

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (File No. SR-CBOE-97-25) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-28027 Filed 10-22-97; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39245; File No. SR-CSE-97-09]

Self-Regulatory Organizations; Cincinnati Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Increasing Net Capital Requirements

October 16, 1997.

On July 30, 1997, the Cincinnati Stock Exchange, Inc. ("CSE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" ¹ and Rule 19b-4 thereunder,² a proposed rule change to increase net capital requirements for members and Designated Dealers.

I. Introduction

The proposed rule change was published for comment in Securities Exchange Act Release No. 38956 (August 21, 1997), 62 FR 45893 (August 29, 1997). No comments were received on the proposal.

II. Description of the proposals

Exchange Article II, Section 5.1 presently requires a minimum net capital level on non-specialist Exchange members equal to the greater of the net capital level required by Commission Rule 15c3-1³ or \$25,000. The Exchange proposes to amend this rule to increase that requirement from \$25,000 to \$250,000. As previously required, members would still be subject to any higher net capital requirements imposed by Commission Rule 15c3-1.⁴

The Exchange also proposes to amend Exchange Rule 11.9(a). That rule currently requires Designated Dealers to maintain net capital of at least the greater of \$100,000 or the amount required under Commission Rule 15c3-

1. The Exchange proposes to amend this rule to increase the Exchange requirement from \$100,000 to \$500,000. Again, members would still be subject to any higher net capital requirement imposed by Commission Rule 15c3-1.⁵

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of Sections 6(b) and 11(b) of the Act.⁶ In particular, the Commission believes the proposal is consistent with the Section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public.⁷ The Commission also believes that the proposal is consistent with Section 11(b) of the Act,⁸ and Rule 11b-1⁹ thereunder, which allows securities exchanges to promulgate rules relating to specialists in order to maintain fair and orderly markets. The proposal is consistent with Rule 11b-(a)(2)(i)¹⁰ which requires that the rules of a national securities exchange which permit a member to register as a specialist and to act as a dealer include, among other things, adequate minimum capital requirements in view of the markets for securities on such exchange.

The Commission finds that the rule change will help ensure greater financial stability of the Exchange's members by requiring those members to maintain higher capital levels. The Commission examined this issue when it revised Rule 15c3-1 in 1992.¹¹ In proposing to raise the minimum net capital requirements under Commission rules, the Commission noted that under Rule 15c3-1 customers are placed at risk by brokers that do not receive or hold customer securities because such brokers have indirect access to customer funds and securities, and can direct the movement of such assets by placing orders with clearing firms. Customers are often unaware of or unable to distinguish between introducing brokers and clearing firms, and tend to rely

heavily upon the representations of brokers of introducing firms. Higher net capital requirements will help ensure the financial integrity of such introducing firms and thereby help to protect investors.¹² The Commission concurs with the Exchange that better capitalized introducing firms are less likely to become insolvent and in the event that an introducing firm does become insolvent, higher net capital levels would help increase the changes that the firm can quickly find a purchaser of its assets and minimize the impact of such a failure on the investing public.¹³ Finally, the Commission has previously stated its belief that raising minimum net capital levels will further the antifraud provisions of the federal securities laws.¹⁴ The Exchange noted that member firms have access to customer securities and funds either directly, as a clearing firm, or indirectly, as an introducing firm that places orders with a clearing firm on behalf of its customers. In either case, firms can convert those assets to their own benefit. A firm with sufficient net capital may be less likely to attempt to convert funds in this manner.

The Commission also believes that it is important that Designated Dealers are adequately prepared to provide depth and liquidity to the Exchange's markets in times of market stress or volatility. The Commission agrees with the Exchange that the growth in the U.S. capital markets generally, and in the CSE's market in particular, has created market conditions which have created a need for greater capital levels on the CSE. The Commission finds that the increased net capital requirement for Designated Dealers will better protect the integrity and quality of the Exchange's market.

IV. Conclusion

It is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-CSE-09) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-28030 Filed 10-22-97; 8:45 am]

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¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ 15 U.S.C. § 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.15c3-1.

⁴ *Id.*

⁵ *Id.*

⁶ 15 U.S.C. § 78f(b); 15 U.S.C. § 78k(b).

⁷ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. § 78c(f).

⁸ 15 U.S.C. § 78k(b).

⁹ 17 CFR 240.11b-1.

¹⁰ 17 CFR 240.11b-1(a)(2)(i).

¹¹ Securities Exchange Act Rel. No. 31512 (Nov. 24, 1992), 57 FR 57027 (Dec. 2, 1992).