CBOE desires to implement the automatic system on a permanent basis for all classes of equity options, CBOE will make a subsequent filing to this effect under Section 19(b)(2) of the Act.

CBOE believes that the implementation of a pilot test of a system that, if successful, would permit the continued availability of CBOE's automatic execution system for public customer orders during the period when options are traded after the close of trading in the primary markets for underlying stocks and would assure that these orders are executed at fair prices in the event of significant news announcements, is in the interest of promoting just and equitable principles of trade and protecting investors and the public interest, and thus is consistent with the objectives of Section 6(b)(5) of the Act.

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

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

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

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

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

The Exchange has requested that the proposed rule change be given accelerated effectiveness pursuant to Section 19(b)(2) of the Act. 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 the requirements of Section 6(b)(5) thereunder.

The Commission believes that the Exchange's proposal provides a reasonable method of testing a system to address pending news announcements after the close of trading in the primary market for the underlying securities.[8] The Commission notes that the test will be limited to news announcements after the close of trading in the primary market for the underlying stock, while continuing to (1) ensure prompt execution of customer orders in the particular class subject to a news announcement by rerouting such orders to a PAR workstation and (2) make RAES executions available in classes of options not subject to news announcements during the time when options continue to be traded after the close of trading in the primary market for underlying stocks.

As noted, the CBOE intends to evaluate the pilot in several respects to determine if it wants to implement the system on a permanent basis.[9] The CBOE will provide the Commission with the analysis of the pilot.

The Commission finds good cause for approving this proposed rule change, as amended, on an accelerated basis prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. Specifically, the Commission believes that accelerated approval of the proposal, as amended, is appropriate because it is to be implemented for a limited 30-day period which will provide CBOE with the time to test the effectiveness of the system.

Accordingly, the Commission believes that it is consistent with Section 6(b)(5) of the Act to approve the proposed rule change, as amended, on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing and Amendment Nos. 1 and 2. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to File No. SR–CBOE–96–37 and should be submitted by July 26, 1996.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR–CBOE–96–37), as amended, is hereby approved for a 30-day pilot period, on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[10]

Jonathan G. Katz,

Secretary.

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[8] See Amendment No. 2, *supra* note 4.

[9] The pilot expires at 3:10 p.m. central time on July 26, 1996. Any request for an extension of the pilot period or request for permanent approval of the system would have to be submitted to the Commission pursuant to Section 19(b)(2) of the Act.

[10] 17 CFR 200.30–3(a)(12).

[Release No. 34–37377; File No. SR–NASD–96–22]

Self-Regulatory Organizations; Notice of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to an Extension of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature Until January 31, 1997

June 27, 1996.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on June 10, 1996, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items, I, II, and III below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The NASD proposes to extend, until January 31, 1997, the effectiveness of certain rules governing the operation of the Nasdaq Stock Market, Inc.'s (''Nasdaq'') Small Order Execution System (''SOES''). Specifically, these SOES rules, which were previously approved by the Commission on a pilot basis on December 23, 1993[2] and recently extended through July 31, 1996,[3] provide for: (1) a reduction in the minimum exposure limit for unpreferenced SOES orders from five times the maximum order size to two times the maximum order size, and for the elimination of exposure limits for preference orders (''SOES Minimum Exposure Limit Rule''); and (2)

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

[2] *See* Securities Exchange Act Release No. 33377 (December 23, 1993), 58 FR 69419 (December 30, 1993) (''Interim SOES Rules Approval Order'').

[3] *See* Securities Exchange Act Release No. 36795 (January 31, 1996), 61 FR 4504 (February 6, 1996) (''Interim SOES Rules Extension Order'').

implementation of an automated function for updating market maker quotations when the market maker's exposure limit has been exhausted (''SOES Automated Quotation Update Feature''). These rules are part of a set of SOES rules approved by the SEC on a pilot basis known as the Interim SOES Rules.[4]

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

In its filing with the Commission, the NASD 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. The NASD 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

The Commission originally approved the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature on a one-year pilot basis in December 1993, along with two other SOES rules which have since lapsed.[5] Since December 1993, the SEC has approved four NASD proposals to extend the effectiveness of the rules, with the most recent approval extending the rules through July 31, 1996.[6] With this filing the NASD proposes to further extend the effectiveness of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature until January 31, 1997, so that the rules can continue on an uninterrupted basis until the SEC has had an opportunity to consider Nasdaq's proposed NAqcess system.

As described in more detail below, because the NASD believes implementation of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature have been associated with positive developments in the markets for Nasdaq securities and clearly have not had any negative effects on market quality, the NASD believes it is appropriate and consistent with the maintenance of fair and orderly markets and the protection of investors for the Commission to approve a further limited extension of the effectiveness of these rules. The NASD believes the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature reflect a reasoned approach by the NASD to address the adverse effects on market liquidity attributable to active intra-day trading activity through SOES, while at the same time not compromising the ability of small, retail investors to receive immediate executions through SOES. Specifically, these rules are designed to address concern that concentrated, aggressive use of SOES by a growing number of order entry firms has resulted in increased volatility in quotations and transaction prices, wider spreads, and the loss of liquidity for individual and institutional investor orders.

The NASD believes that the same arguments and justifications made by the NASD in support of approval of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature and four extensions of these rules are just as compelling today as they were when the SEC relied on them to initially approve these rules. In sum, the NASD continues to believe that concentrated bursts of SOES activity by active order-entry firms contribute to increased short-term volatility, wider spreads, and less market liquidity on Nasdaq and that the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature are an effective means to minimize these adverse market impacts. In addition, given the increased utilization of SOES since the SOES Maximum Order Size Rule lapsed at the end of March 1995, the NASD believes it is even more imperative that the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature remain in effect to help to ensure the integrity of the Nasdaq market and prevent waves of SOES orders from a handful of SOES order-entry firms from degrading market liquidity and contributing to excessive short-term market volatility.

The NASD notes that the SEC made specific findings in the Interim SOES Rules Approval Order that the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature were consistent with the Act. In particular, the SEC stated in its approval order that:

a. Because the benefits for market quality of restricting SOES usage outweigh any potential decrease in pricing efficiency, the Commission concludes that the net effect of the proposal is to remove impediments to the mechanism of a free and open market and a national market system, and to protect investors and the public interest, and that the proposed rule changes are designed to produce accurate quotations, consistent with Sections 15A(b)(6) and 15A(b)(11) of the Act. In addition, the Commission concludes that the benefits of the proposal in terms of preserving market quality and preserving the operational efficiencies of SOES for the processing of small size retail orders outweigh any potential burden on competition or costs to customers or broker-dealers affected adversely by the proposal. Thus, the Commission concludes that the proposal is consistent with Section 15A(b)(9) of the Act in that it does not impose a burden on competition which is not necessary or appropriate in furtherance of the purposes of the Act.[7]

b. The Commission also concludes that the proposal advances the objectives of Section 11A of the Act. Section 11A provides that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure economically effective execution of securities transactions, fair competition among market participants, and the practically of brokers executing orders in the best market. The Commission concludes that the proposal furthers these objectives by preserving the operational efficiencies of SOES for the processing of small orders from retail investors.[8]

c. The Commission believes that it is appropriate to restrict trading practices through SOES that impose excessive risks and costs on market makers and jeopardize market quality, and which do not provide significant contributions to liquidity or pricing efficiency. * * * The Commission believes that it is more important to ensure that investors seeking to establish or liquidate an inventory position have ready access to a liquid Nasdaq market and SOES than to protect the ability of customers to use SOES for intra-day trading strategies.[9]

d. The Commission believes that there are increased costs associated with active intra-day trading activity through SOES that undermine Nasdaq market quality. * * * Active intra-day trading activity through SOES can also contribute to instability in the market.[10]

e. In addition, these waves of executions can make it difficult to maintain orderly markets. Given the increased volatility

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[4] As first approved by the Commission on December 23, 1993, the Interim SOES Rules has four components: (1) the SOES Minimum Exposure; (2) the Automated Quotation Update; (3) a reduction in the maximum size order eligible for executive through SOES from 1,000 shares to 500 shares (''SOES Maximum Order Size''); and (4) the prohibition of short sales through SOES. The SOES Maximum Order Size Rule lapsed effective March 28, 1995 and the rule prohibiting the execution of short sales through SOES lapsed effective January 26, 1995.

[5] *See* Interim SOES Rules Approval Order, *supra* note 2.

[6] *See* Interim SOES Rules Extension Order, *supra* note 3, and Securities Exchange Act Release Nos. 35275 (January 25, 1995), 60 FR 6327 (February 1, 1995); 35535 (March 27, 1995), 60 FR 16690 (March 31, 1995); and 36311 (September 29, 1995), 60 FR 52438 (October 6, 1995) (''October 1995 Extension Order'').

[7] Interim SOES Rules Approval Order, *supra* note 2, 58 FR at 69423.

[8] *Id.*

[9] *Id.* at 69424–25.

[10] *Id.*

associated with these waves of intra-day trading activity, market makers are subject to increased risks that concentrated waves of orders will cause the market to move away. As a result, individual market makers may be unwilling to narrow the current spread and commit additional capital to the market by raising the bid or lowering the offer. When market makers commit less capital and quote less competitive markets, prices can be expected to deteriorate more rapidly. Accordingly, the Commission believes that it is appropriate for the NASD to take measured steps to redress the economic incentives for frequent intra-day trading inherent in SOES to prevent SOES activity from having a negative effect on market prices and volatility.[11]

f. The Commission does not believe the intra-day trading strategies through SOES contribute significantly to market efficiency in the sense of causing prices to reflect information more accurately.[12]

g. The Commission has evaluated each of the proposed modifications to SOES, and concludes that each of the modifications reduces the adverse effects of active trading through SOES and better enables market makers to manage risk while maintaining continuous participation in SOES. In addition, the Commission does not believe that any of the modifications will have a significant negative effect on market quality. To the extent that any of the modifications may result in a potential loss of liquidity for small investor orders, the Commission believes that these reductions are marginal and are outweighed by the benefits of preserving market maker participation in SOES and increasing the quality of executions for public and institutional orders as a result of the modifications.[13]

h. The Commission * * * has determined that the instant modifications to SOES further the objectives of investor protection and fair and orderly markets, and that these goals, on balance, outweigh any marginal effects on liquidity for small retail orders, and any anti-competitive effects on order entry firms and their customers. The Commission concludes that the ability of active traders to place trades through a system designed for retail investors can impair market efficiency and jeopardize the level of market making capital devoted to Nasdaq issues. The Commission believes that the rule change is an appropriate response to active trading through SOES, and that the modifications will reduce the effects of concentrated intra-day SOES activity on the market.[14]

The NASD believes these significant statutory findings by the SEC regarding the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature and the SEC's assessment of the likely benefits to the marketplace that would result from the rules have been confirmed and substantiated by econometric studies on the effectiveness of the Interim SOES Rule conducted by the NASD's Economic Research Development[15] and an independent economist commissioned by the NASD.[16] When the SEC approved the Interim SOES Rules, it stated that ''[a]ny further action the NASD seeks with respect to SOES—extension of these modifications upon expiration, or introduction of other changes—will require independent consideration under Section 19 of the Act.'' [17] In addition, the SEC stated that, should the NASD desire to extend these SOES changes or modify SOES, the Commission would expect ''the NASD to monitor the quality of its markets and assess the effects of the approved SOES changes on market quality for Nasdaq securities.'' Also, if feasible, the SEC instructed the NASD to provide a quantitative and statistical assessment of the effects of the SOES changes on market quality; or, if an assessment is not feasible, the SEC stated that the NASD should provide a reasoned explanation supporting that determination.

In sum, the NASD's study found that:

- Since the SOES changes went into effect in January 1994, the statistical evidence indicated that when average daily volume, stock price, and stock price volatility are held constant through regression techniques, quoted percentage spreads in Nasdaq securities experienced a decline in the immediate period following implementation of the changes and have continued to decline since then. The statistical evidence also showed that the narrowing of quoted percentage spreads became more pronounced and robust the longer the Interim SOES Rules were in effect. In particular, quoted spreads in cents per share for the 500 largest Nasdaq National Market (''NNM'') securities experienced a sharp decline from April 28 to May 12 and from June 23 to July 18.[18]
- With the exception of a brief, market-wide period of volatility experienced by stocks traded on Nasdaq, the New York Stock Exchange, and the American Stock Exchange during the Spring, the volatility of Nasdaq securities appears to be unchanged in the period following implementation of the changes; and
- A smaller percentage of Nasdaq stocks experienced extreme relative price volatility after implementation of the rules and that these modifications, in turn, suggest a reduction in relative volatilities since the rules were put into effect.

The Furbush Study found that there was a statistically significant improvement in effective spreads for the top 100 Nasdaq stocks (based on dollar volume) during the three month period following implementation of the rules. Moreover, the study also found that the most significant improvement in effective spreads for the top 100 stocks occurred for trade sizes between 501 and 1,000 shares, precisely the level that was made ineligible for SOES trading by the Interim SOES Rules. In addition, the study found that the average number of market makers for the top ten Nasdaq-listed stocks increased from 44.3 to 46.0, or 3.8 percent, and from 30.2 to 30.9 for the top 100 stocks, or 2.3 percent. Although correlation does not necessarily imply causation, as noted by the SEC when it approved the Interim SOES Rules and extensions of the Interim SOES Rules, the NASD believes that positive market developments clearly have been associated with implementation of the Interim SOES Rules.

The NASD also believes that these studies of the effectiveness of the Interim SOES Rules lend credence to another NASD study that was submitted to the SEC in support of approval of the Interim SOES Rules.[19] In the May 1993 SOES Study, the NASD found that concentrated waves of orders entered into SOES by active order-entry firms resulted in discernible degradation to the quality of the Nasdaq market. Specifically, the study found, among other things, that: (1) Bursts of orders entered into SOES by active order entry firms frequently result in a decline in the bid price and a widening of the bid-ask spread; (2) that there is a significant

[11] *Id.* at 69425–26.

[12] *Id.*

[13] *Id.*

[14] *Id.* at 69429.

[15] *See* letter from Gene Finn, Vice President & Chief Economist, NASD, to Katherine England, Assistant Director, National Market System & OTC Regulation, SEC, dated October 24, 1994 (letter submitted in connection with the NADD'S)N•PROVE filing, SR–NASD–94–13).

[16] The Association Between the Interim SOES Rules and Nasdaq Market Quality, Fear Furbush, Ph D.

[17] Interim SOES Rules Approval Order , *Supra* note 2, 59 FR at 69429.

[18] Some press reports have attributed the recent decline in spreads for Nasdaq stocks to the publication, on May 26 and 27, 1994, of newspaper articles in The Wall Street Journal, The Los Angeles Times and other publications reporting the results of an economic study conducted by two academicians that illustrated the lack of odd-eighth quotes for active Nasdaq stocks. Contrary to these press reports, this study shows that spreads had indeed narrowed before publication of these articles (from April 28 to May 12), stabilized at these narrower levels from mid-May until June 23, and declined again from June 23 to July 18.

[19] *See* NASD Department of Economic Research: Impact of SOES Active Trading Firms on Nasdaq Market Quality (May 12, 1993) (''May 1993 SOES Study''). *See also* Securities Exchange Act Release No. 32313 (May 17, 1993), 58 FR 29647 (publication of the study for comment).

positive relationship between increases in spreads and volume attributable to active order-entry firms as it related to total SOES volume per security; and (3) activity by active order-entry firms resulted in higher price volatility and less liquidity—higher price changes are associated with high active trading firm volume, even after controlling for normal price fluctuations.

The NASD also believes market activity since the SOES Maximum Order Size Rule lapsed on March 28, 1995, provides further support for the effectiveness of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature and the NASD's economic rationale for these rules. In particular, an analysis prepared by the NASD's Economic Research Department clearly illustrates that there has been a dramatic increase in SOES volume since the SOES Maximum Order Size Rule lapsed and that many market maker positions have been abandoned. These two phenomena appear to be linked. Those Nasdaq stocks that have experienced the greatest decline in the number of market makers are the ones that have experienced the greatest increase in SOES volume since the rule lapsed.[20] The NASD believes these figures indicate that the relaxation of one of the Interim SOES Rules may have contributed to some of the adverse market developments that the NASD was seeking to avoid through implementation of the Interim SOES Rules (*e.g.*, degradation in market maker participation and market liquidity).[21] Accordingly, the NASD believes that any further relaxation of the Interim SOES Rules by permitting the SOES Minimum Exposure Limit Rule or the SOES Automated Quotation Update Feature to lapse would further harm the Nasdaq market. In light of the significance of these figures and their indicated adverse ramifications upon the Nasdaq market, the NASD also believes that SEC reconsideration of its position with respect to the entry of 1,000-share orders into SOES is warranted.

The NASD also has prepared another report that the NASD believes illustrates that the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature have had no adverse impact on the market for Nasdaq securities.[22] This report was in response to the Commission's request in the Interim SOES Rules Extension Order that the NASD:

> monitor the extent to which exposure limits are exhausted, the extent to which the automated quotation update feature is used, and the effects these two aspects have on liquidity. Moreover, the Commission expects the NASD to consider the possibility of enhancements to eliminate the potential for delayed and/or inferior executions.[23]

In sum, the December 1995 Monitoring Report found that it is a very infrequent occurrence for a market maker to have its exposure limit exhausted in a NNM security. In particular, from the period October 2, 1995 to November 22, 1995, there were, on average, 83 instances per day where a market maker's exposure limit in NNM securities was exhausted.[24] Thus, given the fact that there was an average of 44,062 market making positions in NNM securities and 3,932 NNM securities trading per day during this time period, the impact of these individual exposure limit exhaustions on the availability of SOES to investors throughout the trading day was infinitesimal. Each market making position experienced .0019 exposure limit exhaustions per day over this time period and each NNM security experienced .0211 exhaustions per day. Moreover, while Nasdaq could not readily determine the extent to which the exposure limit exhaustions occurred simultaneously in the same security, given the stark infrequency with which the exposure limit exhaustions occurred, the NASD believes it is extremely improbable that a NNM security would experience a situation where the SOES exposure limits for all market makers in that stock were exhausted at the same time. Indeed, this conclusion is borne out by the extremely short time-span in which SOES orders are executed. Specifically, the report shows that, on average, SOES orders are executed 1.62 seconds after entry and that 98.5 percent of all SOES orders are executed within three seconds.[25]

The report also showed that SOES exposure limit exhaustions tend to cluster in active NNM securities with high numbers of market makers. This further illustrates the extremely low probability that all market makers in the same security would ever have their exposure limits exhausted simultaneously. Lastly, examining one trading day, the report shows that active SOES order entry firms accounted for 92 percent of the exposure limit exhaustion, as might be expected given that these firms account for 89 percent of SOES dollar volume. Accordingly, the NASD and Nasdaq believe that the SOES Minimum Exposure Limit Rule has had a very negligible, if any, impact on the availability of SOES to small, retail investors.

The report also found that the Automated Quotation Update Feature appears to be used extensively by some market making firms. Specifically, the report shows that the quote update feature is sued by 126 market makers for 10,646 market making positions. Thus, this feature is currently being used by 26 percent of the market makers and for 24 percent of all market making positions. In addition the report showed that, on average, 3,394 quotations a day were generated by the quote update feature from October 2, 1995 to November 21, 1995. Accordingly, the NASD and Nasdaq believe that the Automated Update Feature has effectively served its intended purpose of helping to maintain continuous quotations in Nasdaq, minimize ''closed quote'' conditions, and avoid unexcused market maker withdrawals, thereby promoting market liquidity.

Accordingly, the NASD believes the Commission should properly view these two SOES rules as strictures that are highly correlated with improvements in market liquidity, not as rules that have had or could have a damaging effect on liquidity. The NASD and Nasdaq also believe the monitoring report illustrates that implementation of the Automated Quotation Update Feature and the SOES Minimum Exposure Limit Rule have not diminished the significant benefits provided to investors through the automatic execution capabilities of SOES. Simply put, these two SOES rules have in no way altered the operation of SOES as an automatic

[20] *See* letter from Richard G. Ketchum, Executive Vice President & Chief Operating Officer, NASD, to Brandon Becker, Director, Division of Market Regulation, SEC, dated August 1, 1995.

[21] The NASD believes that elimination of the ban against short sales through SOES did not have a dramatic negative market effect because the NASD's short sale rule was approved during the time that the ban was in effect.

[22] *See* Monitoring Report of Exhaustion of SOES Exposure Limits and the Usage of Nasdaq Automated Quotation Update Feature, NASD Economic Research Department, December 18, 1995.

[23] October 1995 Extension Order, *supra* note 6, 60 FR at 52439, n. 12 (''December 1995 Monitoring Report'').

[24] The highest number of exposure limits exhausted on any day during this period was 119 on November 21, 1995 and the lowest number was 47 on October 4, 1995.

[25] The report also found that SOES orders can experience brief execution delays in isolated instances, as one order took as long as 87 seconds to be executed. While the NASD could not readily identify the reasons for these infrequent execution delays, the NASD believes these delays are likely the result of two factors. First, consistent with the NASD's short-sale rule, short sales entered into SOES cannot be executed on down bids. Second, waves of SOES orders transmitted by active SOES order-entry firms cause queues to develop in the processing of SOES orders, which, in turn, causes execution delays.

execution system that affords small, retail investors immediate execution at the inside market. However, as noted in the NASD's proposed NAqcess filing, the NASD believes the limit order processing capabilities and order execution algorithm of SOES could be significantly improved upon for the benefit of small investors and the market place as a whole.

Moreover, in the Interim SOES Rules Extension Order, an order approving a proposal identical to the NASD's instant proposal, the SEC found that the continued effectiveness of the SOES Minimum Exposure Limit Rule ''provides customers fair access to the Nasdaq market and reasonable assurance of timely executions.'' [26] With respect to the SOES Automated Quotation Update Feature, the SEC also stated that it believes ''that extending the automated update function is consistent with the Act and, in particular, the Firm Quote Rule. The update function provides market makers the opportunity to update their quotations automatically after executions through SOES; under the Commission's Firm Quote Rule, market makers are entitled to update their quotations following an execution and prior to accepting a second order at their published quotes.'' [27]

Therefore, in light of the above-cited statutory findings made by the SEC when it first approved the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature and extensions of these rules, coupled with the NASD's findings that these rules have been associated with positive market developments in terms of lower spreads on Nasdaq and fewer stocks with extreme relative price volatility, the NASD believes it would be consistent with the Act for the Commission to extend the effectiveness of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature for an additional six-month period. Moreover, even if the Commission is unwilling to find positive significance in the NASD's statistical analyses, at the very least, these studies indicate that the market has not been harmed by implementation of these rules.[28] Indeed, the Commission clearly stated in the Interim SOES Rules Extension Order that the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature have not had a detrimental effect on the Nasdaq market: ''the Commission * * * continues to believe that the data submitted by the NASD demonstrates * * * [no] serious deterioration in the quality of the Nasdaq market subsequent to the adoption of the January 1994, January 1995, March 1995, and September 1995 Amended SOES Rules.'' [29]

The NASD believes that the proposed rule change is consistent with Sections 15A9b)(6), 15A(b)(9), 15A(b)(11) and 11A(a)(1)(C) of the Act. Among other things, Section 15A(b)(6) requires that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. Specifically, the NASD is proposing to extend the effectiveness of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature until January 31, 1997 because of concerns tat concentrated, aggressive use of SOES by a growing number of order entry firms has resulted in increased volatility in quotations and transaction prices, wider spreads, and the loss of liquidity for individual and institutional investor orders, all to the detriment of public investors and the public interest. The NASD believes the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature have operated to rectify this situation while continuing to provide an effective opportunity for the prompt, reliable execution of small orders received from the investing public. Accordingly, in order to protect investors and the public interest, the NASD believes the SEC should approve an additional six-month extension of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature through January 31, 1997, so that small investors' orders will continue to receive the fair and efficient executions that SOES was designed to provide.

Section 15A(b)(9) provides that the rules of the Association may not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature apply across the board and do not target any particular user or participant, as all dealers may set their exposure limits at two times the tier size and all dealers may elect to utilize the automated quote update feature. Accordingly, the NASD believes that these rule changes are not anti-competitive, as they are uniform in application and they seek to preserve the ability of SOES to provide fair and efficient automated executions for small investor orders, while preserving market maker participation in SOES and market liquidity.

Section 15A(b)(11) empowers the NASD to adopt rules governing the form and content of quotations relating to securities in the Nasdaq market. Such rules must be designed to produce fair and informative quotations, prevent fictitious and misleading quotations, and promote orderly procedures for collecting and distributing quotations. The NASD is seeking to continue the effectiveness of SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature so that SOES activity may not result in misleading quotations in the Nasdaq market. Market makers place quotes in the Nasdaq system and these quotes comprise the inside market and define the execution parameters of SOES. When volatility in the SOES environment causes market makers to widen spreads or to change quotes in anticipation of waves of SOES orders, quotes in the Nasdaq market become more volatile and may be misleading to the investing public. Accordingly, absent continuation of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature, the quotations published by Nasdaq may not reflect the true market in a security and, as a result, there may be short-term volatility and loss of liquidity in Nasdaq securities, to the detriment of the investing pubic. Further, the continuation of the automated refresh feature will ensure

[26] Interim SOES Rules Extension Order, *supra* note 3, 61 FR at 4505.

[27] *Id.* (footnotes omitted).

[28] Even if the Commission concludes that the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature have had no impact on market quality, the NASD believes the Commission's approval of New York Stock Exchange (''NYSE'') Rule 80A on a permanent basis illustrates that the Commission would still have a sufficient basis to approve an extension of the rules for a four-month period. In particular, the SEC's discussion of the statutory basis for approval of NYSE Rule 80A focused in large part on the fact that Rule 80A did not have any adverse impacts on market quality on the NYSE and that, as a result, the NYSE should be given the latitude to take reasonable steps to address excessive volatility in its marketplace. *See* Securities Exchange Act Release No. 29854 (October 24, 1994), 56 FR 55963 (October 30, 1994). Accordingly, the NASD believes the SEC should afford the NASD the same regulatory flexibility that it afforded the NYSE to implement rules reasonably designed to enhance the quality of Nasdaq and minimize the effects of potential disruptive trading practice.

[29] Interim SOES Rules Extension Order, *supra* note 3, 61 FR at 4506.

that a market maker's quotation is updated after an exposure limit is exhausted. Uninterrupted use of this function will maintain continuous quotations in Nasdaq as market makers exhausting their exposure limits in SOES will not be subject to a ''closed quote'' condition or an unexcused withdrawal from the market.

Finally, the NASD believes that the proposed rule change is consistent with significant national market system objectives contained in Section 11A(a)(1)(C) of the Act. This provision states it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure, among other things: (i) Economically efficient execution of securities transactions; (ii) fair competition among brokers and dealers; and (iii) the practicality of brokers executing investor orders in the best market. Specifically, the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature advance each of these objectives by preserving the operational efficiencies of SOES for the processing of small investors' orders, by maintaining current levels of market maker participation through reduced financial exposure from unpreferenced orders, and by reducing price volatility and the widening of market makers' spreads in response to the practices of order entry firms active in SOES.

In addition, for the same reasons provided by the SEC when it approved the Interim SOES Rules that are cited above in the text accompanying footnotes 6 through 13, the NASD believes that the proposed rule change is consistent with Sections 15A(b)(6), 15A(b)(9), 15A(b)(11) and 11A(a)(1)(C) of the Act.

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

The NASD believes that the proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Comments were neither solicited nor received.

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

Within 35 days of the date of 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 NASD consents, the Commission will:

A. By order approve such 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, 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 in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File Number SR–NASD–96–22 and should be submitted by July 26, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[30]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–17144 Filed 7–3–96; 8:45 am]

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[Release No. 34–37381; File Nos. SR–NSCC–96–09; SR–SCCP–96–02]

Self-Regulatory Organizations; National Securities Clearing Corporation; Stock Clearing Corporation of Philadelphia; Notice of Filing and Order Granting Permanent Approval on an Accelerated Basis of Proposed Rule Changes Relating to the Guarantee of Trades in Continuous Net Settlement Systems

June 28, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that the National Securities Clearing Corporation (''NSCC'') and Stock Clearing Corporation of Philadelphia (''SCCP'') (collectively referred to as ''Clearing Corporations'') filed with the Securities and Exchange Commission (''Commission'') on April 3, 1996, and May 8, 1996, respectively, the proposed rule changes as described in Items I and II below, which items have been prepared primarily by the Clearing Corporations. On May 8, 1996, SCCP filed an amendment to the proposed rule change to remove from consideration certain proposed amendments to its clearing fund calculations.[2] The proposals seek permanent approval of rule changes relating to the guarantee of trades in the Clearing Corporations' continuous net settlement (''CNS'') systems. The Commission is publishing this notice and order to solicit comments on the proposed rule changes from interested persons and to grant accelerated permanent approval of the proposed rule changes.

I. Self-Regulatory Organizations' Statement of the Terms of Substance of the Proposed Rule Changes

The proposals seek permanent approval of proposed rule changes to which the Commission has granted temporary approval.[3] The proposals authorize the Clearing Corporations to guarantee at an earlier time the settlement of participant trades in their CNS systems. In addition, NSCC's

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[30] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1) (1988).

[2] Letter from J. Keith Kessel, Compliance Officer, SCCP, to Peter R. Geraghty, Senior Counsel, Commission (May 8, 1996). The amendment also requested permanent approval of SCCP's CNS guarantee procedures.

[3] The proposals, along with a similar proposal submitted by the Midwest Clearing Corporation (''MCC''), were originally approved on a temporary basis in 1989. For a complete discussion of these proposals, refer to Securities Exchange Act Release Nos. 27192 (August 29, 1989), 54 FR 37010 (approving File Nos. SR–NSCC–87–04, SR–MCC–87–03, and SR–SCCP–87–03 until December 31, 1990). In addition, the Commission has temporarily extended the respective proposals on six previous occasions in Securities Exchange Act Release Nos. 28728 (December 31, 1990), 56 FR 717 (approving File Nos. SR–NSCC–90–25, SR–MCC–90–08, and SR–SCCP–90–03 until June 30, 1991); 29388 (June 28, 1992), 56 FR 30951 (approving File Nos. SR–NSCC–91–06, SR–MCC–91–03, and SR–SCCP–91–03 through June 30, 1992); 30879 (July 1, 1992), 57 FR 30279 (approving File Nos. SR–NSCC–92–04, SR–MCC–92–07, and SR–SCCP–92–02 through June 30, 1993); 32547 (June 29, 1993), 58 FR 36491 (approving File Nos. SR–NSCC–93–04, SR–MCC–93–02, and SR–SCCP–93–02 through June 30, 1994); and 33996 (June 27, 1994), 59 FR 33996 (approving File Nos. SR–NSCC–94–09, SR–MCC–94–06, and SR–SCCP–94–02 through June 30, 1995); and 35916 (June 28, 1995), 60 FR 35575 (July 10, 1995) (approving File Nos. SR–NSCC–95–04, SR–MCC–95–02, and SR–SCCP–95–03). On January 5, 1996, MCC withdrew from the securities clearance business. Securities Exchange Act Release No. 36684 (January 5, 1996), 61 FR 1195 (order approving File No. SR–MCC–95–04).