Short sales of currency warrants will follow the margin requirements currently applicable to standardized currency options. Specifically, the NASD proposes that short sales of warrants on the German Mark, French Franc, Swiss Franc, Japanese Yen, British Pound, Australian Dollar and European Currency Unit shall each be subject to a margin level of 100 percent of the current market value of each such warrant plus a four percent "add-on." 10 The required margin can be decreased to the extent that the warrant is out-of-themoney, however, the minimum requirement for each such warrant must not be less than the current value of the warrant plus .75% (.0075) of the value of the underlying currency (or such other percentage as specified by the national securities exchange listing the warrant and approved by the Commission). The margin required on currency index warrants would be an amount as determined by the national securities exchange listing the warrant and approved by the Commission.

The NASD also proposes that its index warrant, currency index warrant, and currency warrant margin requirements be permitted offset treatment for spread and straddle positions. In this regard, the NASD proposes that index, currency, and currency index warrants may be offset with either warrants or OCC-issued options on the same index, currency, or currency index, respectively, in the same manner that standardized index and currency options may be offset with other standardized index and currency options. The proposed rules governing the margin treatment for spreads and straddles involving index, currency, and currency index warrants are proposed to be implemented on a one-year pilot basis. The NASD also proposes to allow market participants to use escrow receipts to cover a short call position in broad-based stock index warrants. Specifically, no margin is required for a short position in an index call warrant where the customer promptly delivers an escrow receipt, issued by a bank or trust company, certifying that the issuer holds for the account of the customer (1) cash, (2) cash equivalents, (3) one or more qualified equity securities, or (4) a combination thereof.

Fourth, the proposal makes two minor amendments to the NASD's rules that serve to clarify the Association's rules

regarding index warrants. First, Section 19 of Part I of Schedule D to the NASD's By-Laws is amended to clarify that the term Nasdaq National Market System security includes all index warrants traded through Nasdag. Second, the proposal replaces language currently contained in a policy of the NASD's Board of Governors issued under Article III, Section 2 of the Rule of Fair Practice with a cross-reference to new Schedule J. This change is made to eliminate duplicative and potentially confusing language in the NASD's rules. The text of the proposed rule change is available at the Office of the Secretary of the NASD and at the Commission.

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

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the purposed 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. The 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

The NASD is submitting this proposed rule change to enhance the NASD's regulatory scheme governing index warrants to ensure that, among other things, investors in index warrants traded on Nasdaq are adequately protected and that the trading of index warrants on Nasdaq does not have any adverse market impacts.11 To this end, the NASD has developed a new Schedule J to its By-Laws that consolidates all of the relevant rules, regulations, practices and procedures applicable to index warrants trading on Nasdaq and exchange-listed stock index warrants, currency index warrants, and currency warrants traded by members who are not members of the exchange on which the warrant is listed or traded. The NASD also proposes to impose

more stringent standards on the issuers of index warrants, as well as certain requirements as to the terms of the index warrants themselves. Under the proposal, all exchange-traded index warrants and foreign currency warrants presently outstanding will be grandfathered from these provisions. Even though there currently are no index warrants listed on Nasdag, NASD rules provide that issuers of Nasdaqlisted index warrants are required to have assets in excess of \$100 million and members are obligated to comply with the NASD's options rules governing suitability, account opening, discretionary accounts, and account supervision when handling customer orders in index warrants. The NASD's current proposal expands these requirements in the following ways.

First, because index warrants are derivative in nature and closely resemble index options, the NASD believes it is appropriate to apply to index warrants, currency index warrants, and currency warrants the same or similar safeguards for customer protection that are applicable to exchange-traded standardized options. Accordingly, Schedule J is patterned after the NASD's options rules contained in Article III, Section 33 of the NASD's Rules of Fair Practice. In particular, proposed Sections 3 through 9 of Schedule J impose on index warrants, currency index warrants, and currency warrants the options rules governing account opening, suitability, discretionary accounts, supervision of accounts, customer complaints and communications with the public and customers. These provisions will ensure that members are adequately monitoring their customer accounts trading index, currency, and currency index warrants and that only customers with an understanding of these warrants and the financial capacity to bear the risks attendant thereto will be permitted to trade these instruments based on their broker's recommendation. In addition, as discussed above, the proposed margin rules for index, currency, and currency index warrants are comparable to those applicable to standardized index and currency options. Accordingly, the NASD believes that the special concerns attendant to the secondary trading of index warrants on Nasdaq have been adequately addressed by the NASD.

Second, the NASD proposes to increase the listing standards applicable to issuers of index warrants to ensure that only substantial companies capable of meeting their warrant obligations are able to list index warrants on Nasdaq. In particular, by switching from a \$100

¹⁰ Warrants on the Canadian Dollar would be subject to a one percent "add-on." The "add-on" required on any other foreign currency would be such other percentage as specified by the national securities exchange listing the warrant and approved by the Commission on a case-by-case hasis

¹¹ Due to the current definition of "security" in Section 3(a)(10) of the Act, 15 U.S.C. 78c(a)(10), the NASD, unlike the national securities exchanges, does not have authority to list issuances of currency and currency index warrants on Nasdaq. The NASD is proposing rules, however, that will apply to transactions in currency and currency index warrants entered into by NASD members (or customers thereof) who are not members of the exchange on which the currency or currency index warrant is listed or traded.