through securities dealers. The primary financing vehicle for its mortgage purchases is the sale of Mortgage Passthrough Certificates (PCs). These securities are exempt from registration under the Securities Act of 1933 and the Exchange Act of 1934. In 1990, Freddie Mac redesigned its fixed-rate PC structure and issued a new type of PC, called Gold PC. Since the Gold PCs were entirely new and a separate product, there was limited initial liquidity in the Gold PC market. As a result, dealers responded to the initial lack of liquidity in the Gold PC market, with its potential volatility, by maintaining primary Fannie Mae security positions, and by entering into synthetic transactions in the swap market.

As a result of the above, Freddie Mac launched this Initiative to encourage dealers to purchase Gold PCs directly, rather than through the swap market mechanism. The Initiative includes offering dealers ''credits'' for trading directly on the interdealer cash market, as opposed to the swap market. Freddie Mac has developed procedures and internal controls to calculate trading volume credits monthly to the dealers and assure proper administration of the program. According to your letter, this Initiative is intended to be temporary, and the value of the credits were selected so as to provide a nominal economic incentive over the transaction costs on the swap market, while not providing so much of an incentive as to alter pricing of the securities in the open market. More important, the credits awarded under this Initiative may only be redeemed through transactions with Freddie Mac.

Discussion

NASD Rule 2460 prohibits NASD members from receiving payments or other consideration from an issuer for publishing a quotation or acting as a maker in a security, or for submitting an application to make a market in the issuer's securities. The definition of ''consideration'' specifically includes offering securities products on terms that are more favorable than those granted or offered to the public. The Rule was intended to prevent certain conflicts of interest that may influence a broker-dealer's decision regarding whether to quote or make a market in a security and prices that are quoted and to prevent a misleading appearance of market activity based on such conflicts. Paragraph (b) of the Rule also provides an exemption, among others, for certain payment to members for ''bona fide'' services, including, but not limited to, investment banking services.

Due to unique characteristics of the Freddie Mac Initiative, you principally present three arguments why the Rule was not intended to cover your Initiative: (1) the Initiative promotes Freddie Mac's statutory purpose; (2) the Initiative does not affect the integrity of the marketplace; and (3) the Initiative is intended to be temporary.

First, you represent that the Initiative appears to promote Freddie Mac's statutory purpose, in that, Freddie Mac was created by Congress to provide a conduit for ensuring a continuous supply of funds from the capital markets to the mortgage markets. Freddie Mac purchases mortgages daily and finances them primarily with the issuance of mortgage-backed securities. The prices Freddie Mac pays for its mortgage purchases is based directly on the prices at which it sells its PCs. It has been represented in your letter that this Initiative was developed to eliminate certain unnecessary costs in the mortgage finance system by improving interdealer PC liquidity through encouraging dealers to purchase Gold PCs directly, as opposed to entering into transactions in the swap market.

Second, you represent that the Initiative does not appear to affect the integrity of the marketplace, since the nature and characteristics of the agency mortgage pass-through securities market is unique and appears outside of the intended scope of the Rule. Since the dealers in this market trade these securities as fungible products (i.e., PCs, Mortgage-backed securities, Ginnie Maes) and trade on the interdealer broker screens daily as a matter of course to meet their customer's demand, the concept of market making a particular security has little application in this marketplace.

In addition, you represent that the incentives which lead a broker-dealer to make a quotation on a PC differ from traditional equity trading. Customer demand in fixed-income securities is based primarily on changes in interest rates, supply and demand, and the quality of the credit backing the security. In the agency mortgage-backed securities market, the credit of the three primary agencies (Freddie Mac, Fannie Mae and Ginnie Mae) is considered comparable, the supply of the securities is considered plentiful, and a well-developed forward trading market permits ready hedging of positions. This market differs from the characteristics of the traditional equity market. Accordingly your letter represents that, given the number of comparable securities in the yield driven debt market, it is unlikely that certain dealer credits to purchase Gold PCs would mislead market participants to purchase the Gold PCs versus other comparable securities.

Lastly, you represent that this Initiative is intended to be temporary. According to your letter, it is expected that dealer behavior will eventually become self-sustaining and no further incentives will be required.

Based on the above information and the representations presented by Freddie Mac, and the importance of the role of Freddie Mac in promoting liquidity of these instruments under statutory mandate, it is the staff's opinion that the participation of member firms in the Freddie Mac Initiative as described in your letter would not be deemed in violation of Rule 2460.

I hope this letter is responsive to your inquiry. Please note that the opinions expressed herein are staff opinions only and have not been reviewed or endorsed by the Board of Directors of NASD Regulation. This letter responds only to the issues that you have raised based on the facts as described, and does not address any other rule or interpretation of the Association, or all the possible regulatory and legal issues involved.

Sincerely,

David A. Spotts,

Office of General Counsel, NASD Regulation, Inc.

[FR Doc. 97–33994 Filed 12–30–97; 8:45 am]

BILLING CODE 8010–01–M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39477; File No. SR–PCX–97–43]

Self-Regulatory Organizations; Order Granting Accelerated Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 to Proposed Rule Change by the Pacific Exchange, Inc. Relating to Its Specialist Evaluation Program

December 22, 1997.

On November 17, 1997, the Pacific Exchange, Inc. (''PCX'' 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 extend its pilot program regarding the evaluation of its equity specialists until January 1, 1999, and to implement certain changes to the pilot program.

The proposed rule change was published for comment in Securities Exchange Act Release No. 39358 (November 25, 1997), 62 FR 64035 (December 3, 1997). No comments were received on the proposal. The Exchange filed Amendment No. 2 to the proposed rule filing on December 5, 1997.[3] This order approves the proposed rule change, as amended, on an accelerated basis.

I. Description

On October 1, 1996, the Commission approved a nine-month pilot program for the evaluation of PCX equity specialists.[4] On June 3, 1997, the

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Amendment No. 2 states that the Equity Allocation Committee (''EAC'') will consider mitigating circumstances on a case-by-case basis. The restrictions will apply in all cases in which the specialist fails to meet the standards; any failure to impose the restrictions should not be routine and should only occur in exceptional circumstances which demonstrate that imposing the restrictions is not justified. For example, the EAC may consider a systems problem to be a mitigating circumstance in a particular case. *See* letter from Jeffrey S. Norris, Manager, Regulatory Development, PCX, to Heather Seidel, Attorney, Market Regulation, Commission, dated December 4, 1997 (''Amendment No. 2'').

[4] Prior to the adoption of the pilot program, PCX Rule 5.37(a) provided that the Exchange's EAC evaluate all registered specialists on a quarterly

Commission approved a six-month extension of that pilot program.[5] The reason for the extension was to allow the PCX more time to evaluate the impact of the SEC's new order handling rules on the performance criteria and to determine an appropriate overall passing score and individual passing scores for each criterion. The Exchange now is proposing to extend the pilot program until January 1, 1999. The PCX has established an overall passing score and individual passing scores for each criterion and has determined when specialists that do not attain the minimum passing scores should meet with the EAC. The Exchange is also proposing to replace the ''Bettering the Quote'' criterion with Price Improvement and to lower the weighting of the Specialist Evaluation Questionnaire from 15% to 10% so that Price Improvement can be given a weight of 10%.

Price Improvement

''Price Improvement'' measures the number of trades involving market and marketable limit orders that improve the national best bid or offer (''NBBO'') if the NBBO quote spread at the time the original order is *received* is greater than or equal to two trading differentials, but less than or equal to eight trading differentials for that security. The execution price for stopped market or marketable limit orders will be compared with the guaranteed price (which is the NBBO at the time the order was received).

Orders completely or partially executed will be considered for price improvement. All *one-sided* market or marketable limit orders[6] with an NBBO quote spread greater than ⅛ point are eligible for price improvement. Only agency orders entered or received by an exchange are eligible for price improvement. Orders with time-in-force designations such as good until canceled (GTC), good through day of entry (DAY), immediate or cancel (IOC), and good until executed will be eligible for price improvement. In addition, stocks, rights, warrants, preferred stock, when issued, and when distributed equity securities will be eligible for price improvement.

The following types of orders will not be considered under the category of price improvement: all preopening market and limit orders, limit order executions out of the limit book (i.e., booked orders), electronically entered limit orders whose price falls in between the NBBO, non-regular-way trades (i.e., cash, next day and seller's option), negotiated trades or trades identified as crosses, bonds, orders designated as possible duplicates (POSS DUPE or try to stop (TTS), canceled orders, odd-lot market and odd-lot limit orders, orders designated as all or none (AON), all tick sensitive executions (i.e., buy minus, sell plus, sell short, etc.), market quotations under 200 shares, and principal an program trade account types.[7]

Specialists will be measured on the percentage of trades that are price improved. The following table gives the parameters and corresponding point values:

Percent of eligible trades improved	Points
40+	10
36–39.99	9
32–35.99	8
28–31.99	7
24–27.99	6
20–23.99	5
16–19.99	4
12–15.99	3
8–11.99	2
4–7.99	1
Below 4	0

Overall Passing Score

The PCX has established an overall passing score of 60 as the minimum standard that each specialist must attain each quarter. A specialist will have to obtain better than a passing score in each individual criterion (see minimum passing scores shown below) to obtain a minimum passing score of 60. Any specialist who falls below the minimum passing score will have to appear before the EAC and will be subject to the following restrictions: no new allocations and no trading in alternate specialist stocks for the quarter following the quarter that the specialist was evaluated. Any specialist who does not attain a passing score in any three out of four quarters will also be subject to other restrictions imposed by the EAC, including reallocation of one or more stocks. The EAC will evaluate the effectiveness of the overall passing score and will adjust it accordingly.

Individual Criterion Passing Scores

The PCX has established individual passing scores for each individual criterion based upon third quarter 1997 evaluation results. The third quarter of 1997 was the first evaluation period that the Trading Between the Quote, Book Display Time, and Quote Performance calculations were based upon the NBBO instead of the primary market. In addition, the evaluation results in the third quarter were based upon one-sixteenth trading increments instead of one-eighth increments. As a result of the NBBO changes and the change to

basis and that each specialist receive an overall evaluation rating based on three criteria of specialist performance: (1) Specialist Evaluation Questionnaire Survey (''Questionnaire'') (45% of overall score); (2) SCOREX Limit Order Acceptance Performance (10%); and (3) National Market System Quote Performance (45%). *See* PSE Rule 5.37 (July 1995).

The original pilot program modified Rule 5.37(a) by adding three new criteria of performance and eliminating one performance criterion. Prior to this proposed rule change, the pilot contained the following criteria: (1) Executions (50%) (itself consisting of four criteria: (a) Turnaround Time (15%); (b) Holding Orders Without Action (15%); (c) Trading Between the Quote (10%); and (d) Executions in Size Greater Than BBO (10%)); (2) Book Display Time (15%); and (3) Post-1 p.m.Parameters (10%). The pilot also eliminated the SCOREX Limit Order Acceptance Performance criterion. Further, the pilot added more questions to the Questionnaire, and reduces its weight from 45% to 15% of the overall score. Finally, the National Market System Quote Performance criterion (renamed Quote Performance under the pilot) was amended to include within it an additional submeasure for bettering the quote (each of the two submeasures under this criterion is accorded a weight of 5% of the overall score). For a more detailed description of the performance criteria utilized in the PCX's pilot program, see Securities Exchange Act Release No. 37770 (October 1, 1996), 61 FR 52820 (October 8, 1996) (File NO. SR–PSE–96–28). *See also generally* PCX Rule 5.37 (description of the standards and procedures applicable to the EAC's evaluation of specialists).

[5] *See* Securities Exchange Act Release No. 38712 (June 3, 1997), 62 FR 17941 (July 8, 1997).

[6] According to the PCX, the regional exchanges have agreed to the following definition for marketable limit orders: A marketable limit order to buy is priced at or above the NBBO offer, a marketable limit order to sell is priced at or below the NBBO bid.

[7] The PCX states that preopening market and limit orders were excluded because all such orders are entered prior to there being a market that is trading, so there is no market to improve upon. Limit order executions out of the limit book (i.e., booked orders) were not included because they are filled as the market moves toward them, not when they are outside of the NBBO. Electronically entered limit orders whose price falls in between the NBBO were excluded because these are not executable at the time they are entered, unless the specialist chooses to fill them. Non-regular-way trades (i.e., cash, next day and seller's option) and negotiated trades are not included because they are negotiated and the price does not necessarily depend upon the NBBO. Trades identified as crosses were excluded because specialists do not participate in crosses, by definition. Bonds and orders designated as possible duplicates (POSS DUPE) were not included because they are entered manually. Canceled orders were excluded because orders cannot be improved upon if they are not allowed to be executed. Odd-lot market and odd-lot limit orders were not included because they are executed automatically in the background, and the specialist never has the opportunity to improve upon them. Orders designated as all or none (AON) and all tick sensitive executions (i.e., buy minus, sell plus, sell short, etc.) were excluded because they are conditional orders. Market quotations under 200 shares were not included because they are usually computer generated and the specialists generally have no opportunity to improve them. Principal orders were excluded because they cannot be sent via PCOAST. Program trades were not included because they involve a large portfolio of stocks and derivative index products, which are not generally routed to a regional exchange for execution.

sixteenths, individual passing scores in the affected criteria were lower than in previous quarters. Previous quarter scores were not used to determine individual criterion passing scores because of the aforementioned changes. PCX states that the EAC will evaluate the effectiveness of the individual passing scores and will adjust them accordingly. The individual passing scores for each criterion are as follows:

Evaluation criterion	Passing score
Turnaround Time	12
Holding Orders Without Action	7.5
Trading Between the Quote	5
Executions in Size Greater Than NBBO	2
Specialist Evaluation Questionnaire Survey	5
Book Display Time	10.5
Equal or Better Quote Performance	1
Post 1 P.M. Parameters	3
Price Improvement	4

Any specialist who does not attain a minimum passing score in a particular criterion for two or more consecutive quarters or more will be subject to the following:

1. If a specialist does not attain a passing score in any particular individual criterion for 2 consecutive quarters, the specialist will have to appear before the EAC. The EAC will meet with the specialist with the intent of helping the specialist to improve the score.

2. If a specialist does not attain a passing score in any particular individual criterion for 3 out of 4 consecutive quarters, the specialist will either not be permitted to trade any alternate specialist stocks or not be able to apply for any new stocks for one quarter. The Equity Allocation Committee will decide which restriction will apply.

3. If a specialist does not attain a passing score in any particular individual criterion for 4 out of 5 consecutive quarters, 5 out of 6 quarters, etc., the specialist will be subject to both the alternate specialist and no new stock restrictions for one quarter. The EAC may also, at its discretion, impose other restrictions, including reallocating one or more of the specialist stocks.

The EAC will consider mitigating circumstances on a case-by-case basis. The restrictions will apply in all cases in which the specialist fails to meet the standards; any failure to impose the restrictions should not be routine and should only occur in exceptional circumstances which demonstrates that imposing the restrictions is not justified. For example, the EAC may consider a systems problem to be a mitigating circumstance in a particular case.

II. Discussion

The Commission believes that specialists play a crucial role in providing stability, liquidity, and continuity to the trading of stocks. Among the obligations imposed upon specialists by the Exchange, and by the Act and the rules promulgated thereunder, is the maintenance of fair and orderly markets in their designated securities.[8] To ensure that specialists fulfill these obligations, it is important that the Exchange conduct effective oversight of their performance. The PCX's specialist evaluation program is critical to this oversight.

In its order initially approving the specialist evaluation pilot program,[9] the Commission asked the Exchange to monitor the effectiveness of the amended program. Specifically, the Commission requested information about the number of specialists who fell into the bottom 10% of all registered specialists on their respective trading floors in the overall program, whether they subsequently appeared before the EAC, and any restrictions placed upon, or further action taken against, such specialists. The Commission also requested information as to the number of specialists who appeared before the EAC as a result of scoring in the bottom 10% in any two out of four consecutive quarterly evaluations, whether any restrictions were imposed on such specialists, and the results of any formal proceedings that were initiated against them.

In May 1997, the PCX submitted to the Commission its monitoring report regarding its specialist evaluation pilot program. The report described the PCX's experience with the pilot program during the initial two quarters of its operation (*i.e.*, the fourth quarter of 1996 and the first quarter of 1997). In terms of the overall scope of the program, the Commission continues to believe that the objective measures, together with the floor broker questionnaire, should generate sufficiently detailed information to enable the Exchange to make accurate assessments of specialist performance. In this regard, the increased emphasis on objective criteria under the pilot has been useful in identifying how well specialists carry out certain aspects (*i.e.*, timeliness of execution, price improvement, and market making quality) of their responsibilities as specialists.

In June 1997, the Commission approved an extension of the pilot to January 1, 1997.[10] Since that time, the Exchange has begun (starting with the third quarter of 1997) to utilize the NBBO instead of the primary market quote in Trading Between the Quote, Book Display Time, and Quote Performance criteria, and the PCX is proposing to continue to utilize the NBBO for these criteria during the pilot extension. The Commission continues to believe that the NBBO is a more appropriate standard in this context in that it will enable the Exchange to gauge the performance of PCX specialists in comparison with their competitors not only in the primary market, but in the national market system as a whole.[11] Therefore, the Commission finds that the PCX's proposal is responsive to the Commission's request for such an amendment.

The Commission believes that the proposed overall passing score and the individual criterion passing scores are consistent with the Act. The Commission believes that minimum adequate performance thresholds are an important part of any specialist performance evaluation program because they allow the Exchange to identify specialists who are not operating at an acceptable level of performance, both overall and in individual objective criterion. The Commission has stated that an effective evaluation program should subject specialists who meet minimum performance levels on the overall program, but need help or guidance in improving their performance in a particular area, to review. While the PCX's current specialist evaluation program subjects those specialists falling into the bottom 10% of all specialists on his or her trading floor to review by the EAC, it did not set a minimum performance level on the overall program, or for the individual criterion. The proposed rule change rectifies this situation by imposing overall and individual criterion passing scores.

The Commission notes that the Exchange must apply certain restrictions on any specialist who fails the overall passing score and the

[8] Rule 11b–1, 17 CFR 240.11b–1; PSE Rule 5.29(f).

[9] For a description of the Commission's rationale for initially approving the PCX's adoption of its specialist evaluation pilot program, see Securities Exchange Act Release No. 37770, *supra* note 4. The discussion in the aforementioned order is incorporated by reference into this order.

[10] *See supra* note 5.

[11] The Exchange's use of the primary market quote in these three measures did not allow for such comparisons to be made in instances where the primary market quote is not equal to the NBBO. *See Id.* at n.16.

individual criterion passing scores for certain specified time periods. In addition, the Commission notes that the Exchange has represented that the EAC will evaluate the effectiveness of the overall and individual criterion passing scores and will adjust them as necessary. Finally, the Commission emphasizes that the EAC will consider mitigating circumstances only on a case-by-case basis and that the restrictions will apply in all cases in which the specialist fails to meet the standards, unless exceptional circumstances demonstrate that imposing the restrictions is not justified. The Commission expects that any failure to impose the restrictions should not be routine and should only occur when the exceptional circumstances, such as a systems problem in a particular case, justify not imposing the restrictions.[12]

The Commission believes that replacing the ''Bettering the Quote'' criterion with Price Improvement, and lowering the Specialist Evaluation Questionnaire weighting to 10% and according Price Improvement a 10% weighting, is reasonable under the Act. The Commission notes that price improvement will measure the number of trades involving market and marketable limit orders that improve the NBBO;[13] Bettering the Quote was originally measured against the primary market and is now measured against the NBBO. The Commission also notes that there is still a category for ''Equal or Better Quote Performance.'' Finally, the Commission notes that Price Improvement provides an additional objective criterion to measure specialist performance.

The Commission believes that it is appropriate to extend the current pilot program for an additional year, until January 1, 1999. This period will allow the Exchange to respond to evaluate the effectiveness of the overall passing score and the individual criterion passing scores, and the specialist performance program as a whole. Moreover, the Commission expects the Exchange to conduct an ongoing examination of the parameter ranges and corresponding points allotted under each criterion to ensure that they continue to be set at appropriate levels.

The Commission therefore requests that the PCX submit by October 30, 1998 a proposed rule change pursuant to Rule 19b–4 to include any proposal by the PCX to extend the pilot beyond January 1, 1999.

In addition, the Commission requests that the PCX submit a report to the Commission, by October 30, 1998, describing its continuing experience with the pilot. At a minimum, this report should contain data, for the first, second and third quarters of 1998, on (1) the number of specialists who, as a result of failing the overall passing score in any one quarterly evaluation, appeared before the EAC, and the type of restrictions that were imposed on such specialists (*i.e.*, restriction on new allocations or acting as an alternate specialist), or any further action that was taken against such specialists; (2) the number of specialists who, as a result of failing the overall passing score in any three out of four quarters, appeared before the EAC, and the type of restrictions that were imposed on such specialists (*i.e.*, reallocation of new stocks), or any further action that was taken against such specialists; (3) the number of specialists who, as a result of failing any individual criterion passing score for two consecutive quarters, or three out of four consecutive quarters, four out of five consecutive quarters, and so on, appeared before the EAC, and the type of restrictions that were imposed on such specialists; (4) the number of specialists for whom formal proceedings were initiated, the results of such proceedings, including a list of any stocks reallocated from a particular unit; (5) the number of registered specialists who scored in the bottom 10% of all registered specialists on his or her trading floor in the overall program; (6) the number of specialists who, as a result of scoring in the bottom 10% in any one quarterly evaluation, appeared before the EAC, and the type of restrictions that were imposed on such specialists (*i.e.*, restrictions on new allocations or acting as an alternate specialist), or any further action that was taken against such specialists; (7) the number of specialists who, as a result of scoring in the bottom 10% in any two out of four consecutive quarterly evaluations, appeared before the EAC, whether any restrictions were imposed on such specialists, and whether formal proceedings were initiated against such specialists; and (8) any situation in which the restrictions were not imposed due to mitigating circumstances, what those circumstances where, and the reasoning as to why the restrictions were not imposed.

The Commission notes that the Exchange's pilot program only modifies the performance criteria of PCX Rule 5.37(a). Consequently, the Commission expects the EAC to continue to evaluate the performance of specialists during the pilot period in accordance with the standards and procedures found in the PCX rules.[14]

For the reasons discussed above, the Commission finds that the PCX's proposal to extend its pilot program is consistent with the requirements of Sections 6(b) and 11 of the Act[15] and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposed rule change is consistent with the Section 6(b)(5) requirement that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.[16]

Further, the Commission finds that the proposal is consistent with Section 11(b) of the Act[17] and Rule 11b–1 thereunder which allow securities exchanges to promulgate rules relating to specialists in order to maintain fair and orderly markets and to remove impediments to and perfect the mechanism of a national market system.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register.** This will permit the pilot program to continue both on an uninterrupted basis and with the use of overall and individual criterion passing scores, and a new measure, Price Improvement. In addition, the rule

[12] *See* Amendment No. 2, *supra* note 3.

[13] The NBBO quote spread at the time of the original order is received must be greater than or equal to two trading differentials, but less than or equal to eight trading differentials for that security. The execution price for stopped market or marketable limit orders will be compared with the guaranteed price (which is the NBBO at the time the order was received).

[14] In this regard, all specialists falling within the bottom 10% of specialists on their respective floors in any review period are required to meet with the EAC. *See also* PCX Rule 5.37 (standards applicable to specialists falling into the bottom 10% in any two out of four review periods, including those pertaining to the initiation of formal reallocation proceedings). Moreover, PCX Rule 5.36(d), Commentary .03 requires that all specialists falling into the bottom 10% in a review period must be precluded from acting as alternate specialists until their ranking rises above the bottom 10%, unless the EAC determines otherwise. In addition, PCX Rule 5.37(b), Commentary .01 requires that all such specialists shall not be eligible for new allocations until their ranking rises above the bottom 10%. Consequently, the Commission expects that appropriate action in accordance with PCX rules will be taken with regard to those specialists falling into the bottom 10%. The Commission notes that the PCX stated its intention to file a rule change to PCX Rule 5.37 to reflect all of the aforementioned changes to its Specialist Evaluation Pilot Program.

[15] 15 U.S.C. 78f(b) and 78k.

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

[17] 15 U.S.C. 78k(b).

change that implemented the pilot program initially was published in the **Federal Register** for the full comment period, and no comments were received.[18] The Commission also finds good cause for approving Amendment No. 2 prior to the thirtieth day after the date of publication of notice in the **Federal Register.** Amendment No. 2 strengthened the proposed rule change by clarifying that the EAC will consider mitigating circumstances only an a case-by-case basis, and will only apply them in exceptional circumstances which demonstrate that imposing the restrictions is not justified. Accordingly, the Commission believes good cause exists, consistent with the Act, to accelerate approval of the proposed rule change and of Amendment No. 2.

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2 to the rule proposal. 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 at the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR–PCX–97–43 and should be submitted by January 21, 1998.

III. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) [19] that the proposed rule change, as amended, is hereby approved on an accelerated basis.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97–33995 Filed 12–30–97; 8:45 am]

BILLING CODE 8010–01–M

[18] *See* Securities Exchange Act Release 37770, *supra* note 4.

[19] 19 U.S.C. 78s(b)(2).

[20] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39468; File No. SR–PHLX–97–39]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Changes in Insider Trading and Securities Fraud Enforcement Act Rules

December 18, 1997.

I. Introduction

On August 18, 1997, the Philadelphia Stock Exchange, Inc. (''PHLX'' 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 include PHLX member organizations within the scope of Insider Trading and Securities Fraud Act (''ITSFEA'') coverage and clarify the definition of ''employee'' to include indirectly compensated persons such as independent contractors.

The proposed rule change was published for comment in the **Federal Register** on October 9, 1997.[3] No comments were received on the proposal. This order approves the proposal.

II. Description of the Proposal

Presently, PHLX is the designated examining authority (''DEA'') for approximately eighteen firms that do not have a floor presence. Because PHLX Rule 761 and Floor Procedure Advice F–13 (collectively, ''PHLX ITSFEA rules'') which implement ITSEFA-related written supervisory procedures currently only cover PHLX floor units, members without a floor unit are exempt from the application of these rules. The Exchange is removing this exception. Accordingly, all PHLX members will be covered by the PHLX ITSFEA rules.

Additionally, the PHLX ITSFEA rules currently impose certain regulatory requirements upon ''employees'' of members. The rule, however, does not contain a definition of such term. PHLX proposes to add a commentary to these rules in order to interpret the term ''employee'' to include ''every person who is compensated directly or indirectly by the member organization for the solicitation or handling of business in securities, including those trading securities from the account of the member organization, whether such securities are those dealt in on the Exchange or those dealt over-the-counter.'' This change will now include persons as ''employees'' who might have previously been excluded based on the nature of their compensation arrangements.[4]

III. Discussion

After careful review, 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. The Commission believes the proposal is consistent with the requirements of Section 6 of the Act in general and, in particular, with Section 6(b)(5) in that it is designed to promote just and equitable principles of trade and prevent fraudulent and manipulative acts and practices.[5]

The Commission finds that the proposal will further the goals of ITSFEA by extending to all PHLX members the requirements to maintain written supervisory procedures designed to prevent the misuse of material, non-public information by employees. The rules of other self-regulatory organizations currently extend ITSFEA-related requirements to all members.[6]

The Commission believes that the proposal will also further the goals of ITSFEA by defining the term ''employees'' to include ''every person compensated directly or indirectly by the member organization for the solicitation or handling of business in securities, including those trading securities from the account of the member organization, whether such securities are those dealt in on the Exchange or those dealt over-the-counter.'' In particular, this proposed change appropriately expands coverage of Rule 761 and Floor Procedure Advice F–13 to include as employees those

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 39178 (October 1, 1997), 62 FR 52804.

[4] The PHLX has represented that it currently interprets the term ''employees'' in Rule 761 to include persons such as partners, directors, officers and branch managers. The PHLX has also represented that the proposed commentary will not change the existing interpretation of the term ''employee'' except to expand the universe of persons defined as employees. Letter from Michele R. Weisbaum, Vice President and Associate General Counsel, PHLX, to Kevin Ehrlich, Attorney, Division of Market Regulation, dated December 18, 1997.

[5] 15 U.S.C. 78f(b)(5).

[6] *See* Chicago Stock Exchange Rule 5 and Interpretation .02; Cincinnati Stock Exchange Rule 5.1; Pacific Exchange Rule 2.6(e) and Commentary .03; Chicago Board Options Exchange Rule 4.18 and Commentary .02; Boston Stock Exchange Rule 37(a) and Commentary .03.