to the NASD's By-Laws is revised to add new listing standards applicable to the issuers of index warrants. Previously, issuers of index warrants were required to have assets in excess of \$100 million. Under the revised standards:

(1) issuers would be required to have a minimum tangible net worth in excess of \$250 million or, in the alternative, have a minimum tangible net worth in excess of \$150 million, provided the issuer has not issued warrants such that the aggregate original issue price of all of the issuer's stock index, currency index, and currency warrant offerings (combined with offerings by its affiliates) listed on Nasdaq or a national securities exchange exceeds 25% of the issuer's net worth;

(2) the term of the index warrants must provide that unexercised in-themoney warrants will be automatically exercised on either the delisting date (if the issue is not listed on a national securities exchange) or upon expiration;

(3) for warrant offerings where U.S. stocks constitute 25 percent or more of the index value, issuers must use the opening prices ("a.m. settlement") of the U.S. stocks to determine the index warrant settlement value for expiring warrants on the final determination of settlement value date ("valuation date") as well as during the two business days immediately preceding valuation date ⁵;

(4) in instances where the stock index underlying a warrant is comprised in whole or in part with securities traded outside the United States, the foreign country securities or American Depositary Receipts ("ADRs") thereon that (i) are not subject to a comprehensive surveillance agreement, and (ii) have less than 50% of their global trading volume in dollar value within the U.S., shall not, in the aggregate, represent-more than 20% of the weight of the index, unless such index is otherwise approved for warrant or option trading; and

(5) to assist in the surveillance of index warrant trading, as a condition of listing on Nasdaq, issuers would be required to notify the NASD of any early warrant exercises by 4:30 p.m., Eastern Standard Time, on the day the settlement value for the warrants is determined.

Second, the proposal adds a new Schedule J to the NASD's By-Laws. This schedule consolidates all of the regulatory requirements applicable to the conduct of accounts, the execution of transactions, and the handling of orders in index warrants listed on Nasdaq and exchange-listed stock index warrants, currency index warrants, and currency warrants by members who are not members of the exchange on which the warrant is listed or traded. In particular, Schedule J provides that: (1) All customer accounts trading index warrants, currency index warrants, and currency warrants must be approved to trade options; 6 (2) the options suitability rule applies to all recommendations to customers involving the purchase or sale of index warrants, currency index warrants, and currency warrants; and (3) the options rules contained in Article III, Section 33(b) of the NASD's Rules of Fair Practice regarding discretionary accounts, the supervision of accounts, customer complaints are applicable to index warrants, currency index warrants, and currency warrants. In addition, Schedule J provides that the NASD's rules governing options communications with the public shall apply to communications with the public concerning index, currency, and currency index warrants. To assist NASD members in complying with the regulatory requirements applicable to index warrants, currency index warrants, and currency warrants, the NASD proposes to distribute a Noticeto-Members providing guidance regarding member firm compliance responsibilities when handling transactions in warrants.

In addition, Schedule J provides for position limits, exercise limits, and reporting requirements applicable to index warrants. The position limits are consolidated position limits, meaning that index warrants on the same index on the same side of the market must be aggregated for position limit purposes. Specifically, for index warrants other than index warrants based on the MidCap Index, the position limit is 15 million warrants, provided the initial offering price of the warrants was at or below \$10. For index warrants based on the MidCap Index, the position limit is 7.5 million warrants, provided the initial offering price of the warrants was at or below \$10.7 The proposal also contains a provision that equalizes

7 See Amendment No. 2.

positions in index warrants that initially were priced above \$10 with those that were priced at or below \$10. In particular, positions will be equalized by dividing the original issue price of the index warrants priced above \$10 by ten and multiplying this number by the size of the index warrant position. For example, if an investor held 100,000 Nasdaq 100 Index warrants priced initially at \$20, the size of this position for position limit purposes would be 200,000, or 100,000 times 20 divided by 10.

The exercise limits provide that no investor or group of investors acting in concert may, within five consecutive business days, exercise more index warrants on the same index on the same side of the market than the applicable index warrant position limit. The reporting requirements provide that positions of 100,000 or more index warrants on the same index on the same side of the market must be reported to the Association. Schedule J also contains provisions setting forth the NASD's authority to mandate the liquidation of index warrant positions in excess of applicable position limits.⁸ In addition, proposed Schedule J provides that the NASD may halt or suspend trading in an index warrant if it concludes that such action is appropriate in the interests of a fair and orderly market and the protection of investors.9

Third, the NASD proposes to add a new Section 3(f)(10) to Article III, Section 30 of the NASD Rules of Fair Practice governing the margin treatment for index warrants, currency index warrants, and currency warrants. Specifically, these new requirements, provide that the initial and maintenance requirements for long positions in index warrants shall be 100% of the full purchase price of the warrants. For short positions in index warrants, the margin requirement is 100% of the current market value of the warrant plus 15% of the current value of the underlying index. The margin requirements for short positions can be decreased to the extent that they are out-of-the-money, however, the minimum requirement for each such warrant shall not be less than the current value of the warrant plus 10% of the current index value.

⁵ See Amendment No. 3.

⁶ In this connection, the NASD will permit NASD members to accept the representation of an investment adviser registered under the Investment Advisers Act of 1940 concerning the eligibility status of certain customers to engage in warrant trading even if the underlying documentation relating to the managed account is not provided to the member. The NASD's position would apply to the managed accounts of an institutional customer or where the investment adviser account represents the collective investment of a number of persons (e.g., an investment club account). Permitting member firms to accept the representation of an investment adviser in these instances will conform the handling of warrant accounts to the current practice for options accounts.

⁸ See Amendment No. 1.

⁹ Among the factors that may be considered by the NASD are the following: (1) Trading has been halted or suspended in underlying stocks whose weighted value represents 20% or more of the index value; (2) the current calculation of the index derived from the current market prices of the stocks is not available; and (3) other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.