 will provide greater information to investors about the risk of day trading and thus should strengthen the proposal. Moreover, the amendment raises no significant regulatory issues. Accordingly, the Commission finds good cause, consistent with Sections 15A(b)(6)[47] and 19(b)(2)[48] of the Act, to approve Amendment No. 2 to the proposed rule change on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether Amendment No. 2 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refeer to File No. SR–NASD–99–41 and should be submitted by August 7, 2001.

VI. Conclusion

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act[49] that the proposed rule change (SR–NASD–99–4), as amended, is approved and Amendment No. 2 to the proposed rule change is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[50]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–43023; File No. SR–0CC–99–14]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to Price Used in Calculating Premium Margin

July 11, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on October 26, 1999, The Options Clearing Corporation (''OCC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change would set an option's marking price at the last sale price for purposes of calculating premium margin.

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

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.[2]

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

OCC proposes to amend Rule 601 (relating to margining of equity options) and Rule 602 (relating to margining of non-equity options) to set marking prices at the last sale price, adjusted to the highest bid if the last sale price is below the highest bid or adjusted to the lowest offer if the last sale price is above the lowest offer. The purpose of the proposed rule change is twofold. First, OCC believes that the proposed change results in a more accurate assessment of risk and therefore a more appropriate margin requirement. Second, OCC believes that the proposed rule change will provide consistency with the marking practices of clearing members, the majority of whom are believed to use the method currently proposed.

OCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(A) of the Act[3] and the rules and regulations thereunder applicable to OCC because the proposed rule change will enable OCC to better facilitate the prompt and accurate clearance and settlement of securities transactions.

(B) Self-Regulatory Organization's Statement on Burden on Competition

OCC does not believe that the proposed rule change will have any impact or impose any burden on competition.

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[46] *See* June 30 SIA Letter, *supra* note 29.

[47] 15 U.S.C. 78*o*–3(b)(6).

[48] 15 U.S.C. 78s(b)(2).

[49] 15 U.S.C. 78s(b)(2).

[50] 17 CFR 200.30–3(a)(12).

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

[2] The Commission has notified the text of the summaries prepared by OCC.

[3] 15 U.S.C. 78q–1(b)(3)(A).