Expiration and Settlement

Internet Index options will have European-style exercise (i.e., exercises are permitted at expiration only), and will be ''A.M.-settled index options'' within the meaning of the Rules in Chapter XXIV, including Rule 24.9, which is being amended to refer specifically to Internet Index options. In the case of securities traded through the NASDAQ system, the first reported regular way sale price will be used. The proposed options will expire on the Saturday following the third Friday of the expiration month. Thus, the last day for trading in a expiring series will be the second business day (ordinarily a Thursday) preceding the expiration date. If any component stock does not open for trading on its primary market on the last trading day before expiration, then the prior day's last sale price will be used in the calculation.

The exchange proposes to base trading in options on the Internet Index on the full value of that Index. The Exchange may list full-value long-term index option series (''LEAPS®''), as provided in Rule 24.9. The Exchange also may provide for the listing of reduced-value LEAPS, for which the underlying value would be computed at one-tenth of the value of the Index. The current and closing index value of any such reduced-value LEAP will, after such initial computation, be rounded to the nearest one-hundredth.

Exchange Rules Applicable to Stock Index Options

Except as modified herein, the Rules in Chapter XXIV will be applicable to Internet Index options. These Rules cover issues such as surveillance, exercise prices, and position limits. Index option contracts based on the Internet Index will be subject to the position limit requirements of Rule 24.4A. Currently the position limit is 12,000 contracts. Ten reduced-value options will equal one full-value contract for such purposes. Surveillance procedures currently used to monitor trading in each of the Exchange's other index options will also be used to monitor trading in options on the Internet Index.

CBOE represents that it has the necessary systems capacity to support new series that would result from the introduction of Internet Index options. CBOE has also been informed that OPRA has the capacity to support such new series.[5]

[5] *See* Memorandum from Joe Corrigan, Executive Director, OPRA, to Tom Knorring, CBOE, dated January 18, 1996.

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the ''Act'') in general and furthers the objectives of Section 6(b)(5) in particular in that it will permit trading in options based on the Internet Index pursuant to rules designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade, and thereby will provide investors with the ability to invest in options based on an additional index.

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

CBOE does not believe that the proposed rule change will impose any burden on competition.

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

No written comments were solicited or received with respect to the proposed rule change.

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

Because the foregoing rule change complies with the standards set forth in the Generic Index Approval Order, it has become effective pursuant to Section 19(b)(3)(A) of the Act. Pursuant to the Generic Index Approval Order,[6] the Exchange may not list CBOE Internet Index options for trading prior to 30 days after January 19, 1996, the date the proposed rule change was filed with the Commission. At any time within 60 days of the filing of the 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 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, NW., Washington, DC. 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–96–04 and should be submitted by February 27, 1996.

[6] *See* Generic Index Approval Order, *supra* note 4.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–2405 Filed 2–5–96; 8:45 am]

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[Release No. 34–36795; File No. SR–NASD–95–60]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Accelerated Temporary Approval of Proposed Rule Change To Extend Certain SOES Rules Through July 31, 1996

January 31, 1996.

I. Introduction

On December 19, 1995, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') filed with the Securities and Exchange Commission (''SEC'' or '' Commission'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder.[2] The NASD proposes to extend through July 31, 1996 certain changes to its Small Order Execution System (''SOES'') that were originally implemented in January 1994 for a one-year pilot period (''January 1994 Amended SOES Rules'').[3] These rules

[7] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. § 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 33377 (Dec. 23, 1993), 58 FR 69419 (Dec. 30, 1993) (approving the Interim SOES Rules on one-year pilot basis effective January 7, 1994). *See also* Securities Exchange Act Release No. 33424 (Jan. 5, 1994) (order denying stay and granting interim stay through January 25, 1994) and Securities Exchange Act Release No. 33635 (Feb. 17, 1994) (order denying renewed application for stay).

The changes contained in the January 1994 Amended SOES Rules were as follows:

(1) A reduction in the maximum size order eligible for SOES execution from 1,000 shares to 500 shares;

subsequently were modified in January 1995 (''January 1995 Amended SOES Rules''),[4] further modified in March 1995 (''March 1995 Amended SOES Rules''),[5] and most recently extended in September 1995 (''September 1995 Amended SOES Rules'').[6] The September 1995 Amended SOES Rules are scheduled to expire on January 31, 1996, and the NASD seeks to extend these rules until July 31, 1996. Without further Commission action, the SOES rules and would revert to those in effect prior to January 1994.

Notice of the proposed rule change appeared in the Federal Register on January 22, 1996.[7] No comment were received in response to the Commission release. For the reasons discussed below, this order approves the proposed rule change until July 31, 1996.

II. Description of the Current and Prior Proposals

The NASD proposes to extend until July 31, 1996 the September 1995 Amended SOES Rules. Specifically, the NASD proposes to extend until July 31, 1996 changes that:

(1) Reduce the minimum exposure limit for ''unpreferenced'' SOES orders from five times the maximum order size to two times the maximum order size, and eliminate the exposure limits for ''preferenced'' SOES orders; and

(2) Maintain the availability of an automated function for updating market maker quotations when the market maker's exposure limit has been exhausted (market makers using this update function may establish an exposure limit equal to the maximum order size for that security).

III. Discussion

The Commission must approve a proposed NASD rule change if it finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that govern the NASD.[8] In evaluating a given proposal, the Commission examines the record before it and relevant factors and information.[9] The Commission believes that approval of the proposal through July 31, 1996 meets the above standards. Specifically, the Commission believes that the current minimum exposure limit and automated quotation update feature are appropriate while the Commission considers NAqcess, the NASD's latest proposal for handling small orders from retail customers.[10]

The Commission believes that a sufficient basis exists for approving the NASD's proposal to continue the current operation of SOES. The system will continue to provide retail investors, through automation, an opportunity to obtain execution of orders in size up to 1,000 shares, ensuring access to the Nasdaq market.

In addition, as a result of the March 1995 Amended SOES Rules, the SOES minimum exposure limit was increased from 1,000 shares to 2,000 shares. Moreover, the March 1995 Amended SOES Rules continues the methodology for calculating a market maker's outstanding exposure limit that excluded orders executed pursuant to a preferencing arrangement. Under the SOES Rules prior to the January 1994 Amended SOES Rules, both preferenced and unpreferenced orders were considered when calculating a market maker's remaining exposure limit. Thus, in relative terms, the 2,000 share exposure limit potentially provides greater liquidity under certain conditions compared to the pre-January 1994 Amended SOES Rules' 5,000 share minimum exposure limit.

The Commission continues to believe that the current operation of SOES has eliminated economically significant restrictions imposed on order entry firms by the January 1994 Amended SOES Rules. The Commission believes that while the proposal does not restore the pre-January 1994 Amended SOES Rules' minimum exposure limit, it provides customers fair access to the Nasdaq market and reasonable assurance of timely executions. In this regard, the maximum order size is consistent with the size requirement prescribed under the Firm Quote Rule[11] and NASD rules governing the character of market maker quotations.[12] Moreover, a market maker's minimum exposure limit for unpreferenced orders is double its minimum size requirement prescribed under these rules.

The Commission also believes that extending the automated update function is consistent with the Act and, in particular, the Firm Quote Rule.[13] The update function provides market makers the opportunity to update their quotations automatically after executions through SOES; under the Commission's Firm Quote Rule, market makers are entitled to update their quotations following an execution and prior to accepting a second order at their published quotes.[14]

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(2) A reduction in the minimum exposure limit for ''unpreferenced'' SOES orders for five times the maximum order size to two times the maximum order size, and the elimination of exposure limits for ''preferenced'' orders;

(3) An automated function for updating market maker quotations when the market maker's exposure limit has been exhausted (marked makers using this update function may establish an exposure limit equal to the maximum order size for that security); and

(4) The prohibition of short sale transactions through SOES.

[4] Securities Exchange Act Release No. 35275 (Jan. 25, 1995), 60 FR 6327 (Feb. 1, 1995).

The January 1995 Amended SOES Rules excluded the following feature of the January 1994 Amended SOES Rules:

(1) The prohibition of short sale transactions through SOES.

[5] Securities Exchange Act Release No. 35535 (Mar. 27, 1995), 60 FR 16690 (Mar. 31, 1995).

The March 1995 Amended SOES Rules Excluded the following two features of the January 1994 Amended SOES Rules:

(1) A reduction in the maximum size order eligible for SOES execution from 1,000 to 500 shares; and

(2) The prohibition of short sale transactions through SOES. (This prohibition also was excluded from the January 1995 Amended SOES Rules.) *See supra*, note 4.

[6] Securities Exchange Act Release No. 36311 (September 29, 1995), 60 FR 52438 (October 6, 1995). The September Amended SOES Rules were identical to the March 1995 Amended SOES Rules, and extended the effectiveness of such rules until January 31, 1996.

[7] Securities Exchange Act Release No. 36719 (January 16, 1996), 61 FR 1655 (January 22, 1996).

[8] 15 U.S.C. § 78s(b). The Commission's statutory role is limited to evaluating the rules as proposed against the statutory standards. *See* S. Rep. No. 75, 94th Cong., 1st. Sess., at 13 (1975).

[9] In the Securities Acts Amendments of 1975, Congress directed the Commission to use its authority under the Act, including its authority to approve SRO rule changes, to foster the establishment of a national market system and promote the goals of economically efficient securities transactions, fair competition, and best execution. Congress granted the Commission ''broad, discretionary powers'' and ''maximum flexibility'' to develop a national market system and to carry out these objectives. Furthermore, Congress gave the Commission ''the power to classify markets, firms, and securities in any manner it deems necessary or appropriate in the public interest or for the protection of investors and to facilitate the development of subsystems within the national market system.'' S. Rep. No. 75, 94th Cong., 1st. Sess., at 7 (1975).

[10] *See* Securities Exchange Act Release No. 36548 (December 1, 1995), 60 FR 63092 (December 8, 1995). The comment period for the NAqcess proposal closed on January 26, 1996, and to date the Commission has received over 250 comments on the proposal. The Commission's evaluation of the NAqcess proposal may affect its evaluation of any future submissions relating to SOES.

[11] 17 CFR 240.11Ac1–1(c).

[12] *NASD Manual,* Schedules to the By-Laws, Schedule D, Part V, Sec. 2(a), (CCH) ¶1819.

[13] The SOES automated update function is also consistent with the NASD's autoquote policy which generally prohibits autoquote systems, but allows automatic updating of quotations ''when the update is in response to an execution in the security by that firm.'' *NASD Manual,* Schedules to the By-Laws, Schedule D, Part V, Sec. 2 (CCH) ¶1819.

[14] The Firm Quote Rule requires market makers to execute orders at prices at least as favorable as their quoted prices. 17 CFR 11Ac1–1(c)(2). The Rule also allows market makers a reasonable period of time to update their quotations following an execution; allows market makers to reject an order if they have communicated a quotation update to their exchange or association; and provides for a size limitation on liability at a given quote. 17 CFR 240.11Ac1–1(c)(3)(ii). *See also,* Securities Exchange Act Release No. 14415 (Jan. 26, 1978), 43 FR 4342 (Feb. 1, 1978).

In its Order approving the September 1995 Amended SOES Rules, the Commission noted its concern about the potential for delayed and/or inferior executions. In that regard, the Commission stated that it expected the NASD to monitor the extent to which exposure limits are exhausted, the extent to which the automated quotation update feature is used, and the effects of these two aspects on liquidity. Moreover, the Commission stated that it expected the NASD to consider the possibility of enhancements to eliminate the potential for delayed and/or inferior executions. The NASD, therefore, submitted a report in response to the Commission's requests.[15]

In the Monitoring Report, the NASD found that from October 2, 1995 to November 22, 1995, the average daily number of occurrences of SOES exposure limits being exhausted was eighty-three.[16] The NASD stated that relative to the average number of market making positions on the Nasdaq National Market, the average is equivalent to 0.0019 occurrences per market making position per day or 0.0211 occurrences per stock per day.[17] The NASD concluded that, based on these numbers, the impact of exhaustions on liquidity if negligible.[18]

The NASD also supplied data regarding the automated quotation update feature in the Monitoring Report. The NASD stated that the average daily number of updates using the Nasdaq automated quotation update feature over the period was 3,394.[19] The NASD reported that as of November 21, 1995, the automated quotation update feature was used by 126 market makers for 10,644 market making positions, or 26 percent of all active market makers and 24 percent of all Nasdaq National Market market making positions.[20]

With regard to the Commission's request that the NASD consider the possibility of enhancements to SOES in order to eliminate the potential for delayed and/or inferior executions, the NASD, in its Monitoring Report, stated that the average delay between a SOES market order entry and order execution is 1.62 seconds.[21] The NASD concluded that such delays do not appear to warrant enhancements to SOES.

In further support of its proposal, the NASD continues to rely on the same arguments and justifications previously submitted to the Commission in support of the amendments to SOES. In the orders approving the January 1995, March 1995, and September 1995 Amended SOES Rules, however, the Commission expressed its belief that the data submitted by the NASD was inconclusive, demonstrating neither significant improvement to nor serious deterioration in the quality of the Nasdaq market subsequent to the adoption of the January 1994 Amended SOES Rules.[22] The information submitted by the NASD since its initial study, including the Monitoring Report, does not alter the Commission's original assessment. The Commission, therefore, continues to believe that the data submitted by the NASD demonstrates neither a significant improvement to nor serious deterioration in the quality of the Nasdaq market as a result of the adoption of the January 1994, January 1995, March 1995, and September 1995 Amended SOES Rules.[23] Moreover, the Commission believes this is true whether the amended SOES rules are viewed collectively or individually. Thus, the Commission finds the data submitted by the NASD to be inconclusive. For the reasons discussed above, however, the Commission has determined to approve the proposal to extend the September 1995 Amended SOES Rules through July 31, 1996.

IV. Conclusion

As indicated above, the Commission has determined to approve the extension of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature through July 31, 1996. In light of the balance of factors described above, the Commission believes extension of the reduction in the minimum exposure limit, the limitation of the exposure limit to unpreferenced orders, and the addition of an automation quotation update feature are consistent with the Act.

The Commission, in the exercise of the authority delegated to it by Congress, and in light of its experience regulating securities markets and market participants, has determined that approval of these changes to the SOES Rules until July 31, 1996 is consistent with maintaining investor protection and fair and orderly markets, and that these goals, on balance, outweigh possible anti-competitive effects on order entry firms and their customers.

Accordingly, the Commission finds that the rule change is consistent with the Act and the rules and regulations thereunder applicable to the NASD and, in particular, Sections 15A(b)(6), 15A(b)(9), and 15A(b)(11). In addition, the Commission finds that the rule change is consistent with the Congressional objectives for the equity markets, set out in Section 11A, of achieving more efficient and effective market operations, fair competition among brokers and dealers, and the economically efficient execution of investor orders in the best market.

The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in the Federal Register. In addition to the reasons discussed in this order, the Commission believes that accelerated approval of the NASD's proposal is appropriate given the fact that the proposal is an extension of the amended SOES Rules that have been in effect since March 1995; that the information presently before the Commission leads to the conclusion that the current minimum exposure limit and automated quotation update function are appropriate features for SOES while the Commission considers the NASD's NAqcess proposal; and that without Commission action on or before January 31, 1996, the SOES rules would revert to those in effect prior to January 1994, resulting in a temporary lapse in continuity.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the instant rule change SR–NASD–95–60 be, and hereby is, approved, effective February 1, 1996 through July 31, 1996.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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[15] Monitoring Report of Exhaustion of SOES Exposure Limits and the Usage of Nasdaq Automated Quotation Update Feature, NASD Economic Research Department, December 18, 1995 (''Monitoring Report'').

[16] The high was 119 occurrences on November 21, 1995, and the low was 47 occurrences on October 4, 1995.

[17] These averages were based on averages of 44,062 market maker positions and 3,932 securities per day.

[18] The NASD also noted that even when an exhaustion occurred, it is likely that other market makers were at the inside quote to provide liquidity to SOES orders.

[19] The high was 5,376 on October 10,1995 and the low was 2,157 on October 4, 1995.

[20] The NASD noted that these numbers do not take into account any internal automated quotation update systems that individual market making firms may employ and therefore, overall automated quotation update usage on Nasdaq is greater than the NASD's calculations demonstrate.

[21] The NASD noted that the maximum delay for a recent day was 87 seconds.

[22] *See* Securities Exchange Act Release Nos. 35275 (Jan. 25, 1995), 60 FR 6327 (Feb. 1, 1995); 35535 (Mar. 27, 1995), 60 FR 16690 (Mar. 20, 1995); 36311 (Sept. 29, 1995), 60 FR 52438 (Oct. 6, 1995).

[23] Nonetheless, the Commission continues to be interested in data and studies demonstrating the effect, if any, of the SOES rule changes on the Nasdaq market.