

communications relating to the proposed rule change, as amended, 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, 450 Fifth Street, NW., Washington, DC. 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-95-04 and should be submitted by April 20, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Release No 34-35532; File No. SR-CBOE-94-43]

**Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving a Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 to a Proposed Rule Change Relating to the Listing of Regular and Long-Term Index Options on the S&P SmallCap 600 Index**

March 24, 1995.

**I. Introduction**

On November 8, 1994, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposal to list and trade on the Exchange cash-settled, European-style index options on the Standard & Poor's SmallCap 600 Index ("S&P SmallCap 600" or "Index"), a broad-based capitalization weighted index designed to measure the performance of small capitalization stocks. The CBOE filed Amendment No. 1 to its proposal on January 9, 1995, and Amendment No. 2 to its proposal on March 14, 1995.<sup>3</sup> The proposed rule

change was published for comment and appeared in the **Federal Register** on February 1, 1995.<sup>4</sup> No comments were received regarding the CBOE's proposal.

**II. Description of the Proposal**

**A. General**

The CBOE proposes to list and trade cash-settled, European-style stock index options on the S&P SmallCap, a capitalization-weighted index of 600 domestic stocks chosen for market size, liquidity, and industry group representation.

**B. Composition of the Index**

The S&P SmallCap 600 Index has been designed to measure the performance of small capitalization stocks. The Index is a capitalization-weighted index of U.S. stocks with each stock affecting the Index in proportion to its market capitalization.

As of October 19, 1994, the 600 component stocks ranged in capitalization from \$933 million to \$46 million, and the market capitalization of the Index totalled \$181 billion. The largest stock accounted for 0.51% of the total weighting of the Index, while the smallest accounted for 0.03%. The median capitalization of the components in the Index was \$267 million. A breakdown of the component stocks by trading markets shows that Nasdaq is the primary market for 53% of the weight of the Index (318 issues), the New York Stock Exchange ("NYSE") represents 43% (257 issues), and the American Stock Exchange ("Amex") represents 4% (25 issues). The Nasdaq stocks in the Index are authorized as Nasdaq National Market Securities, the top tier of Nasdaq stocks.

A total of 98 industry groups are represented in the Index. The top five groups and their weights are: (1) Computer Software and Services—9.01%; (2) Insurance—5.13%; (3) Savings and Loans—4.88%; (4) Health Care Services—4.31%; and (5) Banks—Regional—4.26%. During the period April through September 1994, the average monthly trading volume for the Index component stocks ranged from 93,000 to 25.3 million shares. The

Division of Market Regulation ("Division"), Commission, dated January 5, 1995 ("Amendment No. 1").

Amendment No. 2 provides that the CBOE will monitor the Index semi-annually, and will notify staff of the Commission in the event that certain index component capitalization and volume levels fall below designated thresholds. See letter from Joseph Levin, Vice-President, Research & Product Development, CBOE, to Michael Walinskas, Branch Chief, Division, Commission, dated March 14, 1995 ("Amendment No. 2").

<sup>4</sup> See Securities Exchange Act Release No. 35280 (January 25, 1995), 60 FR 6325.

average monthly volume was 1.9 million shares. The top 100 stocks account for 33.42% of the Index, while the bottom 100 stocks account for 5.69% of the Index. The prices for each of the components ranged from \$1.385 to \$64.50. The average price was \$19.37. The shares outstanding for each of the Index component stocks ranged from 4.0 million to 189.0 million with an average of 17.8 million.<sup>5</sup>

S&P relies on several criteria to select Index component stocks. Among other things, stocks must trade on the NYSE or Amex, or be Nasdaq National Market securities; stocks must trade above \$1.00 at the time of selection; companies with 50% or more of their shares outstanding held by another corporation are not included; companies with 60% or more of their shares held by insiders are not included; stocks must have at least a six month trading history; stocks that do not trade on any three days during a 12-month period are not included; and share turnover (annual trading volume as a percent of shares outstanding) has to exceed 20% on an annualized basis. Index component stocks are then chosen from the field of stocks that meets these criteria so that they balance the economic sector weightings, described above.<sup>6</sup>

**C. Calculation of the Index**

The methodology used to calculate the value of the Index is similar to that used to calculate the value of the S&P 500 Index. The value of the Index is determined by adding the price of each stock multiplied by the number of shares outstanding. This sum is then divided by an index divisor ("Index Divisor") which gives the Index a value of 100 on its base date of December 31, 1993. The Index Divisor is adjusted for pertinent changes as described below in the section titled "Maintenance." The Index had a closing value of 96.82 on September 30, 1994.

**D. Maintenance**

The S&P SmallCap 600 will be maintained by S&P, and the CBOE has represented that it will not influence any S&P decisions concerning maintenance of the Index.<sup>7</sup> To maintain

<sup>5</sup> See Amendment No. 1, *supra* note 3.

<sup>6</sup> *Id.* The CBOE has represented that should the character of the Index change from the basic description contained herein, it shall so notify the Commission staff, and such change could require a filing pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder. Telephone conversation between Eileen Smith, Director, Product Development, Research Department, CBOE, and Francois Mazur, Attorney, Division, Commission, on March 1, 1995.

<sup>7</sup> See March 1, 1995 telephone conversation, *supra* note 6.

<sup>6</sup> 17 CFR 200.30-3(a)(12) (1994).

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> 17 CFR 240.19b-4 (1994).

<sup>3</sup> Amendment No. 1 Provides the following information regarding the Index: (1) Industry groups represented; (2) price and volume information regarding the component stocks; and (3) component stock selection criteria. See letter from Eileen Smith, Director, Product Development, Research Department, CBOE, to Steve Youhn, Attorney,

continuity of the Index, the Index Divisor will be adjusted to reflect certain events relating to the component stocks. These events include, but are not limited to, adjustments for company additions and deletions, share changes, stock splits, stock dividends, and stock price adjustments due to company restructurings or spinoffs. Some corporate actions, such as stock splits and stock dividends, require simple changes in the common shares outstanding and the stock prices of the companies in the Index. Other corporate actions, such as share issuances, change the market value of the Index and require an Index Divisor adjustment as well.

Although the CBOE is not involved in the maintenance of the Index, it has represented that it will monitor the Index on a semi-annual basis and will notify staff of the Commission when: (1) 10% of the capitalization of the Index comprises securities with a market capitalization of less than \$100 million; or (2) when 10% of the capitalization of the Index is made up of components with an average daily trading volume of less than 10,000 shares over the previous six months.<sup>8</sup>

#### E. Index Option Trading

In addition to regular Index options, the Exchange may provide for the listing of long-term (up to three years expiration) index options series ("LEAPS") and reduced-value LEAPS on the Index. For reduced-value LEAPS, the underlying value would be computed at one-tenth of the Index level. The current and closing index value of any such reduced-value LEAP will, after such initial computation, be rounded to the nearest one-hundredth.

The Exchange seeks to have the discretion to list series in 2½ point intervals when the Index level is below 200. The minimum tick size for series trading below \$3 will be 1/16th and for series trading above \$3 the minimum tick will be 1/8th. The trading hours for options on the Index will be from 8:30 a.m. to 3:15 p.m. Chicago time.

#### F. Settlement of Index Options

The proposed options on the Index will expire on the Saturday following the third Friday of the expiration month. Trading in the expiring contract month will normally cease at 3:15 p.m. (Chicago time) on the immediately preceding Thursday. The exercise settlement value of the Index at option expiration will be calculated by S&P based on the opening prices of the component securities on the business

day prior to expiration, which will normally be a Friday ("A.M. Settlement").<sup>9</sup> If a stock fails to open for trading, the last available price on the stock will be used in the calculation of the Index, as is done for currently listed indexes.

#### G. Surveillance

The Exchange will use the same surveillance procedures currently used for each of the Exchange's other index options to monitor trading in Index options and Index LEAPS on the S&P SmallCap 600. These procedures include complete access to trading activity in the underlying securities. In addition, the Intermarket Surveillance Group Agreement ("ISG Agreement"), dated July 14, 1983, as amended January 29, 1990, will be applicable to the trading of options on the Index.<sup>10</sup>

#### H. Position Limits

The Exchange proposes to establish position limits for options on the S&P SmallCap 600 at 100,000 contracts on either side of the market, and no more than 60,000 of such contracts may be in the series in the nearest expiration month. Exercise limits will be set at the same level as position limits.<sup>11</sup> The Exchange represents that these limits are roughly equivalent, in dollar terms, to the limits applicable to comparable small-capitalization indexes, including the Wilshire Small Cap Index and the Russell 2000 Index.

### III. Discussion

The Commission finds that the proposed rule change is consistent with

<sup>9</sup> When the last trading day is moved because of Exchange holidays (such as when CBOE is closed on the Friday before expiration), the last trading day for expiring options will be Wednesday and the exercise settlement value of Index options at expiration will be determined at the opening of regular Thursday trading.

<sup>10</sup> The CBOE is a member of the ISG, which was formed on July 14, 1983 to, among other things, coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets. See Intermarket Surveillance Group Agreement, July 14, 1983. The most recent amendment to the ISG Agreement, which incorporates the original agreement and all amendments made thereafter, was signed by ISG members on January 29, 1990. See Second Amendment to the Intermarket Surveillance Group Agreement, January 29, 1990. The members of the ISG are: the Amex; the Boston Stock Exchange, Inc.; the CBOE; the Chicago Stock Exchange, Inc.; the National Association of Securities Dealers, Inc.; the NYSE; the Pacific Stock Exchange, Inc.; and the Philadelphia Stock Exchange, Inc. Because of the potential opportunities for trading abuses involving stock index futures, stock options, and the underlying stock, and the need for greater sharing of surveillance information for these potential intermarket trading abuses, the major stock index futures exchanges (e.g., the Chicago Mercantile Exchange and the Chicago Board of Trade) joined the ISG as affiliate members in 1990.

<sup>11</sup> See CBOE Rule 24.5.

the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5) of the Act.<sup>12</sup> The Commission finds that the trading of options on the Index will permit investors to participate in the price movements of the 600 securities on which the Index is based. The Commission also believes that the trading of options on the Index will allow investors holding positions in some or all of the securities underlying the Index to hedge the risks associated with their portfolios. Accordingly, the Commission believes S&P SmallCap 600 options will provide investors with an important trading and hedging mechanism that should reflect accurately the overall movement of stocks in the small-capitalization range of U.S. equity securities. By broadening the hedging and investment opportunities of investors, the Commission believes that the trading of S&P SmallCap 600 options will serve to protect investors, promote the public interest, and contribute to the maintenance of fair and orderly markets.<sup>13</sup>

The trading of S&P SmallCap 600 options, however, raises several issues, including issues related to index design, customer protection, surveillance, and market impact. For the reasons discussed below, the Commission believes that the CBOE has adequately addressed these issues.

#### A. Index Design and Structure

The Commission finds that it is appropriate and consistent with the Act to classify the Index as broad-based, and therefore to permit Exchange rules applicable to the trading of broad-based index options to apply to the Index options. Specifically, the Commission believes the Index is broad-based

<sup>12</sup> 15 U.S.C. 78f(b)(5) (1988).

<sup>13</sup> Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of any new option or warrant proposal upon a finding that the introduction of such new derivative instrument is in the public interest. Such a finding would be difficult for a derivative instrument that served no hedging or other economic function, because any benefits that might be derived by market participants likely would be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns. In this regard, the trading of listed options or warrants on the S&P SmallCap 600 Index will provide investors with a hedging vehicle that should reflect the overall movement of the small-capitalization stock universe. The Commission also believes that these options and warrants will provide investors with a means by which to make investment decisions in the small-capitalization equity market, allowing them to establish positions or increase existing positions in small-capitalized stocks in a cost effective manner.

<sup>8</sup> See Amendment No. 2, *supra* note 3.

because it reflects a substantial segment of the U.S. equities market, in general, and small-capitalization securities in particular. First, the Index consists of 600 relatively actively traded,<sup>14</sup> small-capitalization domestic securities. Second, the total capitalization of the Index, as of October 19, 1994, was \$181 billion, with the market capitalizations of the individual stocks in the Index ranging from a high of \$933 million to a low of \$46 million, with a median value of \$267 million. Third, the Index includes stocks of companies from a broad range of industries, and no industry segment comprises more than 9.01% of the Index's total value.<sup>15</sup> Fourth, as of October 19, 1994, no single stock comprises more than 0.51% of the Index's total value, and the percentage weighting of the 100 largest issues in the Index accounted for only 33.42% of the Index. Fifth, the Index selection and maintenance criteria will serve to ensure that the Index maintains its broad representative sample of stocks in the small-capitalization range of U.S. equity securities. Accordingly, the Commission believes it is appropriate to classify the Index as broad-based.

The Commission believes that the general broad diversification, capitalizations, and relatively liquid markets of the Index's component stocks significantly minimize the potential for manipulation of the Index. First, as discussed above, the Index represents a broad cross-section of domestic small capitalization stocks, with no single industry group or stock dominating the Index. Second, the majority of the stocks that comprise the Index are relatively actively traded.<sup>16</sup> Third, the Commission believes that the Index selection and maintenance criteria will serve to ensure that the Index will not be dominated by low-priced stocks with

<sup>14</sup> A significant majority of the stocks are relatively actively traded, as indicated by an Index component median average daily trading volume of 53,179 shares. Telephone conversation between Eileen Smith, Director, Product Development, Research Department, CBOE, and Francois Mazur, Attorney, Division, Commission, on February 23, 1995.

The Commission notes that an index purportedly representing high capitalization stocks might not be deemed to have actively traded stocks if the components stocks' median average daily volume was only 53,179 shares. With regard to a small capitalization index, where almost by their nature the most active stocks will likely not be included, a median average daily trading volume less than that for existing broad based indexes could be acceptable, depending upon the index's other features. For the S&P SmallCap 600, the median average daily trading volume is acceptable given the large number of component stocks and the inclusion of criteria designed to exclude inactively traded stocks from being selected.

<sup>15</sup> See Section II.B, *supra*.

<sup>16</sup> See *supra* note 14.

small capitalizations, floats, and trading volumes.<sup>17</sup> Fourth, the CBOE has represented that it will monitor the Index semi-annually and will notify the staff of the Commission when: (1) ten percent of the capitalization of the Index is comprised of securities with a market capitalization of less than \$100 million; or (2) ten percent of the capitalization of the Index is made up of components with an average daily trading volume of less than 10,000 shares over the previous six months.<sup>18</sup> Fifth, the Exchange has proposed reasonable position and exercise limits for the Index options that will serve to minimize potential manipulation and other market impact concerns. Although a position and exercise limit of 100,000 contracts is high by traditional standards, in dollar value it represents \$968,200,000 (based on the September 30, 1994 Index closing value of 96.82), an amount equivalent to that allowed for other small-capitalization index options currently trading.<sup>19</sup> Accordingly, the Commission believes it is unlikely that attempted manipulations of the prices of the Index components would affect significantly the Index's value.

#### B. Customer Protection

The Commission believes that a regulatory system designed to protect public customers must be in place before the trading of sophisticated financial instruments, such as Index options, can commence on a national securities exchange. The Commission notes that the trading of standardized exchange-traded options occurs in an

<sup>17</sup> Currently, 65% of the Index is accounted for by stocks meeting the CBOE's options listing standards. Telephone conversation between Eileen Smith, Director, Product Development, Research Department, CBOE, and Francois Mazur, Attorney, Division, Commission, on February 28, 1995. These standards, which are uniform among the options exchanges, provide that a security underlying an option must, among other things, meet the following requirements: (1) the public float must be at least 7,000,000; (2) there must be a minimum of 2,000 stockholders; (3) trading volume must have been at least 2.4 million over the preceding twelve months; and (4) the market price must have been at least \$7.50 for a majority of the business days during the preceding three calendar months. See CBOE Rule 5.3, Interpretation .01.

As a general matter, for broad-based index options, the Commission prefers that at least 50% of an index's components continue to be options-eligible. Given the broad diversity of the SmallCap 600 Index and the selection and maintenance criteria, together with the fact that 65% of the Index's components are options eligible, the Commission believes that the Index will not be readily susceptible to manipulation. See *supra* Section II.B.

<sup>18</sup> See Amendment No. 2, *Supra* note 3.

<sup>19</sup> The Commission would not be inclined to approve such a high position limit if the position limit dollar equivalent amount were substantially higher than as currently proposed.

environment that is designed to ensure, among other things, that: (1) The special risks of options are disclosed to public customers; (2) only investors capable of evaluating and bearing the risk of options trading are engaged in such trading; and (3) special compliance procedures are applicable to options accounts. Accordingly, because the Index options will be subject to the same regulatory regime as the other standardized options traded on the CBOE, the Commission believes that adequate safeguards are in place to ensure the protection of investors in Index options.

#### C. Surveillance

The Commission generally believes that a surveillance sharing agreement between an exchange proposing to list a stock index derivative product and the exchange(s) trading the stocks underlying the derivative product is an important measure for surveillance of the derivative and underlying securities markets. Such agreements ensure the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the stock index product less readily susceptible to manipulation.<sup>20</sup> In this regard, the NYSE, Amex, and the NASD are all members of ISG.<sup>21</sup> In addition, the CBOE will apply the same surveillance procedures as those used for existing broad based index options trading on the CBOE.

#### D. Market Impact

The Commission believes that the listing and trading of S&P SmallCap 600 Index Options on the CBOE will not adversely affect the underlying securities markets.<sup>22</sup> First, as described above, the Index is broad-based and comprised of 600 stocks with no one stock or industry group dominating the Index. Second, as noted above, the stocks contained in the Index have relatively large capitalizations and are relatively actively traded. Third, existing CBOE stock index options rules and surveillance procedures will apply to S&P SmallCap 600 options. Fourth,

<sup>20</sup> See Securities Exchange Act Release No. 31243 (October 5, 1992), 57 FR 45849.

<sup>21</sup> See *supra* note 10.

<sup>22</sup> The CBOE has stated that it has the necessary systems capacity to support new series that would result from the introduction of the S&P SmallCap 600 options. In addition, the Options Price Reporting Authority ("OPRA") has represented that additional traffic generated by options and LEAPs on the S&P SmallCap 600 Index is within OPRA's capacity. See letter from Joseph P. Corrigan, Executive Director, OPRA, to Eileen Smith, Director, Product Development, Research Department, CBOE, dated October 26, 1994.

the position limits of 100,000 contracts on either side of the market, with no more than 60,000 of such contracts in a series in the nearest month expiration month, will serve to minimize potential manipulation and market impact concerns. Fifth, the risk to investors of contra-party non-performance will be minimized because the Index options will be issued and guaranteed by the Options Clearing Corporation just like any other standardized option traded in the United States.

Lastly, the Commission believes that settling expiring S&P SmallCap 600 options (including full-value and reduced-value Index LEAPS) based on the opening prices of component securities is reasonable and consistent with the Act. As noted in other contexts, valuing expiring index options for exercise settlement purposes based on opening prices rather than closing prices may help reduce adverse effects on the securities underlying options on the Index.<sup>23</sup>

The Commission finds good cause for approving Amendment No. 2 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Specifically, Amendment No. 2 provides that the CBOE will monitor, semi-annually, the Index and will notify staff of the Commission in the event that certain index component capitalization and volume levels fall below designated thresholds. The Commission believes that this monitoring provision is not a material change that raises regulatory concerns not already addressed by the proposal. Accordingly, the Commission believes it is consistent with Sections 6(b)(5) and 19(b)(2) of the Act to approve Amendment No. 2 to the proposal on an accelerated basis.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2. 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. 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, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-94-43 and should be submitted by April 20, 1995.

#### V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act, and, in particular, Section 6 of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (File No SR-CBOE-94-43), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>25</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 95-7841 Filed 3-29-95; 8:45 am]

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[Release No. 34-35533; File No. SR-NASD-95-06]

#### Self-Regulatory Organizations; Notice of Filing of Proposed rule Change by National Association of Securities Dealers, Inc. Relating to Interpretation of the Board of Governors—Forwarding of Proxy and Other Material Under Article III, Section 1 of the NASD Rules of Fair Practice

March 24, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on March 22, 1995,<sup>1</sup> the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD.

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

The NASD is proposing to amend its Interpretation of the board of Governors—Forwarding of Proxy and Other Material under Article III, Section

<sup>24</sup> 15 U.S.C. 78s(b)(2) (1988).

<sup>25</sup> 17 CFR 200.30-3(a)(12) (1994).

<sup>1</sup> The NASD initially submitted the proposed rule change on February 5, 1995. Amendment No. 1, submitted on March 22, 1995, replaces the proposed rule change in its entirety.

1 to the NASD Rules of Fair Practice.<sup>2</sup> Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

#### NASD Rules of Fair Practice

#### Business Conduct of Members

\* \* \* \* \*

#### Article III, Section 1

#### Interpretation of the Board of Governors

#### Forwarding of Proxy and Other Materials Introduction

A member has an inherent duty in carrying out high standards of commercial honor and just and equitable principles of trade to forward (i) all proxy material which is properly furnished to it by the issuer of the securities or a stockholder of such issuer, to each beneficial owner of shares of that issue (*or the beneficial owner's designated investment adviser*) which are held by the member for the beneficial owner thereof and (ii) all annual reports, information statements and other material sent to stockholders, which are properly furnished to it by the issuer of the securities to each beneficial owner of shares of that issue (*or the beneficial owner's designated investment adviser*) which are held by the member for the beneficial owner thereof. For the assistance and guidance of members in meeting their responsibilities, the Board of Governors has promulgated this interpretation. The provisions hereof shall be followed by all members and failure to do so shall constitute conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of Article III, Section 1 of the Rules of Fair Practice of the Association.

#### Interpretation

Section 1. No member shall give a proxy to vote stock which is registered in its name, except as required or permitted under the provisions of Section 2 or 3 hereof, unless such member is the beneficial owner of such stock.

Section 2. Whenever an issuer or stockholder of such issuer soliciting proxies shall timely furnish to a member:

(a)[1] sufficient copies of all soliciting material which such person is sending to registered holders, and

(b)[2] satisfactory assurance that he will reimburse such member for all out-of-pocket expenses, including reasonable clerical expenses incurred by such member in connection with such solicitation, such member shall transmit promptly to each beneficial owner of stock of such issuer (*or the beneficial owner's designated investment adviser*) which is in its possession or control and registered in a name other than the name of the beneficial owner all such material furnished. Such material shall include a signed proxy indicating the number of shares held for such beneficial owner and bearing a symbol identifying the proxy with proxy

<sup>2</sup> NASD Manual, Rules of Fair Practice, Art. III, Sec. 1 (CCH) ¶ 2151.05.

<sup>23</sup> Securities Exchange Act Release No. 30944 (July 28, 1992), 57 FR 33376.