

notes that the recommended fine levels being proposed are comparable to the fines that the Exchange has imposed previously for violations of Rule 6.87(c).

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) <sup>7</sup> of the Act in general and furthers the objectives of Section 6(b)(5) <sup>8</sup> and Section 6(b)(7) <sup>9</sup> in particular in that it is designed to promote just and equitable principles of trade, to assure that members, member organizations, and persons associated with members and member organizations are appropriately disciplined for violations of Exchange rules and, in general, to protect investors and the public interest.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes the proposed rule change will impose no burden on competition.

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

The Exchange has neither solicited nor received written comments.

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

Within 35 days of the publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 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 the self-regulatory organization consents, the Commission will:

(A) By order approve the proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## 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

handwritten notes will indicate that the original order has been divided up. In addition, the Exchange's time and sales report will establish that a number of sub-orders occurred sequentially on the Auto-Ex system during a relatively short period of time.

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 15 U.S.C. 78f(b)(7).

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 at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Also, copies of such filing will be available for inspection and copying at the principal office of the PSE. All submissions should refer to File No. SR-PSE-96-42 and should be submitted by March 17, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-38286; File No. SR-CBOE-96-70]

## Self-Regulatory Organizations; Chicago Board Options Exchange, Inc., Order Approving Proposed Rule Change Relating to the Reporting Requirements for Securities Accounts and Orders of Market-Makers and Joint Account Provisions

February 13, 1997.

### I. Introduction

On November 20, 1996, 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 proposed rule change relating to the reporting requirements for securities accounts and orders of market-makers and joint account provisions. The proposed rule change was published for comment in Securities Exchange Act Release No. 38085 (December 24, 1996), 62 FR 434 (January 3, 1997). The Commission received no comments on the proposal.

### II. Description of the Proposal

CBOE proposes amending Rule 8.9, regarding Securities Accounts and Orders of Market-Makers. Specifically, CBOE is amending Rule 8.9(a),

regarding the identification of accounts, to eliminate the routine submission of information by market-makers respecting non-market-maker trading accounts, or "outside accounts." Currently, Exchange market-makers are required to identify and report to the Exchange all accounts in which the market-maker may engage in stock, option and securities trading, directly or indirectly, or over which it has investment discretion. The rule in its current form is broad enough to require market-makers to report professional trading accounts held at clearing firms, as well as outside personal accounts such as brokerage accounts. The Exchange is amending the reporting requirements of Rule 8.9(a) to eliminate the routine submission of information respecting non-market-maker trading accounts, or "outside accounts." The rule change will require market-makers to report outside account information only when requested by the Exchange.

CBOE also proposes amending Rule 8.9(b), regarding the reporting of market-maker orders. Currently, each market-maker is required to report to the Exchange every order entered into by that market-maker within the specifications of the Rule. CBOE proposes amending Rule 8.9(b) to require the clearing firm that maintains the market-maker's trading account, rather than the market-maker personally, to report executed order information to the Exchange. The Exchange believes it is appropriate to limit the required order information to "executed" orders only, based upon its position that only marginal surveillance benefits are derived from gathering unexecuted order information on a routine basis.

Under the proposal, the market-maker will be held responsible for the reporting requirements only if the clearing firm is not reporting executed order information to the Exchange and/or if the Exchange has requested that the market-maker provide the information. Furthermore, the proposed rule change will clarify that this reporting requirement applies to "professional trading accounts" (i.e., transactions cleared into all accounts carried for market-makers who are the subject of a clearing firm letter of guarantee issued to the Exchange pursuant to CBOE Rule 8.5).

The clearing firm thus will be the primary source for the reporting of market-maker executed order information to the Exchange. However, all firms which represent and execute market-maker orders, including order services firms as defined in Exchange Rule 6.77, will continue to be

<sup>10</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 17 CFR 240.18b-4.

responsible for maintaining and retaining executed and unexecuted order information as required by Rules 17a-3 and 17a-4 under the Act and by Exchange Rule 15.1. The continuing recordkeeping obligations of such firms pursuant to Exchange rules and other applicable securities laws and regulations will be noted in an Exchange regulatory circular upon approval of the proposed rule change.

In an effort to improve reporting and move toward electronic reporting in the future, CBOE proposes to eliminate the existing description of specific order information required to be reported as set forth in Rule 8.9(b).<sup>3</sup> Upon approval of this filing, the Exchange will issue a regulatory circular to clearing firms which will list the order reporting requirements that were previously embodied in Rule 8.9(b). CBOE will issue additional circulars as reporting requirements are added.

Finally, CBOE proposes to amend Interpretation and Policy .06 to Rule 8.9 to clarify that the existing prohibition against a joint account participant effecting a transaction with another member acting on behalf of the same joint account applies whether the transaction is effected in person or via order. CBOE will also revise Interpretation and Policy .06 to Rule 8.9 to prohibit transactions between two joint accounts if the member who causes a transaction to be executed for one of the joint accounts knows or has reason to know that the two joint accounts have one or more common participants.

The addition to Interpretation .06 to Rule 8.9 codifies in the rule's current provisions in regulatory circulars which seek to ensure that joint account transactions result in a bona fide change in beneficial ownership. Existing regulatory circulars RG96-28 (item 7(b)) and RG95-64 (item 8(b)) provide that a member has the responsibility to ensure that in-person transactions or the entry of orders with floor brokers do not result in trades occurring "between two joint accounts that have common participants." The rule change expressly imposes a knowledge requirement as an element of the offense of effecting a transaction between joint accounts with common participants. This recognizes that members are not always able to know whether there are common participants in two joint accounts

<sup>3</sup> CBOE Rule 8.9(b) states that the report pertaining to orders must include the terms of each order, identification of the brokerage firms through which the orders were entered, the times of entry or cancellation, the times report of execution were received and, if all or part of the order was executed, the quantity and execution price.

because of the frequency with which joint account composition may change.

### III. Discussion

The Commission believes CBOE's proposed rule change is consistent with Section 6(b)(5) of the Act.<sup>4</sup> Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, perfect the mechanism of a free and open national market system, and, in general, to further investor protection and the public interest.

The Commission believes that CBOE's proposal to allow market-makers to provide outside account information upon request by the Exchange rather than providing such information on a routine basis is a reasonable revision to CBOE's market-maker account reporting procedures. This conclusion is based on CBOE's representation that outside account information provides little benefit to the Exchange's surveillance programs unless special circumstances exist. The Commission believes that the ability of the Exchange to request outside account information upon request should help preserve the Exchange's ability to conduct adequate surveillance.

The Commission believes that CBOE's proposal to make a market maker's clearing firm the primary responsible source for reporting market-maker executed order information to the Exchange is a reasonable means of streamlining the order reporting process. The Commission also recognizes the Exchange's position that clearing firms with back-office systems capabilities can most accurately gather and report market-maker order information to the Exchange. Accordingly, the proposed change should result in more effective and efficient reporting of market-maker accounts and executed order information to the Exchange, thus promoting just and equitable principles of trade, perfecting the mechanism of a free and open national market system, and furthering investor protection and the public interest.

The Commission believes it is appropriate to limit the required submitted order information to "executed" orders only, based on CBOE's representation that only minimal surveillance benefits are gained by gathering unexecuted order information on a routine basis. Where the clearing firm is not reporting the information to the Exchange and if the Exchange requests that the market-

maker provide the information, the market-maker will be responsible for reporting executed order information. Moreover, while the clearing firm is the primary source for the reporting of market-maker executed order information, the firms representing and executing market-maker orders will continue to be responsible for maintaining and retaining executed and unexecuted order information pursuant to Rules 17a-3<sup>5</sup> and 17a-4,<sup>6</sup> of the Act and CBOE Rule 15.1. These provisions offer further assurance that executed order information will be reported and records of executed and unexecuted orders will be maintained.

The Commission believes that CBOE's proposal to eliminate the existing description of specific order information required to be reported pursuant to Rule 8.9(b), and its proposal to issue a regulatory circular to clearing firms listing the order reporting requirements, will provide the CBOE with greater flexibility in adding reporting requirements as needed. The Commission notes that the Exchange has agreed to issue a regulatory circular to its members reflecting that all of the specific order information currently contained in Rule 8.9(b)<sup>7</sup> will continue to be required to be reported pursuant to the rule. If the CBOE in the future seeks to eliminate the required reporting of any of this specific information, such a change would require the submission of a rule filing pursuant to Section 19(b)<sup>8</sup> of the Act.<sup>9</sup>

The Commission believes that CBOE's proposed clarifications to Interpretation .06 will aid members in understanding their responsibilities with regard to joint account transactions, thus assuring that such transactions result in a bona fide change in beneficial ownership. Finally, the Commission believes that CBOE's proposed change to require knowledge as an element of the offense of effecting a transaction between joint accounts with common participants constitutes a reasonable clarification of CBOE's existing joint account provisions, thereby serving to protect investors and the public interest.

<sup>5</sup> 17 CFR 240.17a-3.

<sup>6</sup> 17 CFR 240.17a-4.

<sup>7</sup> See *supra* note 3.

<sup>8</sup> 15 U.S.C. 78s(b).

<sup>9</sup> Although the submitted filing indicated that circulars would be issued to clearing members, the CBOE has clarified that all members will receive a circular informing them of changes in the reporting requirements. Although the circulars sent to clearing firms may differ from those sent to other CBOE members, the information contained therein will be the same. Phone conversation between Jeff Schroer, Market Surveillance, CBOE, and Peggy Blake, Division of Market Regulation, Commission (February 13, 1997).

<sup>4</sup> 15 U.S.C. § 78f(b)(5).

#### IV. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the CBOE, and in particular Section 6(b)(5).

*It is therefore ordered*, Pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (File No. SR-CBOE-96-70) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

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[Release No. 34-38294; File No. SR-NASD-97-07]

#### **Self-Regulatory Organizations; Notice of Filing and Order Granting Temporary Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Rule 4612, Primary Nasdaq Market Maker Standards Through October 1, 1997**

February 14, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on January 31, 1997, the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval to the proposal.

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

Pursuant to the provisions of Section 19(b)(1) under the Act, Nasdaq, a wholly owned subsidiary of the National Association of Securities Dealers, Inc. ("NASD" or "Association"), is herewith filing a proposed rule change to temporarily suspend the use of the Primary Nasdaq Market Maker qualification criteria found in Rule 4612 (a) and (b) of the Nasdaq Market Maker Requirements of the NASD Rules for all Nasdaq National Market securities for the remainder of the current pilot period of the Nasdaq Short Sale Rule or until such earlier time when new primary

market maker qualification criteria can be devised and adopted.

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

In its filing with the Commission, Nasdaq 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. Nasdaq 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*

After the first week of trading under the new SEC rules regarding a Nasdaq market maker's order handling obligations, *i.e.*, Rule 11Ac1-4 (the customer limit order display rule) and amended Rule 11Ac1-1 (amendments to the firm quote rule regarding the display of priced orders entered by market makers or specialists into electronic communications networks ("ECNs")),<sup>2</sup> Nasdaq has re-evaluated its existing qualification criteria in the primary market maker standards rule, Rule 4612 (a) and (b), in those stocks that are not subject to the primary market maker standard suspension approved in SR-NASD-96-55.<sup>3</sup> In that rule filing, Nasdaq noted that because of the potential changes in quotation and trading activity in Nasdaq securities when the new SEC Rules became effective, the existing numerical criteria used to qualify a registered market maker as a primary market maker would be significantly affected. Because the precise effects on market maker quotes and trades were not possible to predict until Nasdaq could develop practical experience with new patterns of activity under the new rules, Nasdaq believed that it should attempt to minimize the possible harmful unintended consequences that could occur by leaving the current standards in place. Accordingly, Nasdaq proposed, and the SEC approved, that the existing standards would be temporarily suspended on the same schedule for the phase in of the SEC Rules requirements.

However, based upon trading experience in the first week of trading under the new SEC and NASD Rules, Nasdaq believes that the primary market maker standards should be suspended immediately for *all* National Market securities and all registered market makers in those securities should be designated as primary market makers. Nasdaq bases this proposed rule change on three factors that were not readily apparent at the time it filed SR-NASD-96-55: (1) many market makers have voluntarily chosen to display customer limit orders in their quotes even though the SEC's Limit Order Display Rule does not yet require it; (2) SOES decrementation for all Nasdaq stocks has significantly affected market maker ability to meet several of the primary market maker standards; and (3) with the inability to meet the existing criteria for a larger number of securities, a market maker may be prevented from registering as a primary market maker in an initial public offering because it fails to meet the 80% primary market maker test contained in Rule 4612(g)(2)(B).

Under existing Rule 4612, a registered Nasdaq Market Maker may be deemed to be a Primary Market Maker in National Market securities if the market maker meets two of three criteria: (1) the market maker maintains the best bid or best offer as shown on Nasdaq no less than 35% of the time; (2) a market maker maintains a spread no greater than 102% of the average dealer spread; and (3) no more than 50% of a market maker's quotation changes occur without a trade execution. In addition, if a registered market maker meets only one of the above criteria, it may nevertheless qualify as a primary market maker if the market maker accounts for volume at least 1½ times its proportionate share of overall volume in the stock. The review period for meeting any of these criteria is one calendar month. Nasdaq notifies a market maker at the beginning of the new calendar month if it does not meet the tests, and one business day following the notification, Nasdaq withdraws the "p" designator.

The changes to market maker quotation and trading activities have been dramatic in the first week of trading in the new environment. To provide their customers with the greater transparency, many market makers have begun to display customer limit orders in *all* Nasdaq securities, not only those subject to the phase-in of the Limit Order Display Rule, Rule 11Ac1-4. With the voluntary display of customer limit orders in stocks not yet subject to Rule 11Ac1-4, Nasdaq market makers are changing their quotes when they are in

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. § 78s(b)(1).

<sup>2</sup> See Securities Exchange Act Release No. 37619A (September 6, 1996); 61 FR 48290 (September 12, 1996) (Order Handling Rules Adopting Release).

<sup>3</sup> See Securities Exchange Act Release No. 38175 (January 23, 1997); 62 FR 3548.