any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The proposed rule change has become effective pursuant to section 19(b)(3)(A)(ii) of the Act [5] and subparagraph (f)(2) of Rule 19b–4 thereunder [6] because it establishes or changes a due, fee, or other charge imposed by the Exchange. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 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 Section. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR–Amex–2002–28 and should be submitted by May 7, 2002.

[5] 15 U.S.C. 78s(b)(3)(A)(ii).

[6] 17 CFR 240.19b–4(f)(2).

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–9191 Filed 4–15–02; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45721; File No. SR–NASD–2002–12]

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

April 10, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'' or ''Exchange Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on January 17, 2002, 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 (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. The Association filed Amendment No. 1 to the proposed rule change on March 21, 2002.[3] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

NASD Regulation has filed with the Commission a proposed rule change that would require, as part of a subordination agreement, the execution of a Subordination Agreement Investor Disclosure Document (''Disclosure Document''). The proposed form of the Disclocure Document is as follows:

SUBORDINATION AGREEMENT

INVESTOR DISCLOSURE DOCUMENT

PLEASE READ THIS DOCUMENT CAREFULLY BEFORE DECIDING TO ENTER INTO A SUBORDINATION AGREEMENT WITH A BROKER/DEALER. SUBORDINATION AGREEMENTS ARE AN INVESTMENT. THESE INVESTMENTS CAN BE RISKY AND ARE NOT SUITABLE FOR ALL INVESTORS. AN INVESTOR SHOULD NEVER ENTER INTO A SUBORDINATION AGREEMENT WITH A BROKER/DEALER UNLESS HE/SHE CAN BEAR THE LOSS OF THE TOTAL INVESTMENT.

Subordination agreements are complicated investments. A subordination agreement is a contract between a broker/dealer (the borrower) and a lender (the investor), pursuant to which the lender lends money and/or securities to the broker/dealer. The proceeds of this loan can be used by the broker/dealer almost entirely without restriction. The lender agrees that if the broker/dealer does not meet its contractual obligations, his/her claim against the broker/dealer will be subordinate to the claims of other parties, including claims for unpaid wages. Lenders may wish to seek legal advice before entering into a subordination agreement.

KEY RISKS

All investors who enter into Subordination Agreements with broker/dealers should be aware of the following *key risks*:

Money or securities loaned under subordination agreements are not customer assets and are not subject to the protection of the Securities Investor Protection Corporation (SIPC). In other words, your investment in the broker/dealer is *not* covered by SIPC. Nor are subordination agreements generally covered by any private insurance policy held by the broker/dealer. Thus, if the broker/dealer defaults on the loan, the investor can lose all of his/her investment.

- The funds or securities lent to a broker/dealer under a subordination agreement can be used by the broker/dealer almost entirely without restriction.
- Subordination agreements cause the lender to be subordinate to other parties if the broker/dealer goes out of business. In other words, you, as an investor, would be paid after the other parties are paid, assuming the broker/dealer has any assets remaining.
- The NASD Regulation approval of subordination agreements is a regulatory function.

It does *not* include an opinion regarding the viability or suitability of the investment. Therefore, NASD Regulation approval of a subordination agreement does not mean that NASD Regulation has passed judgment on the

[7] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19b–4.

[3] On March 21, 2002, the Association filed, pursuant to Rule 19b–4 of the Act, an amendment to its initial Form 19b–4, which made certain clarifications to the proposed disclosure document.

soundness of the investment or its suitability as an investment for a particular investor.

SIPC COVERAGE

Q. *In general, what is SIPC coverage?*

A. SIPC is a non-profit, non-government, membership corporation created to protect customer funds and securities held by a broker/dealer if the broker/dealer closes because of bankruptcy or other financial difficulties. SIPC defines customers as persons who have securities or cash on deposit with a SIPC member for the purpose of, or as a result of, securities transactions.

Q. *Is an investor who enters into a subordination agreement covered by SIPC?*

A. No. SIPC considers these agreements to be investments in the broker/dealer. Once a customer signs a Subordinated Loan Agreement (SLA) or Secured Demand Note Agreement (SDN), he or she is no longer considered a customer of the broker/dealer relative to this investment. (These agreements are explained in further detail below.) For example, Mr. Jones has an IRA rollover account and a separate investment account with a broker/dealer. Mr. Jones enters into a subordination agreement with the broker/dealer and uses the investment account as collateral. This action would cause Mr. Jones to lose SIPC coverage for the investment account but not for his IRA account. If Mr. Jones pledges physical shares (i.e., certificates) as collateral for his subordination agreement, as opposed to pledging an account, he will lose SIPC coverage for the shares pledged.

OTHER INSURANCE COVERAGE

Q. *If my broker/dealer tells me that the firm has Fidelity Bond Coverage, will this coverage insure my investment?*

A. Fidelity Bond Coverage provides limited protection that generally would not benefit a subordinated lender (investor) under an SLA or SDN. In addition, NASD Regulation is not aware of any other insurance product that will protect an investor in this situation. If a broker/dealer claims that an SLA or SDN is covered by any type of insurance, the investor should insist on receiving that representation in writing from the insurance company.

GENERAL INFORMATION ABOUT SUBORDINATION AGREEMENTS

Q. *Why would a broker/dealer ask an investor to enter into a subordination agreement?*

A. Subordination agreements add to the firm's capital and thereby strengthen the broker/dealer's financial condition.

Q. *What are the advantages and disadvantages for an investor to enter into a subordination agreement with a broker/dealer?*

A. An investor may be able to obtain a higher interest rate than from other investments. There are, however, key disadvantages. If the broker/dealer goes out of business, the investor's claims are subordinated to the claims of other parties, i.e., customer and creditor claims will be paid before investors' claims. Thus, the subordinated investor may or may not get his/her funds or securities back, depending on the financial condition of the broker/dealer. FINALLY, MONEY OR SECURITIES LOANED UNDER SUBORDINATION AGREEMENTS ARE NOT CUSTOMER ASSETS AND ARE NOT COVERED BY SIPC, OR IN GENERAL, ANY OTHER PRIVATE INSURANCE.

Q. *Per the Lender's Attestation, the broker/dealer is required to give the prospective lender copies of various financial documents, including a certified audit. Why is this necessary?*

A. A subordination agreement is an investment in the broker/dealer. Therefore, the investor, as a prospective lender, should assess the firm's financial condition to determine whether the loan makes good business sense. Financial documents can be complicated and the investor should consider consulting with an attorney or accountant.

Q. *Outside counsel can be expensive. What if my broker/dealer provides an attorney for me at its expense?*

A. It may not be desirable to use a broker/dealer's attorney to assist you in the transaction. To ensure independent, objective representation, an investor should retain his/her own attorney.

Q. *How many types of subordination agreements are there?*

A. In general, there are only two, the Subordinated Loan Agreement and the Secured Demand Note Agreement.

SUBORDINATED LOAN AGREEMENTS (SLA)

Q. *What is an SLA?*

A. If an investor lends cash to a broker/dealer, the investor will usually do this as part of an SLA. The SLA discloses the terms of the loan, including the identities of the broker/dealer and investor, the amount of the loan, the interest rate, and the date on which the loan is to be repaid.

Q. *Can the lender restrict the broker/dealer's use of the loan?*

A. No. Language in the SLA precludes the lender from placing restrictions on how the broker/dealer may use the funds. Therefore, lenders should not rely on side agreements with a broker/dealer that purport to limit the use of the loan proceeds. These agreements are inconsistent with the SLA and may not be enforceable.

SECURED DEMAND NOTE AGREEMENTS (SDN)

Q. *What is an SDN?*

A. An SDN is a promissory note, in which the lender agrees to give cash to the broker/dealer on demand during the term of the SDN. This ''promissory note'' must be backed by collateral, generally the lender's securities. The lender retains his/her status as beneficial owner of the collateral, but the securities must be in the possession of the broker/dealer and registered in its name. As securities can fluctuate in value, the lender must give sufficient securities to the broker/dealer so that when the securities are discounted, the net value of the securities will be equal to or greater than the amount of the SDN. This ''discounting'' is required by regulation. The rate of the discount varies and can be as high as 30 percent in the event common stock is used as collateral.

For example, assuming common stock is used as collateral, for every $1,000 of face amount of the SDN, the investor must give the broker/dealer collateral that has a market value of at least $1,429. Therefore, collateral for a $15,000 SDN would require common stock that has a current market value of at least $21,435.

Q. *What happens to the securities that I pledge as collateral under an SDN?*

A.• The investor gives up the right to sell or otherwise use the securities that have been pledged to the broker/dealer under an SDN. Once securities are pledged as collateral for an SDN, the broker/dealer has exclusive use of the securities.

• The investor may exchange or substitute the securities that have been pledged to the broker/dealer with different securities, but the value of the new securities (after applying the appropriate discount) must be sufficient to collateralize the SDN.

• The broker/dealer may use them as collateral, i.e., the broker/dealer may borrow money from another party using the securities the investor has pledged as collateral under the SDN as collateral for the new loan.

• If the securities pledged as collateral decline in value so that their discounted value is less than the face amount of the SDN, the investor must deposit additional securities with the broker/dealer to keep the SDN at the

proper collateral level. If the investor does not give the broker/dealer additional collateral, the broker/dealer may sell some or all of the investor's securities.

• If the broker/dealer makes a demand for cash under an SDN, and the investor does not provide the broker/dealer with the cash, the broker/dealer has discretion to sell some or all of the investor's collateral (or securities). The SDN gives the broker/dealer the discretion to choose which of the investor's collateral to sell.

• All securities pledged as collateral for the SDN, including excess collateral, are subordinated to the claims of the broker/dealer's customers and creditors. Thus, if the firm becomes insolvent, the investor's ability to retrieve his/her collateral may be at risk.

THE NASD REGULATION APPROVAL PROCESS

Q. *What is involved in the NASD Regulation approval process?*

A. NASD Regulation will review the subordination agreement to ensure that it meets all technical requirements of Appendix D of SEC Rule 15c3–1 and to verify and that the broker/dealer has actually received the investor's funds or securities. This review is done to enable the borrower broker/dealer to use the subordination agreement as part of its regulatory capital. As previously stated, NASD Regulation does not review subordination agreements to determine whether the investment is viable or suitable for the investor (lender). The investor must make this determination.

By signing below, the investor attests to the fact that he/she has read this Subordination Agreement Investor Disclosure Document.

_____

Investor Name

_____

Investor Signature Date

FOR NASD USE ONLY

Effective Date:
LOAN Number:
NASD ID Number:
Date Filed:

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 Regulation included statements concerning the purpose of and basis for the proposed rule change, as amended, 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 Regulation 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

In order to receive benefit under the Commission's net capital rule,[4] funds or securities loaned by an investor to a broker-dealer must be the subject of a satisfactory subordination agreement. Rule 15c3–1d under the Act[5] sets forth the minimum and non-exclusive requirements for satisfactory subordination agreements. Rule 15c3–1d(a)(1)[6] also provides that the ''Examining Authority'' may require ''such other provisions as deemed necessary or appropriate to the extent such provisions do not cause the subordination agreement to fail to meet the minimum requirements of [Exchange Act Rule 15c3–1d].'' Under Rule 15c3–1d(c)(6)(i),[7] ''[n]o proposed agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the Examining Authority has found the agreement acceptable and such agreement has become effective in the form found acceptable.'' As an Examining Authority,[8] NASD Regulation proposes a rule change that would require each of its members that is a ''lender'' under Rule 15c3–1d[9] to execute a Disclosure Document as part of every subordination agreement. NASD Regulation states that the purpose of the Disclosure Document is to help lenders understand the risks associated with subordination agreements.

NASD Regulation states that it is concerned that an increasing number of retail investors may be entering into subordination agreements with broker-dealers without fully appreciating the risks or implications of such arrangements. For example, NASD Regulation notes that a number of investors in two recently failed firms found that entering into subordination agreements affected their rights to the protection of the Securities Investor Protection Corporation (''SIPC''). The proposed rule change would require members to make the Disclosure Document a part of the subordination agreement, and NASD Regulation staff would not consider a subordination agreement to be satisfactory under Rule 15c3–1d unless it includes a signed copy of the Disclosure Document.[10] NASD Regulation states that it would advise Members of this requirement in the instructions for subordination agreements.

NASD Regulation believes that the proposed Disclosure Document outlines in ''plain English'' the risks to an investor of entering into a subordination agreement. The Disclosure Document first reviews the ''key risks'' associated with subordination agreements and then, in question and answer form, provides the prospective investor with additional information to heighten his or her understanding of what it means to enter into a subordination agreement.

NASD Regulation states that, among other things, the Disclosure Document explains that money or securities loaned under subordination agreements are no longer customer assets that are subject to the protection of SIPC or, generally, any other insurance. The Disclosure Document would also advise investors that once they invest in a broker-dealer, they would have no say in how the broker-dealer uses the funds. In addition, it would advise investors that if they enter into a secured demand note agreement, the broker-dealer may borrow against any securities that are used to collateralize the note. It would further explain that if the broker-dealer closes because of bankruptcy or other financial difficulties, the claims of investors who have entered into subordination agreements are subordinate to the claims of other parties, including customers, creditors, and employees of the firm. Because NASD Regulation staff review of subordination agreements is merely to ensure that the terms of such agreements are consistent with the requirements of Rule 15c3–1d, the Disclosure Document would also advise prospective investors that they may wish to seek legal advice before entering into subordination agreements.

(2) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of sections 15A(b)(6) of

[4] Rule 15c3–1 under the Act, 17 CFR 240.15c3–1.

[5] 17 CFR. 240.15c3–1d.

[6] 17 CFR. 240.15c3–1d(a)(1).

[7] 17 CFR. 240.15c3–1d(c)(6)(i).

[8] The term ''Examining Authority'' is defined in Rule 15c3–1(d) under the Act. 17 CFR 240.15c3–1(d).

[9] The term ''lender'' is defined in Rule 15c3–1d(a)(2)(v)(f) under the Act. 17 CFR 240.15c3–1d(a)(2)(v)(f).

[10] The NASD states that it issued a Notice to Members announcing this proposed rule change and urged its members that enter into subordination agreements to adopt immediately, as a ''best practice,'' procedures to deliver the Disclosure Document to, and obtain a signed copy from, all lenders.

the Act,[11] which requires, among other things, that the Association'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 Regulation believes that the proposed rule change is designed to accomplish these ends by disclosing to investors certain key risks associated with subordination agreements.

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

NASD Regulation 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.

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. The proposed rule change was not noticed for comment by the NASD through its Notice to Members process.

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 Exchange 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, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 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 filings will also be available for inspection and copying at the principal office of the Association. All submissions should refer to File No. SR–NASD–2002–12 and should be submitted by May 7, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[12]

Margaret H. McFarland,

Secretary.

[FR Doc. 02–9193 Filed 4–15–02; 8:45 am]

BILLING CODE 8010–01–P

[11] 15 U.S.C. 78*o*–3(b)(5).

[12] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45720; File No. SR–NFA–2002–02]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Futures Association Regarding Broker-Dealer Registration, Fair Commissions, and Best Execution Obligations with Respect to Security Futures Products

April 10, 2002.

Pursuant to section 19(b)(7) of the Securities Exchange Act of 1934 (''Exchange Act''),[1] and Rule 19b–7 under the Exchange Act,[2] notice is hereby given that on March 20, 2002, National Futures Association (''NFA'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule changes described in Items I, II, and III below, which Items have been prepared by NFA. The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons.

On March 19, 2002, NFA submitted the proposed rule change to the Commodity Futures Trading Commission (''CFTC'') for approval. Under section 19(b)(7)(B) of the Act,[3] the proposed rule change may take effect upon approval by the CFTC.

I. Self-Regulatory Organization's Description of the Proposed Rule Change

Section 15A(k) of the Exchange Act[4] makes NFA a national securities association for the limited purpose of regulating the activities of members who are registered as brokers or dealers in security futures products under section 15(b)(11) of the Exchange Act.[5] The proposed ''Interpretive Notice to NFA Compliance Rule 2–4 Regarding the Registration Requirements for Trading Security Futures Products' clarifies that it is a violation of NFA rules for an NFA member to act as a broker-dealer for security futures products unless the member is properly registered as a broker-dealer. Proposed NFA Compliance Rule 2–37(g) and the proposed interpretive notices regarding fair commissions and best execution are in keeping with the SEC's August 21, 2001 Order, which requires NFA to adopt customer protection rules comparable to the rules of the National Association of Securities Dealers, Inc. (''NASD'').[6] Proposed NFA Compliance Rule 2–37(g) and its ''Interpretive Notice Regarding Fair Commissions'' specifically require notice-registered broker-dealers to charge fair commissions. The proposed ''Interpretive Notice to NFA Compliance Rule 2–4 Regarding Best Execution'' sets forth a notice-registered broker-dealer's best execution obligation for security futures orders.

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

NFA has prepared statements concerning the purpose of, and basis for, the proposed rule change, burdens on competition, and comments received from members, participants, and others. The text of these statements may be examined at the places specified in Item IV below. These statements are set forth in Sections A, B, and C below. The text of the proposed rule change is available for inspection at the Office of the Secretary, the NFA, the Commission's Public Reference Room, and on the Commission's Web site (*http://www.sec.gov*).

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

1. Purpose

Proposed Interpretive Notice to NFA Compliance Rule 2–4 Regarding the Registration Requirements for Trading Security Futures Products

The CFMA provides that security futures products are securities as well as futures and therefore are subject to

[1] 15 U.S.C. 78s(b)(7).

[2] 17 CFR 240.19b–7.

[3] 15 U.S.C. 78s(b)(7)(B).

[4] 15 U.S.C. 78o–3(k).

[5] 15 U.S.C. 78o(b)(11).

[6] *See* Securities Exchange Act Release No. 44729.