

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

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-37317; File No. SR-NASD-95-40]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to PORTAL Market Pilot of Member's Reporting Obligations

June 17, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on October 4, 1995 the National Association of Securities Dealers, Inc. ("NASD" or "Association") 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 NASD. On November 22, 1995, the NASD filed Amendment No. 1 to advise the Commission that the NASD's Board of Governors approved this rule filing to adopt a pilot of the PORTAL reporting requirements.¹ On June 12, 1996, the NASD filed Amendment No. 2 to revise a footnote to the proposed rule change.² Initially, this footnote stated that the investor status information requirement concerning 144A transactions in the U.S. private market would be satisfied if the member provided the requisite information with respect to the member's direct customer. The revision clarifies the circumstances in which the contra-party would be required to provide investor status information and affirms industry reliance on these representations in determining whether the buyer is a qualified institutional buyer ("QIB").³ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

¹ See, letter from Suzanne E. Rothwell, Associate General Counsel, NASD, to Mark P. Barracca, Branch Chief, Division of Market Regulation, SEC, dated November 22, 1995.

² See, letter from Suzanne E. Rothwell, Associate General Counsel, NASD, to Elizabeth MacGregor, Branch Chief, Division of Market Regulation, SEC, dated June 12, 1996.

³ *Infra* note 16.

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

The NASD is proposing to amend Schedule I to the NASD By-Laws ("PORTAL Rules")⁴ that regulates The PORTAL Market to establish a pilot for one year for the reporting of the initial placement ("primary transactions") and secondary transactions in securities designated in the PORTAL Market as PORTAL securities.⁵ The pilot will apply to members of the NASD that are designated in the PORTAL Market as PORTAL dealers and PORTAL brokers⁶ and to other members of the NASD that transact business in PORTAL securities.

PORTAL dealers and PORTAL brokers will be required to provide a weekly transaction report to the PORTAL system of secondary market transactions in securities designated in the PORTAL Market. The weekly PORTAL transaction report by PORTAL dealers and PORTAL brokers of such secondary market transactions will include all trade report information and surveillance information as to the status of the investor⁷ and will be required to be submitted no later than the Friday of the following week with respect to the prior calendar week's transactions. PORTAL dealers and PORTAL brokers will also be required to submit a monthly PORTAL Surveillance Report to the PORTAL system that includes trade report and investor status information, but only with respect to primary market transactions in PORTAL securities.⁸ The monthly report will be required to be submitted by the tenth business day of the month with respect

⁴ In connection with the recent reorganization of the NASD Manual, The PORTAL Market Rules that were set forth in Schedule I to the NASD By-Laws are now set forth in the Rule 5300 series of the Market Rules. When adopted, the rule change proposed herein will be modified to comply with the new Manual form. See, NASD Notice to Members 96-24 (April 1996).

⁵ NASD Manual, Schedules to the By-Laws, Schedule I, Part II, Sec. 2 (CCH ¶ 1953 (outlining the requirements for the designation of securities in the PORTAL Market)).

⁶ NASD Manual, Schedules to the By-Laws, Schedule I, Part III, Secs. 8 and 9 (CCH ¶¶ 1962-1963 (setting forth the requirements for registration of an NASD member as a PORTAL dealer and PORTAL broker)).

⁷ "Investor status information" includes information on whether the contra-party was a QIB under Rule 144A, a non-QIB institution, or an individual or, alternatively, whether the transaction is to an offshore market or is into the U.S. public market.

⁸ NASD Manual, Schedules to the By-Laws, Schedule I, Part III, Secs. 4(a) and 6(b) (CCH ¶¶ 1958, 1960 (describing certain information required to be included in the weekly transaction report and the monthly Surveillance Report submitted to the NASD by PORTAL dealers and PORTAL brokers)).

to the primary offerings that occurred in the prior calendar month.

The NASD is not proposing to modify the current reporting requirements with respect to other NASD members who are not designated as PORTAL dealers and PORTAL brokers. Such members are required to submit by the fifth business day of each month a PORTAL Non-Participant Report that includes trade and investor status information with respect to primary and secondary market transactions that occurred in the prior month in which no PORTAL dealer or broker participated. It is anticipated that the PORTAL Non-Participant Report will be submitted in paper form.

The NASD will provide a report to the SEC analyzing the information generated from weekly transaction reports submitted by PORTAL dealers and PORTAL brokers during the first six months of the pilot to determine whether there is an identifiable group of securities that have sufficient liquidity and volume in the secondary market to permit some form of last sale or other display of transactions in order to enhance price discovery.⁹ With respect to the reporting of primary transactions submitted in the monthly PORTAL Surveillance Report, the NASD will review such reports to determine whether they provide sufficient support to the NASD's surveillance function to justify their continued submission. The pilot will also provide necessary surveillance of transactions in PORTAL securities.

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.

⁹ Because the PORTAL Non-Participant Report includes both primary and secondary market data, this data will not be used to develop statistics regarding secondary market trading in PORTAL securities.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Background

The Nasdaq Stock Market operates The PORTAL Market for the trading of privately placed securities that qualify under Rule 144A under the Securities Act of 1933. The PORTAL Market is the only SEC-authorized system to provide a trading market for the resale of restricted securities. Securities that are designated PORTAL securities are eligible to receive a CUSIP number and to be settled through the Depository Trust Company ("DTC"). Participants in the PORTAL Market include PORTAL dealers, PORTAL brokers, and PORTAL qualified investors ("PORTAL participants"). Any member of the NASD that is registered as a general securities firm can become a PORTAL dealer if the member meets the \$10 million investment in securities test under Rule 144A or as a PORTAL broker, where the member cannot meet the \$10 million test.¹⁰ Investors that meet the \$100 million investment in securities test under Rule 144A can be registered as PORTAL qualified investors.¹¹ There are currently 115 participants in The PORTAL Market.

The PORTAL Market accepts quotations from PORTAL dealers and PORTAL brokers that are one- or two-sided, firm or indicative. The PORTAL Market requires neither firm quotations nor market making. NASD members may sell PORTAL securities to any customers, regardless of whether the customer is a participant in the PORTAL market, so long as the transaction is in compliance with Rule 144A or any other available exemption from registration.

On December 13, 1993, the SEC approved SR-NASD-91-05, which adopted significant amendments to The PORTAL Market Rules (formerly in Schedule I to the NASD By-Laws).¹² The amendments were immediately effective on the date of approval, with the exception of the new reporting rules which were to be effective on a date announced by the NASD within six months following publication in the Federal Register. The NASD has not

announced a date of effectiveness for the new reporting rules.

The reporting requirements approved by the SEC required that members of the NASD registered as PORTAL dealers and PORTAL brokers enter a PORTAL transaction report in the PORTAL Market within 15 minutes of a secondary market transaction. The PORTAL transaction report included the standard items of information relative to a securities trade. PORTAL dealers and PORTAL brokers were also required to submit by the fifth business day of a month a PORTAL Surveillance Report that included the same trade data with respect to the prior month's primary and secondary market transactions of PORTAL securities and, with respect to each such transaction, information on whether the contra-party was a QIB under Rule 144A, a non-QIB institution, or an individual ("investor status information"). NASD members that are not registered as PORTAL dealers or PORTAL brokers were also required to submit a monthly PORTAL Non-Participant Report including the same information with respect to primary and secondary transactions that occurred in the prior month.

The SEC's December 13, 1993 approval order reflected in footnotes 48 and 49 thereof the concerns of several commentators, including the Securities Industry Association, regarding the need for and the technological, staffing, and costs related to the requirement that PORTAL transaction reports for secondary market transactions in PORTAL securities be submitted to the NASD within 15 minutes of the transaction and that such reports would be subject to last sale display. In addition, the approval order referenced in footnote 62 the undertaking of the NASD that it would meet with members of the International Operations Association to determine the extent to which broker/dealer firms have decentralized computer and trade processing systems operating in different areas of their businesses, and to determine further the views of market participants regarding the timing of the secondary market reporting requirements.

Description of Proposed Rule Change

Commencing in February 1994, the NASD entered into discussions with its members that are currently PORTAL brokers and PORTAL dealers. During such meetings, members discussed the unique problems associated with trade reporting of primary and secondary market transactions in restricted securities designated in the PORTAL Market. As a result of these concerns of

member firms, the implementation of the reporting requirements approved by the SEC has been delayed and the NASD is proposing to establish a pilot for one year for the reporting of primary and secondary market transactions in securities designated in the PORTAL Market as PORTAL securities. The pilot will apply to members of the NASD that are designated in the PORTAL Market as PORTAL dealers and PORTAL brokers and to members of the NASD that are not PORTAL dealers or PORTAL brokers.¹³

Reporting Obligations of PORTAL Dealers and PORTAL Brokers

Transactions in PORTAL securities will be subject to the reporting requirements set forth in Section 2(a) to Part III of the PORTAL Market Rules. Pursuant to Section 2(a), if both the buyer and the seller to a transaction are PORTAL dealers or PORTAL brokers, the seller is obligated to report the transaction to the PORTAL System. If only one party to a transaction in PORTAL securities is a PORTAL dealer or PORTAL broker, that party is obligated to report the transaction to the PORTAL System. Where the reporting party is the buyer, the PORTAL dealer or PORTAL broker is required to provide the investor status information with respect to his status as a buyer.

Reporting Obligations of NASD Members That Are Not PORTAL Participants

The NASD is not proposing to modify the reporting requirements with respect to other NASD members who are not designated as PORTAL dealers and PORTAL brokers. Such members are required by Section 2(b) and Section 5 of Part III of the PORTAL Rules to submit by the fifth business day of each month a PORTAL Non-Participant Report to the Market Surveillance Department of the NASD that includes trade and investor status information with respect to primary and secondary market transactions that occurred in the prior month. A member who is not a PORTAL dealer or broker will only be required to submit a PORTAL Non-

¹³The NASD issued Notice to Members 95-34 in May 1995 to survey its members with respect to their transactions in PORTAL securities. The purpose of the survey was to identify members of the NASD that were not already PORTAL dealers and PORTAL brokers that transact business in PORTAL securities and, with respect to such members, obtain information on the level of transactions. Only nine members of the NASD submitted a survey form, of which, only three indicated that they had conducted transactions in PORTAL securities in the prior six months. Moreover, of the three, only one member had transacted business in an amount of at least \$250 million.

¹⁰ See, *supra* note 6.

¹¹ NASD Manual, Schedules to the By-Laws, Schedule I, Part IV, Sec. 1 (CCH) ¶ 1965 (setting forth the requirements for registration of institutional investors as PORTAL qualified investors).

¹² Securities Exchange Act Rel. No. 33326 (Dec. 13, 1993); 58 FR 66388 (Dec. 20, 1993).

Participant Report if it is the only member participating in the transaction or if the contra-party is a member that is also not a PORTAL dealer or broker. Pursuant to Section 2(b), the report must be submitted by the seller, if both parties to the transaction are members. If only one party to the transaction is an NASD member, the member is responsible for filing the report. Because the PORTAL Non-Participant Report includes both primary and secondary market data, this data will not be used to develop statistics regarding secondary market trading in PORTAL securities.

Securities Subject to Reporting

The pilot reporting requirements will apply to all reportable PORTAL-designated securities. Reportable PORTAL-designated securities include all securities designated in the PORTAL Market, except for nonconvertible debt securities and nonconvertible preferred stock issued prior to December 13, 1993 which are rated in one of the top four generic rating categories by a nationally recognized statistical rating organization for which a request for deletion from the list of reportable securities has been made as set forth below.¹⁴ On December 13, 1993, the SEC approved amendments to the rules of the DTC that permitted DTC to make such investment grade securities eligible for its book-entry delivery and other depository services without the need for the securities to also be designated for inclusion in The PORTAL Market. Thus, subsequent to that date, issuers of such investment grade securities have the option of not being PORTAL designated. To the extent issuers have nonetheless determined to obtain PORTAL designation of their securities, transactions in such securities will be subject to the PORTAL pilot reporting requirements unless a procedure is followed that would result in termination of the PORTAL designation of the security.

With respect to investment grade securities issued *on or after* December 13, 1993, such securities will be included in the list of reportable securities, unless PORTAL designation of the issue has been terminated as a result of the submission of an appropriate modified letter of representation by the issuer to DTC to qualify for the investment grade exemption from PORTAL designation under DTC rules. This procedure would require that the issuer agree to amend its original letter of representation to provide information on the investment

grade rating of the issue and to request that the security be approved in DTC under the exemption from PORTAL designation for investment grade securities. Upon acceptance by DTC of the issuer's modified letter of representation, a letter must be submitted to The PORTAL Market by a PORTAL dealer or PORTAL broker that is signed by an associated person of the member with supervisory authority. The letter must request that a security's designation be terminated and include a copy of the letter of representation by the issuer to DTC (as well as any other documentation) to qualify for the investment grade exemption from PORTAL designation under DTC rules. DTC and the PORTAL Market will coordinate to promptly set a date for termination of the security as a PORTAL-designated security.

With respect to investment grade securities designated in the PORTAL Market *prior to* December 13, 1993, such securities will be included in the list of reportable PORTAL securities unless a PORTAL dealer or PORTAL broker submits a letter of representation signed by an associated person of a member with supervisory authority that identifies each security that the member believes is rated investment grade and provides with respect to each such security: (1) A statement whether the security is a nonconvertible debt security or a nonconvertible preferred stock; (2) the rating of the security and/or the lowest rating of any tranche of the security;¹⁵ and (3) the date the offering was issued. Upon acceptance of this submission by the PORTAL Market, the security will be deleted from the list of securities subject to the PORTAL pilot reporting requirements, but the security will not be terminated as a PORTAL-designated security.

The PORTAL Market is currently developing a list of PORTAL securities in order for PORTAL brokers and dealers and other members to be able to identify those securities subject to the PORTAL pilot reporting requirements. All securities designated in the PORTAL Market will be included in the list, unless: (1) a member has requested to not include a security that is an investment grade rated nonconvertible debt security or preferred stock issued prior to December 13, 1993; or (2) the security's designation has been terminated pursuant to the procedures set forth above for investment grade rated nonconvertible debt or preferred

stock issued on or after December 13, 1993 or is terminated for another reason.

Investor Status Information

The PORTAL pilot will require that the weekly transaction report and monthly Surveillance Report of PORTAL dealers and brokers include investor status information. In reviewing this requirement, which is drawn from the provisions of the PORTAL Rules, the NASD determined that there are two situations where the investor status information is not relevant; the first is in connection with sales to an offshore market and the second relates to sales into the U.S. public market (pursuant to a registration statement, Rule 144 or any other applicable exemption). The NASD believes that the request of SEC staff for information on investor status in the reporting of a transaction to the PORTAL system was intended to be applicable to transactions within the U.S. private market. The NASD, therefore, determined that the required reports by PORTAL dealers and PORTAL brokers will permit the investor status information field to accept two alternative entries of either "Offshore" or "U.S. Public Market" to indicate that the transaction is not in the U.S. private market. Thus, with respect to each reported transaction, members may either enter the requisite investor status information on the contra-party or indicate that such information is not applicable as the transaction is to an offshore market or the U.S. public market.¹⁶

Time of Execution

The PORTAL reporting requirements under the pilot are triggered when a trade is "executed." The term "execution" is defined in the PORTAL Rules as "entering into a purchase, sale or transfer of a PORTAL security." Members have requested clarification of when a transaction in a PORTAL security is considered executed in light of the fact that transactions in restricted

¹⁴ See, Securities Exchange Act Release No. 33327 (Dec. 13, 1993), 58 FR 67878 (Dec. 21, 1993).

¹⁵ If separate tranches of a security are rated individually, the security does not qualify for the exemption from the reporting requirements if any tranche is rated below investment grade.

¹⁶ While the identity of the contra-party is only required with respect to the party with whom the member is engaged in the transaction consistent with Section 4 to Part III of the PORTAL Rules, investor status information is required with respect to the buyer or buyers in the transaction consistent with Section 6 of Part III of the PORTAL Rules. If the contra-party is purchasing as principal, the investor status information would be provided with respect to the contra-party. If the contra-party is purchasing as agent, the investor status information would be required with respect to the account(s) on whose behalf the contra-party is purchasing. In providing the investor status information, it is the understanding of the NASD that it is industry practice for members to rely on representations of the agent/contra-party as to whether the buyer is a qualified institutional buyer, a non-QIB institution, or an individual.

securities may require negotiation of the transaction price, agreement on the currency of settlement and time to obtain Rule 144A compliance documentation.

The NASD has determined that the time of "execution" with respect to a transaction in a PORTAL security shall be the point when all of the terms of the trade have been agreed to and the parties are ready to send the transaction to clearance and settlement. So long as the terms of the transaction remain outstanding, the transaction would not be deemed to be executed because the parties are not ready to enter "into a purchase, sale or transfer of a PORTAL security." With respect to the transfer of documents demonstrating compliance with Rule 144A or any other applicable exemption, it appears that the transfer of such documentation may occur at some later time although the seller would have previously determined the exemption to be relied on. Thus, the time when documentation supporting reliance on Rule 144A or any other applicable exemption is completed would not affect the time when an "execution" of a transaction in a PORTAL security is deemed to occur.

(b) The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act in that the establishment of a pilot to develop criteria for designation of securities that should be subject to last sale display and to initiate trade reporting under the pilot will allow the NASD to surveil transactions in restricted securities that are designated in The PORTAL Market and will prevent fraudulent and manipulative acts and practices, will promote just and equitable principles of trade, and will remove impediments to and perfect the mechanism of a free and open market.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The NASD 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

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 approved 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 in Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by July 17, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-37341; File No. SR-NSCC-96-10]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change To Permit Establishment of Alternative Settlement Cycles for Mutual Fund Transactions Through the Fund/SERV System

June 20, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on April 4, 1996, National Securities

Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change and described in Items I, II, and III below, which items have been prepared primarily by NSCC. On May 8, 1996, NSCC filed an amendment to its proposed rule change.² 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 will modify NSCC's Rules to enable NSCC members using NSCC's Fund/SERV system to establish settlement cycles for mutual fund transactions other than that which would be automatically assigned by Fund/SERV.

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

In its filing with the Commission, NSCC 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. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.³

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The purpose of the proposed rule change is to enable NSCC members using NSCC's Fund/SERV system to establish settlement cycles for mutual fund transactions other than that which would be automatically assigned by Fund/SERV. Fund/SERV is an NSCC service that permits NSCC members to process and to settle on an automated basis mutual fund purchase and redemption orders and to transmit registration instructions.

Currently, the Fund/SERV system automatically establishes a settlement cycle and assigns a settlement date to a mutual fund transaction based on the underlying security type. The proposed rule change will permit mutual fund transactions to settle on an expanded or

² Letter from Julie Beyers, Associate Counsel, NSCC, to Jerry Carpenter, Assistant Director, Division of Market Regulation, Commission (May 8, 1996).

³ The Commission has modified parts of these statements.

¹ 15 U.S.C. 78s(b)(1) (1988).