

required by that section.¹³ To date, EMCC continues to limit the categories of entities eligible for membership to U.S. broker-dealers, United Kingdom broker-dealers, U.S. banks, and non-U.S. banks. As the Commission noted in the Registration Order, the Commission believes that providing for limited categories of members is appropriate at least during a clearing agency's initial phases of operations especially when no one in a category not covered by EMCC desires to be a member. Accordingly, the Commission is extending EMCC's temporary exemption from Section 17A(b)(3)(B).

The Commission also granted EMCC a temporary exemption from Sections 17A(b)(3)(A) and 17A(b)(3)(F) of the Act to permit EMCC to use, subject to certain limitations, ten percent of its clearing fund to collateralize a line of credit at Euroclear to finance on an intraday basis the receipt by EMCC of eligible instruments from one member that EMCC will redeliver to another member.¹⁴ The Registration Order limited EMCC's use of clearing fund deposits for this intraday financing to the earlier of one year after EMCC commenced operations or the date on which EMCC begins its netting service. On April 2 and May 17, 1999 the Commission approved rule changes that permitted EMCC to implement a netting service and that extended EMCC's ability to use clearing fund deposits for intraday financing at Euroclear until all EMCC members are netting members (as opposed to the date on which netting services are available or EMCC's first anniversary).¹⁵ Accordingly, the Commission is extending EMCC's temporary exemption from Section 17A(b)(3)(A) and (F).

Interested persons are invited to submit written data, views, and arguments concerning the foregoing application. Such written data, views, and arguments will be considered by the Commission in granting registration or instituting proceedings to determine whether registration should be denied in accordance with Section 19(a)(1) of the Act.¹⁶ 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 amended application for registration and all written comments will be available for

inspection at the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. All submissions should refer to File No. 600-30 and should be submitted by September 8, 1999.

It is therefore ordered, pursuant to Section 19(a) of the Act, that EMCC's registration as a clearing agency (File No. 600-30) be and hereby is temporarily approved through August 20, 2000.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41731; File No. SR-NASD-99-39]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding Riskless Principal Trade Reporting Rules

August 11, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 5, 1999, 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") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq has designated this proposal as one constituting a stated policy and interpretation with respect to the meaning of an existing rule under Section 19(b)(3)(A)(i) of the Act³ and Rule 19b-4(f)(1)⁴ thereunder, which renders the rule effective upon the Commission's receipt of this filing. 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

Nasdaq filed with the SEC an interpretation to NASD Rules 4632, 4642, 4652, and 6620, regarding riskless principal trade-reporting. The interpretation, which will be issued as a *Notice to Members*, addresses how mark-ups and other fees will be treated for determining whether trades are executed at the "same" price, for purposes of the aforementioned NASD rules. The text of the proposed rule change is available at the NASD, and at the Commission.

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

In its filing with the Commission, Nasdaq 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. Nasdaq 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

1. Purpose

Background. On March 24, 1999, the Commission approved a proposal to amend the trade reporting rules relating to riskless principal transactions in Nasdaq National Market, The Nasdaq SmallCap Market, Nasdaq convertible debt, and non-Nasdaq OTC equity securities.⁵ When the SEC approved the rule change, the Commission asked Nasdaq to submit an interpretation providing examples of how mark-ups, mark-downs, and other fees will be excluded for purposes of the amended riskless principal rules.⁶ As requested, Nasdaq is distributing *Notice to Members* 99-65,⁷ which provides examples of how mark-ups and other fees will be excluded for purposes of the riskless principal trade-reporting rules, as an interpretation to existing NASD Rules 4632, 4642, 4652, and 6620.

⁵ See Securities Exchange Act Release No. 41208 (March 24, 1999) 64 FR 15386 (March 31, 1999) (SR-NASD-98-59).

⁶ See *id.* at footnote 15.

⁷ The NASD has submitted *Notice to Members* 99-65 as Exhibit 2 to this rule filing. The Notice is available for inspection at the NASD and at the Commission.

¹³ Registration Order at 8716.

¹⁴ Registration Order at 8720.

¹⁵ Securities Exchange Act Release Nos. 41247 (April 2, 1999), 64 FR 17705 (April 12, 1999) and 41415 (May 17, 1999), 64 FR 27841 (May 21, 1999).

¹⁶ 15 U.S.C. 78s(a)(1).

¹⁷ 17 CFR 200.30-3(a)(16).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(i).

⁴ 17 CFR 240.19b-4(f)(1).

Substance of the Interpretation. Under the riskless principal trade reporting rules approved by the Commission, a market maker reports as "riskless" principal once if the market maker receives an order to buy (sell) a security, and then purchases (sells) the security as principal at the same price as the order in hand to satisfy the order to buy (sell). As stated in the interpretation contained in *Notice to Members* 99-65, to determine whether two transactions are executed at the same price, a market maker must compare the price reported to the Automated Confirmation Transaction Service ("ACT")⁸ pursuant to NASD trade reporting rules, which require members to exclude any mark-up or mark-down, commission-equivalent, or other fee when trade reporting ("tape price"), and the price of the offsetting trade with the customer, exclusive of any mark-up or mark-down, commission-equivalent, or other fee ("net price"). If the tape price and the net price to the customer are the same, then the transaction must be reported as riskless principal to the NASD and the offsetting leg with the customer should not be reported to the NASD. If a market maker is executing a large order through a series of trades and has an arrangement to charge the customer an average price based on the various executions received, the net price to the customer and the volume weighted average price ("VWAP") of the trades must be the same for the transaction to receive riskless principal treatment.

Notice to Members 99-65 also states that the riskless principal trade reporting rules do not mandate the prices at which market makers must execute the various legs of "riskless principal" transactions. Nor do the rules prohibit market makers from trading on a net basis. Thus, a market maker is not precluded from accumulating a position at one price and executing the offsetting trade with the customer at another price (with no mark-up, mark-down, commission-equivalent or other fee), provided such arrangement satisfies the member's best execution obligation and is consistent with SEC and NASD statements regarding the matching of limit and market orders.⁹

Nasdaq recognizes that there are times when a market maker will, while holding a customer's order, effect a buy (sell) at one price and an offsetting sell

(buy) with the customer at another price, such as when a market maker is trading "net" with an institution. If what otherwise would appear to be a riskless principal trade is effected at two different net prices, a market maker is required to report both legs of the transaction to the tape.¹⁰ *Notice to Members* 99-65 instructs, however, that if a member is working an order for an institutional account or a block size and the member finds the other side of the order, the presumption will be that the orders will be matched off at the same price (exclusive of any mark-up or mark-down, commission equivalent or other fee) and reported as riskless principal, unless the customer has specifically requested that the order be traded on a net basis, at a different price. The *Notice to Members* 99-65 further notes that, while net trading is not impermissible, market makers should endeavor to trade at one price when executing riskless principal transactions because this will provide greater transactional integrity and will have the corollary benefit of reducing SEC transaction fees (commonly known as "Section 31 fees").¹¹

The following provides an example of how Nasdaq believes the riskless principal trade reporting rules will operate:

Nasdaq Inside Market: \$10—10 $\frac{3}{8}$ %, 10 \times 10

Question—MMA receives a not-held order from an institutional customer to sell 6,000 shares, with instructions to obtain the best price available with a "bottom" of \$10 $\frac{1}{8}$. Using the phone, MMA sells 4,000 shares at \$10 $\frac{3}{8}$ to MMB and 2,000 shares at \$10 to MMC. What are MMA's trade reporting obligations?

Answer—MMA must report to ACT the sell to MMB of 4,000 shares at \$10 $\frac{3}{8}$ and the sell to MMC of 2,000 shares at \$10. (Note that the volume weighted average price for this trade is \$10 $\frac{1}{4}$.) If MMA buys 6,000 shares from his customer at a volume weighted average price (VWAP) of \$10 $\frac{1}{4}$, she/he will not be required to report to the tape the offsetting buy with the customer. The NASD believes that it would be consistent with the SEC No Action Letter Regarding SEC Rule 10b-10¹² for MMA to disclose on the confirmation a reported price of \$10 $\frac{1}{4}$ —the VWAP—instead of a reported price for each individual transaction. The confirmation must contain a notation that the disclosed price is an average price, and must note that details regarding the actual price are available to the customer

upon request.¹³ If market maker charged a mark-down, commission-equivalent, or other fee on top of the \$10 $\frac{1}{4}$, it also would be permissible for the confirmation to disclose the fee as a single amount.

Alternatively, if MMA trades on a net basis and buys 6,000 shares from his customer at \$10 (or another price different than the VWAP of \$10 $\frac{1}{4}$), MMA would also report the buy with its customer to the tape because the VWAP and the buy from the customer are different prices. The confirmation would disclose a reported price of \$10, a price to the customer of \$10, and no differential.

2. Statutory Basis

The NASD and Nasdaq believe that the new interpretation increases investor protection and clarifies a member's obligations under the NASD trade reporting rules. Accordingly, the NASD and Nasdaq believe that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁴ 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 market and a national market system, and, in general, to protect investors and the public interest.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule change and timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(i) of the Act¹⁵ and Rule 19b-4(f)(1)¹⁶ in that it constitutes a stated policy and interpretation with respect to the meaning of an existing rule.

At any time within 60 days of the filing of a rule change pursuant to Section 19(b)(3)(A) of the Act, the Commission may summarily abrogate the rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors,

⁸ See NASD Rule 4651(b).

⁹ See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) (Order Handling Rules Adopting Release); NASD *Notice to Members* 96-65 (October 1996); NASD *Notice to Members* 97-57 (September 1997).

¹⁰ The NASD and Nasdaq currently are examining whether trade reporting rules should be further amended to cover market makers reporting riskless principal trades at different prices.

¹¹ See Section 31 of the Act, 16 U.S.C. 78ee.

¹² See, e.g., SEC No-action letter from Catherine McGuire, SEC, to Eugene Lopez, Nasdaq, dated May 6, 1997 (permitting the issuance of a single confirmation at an average price and with multiple capacities for a single customer order effected with multiple executions).

¹³ See *id.*

¹⁴ 15 U.S.C. 78o-3(b)(6).

¹⁵ 15 U.S.C. 78s-(b)(3)(A).

¹⁶ 17 CFR 240.19b-4(f)(1).

or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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 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-99-39 and should be submitted by September 8, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41726; File No. SR-NYSE-99-26]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the New York Stock Exchange, Inc. Amending Cancellation Procedures for MOC/LOC Orders

August 11, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 14, 1999, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange.

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 proposed rule change amends the Exchange's market-at-the-close ("MOC") and limit on-close ("LOC") procedures to prohibit cancellation of MOC and LOC orders for any reason after 3:50 p.m.

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 Exchange 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 Exchange 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

1. Purpose

Current procedures³ utilized for MOC and LOC orders prohibit the cancellation of MOC orders and LOC orders after 3:40 p.m., except (1) in the case of legitimate error or; (2) to comply with the provisions of Exchange Rule 80A⁴ or; (3) when a regulatory trading halt is in effect at or after 3:40 p.m.⁵

The Exchange is proposing to prohibit cancellation or reduction in size of MOC/LOC orders after 3:50 p.m. for any reason, including cases of legitimate error or to comply with the provisions of Rule 80A. If Rule 80A goes into effect

³ See Securities Exchange Act Release No. 40094 (June 15, 1998), 63 FR 33975 (June 22, 1998).

⁴ Rule 80A requires index arbitrage orders in any stock in the Standard & Poor's 500 Stock Price Index entered on the Exchange to be stabilizing (*i.e.*, the order must be marked either buy minus or sell plus) when the Dow Jones Industrial Average ("DJIA") advances or declines from its closing value on the previous trading day by 2% of the DJIA average closing value from the last month of the previous calendar quarter. Current procedures require that, when the Rule goes into effect, an MOC index arbitrage order without the appropriate tick restriction must be canceled unless it is related to an expiring derivative index product.

⁵ See Securities Exchange Act Release No. 41497 (June 9, 1999), 64 FR 32595 (June 17, 1999). If a regulatory trading halt is in effect at or after 3:40 p.m., MOC/LOC orders can be canceled until 3:50 p.m. or the time the stock reopens, whichever occurs first.

before 3:50 p.m., members and member organizations must cancel MOC index arbitrage orders that are related to a derivative index product that is not expiring and that do not meet the Rule's tick, restrictions no later than 3:50 p.m.

In June 1998, the Commission approved amendments to procedures regarding entry of MOC and LOC orders and the publications of order imbalances.⁶ The Commission noted in its approval order that the enhanced publication requirements (*e.g.*, at 3:50 p.m. and the integration of marketable LOC orders in the imbalance may help ease market volatility at the close by attracting additional offsetting MOC/LOC orders for stocks that have a significant order imbalance at 3:50 p.m.

Historically, the window of opportunity for correcting errors has been from 3:50 p.m. to 4:00 p.m. When the cutoff time for MOC/LOC order entry on non-expiration days was moved from 3:50 p.m. to 3:40 p.m.,⁷ the Exchange did not revisit the issue of cancellations to correct errors. Upon review, the exchange has determined that it is appropriate to move the ten-minute window for error correction to 3:40 p.m. This would put the responsibility on members and member organizations to make sure by 3:50 p.m. that MOC/LOC orders entered are accurate. In turn, this will ensure that the 3:50 p.m. imbalance publication is accurate when offsetting orders are entered.

The Exchange believes that canceling MOC/LOC orders after 3:50 p.m. could exacerbate an order imbalance or cause a reversal in an order imbalance near the close. Precluding such cancellations would enhance the effectiveness of the MOC/LOC publication procedures in reducing volatility at the close.

Upon Commission approval of this proposed rule change, the Exchange intends to issue an information Memo to inform its members of the revised procedures.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the requirement under Section 6(b)(5) of the Act⁸ that the rules of an exchange be 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 a national market

¹⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

⁶ See *supra* note 3.

⁷ See *supra* note 3.

⁸ 15 U.S.C. 78f(b)(5).