

a security interest or other limited interest in the securities (*i.e.*, a pledge).⁵

Under the proposed rule change, any organization that is eligible to establish a pledgee account (*i.e.*, "receiver") at DTC may establish a repo account. Consequently, a participant engaging in a repo or other type of financing transaction will be able to deliver securities to the receiver's repo account instead of the receiver's pledgee account.⁶ DTC will deem instructions to deliver securities to a repo account as instructing DTC to transfer to the receiver the entire interest in the securities and not just a security interest or other limited interest.⁷

DTC will accept instructions solely from a receiver with respect to the disposition of securities credited to the receiver's repo account. The receiver may instruct DTC to deliver securities credited to its repo account to its DTC participant account if the receiver is also a DTC participant or to any other DTC participant account.⁸ Any receiver

⁵ According to DTC, many of its participants use the CLP to effect repos.

⁶ The instructions for a delivery of securities to a repo account use the same data fields as the instructions for a pledge to a pledgee account, which includes a mandatory hypothecation code field. A participant delivering securities to a repo account must enter the number seven, eight, or nine in the hypothecation code field. The entry of the number seven, eight, or nine in the hypothecation code field of instructions for a delivery to a repo account does not constitute a notice or representation as to any matter by the delivering participant. The entry of the number seven, eight, or nine in the hypothecation code field of such instructions is merely an action needed to effect the delivery through DTC's facilities. A participant pledging securities to a pledgee account must continue to enter the number one, two, or three, whichever is applicable, in the hypothecation code field. Participants are responsible for entering the appropriate number in the hypothecation field for all transactions. Letter from Carl Urist, Deputy General Counsel, DTC (August 7, 1997).

⁷ According to DTC's proposed procedures for repo accounts, the operation of a repo account will be identical to the operation of a pledgee account. As with a pledgee account: (1) the voting rights on securities credited to a repo account will be assigned to the participant that delivered the securities to the repo account; (2) cash dividend and interest payments and other cash distributions on the securities will be credited to the account of the delivering participant; (3) distributions of securities for which the exdistribution date is on or prior to the payable date or in which the distribution is payable in a different security will be credited to the account of the delivering participant; and (4) any stock splits or other distributions of the same securities for which the ex-distribution date is after the payable date will be credited to the repo account of the receiver. Also, the reports and statements that DTC sends to participants and receivers for transactions involving repo accounts will be the same as the reports that DTC generates for a pledgee account except that such reports and statements will carry a repo account number.

⁸ According to DTC, there are a small number of non-member banks that maintain pledge accounts at DTC. Conversation with Carl H. Urist, Deputy General Counsel, DTC (August 22, 1997).

that instructs DTC to deliver securities credited to its repo account to another receiver or to a DTC participant other than the original delivering participant will be required to provide DTC with certain warranties and must indemnify DTC, its stockholders, and certain employees against potential liability.⁹

II. Discussion

Section 17A(b)(3)(F)¹⁰ of the Act requires that the rules of a clearing agency be designed to safeguard securities and funds in DTC's custody or control or for which it is responsible. The Commission believes that DTC's proposed rule change is consistent with DTC's obligations under the Act because the new procedures should enable DTC participants to avoid any confusion as to whether a securities transfer is actually the sale of a security or the pledge of a security as collateral. Consequently, the procedures should reduce the potential for the inadvertent delivery of dividend payments, proxy materials, or other items to the wrong party.

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act and the rules and regulations thereunder.

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-97-05) be, and hereby is, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-23005 Filed 8-28-97; 8:45 am]

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⁹ The indemnification provides protection from liability that may arise in the event that, unknown to DTC, at the time of the transfer there was a filing by the Securities Investor Protection Corporation or other court order that prohibited such transfer. *Id.*

¹⁰ 15 U.S.C. 78q-1(b)(3)(F).

¹¹ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38961; File No. SR-NASD-97-16]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 3 Relating to the Revision of the Criteria for Initial and Continued Listing on The Nasdaq Stock Market, Inc.

August 22, 1997.

I. Introduction

On March 3, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder² to revise its listing and maintenance standards for Nasdaq National Market ("NNM") and SmallCap designated issuers. On March 27, 1997, the NASD filed Amendment No. 1 to the proposal.³ On April 1, 1997, the NASD filed Amendment No. 2 to the proposal.⁴ On June 17, 1997, the NASD filed Amendment No. 3 to the proposal.⁵

Notice of the substance of the proposed rule change and Amendment Nos. 1 and 2 was provided by issuance of a release⁶ and by publication in the **Federal Register**.⁷ Eight comment letters regarding the proposed rule change

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

³ Letter from Robert E. Aber, Vice President and General Counsel, Nasdaq, to Katherine England, Assistant Director, Commission (March 27, 1997) ("Amendment No. 1"). Amendment No. 1 makes technical and conforming changes to the proposed rule filing.

⁴ Letter from Robert E. Aber, Vice President and General Counsel, Nasdaq, to Katherine England, Assistant Director, Commission (April 1, 1997) ("Amendment No. 2"). Amendment No. 2 makes technical and conforming changes to the proposed rule filing.

⁵ Letter from Robert E. Aber, Vice President and General Counsel, Nasdaq, to Katherine England, Assistant Director, Commission (June 17, 1997) ("Amendment No. 3"). Amendment No. 3 makes technical and conforming changes to the proposed rule filing, correcting clerical errors and defining terms used in the rule language. For example, Amendment No. 3 defines two abbreviations used in the rules, as well as the terms "Market Value" and "Country of Domicile."

⁶ Exchange Act Release No. 38469 (April 2, 1997).

⁷ 62 FR 17262 (April 9, 1997).

were received.⁸ This order approves the proposed rule change, as amended, and approves Amendment No. 3 on an accelerated basis.

II. Description of the Proposal

The NASD has filed with the Commission a proposal to revise the Rule 4300 and 4400 Series governing the listing and maintenance standards for NNM and SmallCap designated issuers. Listing and maintenance standards for NNM issuers were last modified on January 9, 1989.⁹ SmallCap listing and maintenance standards were last modified on August 30, 1991.¹⁰

The NASD states that the purpose of the revision to the listing and maintenance standards is to increase the quality of companies listed on Nasdaq and raise the level of investor protection. The changes, according to the NASD, will allow Nasdaq to balance its role in capital formation with its responsibility to provide adequate investor protection. The NASD believes the proposed standards will: (1) Increase safeguards to protect public investors; (2) address growth and change in the market; (3) conform with structural enhancements to the market that are currently underway; and (4) address the changes in the market since Nasdaq listing and maintenance standards were last revised.

More specifically, the proposal would: (1) Extend corporate governance requirements already applicable to the NNM issuers to SmallCap issuers;¹¹ (2) require peer review of auditors for both NNM and SmallCap issuers;¹² and (3) increase the minimum requirements, both for listing and maintenance, for NNM and SmallCap issuers.¹³ The minimum requirements that will be increased include: (1) Net tangible assets, market capitalization, or assets

and revenue;¹⁴ (2) public float and market value of public float;¹⁵ (3) number of market makers;¹⁶ and (4) minimum bid price.¹⁷ These requirements are explained in greater detail below.

Elimination of the Exception to the \$1 Minimum Bid Price

Currently, maintenance standards for both SmallCap and NNM designated issuers require that issuers maintain a minimum bid price of \$1. The existing standards provide an exception to the \$1 bid price requirement for issuers able to meet higher float as well as higher capital and surplus or net tangible asset requirements.¹⁸

The NASD proposes to eliminate the exception to the \$1 bid price minimum for several reasons. First, the NASD believes the change would remove the incentive to engage in large, below market private placements that cause dilution and concomitant harm to Nasdaq investors. The NASD also believes the change would provide a safeguard against abusive market activity sometimes associated with low-priced securities. Further, when the exception was adopted, it was intended to address a "temporary adverse market condition[]" that may result in a bid price below \$1.¹⁹ Contrary to the NASD's stated intent in 1991, issuers have used the exception as a permanent means of meeting the listing standards. Finally, the NASD believes that a \$1 minimum bid price would serve to increase investor confidence and the credibility of the Nasdaq market, commensurate with its increased prominence.

Corporate Governance Standards for SmallCap Issuers

The NASD proposes to extend the corporate governance requirements currently applicable to NNM issuers to SmallCap issuers. The requirements include: (1) A minimum of two independent directors; (2) an audit committee with a majority of independent directors; (3) an annual

shareholder meeting; and (4) shareholder approval for certain corporate actions.²⁰ The NASD believes the shareholder approval requirement should help prevent further stock issuances that dilute shareholder interest without the prior knowledge of investors. Further, the NASD believes the audit committee, independent director, and annual meeting requirements will provide enhanced safeguards to the investing public.

Increase in the Quantitative Standards for Both the SmallCap and NNM

The NASD proposes to increase the quantitative standards for issuers to list on SmallCap and NNM. The NASD proposes this change because of the passage of time since the standards were last adjusted, the opportunities to improve the quality of the market as identified by the NASD from its experience over that period, and the concomitant increases in the growth of the market and the rate of inflation. The NASD believes the increases will further strengthen Nasdaq listing criteria and enhance the quality of Nasdaq companies, while preserving the ability of qualified Nasdaq companies to raise capital.

Market Capitalization Test for NNM

The NASD proposes to permit an issuer unable to meet either of two alternative net tangible asset tests, as amended by the proposed rule change,²¹ to be afforded designation as a NNM issuer provided it initially had a market capitalization of \$75 million, or total assets and total revenue of \$75 million each. For continued listing, such an issuer would have to maintain a market capitalization of \$50 million, or total assets and total revenue of \$50 million. The NASD states that this provision would provide an alternative for issuers that may fail to comply with the NNM net tangible asset test as a result of accounting for goodwill associated with various merger and acquisition activities or, as in the case of the telecommunications industry, significant depreciation charges. The

⁸ Letters from Gerald L. Fishman, Fishman & Merrick, P.C. (April 18, 1997) ("Fishman Letter"); Sam Rosen, Shannon, Gracey, Ratliff & Miller, L.L.P. (April 28, 1997) ("Rosen Letter"); Friedlob Sanderson Raskin Paulson & Tourtillot, LLC (April 30, 1997) ("Friedlob Letter"); Van P. Carter, Walter & Haverfield P.L.L. (April 30, 1997) ("Carter Letter"); James F. Duffy, American Stock Exchange, Inc. (May 1, 1997) ("Amex Letter"); Bob Cardon, Corporate Secretary, Dynatronics (May 6, 1997) ("Dynatronics Letter No. 1"); Kelynn H. Cullimore, Jr., President, Dynatronics (May 8, 1997) ("Dynatronics Letter No. 2"); and Sharon C. Kaiser, Chief Financial Officer, HemaCare Corporation (May 30, 1997) ("HemaCare Letter").

⁹ Exchange Act Release No. 26433 (January 9, 1989), 54 FR 1463 (January 13, 1989). Many states have exempted securities designated as NNM from state registration requirements.

¹⁰ Exchange Act Release No. 29638 (August 30, 1991), 56 FR 44108 (September 6, 1991).

¹¹ Proposed Rule 4310(c)(25).

¹² Proposed Rules 4310(c)(27) and 4450(m).

¹³ See generally Proposed Rule 4300 and 4400 Series.

¹⁴ Proposed Rules 4310(c)(2)(A), 4420(a)(5), 4420(b)(1) and 4420(c)(6) (for listing standards); Rules 4310(c)(2)(B), 4450(a)(3), and 4450(b)(1) (for maintenance standards).

¹⁵ Proposed Rules 4310(c)(7), 4420(a), 4420(b) and 4420(c).

¹⁶ Proposed Rules 4310(c)(1), 4420(a)(7), 4420(b)(5), 4420(c)(4), 4450(b)(6) and 4450(e).

¹⁷ Proposed Rules 4310(c)(4) and 4450(a)(5).

¹⁸ For SmallCap, the current exception requires \$1 million in market value of public float and \$2 million in capital and surplus. For NNM, the current exception requires \$3 million in market value of public float and \$4 million in net tangible assets.

¹⁹ See Exchange Act Release No. 29638 (August 30, 1991), 56 FR 44108 (September 6, 1991).

²⁰ It is contemplated that, as is currently the case with respect to NNM issuers, the NASD would have the discretion to waive or modify these corporate governance standards for foreign SmallCap issuers where the standards are contrary to generally accepted business practices in the issuer's country of origin.

²¹ As amended under the proposed rule change for initial listing on the National Market, an issuer must have net tangible assets of \$18 million, or \$6 million if the issuer has had earnings of \$1 million in the most recent year or two of the last three years. Net tangible assets equals total assets (including the value of patents, copyrights and trade marks but excluding the value of goodwill) less total liabilities. See Rule 4200(w).

NASD believes the proposed changes provide access to NNM listing for NNM caliber companies that would otherwise not qualify due to accounting conventions associated with certain business combinations and specialized industries.

Peer Review for Auditors of Nasdaq Listed Companies

The NASD proposes to require that auditors of Nasdaq listed companies be subject to a practice monitoring program under which the auditors' quality control systems would be reviewed by independent peer auditors on a periodic basis. Currently, companies whose shares are designated NNM or SmallCap are not required to have auditors who are subject to such peer review.²² The proposal requires all independent public accountants auditing Nasdaq listed companies to receive, or be enrolled in, a peer review that meets acceptable guidelines. Acceptable guidelines would include comparability to standards of the American Institute of Certified Public Accountants ("AICPA") included in the Standards for Performing on Peer Reviews codified in the AICPA's SEC Practice Section Reference Manual, and oversight by an independent body comparable to the organizational structure of the Public Oversight Board as codified in the AICPA's SEC Practice Section Reference Manual. Further, the NASD proposes requiring that copies of peer review reports, accompanied by any letters of comment and letters of response, would be maintained by the administering entity of the peer review program and be made available to Nasdaq upon request. Similarly, the NASD proposes that working papers of the administering entity and the independent oversight body would also be required to be retained for a period after the report is filed, and be made available to Nasdaq upon request.

Other Clarifying and Conforming Changes

The NASD also proposes to specify that the requirements relating to the number of outstanding shareholders for SmallCap issuers be based on the number of "round lot" holders of an issuer's shares. The NASD believes this definition conforms with the standards of NNM and other exchanges, and ensures that issuers maintain a broad and significant shareholder base justifying a listing on a national securities market.

²² Amex does require a program of peer review for auditors of issuers that are applying for listing on Amex. See Amex Letter, *supra* n.27.

In addition, the NASD proposes to conform the stock price compliance mechanism for initial listing under the NNM standards with that of the SmallCap by specifying that the applicable price is the bid price, and by removing the provisions under the NNM standards that require satisfaction of the applicable stock price only "on each of the five business days prior to the date of application by the issuer." The NASD states that the purpose of this change is to clarify the requirement and ensure that issuers be in compliance with the bid price requirement at the time of listing, and not just at the time coinciding with the filing of the application.

Furthermore, the NASD proposes to amend certain provisions and cross-references to the proposed rule changes and renumber them appropriately. Finally, the NASD proposes to eliminate outdated references and definitions, rename headings, and amend the Rule 4300 and 4400 Series where appropriate to replace "Association" with "Nasdaq."

III. Comments

The Commission received eight comment letters in response to the filing, with one commenter submitting two letters.²³ One comment letter requested an extended comment period,²⁴ six letters opposed portions of the proposal,²⁵ one letter supported portions of the proposal,²⁶ and one letter offered a clarification to the Notice publishing the proposed rule change.²⁷ The NASD submitted a letter in response to those commenters in opposition to the proposal.²⁸

One commenter stated that issuers unable to meet the proposed NNM maintenance requirements (which therefore would lose their NNM designation) should not be required to apply anew for SmallCap designation.²⁹ The commenter suggested requiring issuers that lost their NNM designation as a result of the increased maintenance requirements to apply for SmallCap designation could have the effect of punishing companies initially

designated NNM instead of SmallCap. In response to this comment, the NASD has stated it will provide for a one-time waiver of the application for SmallCap designation for issuers losing NNM designation through the implementation of the proposed maintenance standards.³⁰

Another commenter argued that the proposed implementation period for the new listing and maintenance standards would only provide temporary relief for affected issuers.³¹ Three commenters objected to the proposed listing and maintenance standards because of reliance by issuers or shareholders on existing standards.³² One commenter proposed that companies currently listed on Nasdaq be governed by the existing standards, and that companies listed after the new standards became effective be governed by the proposed listing standards.³³ Another commenter suggested a three year implementation period for the new standards.³⁴ A third commenter expressed a concern that issuers were not aware of the proposal to revise the listing and maintenance requirements because the NASD had not notified issuers that it was going forward with the revision.³⁵

The NASD, in its response to these comments, stated that issuers may meet the new listing standards at any time between their initial listing until 90 days after the proposal is approved by the Commission.³⁶ The NASD noted that issuers applying for Nasdaq designation were provided with notice of the proposed changes to the listing and maintenance standards. Further, the NASD pointed out that when new standards were implemented in 1991, they were also applied retroactively.

Another commenter believed that the proposed higher standards will have a negative effect on small businesses and capital formation.³⁷ The commenter also stated that neither the \$1 minimum bid price nor the quantitative entry and maintenance standards reflect the strength and stability of an issuer. Another commenter objected to the maintenance standard requiring a \$1 minimum share price, stating that issuers do not control their stock price.³⁸ The commenter argued that a reverse stock split, which could assist an issuer in meeting the \$1 share price

²³ See *supra* n.8.

²⁴ See Fishman Letter.

²⁵ See Rosen Letter, Friedlob Letter, Carter Letter, Dynatronics Letter No. 1, Dynatronics Letter No. 2 and HemaCare Letter.

²⁶ See Friedlob Letter.

²⁷ See Amex Letter. Amex clarified that, contrary to the NASD's statement in its rule filing, Amex does require a program of peer review for auditors of issuers that are applying for listing on Amex.

²⁸ See letter from Robert E. Aber, Vice President and General Counsel, Nasdaq, to Katherine England, Assistant Director, Commission (May 28, 1997) ("Nasdaq Letter").

²⁹ See Rosen Letter.

³⁰ See Nasdaq Letter, *supra* n.28.

³¹ See Friedlob Letter.

³² See Carter Letter, HemaCare Letter and Dynatronics Letter No. 2.

³³ See Carter Letter.

³⁴ See HemaCare Letter.

³⁵ See Dynatronics Letter No. 1.

³⁶ See Nasdaq Letter, *supra* n.28.

³⁷ See Friedlob Letter.

³⁸ See Dynatronics Letter No. 2.

minimum, is expensive and often has a negative impact on the market capitalization of an issuer. The commenter also noted that the change in minimum share price would not be a safeguard against improper market activity, and might lead to manipulation as companies tried to maintain the \$1 minimum share price.

The NASD responded to these comments by reiterating that the \$1 bid price requirement is an important component in the NASD's efforts to provide safeguards against abusive market activity associated with low-priced securities. The NASD also stated that the requirement would: reduce large, below market issuances; curtail the interim exceptions' use as a permanent solution for bid price deficiencies; and increase investor confidence as well as the credibility of Nasdaq.³⁹ The NASD noted that, in response to comments it received, it expanded the time period the bid price must be under \$1 (from 10 to 30 consecutive days) in order to fail this maintenance requirement.⁴⁰

Finally, one commenter endorsed the proposed corporate governance standards, the auditor peer review proposal, and the retention of discretion by the NASD in applying the listing criteria to issuers applying for Nasdaq designation.⁴¹

IV. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and in particular, Section 15A(b)(6).⁴² Section 15A(b)(6) requires, among other things, that the rules of an association be designed to promote just and equitable principles of trade, perfect the mechanism of a free and open market, and in general, to further investor protection and the public interest.⁴³

The development and enforcement of adequate standards governing the initial listing and maintenance of listing of securities is an activity of critical importance to financial markets and the investing public. Listing standards serve as a means for a marketplace to screen issuers and to provide listed status only to bona fide companies with sufficient float, investor base and trading interest to maintain fair and orderly markets. Once an issuer has been approved for initial listing, the maintenance criteria allow a marketplace to monitor the status and trading characteristics of that issuers to ensure that it continues to meet standards for market depth and liquidity. Many states have recognized the importance of listing and maintenance standards by exempting from state registration requirements securities traded on the New York Stock Exchange, Inc., the American Stock Exchange, Inc., or Nasdaq (for securities designated as NNM).

The Commission finds that the proposed rule change is an appropriate action by the NASD in light of market growth and changes, and the goals stated by the NASD in revising Nasdaq listing and maintenance standards. There has been tremendous change in the Nasdaq stock market, both in terms of volume and market developments, since the most recent changes to the listing and maintenance requirements. Since 1991, when the Nasdaq listing and maintenance standards were last revised, volume on Nasdaq has more than tripled.⁴⁴ Nasdaq is now the second largest securities market in the world and includes hundreds of stocks that would qualify for a New York Stock Exchange, Inc. listing. This growth has resulted in investor expectations of a commensurate level of quality for Nasdaq designated issuers. The Commission finds that the NASD's attempts to meet such expectations by raising its listing standards are appropriate and reasonably related to enhancing the overall quality of issuers included on Nasdaq.

The new maintenance standards will become effective six months after this rule change is approved by the Commission. The Commission believes this time period will provide current issuers with adequate time to complete any corporate actions necessary to comply with the new maintenance rules.⁴⁵ The Commission notes that

efficiency, competition, and capital formation. See 15 U.S.C. § 78c(f).

⁴⁴ In 1991, Nasdaq's volume was 41.3 billion shares. For 1996, Nasdaq's volume was 138.1 billion shares.

⁴⁵ Such corporate actions could include the implementation of the new corporate governance

when new listing and maintenance standards were implemented in 1991, they were also applied retroactively.⁴⁶ At that time, the Commission stated that retroactive implementation was necessary in order to avoid creating a two-tiered Nasdaq market: one for issuers governed by the previous criteria, and one for issuers required to meet the new requirements.⁴⁷ The Commission believes that this rationale applies to the revision of the Nasdaq listing and maintenance standards approved here. The Commission notes that, as discussed above, the NASD will provide for a one-time waiver of the application for SmallCap designation for issuers losing NNM designation through the implementation of the proposed NNM maintenance standards.⁴⁸

Under the current maintenance standards for both SmallCap and NNM, issuers must maintain a minimum bid price of \$1. The current standards provide an exception to the \$1 bid price for those issuers that can meet a higher float as well as higher capital and surplus or net tangible asset requirements.⁴⁹ The NASD has proposed to eliminate the exception to the \$1 bid price requirement, thereby requiring all issuers to maintain a bid price of \$1.⁵⁰

The Commission believes that while the maintenance standard requiring the \$1 minimum bid price will have an impact on some issuers, the potential impact is not unreasonable when viewed in light of the goals of the revised standards. In enhancing its market, Nasdaq would like to remove extremely low-priced stocks. The Commission finds that the \$1 bid price minimum is a reasonable measure for the NASD to use to maintain its quality

provisions required for SmallCap issuers, or the authorization and issuance of additional shares to meet the new market capitalization requirements.

⁴⁶ Exchange Act Release No. 29638 (August 30, 1991), 56 FR 44108 (September 6, 1991).

⁴⁷ The Commission also stated that retroactive application was appropriate because the standards would assist the Commission in its enforcement role pursuant to newly implemented rules under the Act designed to prevent manipulation and fraud in the sale of low-priced, non-Nasdaq designated securities. See Rule 15g-9 (previously Rule 15c2-6).

⁴⁸ See n.29 and accompanying discussion, *supra*.

⁴⁹ For SmallCap issuers, the current exception requires \$1 million in market value of public float and \$2 million in capital and surplus. For NNM issuers, the current exception requires \$3 million in market value of public float and \$4 million in net tangible assets.

⁵⁰ Under the proposal, an issuer would fail the maintenance standard if the issuer's bid price fell below \$1 for 30 consecutive days. Once an issuer's stock falls below \$1 for 30 consecutive business days, it would have 90 days to meet the \$1 standard for 10 consecutive business days, thus returning to compliance with the maintenance standard.

³⁹ See Nasdaq Letter, *supra* n.28.

⁴⁰ One commenter argued that the rule governing the 90-day period for an issuer to return to minimum bid price maintenance compliance applies to NNM issuers as well as SmallCap. See Rosen Letter (discussing application of Rule 4310(c)(8)(B)). The NASD has confirmed that this interpretation is correct. See Nasdaq Letter, *supra* n.28. The NASD has clarified that the rules of the Rule 4300 Series, unless otherwise specifically noted, also apply to the NNM issuers. Phone conversation between Andrew Margolin, Nasdaq and Janice Mitnick, Commission, on June 13, 1997. Therefore, under the proposed rules, both SmallCap and NNM issuers would have 90 days to return to compliance with the \$1 minimum bid.

⁴¹ See Friedlob Letter.

⁴² 15 U.S.C. § 78o-3(b)(6).

⁴³ In approving this rule, the Commission notes that it has considered the proposed rule's impact on

control standards for issuers quoted on Nasdaq. As of May 31, 1997, the average bid price for an NNM common stock was \$15.62 and the average bid price for a SmallCap common stock was \$5.44. The Commission notes that the \$1 bid price minimum is approximately 6.4% of the NNM bid price average and approximately 18.4% of the SmallCap bid price average. In establishing criteria to uphold the quality of the market, it is appropriate for the NASD to set a minimum for the stock price that is acceptable in conjunction with the other standards for listing and maintenance. The \$1 price minimum is well below the price of most Nasdaq securities and is a reasonable standard to use to remove low-priced securities from Nasdaq. In addition, the Commission believes that because share price may be increased by a reverse stock split, not all issuers predicted to fail this maintenance standard will actually do so.

Some of the listing and maintenance standards, as modified, will have an impact on the ability of some issuers currently designated as NNM and SmallCap issuers to remain as such. Since the SmallCap listing standards were last revised in 1991, there have been modifications to the OTCBB.⁵¹ Pursuant to rules patterned after the Nasdaq reporting requirements, NASD rules now require member firms effecting transactions in OTCBB eligible securities to transmit last sale reports of transactions made during normal market hours within 90 seconds after execution.⁵² The OTCBB also has a firm quote requirement pursuant to NASD rules, obligating market makers to display firm quotes for domestic equity securities up to a minimum quotation size⁵³ determined by the bid or offer price of the security.⁵⁴ Like information

for Nasdaq issuers, last sale prices and quotes for the OTCBB are distributed on a real-time basis through Nasdaq Workstations and market data vendors, which in turn distribute this information to approximately 250,000 terminals worldwide.

Hence, while there may be some effect on the quality of the market for an issuer designated as SmallCap that moves to the OTCBB, the impact of such a move may be less than in 1991. For example, it appears that the average number of market makers per issuer on the OTCBB for issuers that lost their SmallCap designation is not significantly lower than for those same issuers on Nasdaq, just prior to losing their SmallCap designation.

In summary, the Commission believes it is reasonable for the NASD to raise its criteria for issuer inclusion. The heightened standards reflects the NASD's judgment that it wants only higher quality companies to avail themselves of the Nasdaq marketplace, and the imprimatur that such inclusion confers. The increase in standards is neither discriminatory nor arbitrary, and the standards are directly related to the NASD's intended goals of enhancing its listing standards. Therefore, the Commission believes that the proposal is consistent with the Act.

In approving this rule change, the Commission finds that the NASD has reached an acceptable balance between the burden that may be imposed on issuers seeking NNM or SmallCap designation, and the market and investor benefits to be gained by increased listing and maintenance standards for NNM and SmallCap issuers. Issuers desire to list and trade on Nasdaq to improve their visibility and aid in their capital formation. Against this, the NASD must balance its statutorily mandated obligation to maintain the integrity of the Nasdaq market, and to protect investors and their confidence in the market. In response to these considerations, the NASD is working to achieve its general goal of improving the quality and nature of the market.⁵⁵ The Commission believes that the potential impact on some small issuers resulting from the proposed revision to the Nasdaq listing and maintenance standards is not

unreasonable when weighed against the anticipated benefits to the market and investors.

The Commission finds good cause for approving Amendment No. 3 to the filing prior to the 30th day after the date of publication of the notice of the filing. Amendment No. 3 merely serves to effect a clarification to the NASD's proposal, raises no new regulatory issues, and does not materially impact the substance of the proposal.⁵⁶ Accordingly, the Commission believes there is good cause, consistent with Sections 15A(b)(6) and 19(b)(2) of the Act, to approve Amendment No. 3 to the proposal on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3. Persons making written submissions should file six copies 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 the SEC'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 No. SR-NASD-97-16, and should be submitted by September 19, 1997.

VI. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act, and, in particular, Section 15A of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁵⁷ that the proposed rule change (SR-NASD-97-16), as amended, is approved.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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⁵⁶ See *supra* n.3.

⁵⁷ 15 U.S.C. § 78s(b)(2).

⁵¹ On March 31, 1997, the Commission issued an order granting permanent approval to the OTCBB. Exchange Act Release No. 38456 (March 31, 1997), 62 FR 16635 (April 7, 1997).

⁵² See Rule 6550.

⁵³ See Rule 6540(b)(1)(B). The OTCBB did mandate a firm quote requirement when the SmallCap listing standards were last revised; however, the firm quote requirement did not have a minimum quote size component. This was approved by the Commission on July 1, 1993. Exchange Act Release No. 32570 (July 1, 1993), 58 FR 36725 (July 8, 1993).

⁵⁴ See Rule 6750. Generally, the rule provides that the lower the share price, the higher the minimum quote requirement. For example, an issue with a bid price of \$.50 has a minimum quote requirement of 5,000 shares; an issue with a \$.95 bid price has a minimum quote requirement of 500 shares. See *id.*

⁵⁵ The 21(a) report and the undertakings agreed to be the NASD have been well publicized. See August 8, 1996 Order issued pursuant to Administrative Proceeding File No. 3-9056. The NASD is also working to conform itself to the undertakings agreed to pursuant to this action. See *id.*