

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41469; File No. SR-NYSE-97-25]

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change to Amend its Rule 382 Relating to Carrying Agreements

June 2, 1999

I. Introduction

On September 16, 1997, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") submitted to the Securities and Exchange Commission ("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 amend NYSE Rule 382 to monitor the activities of introducing firms that are parties to carrying agreements.

The proposed rule change was published for comment in the **Federal Register** on October 14, 1997.³ Seven comment letters were received on the proposal.⁴ On November 12, 1998, the NYSE submitted to the Commission a letter responding to the issues raised in the comment letters received by the Commission.⁵ On November 25, 1998, the NYSE submitted Amendment No. 1

to the proposed rule change.⁶ This order approves the proposed rule change and approves Amendment No. 1 on an accelerated basis.

II. Description of the Proposal

The NYSE proposes to revise NYSE Rule 382 to enhance the ability of the Exchange and other securities self-regulatory organizations ("SROs") to monitor the activities of introducing firms that are parties to carrying agreements. NYSE Rule 382 governs the contractual agreements, known as "carrying agreements," between a carrying firm and an introducing firm, that allocate certain functions and responsibilities associated with the carrying of, and transactions in, customer accounts. Generally, the proposed amendments to NYSE Rule 382 would provide for increased monitoring of customer complaints regarding introducing firms, require specific procedures for introducing firms requesting reports offered by carrying firms, and address procedures and responsibilities of introducing firms that are permitted to issue negotiable instruments of the carrying firms.

Specifically, the proposal, as amended, would require a carrying firm to provide promptly any written customer complaint it receives regarding the introducing firm to the introducing firm and the introducing firm's Designated Examining Authority ("DEA"). In addition, the proposal would require that the carrying firm notify the customer who submitted the written complaint in writing that the complaint was received and that it was provided to the introducing firm and the DEA. As initially proposed, the carrying firm would also have been required, in response to customer complaints, to inform customers of their right to transfer their accounts to another broker-dealer. As discussed further below, this provision was subsequently deleted from the proposal in response to comment letters received by the Commission.⁷

The proposal also would require a carrying firm to provide to each of its

introducing firms, at the beginning of the agreement and annually thereafter, a list of all exception and other reports that it offers to assist its introducing firms in supervising and monitoring their customer accounts. The proposal would require each introducing firm to notify the carrying firm of those specific reports offered that should be provided to the firm.⁸

In addition, the proposal would require the carrying firm to provide written notice, on an annual basis within 30 days of July 1 of each year (*i.e.*, between June 1 and July 31), to the introducing firm's Chief Executive Officer, Compliance Officer, and DEA, of the list of reports offered to the introducing firm and to specify those reports actually requested or supplied as of the report date.

The Exchange also proposes to amend its original filing to conform its rule language to the amended proposal submitted by the National Association of Securities Dealers, Inc. ("NASD").⁹ The proposal, as amended, would grant the NYSE the discretion, upon a showing of good cause, to grant exemptions from the requirements relating to the handling of customer complaints and the provision of exception reports in instances where the introducing firm is an affiliated entity of the carrying firm.¹⁰

Finally, the proposal addresses those agreements that allow introducing firms to issue negotiable instruments (*e.g.*, checks) to their customers, for which the carrying firm is the maker or drawer. The proposed rule provides that the introducing firm must represent to the carrying firm that it has supervisory procedures in place, which it enforces and which are satisfactory to the carrying firm, with respect to the issuance of such instruments.

III. Summary of Comments

The Commission received seven comment letters on the proposed rule change.¹¹ As discussed further below, all of the commenters, except one,¹² generally opposed the proposal: four expressed concerns that the proposal was unnecessarily broad,¹³ while two stated that the proposal was inadequate

⁸ In addition, the carrying firm will be required to retain and preserve copies of the specific reports requested by, or supplied to, the introducing firm or have the capability to: (1) recreate copies of reports provided, or (2) make available the report format and data elements provided in the original reports necessary to recreate the original reports.

⁹ See Amendment No. 1, *supra* note 6.

¹⁰ *Id.*

¹¹ See note 4, *supra*.

¹² See SIA Letter, *supra* note 4.

¹³ See Letters from Schroder, Global, Coker & Palmer, and Repex, *supra* note 4.

⁶ See Letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Richard C. Strasser, Assistant Director, Division, Commission, dated November 24, 1998 ("Amendment No. 1"). In Amendment No. 1, NYSE proposes to amend its filing to: (1) delete the proposed requirement that, in response to customer complaints, the carrying firm must notify the customers of their right to transfer their accounts; and (2) add a good cause exclusion from certain provisions of the proposed rule when the introducing firm is an affiliated entity of the carrying firm.

⁷ See Amendment No. 1, *supra* note 6.

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4

³ See Securities Exchange Act Release No. 39200 (October 3, 1997), 62 FR 53369.

⁴ See Letters to Jonathan Katz, Secretary, Commission, from Mark R. Grewe, Schroder & Co. Inc., dated October 14, 1997 ("Schroder"); Jonathan Kord Lagemann, Esq., dated October 30, 1997; Olga Monetti, dated October 29, 1997; Stephen Tenison, Senior Vice President-Compliance, Global Financial Services, L.L.C., dated October 29, 1997 ("Global"); J. David Coker, Coker & Palmer, Inc., dated October 29, 1997 ("Coker & Palmer"); Erich Sokolower, Managing Director, Repex & Co., Inc., dated October 31, 1997 ("Repex"); and Thomas J. Berthel, Chairman, Local Firms Committee, Edward Schlitzer, Chairman, Clearing Firms Committee, and Thomas A. Franko, Ad Hoc Clearing Subcommittee, Securities Industry Association, dated November 3, 1997 ("SIA").

⁵ See Letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Richard Strasser, Assistant Director, Division of Market Regulation ("Division"). Commission, dated November 11, 1998 ("NYSE Response Letter").

as it failed to hold carrying firms responsible for the actions of their introducing firms.¹⁴ Two of the commenters specifically opposed any attempts by the NYSE to hold carrying firms liable for the actions of their introducing brokers.¹⁵ In response, the NYSE stated that the proposed rule change would not hold the carrying firms responsible for the actions of their introducing firms, noting, "the proposals are not intended to alter the fundamental carrying/clearing contractual relationship."¹⁶

A. Customer Complaints

Two of the comment letters stated that requiring carrying firms to send copies of written customer complaints to the introducing firm's DEA is unnecessary because the introducing firm is already required to submit information about its customer complaints to its DEA.¹⁷ In response, the NYSE distinguished the proposed customer complaint requirements from existing reporting rules, such as NYSE Rule 351, which require statistical information about customer complaints to be provided to the DEA on a quarterly basis. The NYSE noted that the proposal would supplement, rather than duplicate, the existing reporting requirements by requiring that copies of actual written complaints be provided immediately to the DEA.¹⁸

Three comment letters expressed concerns that the proposed notification provisions advising complaining customers of their rights to transfer their accounts would be misleading as it could create the perception that the subject of the complaint necessarily warranted a transfer.¹⁹ For example, one commenter pointed out that the proposed statement "might well cause the customer to infer wrongdoing and take his or her business elsewhere, regardless of the merit of the complaint or the underlying circumstances * * *."²⁰ Another commenter suggested that the proposed response "should be reserved for only serious allegations where a transfer of account is an appropriate response."²¹ In response, the NYSE proposes to delete this provision from its proposal, noting

¹⁴ See Letters from Lagemann and Monetti, *supra* note 4.

¹⁵ See Letters from Schroder and SIA, *supra* note 4.

¹⁶ See NYSE Response Letter, *supra* note 5.

¹⁷ See Letters from Schroder and Global, *supra* note 4.

¹⁸ See NYSE Response Letter, *supra* note 5.

¹⁹ See Letters from Schroder, Global, and SIA, *supra* note 4.

²⁰ See SIA Letters, *supra* note 4.

²¹ See Global Letter, *supra* note 4.

that investor education initiatives may more effectively accomplish the objectives of the proposed requirements.²²

B. Exception Reports

One commenter believed that the proposed requirement that carrying firms provide a notice, on an annual basis, of reports offered to their introducing firms was unnecessary and served no ongoing useful purpose.²³ This commenter recommended that the DEA and introducing broker should be permitted to choose whether or not to receive such annual notices.²⁴ In response, the Exchange reaffirmed its belief that the annual notice would serve as an important regulatory tool for the introducing firm's DEA by enhancing the DEA's ability to conduct on-site examinations and by providing useful information regarding the specific data available to the introducing firm to monitor its customer accounts.²⁵ The NYSE further noted that the proposal would require carrying firms to provide information about updated, and possibly reformatted, reports that might be useful to the introducing firm, as well.²⁶

C. Negotiable Instruments

One commenter noted that the representations required of the introducing firm that it have supervisory procedures in place with respect to check writing that are "satisfactory" to the carrying firm places responsibility on the carrying firm that may be inconsistent with other requirements, noting that NYSE rule 382(b)(4) permits the responsibility for the receipt and delivery of funds to be allocated pursuant to the carrying agreement.²⁷ The NYSE stated that although the carrying firm, as the maker or drawer of the negotiable instrument, should be satisfied as to the adequacy of the introducing firm's procedures relating to the issuance of such negotiable instruments, the proposal was not intended "to impose supervisory obligations on the carrying organization that are not part of its contractual allocated responsibilities or part of its supervisory responsibilities pursuant to Rule 382."²⁸

²² See Amendment No. 1, *supra* note 6; see also NYSE Response Letter, *supra* note 5.

²³ See Global Letter, *supra* note 4.

²⁴ *Id.*

²⁵ See NYSE Response Letter, *supra* note 4.

²⁶ *Id.*

²⁷ See SIA Letter, *supra* note 4.

²⁸ See NYSE Response Letter, *supra* Note 5.

IV. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act²⁹ and the rules and regulations thereunder applicable to a national securities exchange.³⁰ The Commission believes that the proposed rule change is consistent with and furthers the objectives of Section (b)(5) of the Act³¹ in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

The Commission believes that the proposed rule change, by assisting the NYSE to better monitor the activities of introducing firms, should help to prevent fraudulent and manipulative acts and practices. The proposal and the companion proposal submitted by the NASD³² represent an important step toward addressing recent concerns about questionable sales practices and potentially fraudulent activity engaged in by some introducing firms.³³ The Commission expects that the proposed rules, by establishing procedures for the handling of customer complaints, the offer and receipt of exception reports, and the introducing firm's issuance of negotiable instruments of the carrying firm, should assist the SROs in their regulatory efforts. In addition, by requiring carrying firms to provide to their introducing firms copies of customer complaints and lists of available exception reports, the proposal should help introducing firms to better monitor their customer accounts.

A. Customer Complaints

The proposed customer complaint provisions of the proposal would require carrying firms to provide any written customer complaint they receive regarding the introducing firm to the introducing firm and the introducing firm's DEA. In addition, the proposal would require that the customer who submitted the written complaint be

²⁹ 15 U.S.C. 78f.

³⁰ In approving this rule, the Commission considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³¹ 15 U.S.C. 78f(b)(5).

³² The Commission is simultaneously approving the NASD's amended proposal, File No. SR-NASD-97-76.

³³ The Commission encourages the NYSE, the NASD, and others to continue to consider additional measures focusing on introducing and clearing firm processes that would assist in detecting and deterring fraudulent and manipulative activities.

notified in writing by the carrying firm that the complaint was received and that it was provided to the introducing firm and the DEA.

The Commission believes the proposed requirements relating to the handling of customer complaints received by carrying firms are reasonable. These procedures should enhance the ability of introducing firms and their DEAs to monitor complaints. In particular, DEAs and firms should be better able to identify patterns of complaints and to determine, for example, whether there is a problem with the firms' supervisory procedures, operations, or an individual registered representative. The Commission notes the commenters' concerns that the proposal is duplicative because existing NYSE Rule 351 requires member firms to report to the Exchange statistical and summary information regarding customer complaints.³⁴ The Commission, however, believes that because this proposal would require the submission of a copy of the actual complaint to the DEA, the proposed reporting requirements supplement, rather than duplicate, the existing reporting requirements.

Moreover, the Commission agrees with the commenters that the notification provisions, initially proposed, which required carrying firms to advise complaining customers of their right to transfer their accounts, could have created the perception that the subject of the customer's complaint warranted a transfer. Many customer complaints relate to operational issues, such as delayed dividend checks, and are easily resolved by the firm. The Commission believes that broader investor education initiatives designed to inform investors of their rights would more effectively achieve the same objectives without creating the possibility of unnecessary confusion. The Commission is working with the SROs on educational initiatives in this area. Accordingly, the Commission believes that the NYSE's proposal to delete the proposed notification provision is appropriate.

B. Exception Reports

The proposal also would require carrying firms to provide a list of all reports that are offered to their introducing firms and would require each introducing firm to provide its carrying firm with a list of specific reports requested. The proposal further would require carrying firms to provide to their introducing firms and the

introducing firms' DEA written annual notice, within 30 days of July 1, of the list of reports offered to each introducing firm and to specify those reports actually requested or supplied as of the report date.

Exception and other reports are important tools in the monitoring and supervision of customer accounts, from both a risk management and customer services perspective. For example, reports that flag unusual account activity or possible unauthorized trades may allow for early detection and correction of potential problems with a firm's supervisory procedures, operations, or an individual registered representative. In addition, the Commission believes that information regarding reports available and those reports requested as of a specific date should assist both the introducing firm in assessing its prospective needs and the introducing firm's DEA in its regulatory efforts.

Finally, the Commission notes that the proposed requirements relating to exception reports apply to all carrying firm/introducing firm relationships, regardless of the manner in which the date is transmitted from the carrying firm to the introducing firm. Therefore, the proposed rules are equally applicable to carrying agreements that provide for the transmission from the clearing firm to the introducing firm of raw data, rather than information organized in a formatted report. Under either scenario, the Commission expects the introducing firm to determine what information is needed for the proper supervision of its customer accounts, and to have the ability to use the data provided by its carrying firm in its supervisory efforts.

C. Exemption for Good Cause Shown

The NYSE is proposing to include an exemption from the customer complaint and exception report provisions of the proposal for those situations in which carrying firms are already performing these compliance functions for their introducing firm affiliates. The Commission believes that it is reasonable for the Exchange to have the authority to grant such an exemption in the limited circumstances in which the introducing firm is an affiliated entity of the carrying firm to avoid duplication of efforts.

In addition, the Commission notes that this proposed revision to the NYSE's original filing seeks to conform the Exchange's rule language to the amended proposal submitted by the NASD. The Commission believes that uniformity between the NYSE's and the NASD's rules in this area should ease

the compliance burden on introducing firms and their carrying brokers alike, as well as enhance the usefulness of the rules for the firms' respective DEAs.

D. Negotiable Instruments

The Commission believes that the proposed procedures to be followed by introducing firms that issue negotiable instruments for which the carrying firm is the maker or drawer are reasonable. Specifically, the Commission believes that it is appropriate for the introducing firm to be required to represent to the carrying firm that it has supervisory procedures in place, which it enforces, and which are satisfactory to the carrying firm. A carrying firm that finds that its introducing firm does not have minimal safeguards and procedures for the issuance of checks drawn on the carrying firm's account should, at a minimum, reexamine its relationship with the introducing firm. The Commission views the proposed requirement as a supplement to, rather than a replacement for, any other obligation or legal liability of the carrying firm as maker or drawer of the instrument.³⁵

The Commission finds good cause for approving proposed Amendment No. 1 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. In Amendment No. 1, the NYSE addresses the concerns raised in the seven comment letters received by the Commission on this proposal. Moreover, Amendment No. 1 modifies the original filing only slightly, in response to specific comments raised by interested parties. Specifically, Amendment No. 1 deletes the proposed rule language requiring carrying firms to include in their responses to customer complaints a statement regarding the customer's right to transfer the account to another broker-dealer. As discussed above, the Commission believes that alternative investor education initiatives to inform public customers of their rights as investors would be equally effective, without raising the possibility of customer confusion regarding whether the carrying firm believes such action is warranted. Amendment No. 1 also adds a good cause exclusion from certain provisions of the proposed rule in circumstances in which the introducing firm is an affiliated entity of the carrying firm and the carrying firm has assumed the responsibility for performing certain compliance functions for the introducing firm. As the modifications proposed in

³⁴ See Letters from Schroder and Global, *supra* note 4.

³⁵ See, e.g., NYSE Information Memo No. 96-4 (November 22, 1996); NYSE Interpretation Handbook, p. 561-62, (k)(2)(ii)/017.

Amendment No. 1 are reasonable and do not significantly alter the original proposal, the Commission believes that Amendment No. 1 raises no new issues of regulatory concern. Accordingly, the Commission believes that it is consistent with section 6 of the Act³⁶ to approve Amendment No. 1 to the proposed rule change on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 Room. Copies of all such filings will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR-NYSE-97-25 and should be submitted by July 1, 1999.

VI. Conclusion

The Commission believes that the proposal, as amended, should significantly assist the efforts of introducing firms and their DEAs to fulfill their supervisory responsibilities. Specifically, the Commission believes that, by ensuring that carrying firms provide introducing firms with important information about their customers' accounts and by requiring that the introducing firms have in place supervisory procedures with respect to their issuance of negotiable instruments, the proposed rules should enhance good business practices by introducing firms. Further, by requiring that introducing firms receive copies of customer complaints and exception and other reports about their customers' account, the proposal should assist introducing firms in more quickly identifying and addressing potential problems with their supervisory procedures, operations, or an individual registered representative. This should reduce the

risks to both the firm and its customers from questionable sales practice and potentially fraudulent activity.

In addition, the Commission believes that the proposal should also assist the regulatory efforts of the introducing firms' DEAs. Specifically, the Commission believes that the proposal may allow earlier detection by an introducing firm's DEA of potentially fraudulent activity, which will benefit investors and the public. Therefore, the Commission finds the approval of the proposed rule change, as amended, is consistent with the requirements of the Act applicable to a national securities exchange, and in particular, with the requirements of section 6(b)(5) of the Act³⁷ and the rules and regulations thereunder.

It Is Therefore Ordered, pursuant to section 19(b)(2) of the Act,³⁸ that the proposed rule change (SR-NYSE-97-25) is approved, as amended.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁹

Margaret H. McFarland,

Deputy Secretary.

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SMALL BUSINESS ADMINISTRATION

Data Collection Available for Public Comments and Recommendations

ACTION: Notice and request for comments.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995, this notice announces the Small Business Administration's intentions to request approval on a new, and/or currently approved information collection.

DATES: Comments should be submitted on or before August 9, 1999.

FOR FURTHER INFORMATION CONTACT: Curtis B. Rich, Management Analyst, Small Business Administration, 409 3rd Street, SW, Suite 5000, Washington, DC 20416. Phone Number: 202-205-7030.

SUPPLEMENTARY INFORMATION:

Title: "Trade Mission Online Company Profile Data".

Form No: 2111.

Description of Respondents: U.S. Small Business Exporters.

Annual Responses: 100,000.

Annual Burden: 50,000.

Comments: Send all comments regarding this information collection to Ken Fletcher, Program Analysts, Office

³⁷ 15 U.S.C. 78f(b)(5).

³⁸ 15 U.S.C. 78s(b)(2).

³⁹ 17 CFR 200.30-3(a)(12).

of International Trade, Small Business Administration, 409 3rd Street SW, Suite 8500, Washington, DC 20416. Phone No: 202-205-6436.

Send comments regarding whether this information collection is necessary for the proper performance of the function of the agency, accuracy of burden estimate, in addition to ways to minimize this estimate, and ways to enhance the quality.

Jacqueline K. White,

Chief, Administrative Information Branch.

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SMALL BUSINESS ADMINISTRATION

Delegation of Authority To Conduct Asset Sales of Loans and Other Properties

A. The Administrator of the Small Business Administration (the "Agency") Aida Alvarez pursuant to the authority vested in her by the Small Business Act, 72 Stat. 384, as amended and the Small Business Investment Act of 1958, 72 Stat. 689 as amended, hereby delegates to the Assistant Administrator for Portfolio Management the following authority to conduct sales in bulk of Agency assets including loans and properties.

1. To conduct a public sale of 7(a), 503, 504 and disaster business and home loans or portfolios of loans and properties that have been designated for the Asset Sales Program.

2. To enter into any and all agreements with lenders that are required to market and sell assets as part of the Asset Sales Program.

3. To remove any loans or properties from a particular sale or from the Asset Sales Program.

4. To oversee and take all necessary action in connection with the administration, servicing, collection and liquidation of any loan that has been designated for the Asset Sales Program.

5. To solicit bids from qualified bidders for the purchase of loan assets or properties held by the Agency or for which the Agency has been authorized to act as agent for their sale by participating lenders or third parties holding Agency guaranteed or direct loans.

6. To execute on behalf of SBA loan sale agreements and any other documents necessary to consummate the sale and transfer of certain loans and properties designated for the Asset Sales Program to successful bidders approved by the Deputy Administrator.

7. To take all necessary action in connection with matters related to the

³⁶ 15 U.S.C. 78f.