

By the Commission.

**Jonathan G. Katz,**

Secretary.

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[Release No. 34-35740 ; File No. SR-PSE-95-14]

**Self-Regulatory Organizations; The Pacific Stock Exchange, Incorporated; Notice of Filing of Proposed Rule Change Regarding Depository Eligibility Requirements**

May 19, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on May 15, 1995, The Pacific Stock Exchange, Incorporated ("PSE") 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 PSE. The Commission is publishing this notice to solicit comments from interested persons.

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

PSE proposes to adopt a rule which will set forth depository eligibility requirements for issuers that apply to list their securities on PSE.

**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 self-regulatory organization 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. The self-regulatory organization has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>2</sup>

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

Under the proposed rule change, PSE will adopt a uniform depository eligibility rule for issuers that desire to list their securities on PSE. The uniform rule has been developed by the Legal and Regulatory Subgroup of the U.S.

Working Committee of the Group of Thirty in coordination with each of the national securities exchanges and the National Association of Securities Dealers ("NASD"). It is anticipated that each national securities exchange and the NASD will file rule changes proposing adoption of depository eligibility standards substantially similar to PSE's proposed rule and will seek to make such changes effective contemporaneously with the effective date of the transition from a five-day ("T+5") to a three-day ("T+3") settlement cycle. The transition is set to occur June 7, 1995.<sup>3</sup>

The proposed rule change will require domestic issuers to represent to PSE before issues of securities are listed that the CUSIP numbers identifying the securities have been included in the file of eligible issues maintained by a securities depository registered as a clearing agency under Section 17A of the Act.<sup>4</sup> This requirement will not apply to a security if the terms of such security cannot be reasonably modified to meet the criteria for depository eligibility at all securities depositories. In addition, the rule will not apply to American Depository Receipts for securities of a foreign issuer.

The proposed rule change sets forth additional requirements that must be met before a security will be deemed to be "depository eligible" within the meaning of PSE Rule 5.9(c)(4). The proposed rule specifies different requirements for depository eligibility depending upon whether a new issue is distributed by an underwriting syndicate before or after the date a securities depository system is available for monitoring repurchases of the distributed shares by syndicate members ("flipping tracking system").

Currently, a flipping tracking system is being developed that will include a securities depository service that (i) can be activated upon the request of the managing underwriter for a period of time that the managing underwriter specifies, (ii) in certain circumstances, will require the delivering participant to provide to the depository information sufficient to identify the seller of such shares as a precondition to the processing of book-entry delivery instructions for distributed shares, and (iii) will report to the managing underwriter the identity of any other syndicate member or selling group member whose customer(s) sold

distributed shares (but will not report to the managing underwriter the identity of such customer[s]) and, in certain circumstances, will report to such syndicate member or selling group member the identity of such customer(s). Prior to the availability of a flipping tracking system, the managing underwriter may delay the date a security is deemed "depository eligible" for up to three months after trading has commenced in the security. After the availability of a flipping tracking system, a new issue will be deemed to be depository eligible upon commencement of trading on PSE.

The proposed rule change is consistent with Section 6(b)(5) of the Act<sup>5</sup> in that it is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

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

PSE does not believe that the proposed rule change will impose 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 on the proposed rule change were neither solicited nor received.

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

Within thirty-five 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 ninety 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 PSE 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.

PSE has requested accelerated effectiveness of the proposed rule change in order that the rule can become effective on June 7, 1995.<sup>6</sup>

<sup>3</sup> Securities Exchange Act Releases Nos. 33023 (October 6, 1993), 58 FR 52891 (adoption of Rule 15c6-1) and 34952 (November 9, 1994), 59 FR 59137 (change of effective date of Rule 15c6-1 from June 1, 1995 to June 7, 1995).

<sup>4</sup> 15 U.S.C. § 78q-1 (1988).

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

<sup>2</sup> The Commission has modified the language in these sections.

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

<sup>6</sup> *Supra* note 3 and accompanying text.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submission should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington DC 20549. Copies of the submissions, 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 5th Street, NW., Washington, DC 20549. Copies of such filings will also be available for inspection and copying at the principal office of PSE. All submissions should refer to file number SR-PSE-95-14 and should be submitted by June 15, 1995.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Jonathan G. Katz,**  
Secretary.

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[Release No. 34-35751; File No. SR-NASD-94-62]

#### Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Limit Order Protection and Nasdaq

May 22, 1995.

On November 22, 1994, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed a proposed rule change with the Securities and Exchange Commission ("SEC" or "Commission")<sup>1</sup> pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>2</sup> and Rule 19b-4 thereunder.<sup>3</sup> The proposed rule change amends the NASD's Interpretation to Article III, Section 1 of the NASD Rules of Fair Practice

("Interpretation")<sup>4</sup> to prohibit a member firm that accepts and holds an unexecuted limit order from its own customer or from a customer of another member in a Nasdaq security from trading ahead of the customer's limit order—that is to trade the subject security for its own market-making account at prices that would satisfy the customer's limit order—unless it also executes that limit order.

Notice of the proposed rule change, together with the substance of the proposal as initially filed, was provided by issuance of a Commission release (Securities Exchange Act Release No. 35122, Dec. 20, 1994) and by publication in the **Federal Register** (59 FR 66389, Dec. 23, 1994, "Release 34-35122"). Two comment letters were received.<sup>5</sup>

On February 15, 1995, the NASD filed Amendment No. 1 with the Commission. Amendment No. 1 clarified that the "terms and conditions" exception to the Interpretation applies only to limit orders from institutional accounts, as defined in Article III, Section 21(c)(4) of the NASD Rules of Fair Practice,<sup>6</sup> whether such limit orders originate with a firm's own customers or are sent to it for execution by another member firm.

Notice of the proposed rule change, as amended, together with the substance of the proposal, was provided by issuance of a Commission release (Securities Exchange Act Release No. 35391, Feb. 16, 1995) and by publication in the **Federal Register** (60 FR 9878, Feb. 22, 1995, "Release 34-35391"). No comment letters were received in response to Amendment No. 1.

On March 7, 1995, the NASD filed Amendment No. 2 with the Commission. Amendment No. 2 amended the proposed rule change to extend the "terms and conditions" exception to the Interpretation to limit orders for 10,000 shares or more, unless such orders are less than \$100,000 in value, as well as to limit orders from institutional accounts.

Notice of the proposed rule change, as amended, together with the substance of the proposal, was provided by issuance of a Commission release (Securities

Exchange Act Release No. 35454, Mar. 8, 1995) and by publication in the **Federal Register** (60 FR 13199, Mar. 10, 1995, "Release 34-35454"). One comment letter was received in response to Amendment No. 2.<sup>7</sup> This order approves the proposed rule change.

#### I. Introduction and Background

Last year, the NASD submitted to the Commission a proposed Interpretation to its Rules of Fair Practice to prohibit member firms from trading ahead of their customers' limit orders in their market making capacity.<sup>8</sup> The Commission approved the NASD Interpretation on June 29, 1994, but expressed concern that the prohibition did not extend to trading ahead of limit orders of other firm's customers that have been sent to the market maker for execution.<sup>9</sup> In fact, the Commission's Division of Market Regulation, in its Market 2000 Study, previously had examined this practice and recommended that a ban apply to trading of all customer limit orders, not just those of a firm's own customer.<sup>10</sup> The Study noted that the adverse effects of trading ahead exist whether the customer's order is handled by the customer's firm or by another market maker.<sup>11</sup>

Upon Commission approval the NASD Interpretation, the NASD convened a special task force ("Task Force") to study the potential effect of expanded limit order protection on market liquidity and market maker capital commitment and to report to the NASD Board of Directors in September 1994. At the time, the Commission

<sup>7</sup> See Letter from James T. Halverson, Esq., Shearman & Sterling, on behalf of Herzog, to Jonathan G. Katz, Secretary, SEC, dated March 27, 1995 ("March Herzog Letter") (the January Herzog Letter and the March Herzog Letter are referred to collectively as "Herzog Letters").

<sup>8</sup> Securities Exchange Act Release No. 33697 (March 1, 1994), 59 FR 10842 (March 8, 1994).

The Commission first addressed the issue of customer limit order protection in the Nasdaq market in the co-called *Manning* decision in 1988. In that decision, the Commission affirmed, based on principles of agency law, an NASD determination that it is inconsistent with just and equitable principles of trade for a market maker to trade ahead of a customer limit order unless the customers is first informed of the firm's limit order policy. See *In re E.F. Hutton & Co.* (the so-called "Manning decision"), Securities Exchange Act Release No. 25887 (July 6, 1988), 41 SEC Doc. 473, appeal filed *sub nom Hutton & Co. Inc. v. SEC*, Dec. No. 88-1649 (D.C. Cir. Sept. 2, 1988), (Stipulation of Dismissal Filed, Jan. 11, 1989).

<sup>9</sup> Securities Exchange Act Release No. 34279 (June 29, 1994), 59 FR 34883 (July 7, 1994) ("Release 34-34279").

<sup>10</sup> Division of Market Regulation, SEC, Market 2000: An Examination of Current Equity Market Developments ("Market 2000 Study"), V-8 (1994).

<sup>11</sup> *Id.*

<sup>7</sup> 17 CFR 200.30-3(a)(12) (1994).

<sup>1</sup> On February 15, 1995, the NASD filed Amendment No. 1 with the Commission on March 7, 1995 the NASD filed Amendment No. 2 with the Commission. See *infra* notes 6-7 and accompanying text.

<sup>2</sup> 15 U.S.C. 78s(b)(1).

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> NASD Manual, Rules of Fair Practice, Art. III, Sec. 1 (CCH) ¶ 2151.07.

<sup>5</sup> See Letter from James T. Halverson, Esq., Shearman & Sterling, on behalf of Herzog, Heine, Geduld, Inc. ("Herzog") to Jonathan G. Katz, Secretary, SEC, dated January 12, 1995 ("January Herzog Letter"); and Letter from James F. Duffy, Executive Vice President and General Counsel, Legal & Regulatory Policy, American Stock Exchange ("Amex") to Jonathan G. Katz, Secretary SEC, dated January 18, 1995 ("Amex Letter").

<sup>6</sup> NASD Manual, Rules of Fair Practice, Art. III, Sec. 21 (CCH) ¶ 2171.