

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

Written comments were neither solicited nor received.

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

The Exchange has designated this proposal as concerned solely with the administration of the Exchange under Section 19(b)(3)(A)(iii)⁴ of the Act and Rule 19b-4(e)(3)⁵ thereunder, which renders the proposal effective upon filing with the Commission.

At any time within sixty days of the filing of this proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, 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. 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, 450 Fifth Street, N.W., Washington, D.C. 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-97-61 and should be submitted by January 21, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-34059 Filed 12-30-97; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39480; File No. SR-CBOE-97-36]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to Proposed Rule Change Revising the Exchange Rules Governing the Halting and Resumption of Trading in Index Options

December 22, 1997.

I. Introduction

On July 25, 1997, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to revise the Exchange rules governing the halting and resumption of trading in index options on the Exchange.

The proposed rule change was published for comment in Securities Exchange Act Release No. 38962 (Aug. 22, 1997), 62 FR 45890 (Aug. 29, 1997). No comments were received on the proposal. The Exchange filed Amendment No. 1 to the proposed rule change with the Commission on September 15, 1997.³ This order approves the proposed rule change including, on an accelerated basis, Amendment No. 1.

II. Description of the Proposal

The Exchange seeks to amend Exchange Rule 24.7, "Trading Halts or Suspensions," to eliminate certain fixed percentage tests that presently apply to the decision to halt trading in index options as well as the decision to resume trading after such a halt. The proposed rule change also makes certain

conforming changes to related Exchange rules.⁴

A. Trading Halts

Currently, under Exchange Rule 24.7(a)(i), one of the enumerated factors that the designated Exchange officials may consider in deciding whether to halt trading in an index option is whether trading has been halted or suspended in underlying stocks whose weighted value presents "20% or more of the index value." The Exchange has expressed concern that by including a fixed percentage test among those factors that "may be considered," the present rule may imply that it would be improper for the designated Exchange officials to consider trading interruptions in underlying stocks whose weighted value represents less than 20% of the index value.

The Exchange believes this interpretations conflicts with the purpose of Exchange Rule 24.7, which grants designated Exchange officials the discretion to halt index option trading whenever they "conclude in their judgment that such action is appropriate in the interests of a fair and orderly market and to protect investors." Because Exchange Rule 24.7(a)(i)-(iv) sets forth a non-exclusive list of factors that Exchange officials may consider in exercising that discretion, the Exchange contends it would be inappropriate to forbid those officials from considering trading disruptions in underlying stocks that fall below a predetermined level. Accordingly, the proposed rule change would clarify that Exchange officials, in evaluating whether to halt trading in index options, are not limited to situations in which 20% of the underlying stocks have halted, but rather may consider "the extent to which" trading is not occurring in the underlying stocks.

In addition, the proposed rule change would provide Exchange officials with the flexibility to consider not only whether trading in underlying stocks has been "halted or suspended," but also whether such trading is "not occurring." The term "halted or suspended" indicates that Exchange authorities have taken formal action to discontinue trading in stock. However, in deciding whether to continue trading a derivative instrument like an index

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 amends Exchange Rule 24.13, "Trading Rotations," Interpretation .03, and eliminates the 50% fixed test as a factor in the determination whether an opening rotation in an index option class may be delayed. See Letter from Paul E. Dengel, Schiff Hardin & Waite, to Michael Walinskas, Senior Special Counsel, Division of Market Regulation, Commission, dated September 10, 1997.

⁴ The Commission notes that this proposed rule change does not address or impact the Exchange's circuit breaker trading halt rule and policy. However, the proposal makes a conforming change to Exchange Rule 24.7(c) that amends certain language cross referencing the Exchange's circuit breaker trading halt rule, Exchange Rule 6.3B, "Trading Halts Due to Extraordinary Market Volatility."

⁴ 15 U.S.C. 78s(b)(3)(A)(iii).

⁵ 17 CFR 240.19b-4(e)(3).

⁶ 17 CFR 200.30-3(a)(12).

option, Exchange officials should be able to consider the full extent to which underlying stocks are not trading, whether trading is not occurring because of formal exchange action, systemic problems, market emergencies, or other cause. The proposed rule change would clarify that in determining whether to halt index option trading, Exchange officials may consider the extent to which "trading is not occurring" in the underlying stocks, without limiting that consideration to formal halts or suspensions.

The Exchange also believes that Exchange Rule 24.7 may imply that the Exchange is required to calculate, on an ongoing basis, the extent to which stocks underlying a subject index are trading. The Exchange contends that such calculations would be difficult to perform on a real time basis for those indexes comprised of a large number of stocks (e.g., the Russell 2000, which consists of 2000 stocks), or those indexes for which data on trading halts is not readily available (e.g., NDX, an index based on over-the-counter stocks). The removal of the fixed percentage tests from Exchange Rule 24.7 is expected to rectify any misperception regarding the Exchange's duty to maintain and calculate trading information for stocks underlying an index on which options are traded.

B. Resumption Of Trading After Trading Halts

The proposed rule change would eliminate the provision in Exchange Rule 24.7(b) that makes trading in a fixed percentage of stocks underlying an index a prerequisite to the resumption of index options trading after a trading halt. Currently, trading may resume when the designated Exchange officials determine either (i) that the conditions that led to the halt no longer are present; or (ii) that the interests of a fair and orderly market are served by a resumption of trading. However, Exchange Rule 24.7(b) provides that in no event may trading resume until the Exchange has determined that trading is occurring in underlying stocks whose weighted value presents more than 50% of the index value.

The Exchange has represented that it would continue its practice of assessing the extent to which underlying stocks are trading in deciding whether to resume trading after an index options trading halt. However, the Exchange believes it is inappropriate to delay the resumption of trading until the level of trading in stocks underlying an index has reached a predetermined, fixed level, particularly since it often may be difficult to make a precise

determination of trading activity for indexes with a large number of constituent stocks.

Accordingly, the proposed rule change would eliminate the 50% fixed test and instead would specify that one of the factors that Exchange officials may consider in determining whether the "interests of a fair and orderly market are served by a resumption of trading" is "the extent to which trading is occurring in stocks underlying the index." According to the Exchange, the proposed rule change would enable the Exchange to resume trading as soon as conditions warrant, without interposing an artificial barrier that might result from a fixed percentage test. The Exchange believes the proposed rule change continues to provide Exchange officials with the opportunity to give appropriate weight to the extent to which underlying stocks are trading.

In addition, the proposed rule change would clarify that index options trading may resume only upon a determination by the designated Exchange officials that such a resumption is in the interests of a fair and orderly market. The present form of Exchange Rule 24.7(b) allows trading to resume (subject to the 50% requirement) when the designated Exchange officials determine either (i) that the conditions that led to the halt no longer are present; or (ii) that a resumption of trading would serve the interests of a fair and orderly market. Read literally, Exchange Rule 24.7(b) would permit trading to resume if the conditions that led to the halt no longer are present, even if a resumption of trading would be contrary to the interests of a fair and orderly market. Such an interpretation would conflict with the Exchange's practice and run counter to the Act. Accordingly, the proposed rule change would state that: (1) index options trading may resume only if the designated Exchange officials determine that such a resumption would be in the interests of a fair and orderly market,⁵ and (2) the fact that the conditions leading to the halt no longer are present is one of several factors which Exchange officials may consider in determining whether the interests of a fair and orderly market would be served by a resumption of trading.

The proposed rule change also conforms the cross reference to

⁵ A similar change has been made to Exchange Rule 6.3(b), "Trading Halts," which generally governs the resumption of trading after a trading halt in an equity option class. As a result, trading in an equity option class that has been the subject of a halt may resume only upon a determination by two Floor Officials that such a resumption is in the interests of a fair and orderly market. See Securities Exchange Act Release No. 39292 (Nov. 3, 1997), 62 FR 60738 (Nov. 12, 1997).

Exchange Rule 6.3B that appears in Exchange Rule 24.7(c) to the current language of the referenced rule. Exchange Rule 6.3B sets forth the Exchange's circuit breaker trading halt policy, the text of which was recently amended.⁶

Finally, the proposed rule change would add Interpretation .02 to Exchange Rule 24.7 to address the manner in which trading is to resume after a trading halt. This topic is not directly addressed under current Exchange Rule 24.7, although the last sentence of existing Exchange Rule 24.7(b) contemplates that a rotation will be used. Proposed Interpretation .02 would adopt the identical procedure that now governs the resumption of trading after a circuit breaker halt. The procedure is set forth in Interpretation .02 to Exchange Rule 6.3B and provides that trading will resume by a rotation after a trading halt unless the designated Exchange officials conclude that a different method of reopening is appropriate under the circumstances. The officials may determine, among other things, not to employ a rotation, to use an abbreviated rotation, or otherwise to vary the manner of the rotation. The Exchange seeks to adopt proposed Interpretation .02 so that comparable rules govern the resumption of trading after circuit breaker halts as well as halts effected for other reasons.

III. Discussion

For the reasons discussed below, 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 with the requirements of Section 6(b).⁷ In particular, the Commission believes the proposed rule change is consistent with the Section 6(b)(5) requirements that the rules of an exchange be designed 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 system, and, in general, to protect investors and the public interest.

While the current language of Exchange Rule 24.7(a) states that the 20% fixed test is one of several factors that may be considered in determining whether to halt index options trading, the Exchange has expressed concern that the test may be interpreted as having a mandatory rather than

⁶ See Securities Exchange Act Release No. 38221 (Jan. 31, 1997), 62 FR 5871 (Feb. 7, 1997).

⁷ 15 U.S.C. § 78f(b).

permissive application.⁸ The Commission finds that the Exchange is justified in its efforts to clarify Exchange policy regarding the halting of index options trading. Market participants should possess a clear understanding of the rules and procedures which the Exchange is bound to observe when considering the halting of trading in index options.

The Exchange currently may halt trading in index options classes when the designated Exchange officials have determined that "such action is appropriate in the interests of a fair and orderly market and to protect investors." The 20% fixed test represents one of several non-exhaustive factors that *may* be considered by Exchange officials when determining whether to halt trading pursuant to Exchange Rule 24.7. It provides Exchange officials and market participants notice that it may be appropriate to effect a trading halt in index options trading whenever a number of component securities underlying a substantial value of the index are not trading. The proposed rule change continues to provide such notice, albeit without a specific numerical guideline.

Accordingly, the Commission believes it is appropriate for the Exchange to replace the 20% fixed test with language indicating that Exchange officials may consider the extent to which "trading is not occurring" in stocks underlying an index when deciding whether to halt index options trading. The revised language properly reflects that in determining whether to halt index options trading pursuant to Exchange Rule 24.7, Exchange officials may consider all types of events that disrupt trading including, for example, formal halts or suspensions, systemic problems, market emergencies, or natural disasters.

The Commission also believes it is reasonable for the Exchange to remove the mandatory 50% fixed test from Exchange Rule 24.7(b) and include "the extent to which trading is occurring in stocks underlying the index" as a factor

to be considered when deciding whether to resume index options trading. The Exchange believes that the determination whether trading should resume after a halt can be made without regard to fixed thresholds by evaluating whether key stocks have reopened, and by examining the speed with which stocks in general are reopening. The Commission recognizes that adherence to a mandatory, fixed percentage test prevents the Exchange from relying primarily on such indicators. As a result, the Exchange could remain closed to market participants longer than desirable. The revised language permits Exchange officials to use their expert judgment in determining whether to resume trading from a halt. Exchange Rule 24.7 will continue to require Exchange officials to consider the extent to which trading is occurring in the stocks underlying the index, but absent the strict 50% fixed test.

Although the Commission recognizes the Exchange's need for flexible trading halt rules, it expects the Exchange to apply revised Exchange Rule 24.7 in a manner which ensures that trading is occurring in a substantial number of stocks underlying an index before trading in index options is allowed to resume. As the Commission has previously noted, "[i]t is questionable whether fair markets can be maintained in derivative index products when many of the index's component securities are not trading"⁹ The Commission is concerned that unless a substantial number of stocks underlying an index are trading, the related index options may be mispriced and fail to accurately reflect the current market value of all underlying stocks. While it would be counterproductive for the Commission to define "substantial" in numerical terms, or discuss what constitutes an acceptable level of trading in stocks underlying an index, the Commission nonetheless expects the Exchange to maintain fair markets in its index option products.

The Commission further believes it is reasonable for the Exchange to establish procedures governing the resumption of trading in index options after a trading halt. Although the current text of Exchange Rule 24.7(b) contemplates the use of a rotation in such circumstances, the Commission recognizes the need for definite procedures, particularly because confusion may still linger from the event that precipitated the trading halt. Furthermore, by adopting the identical procedure that currently

governs the resumption of trading following a circuit breaker halt, the Exchange's policies and rules will be consistent with respect to the resumption of trading after halts.

The Commission finds good cause for approving proposed Amendment No. 1 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission notes that Amendment No. 1 makes a conforming change to Exchange Rule 24.13, "Trading Rotations," Interpretation .03, that is consistent with the Exchange's decision to eliminate fixed percentage thresholds from the determination whether index options trading should be halted or resumed. In place of a 50% fixed test, Amendment No. 1 substitutes "the extent to which trading is not occurring" as a factor in deciding whether to delay an opening rotation in index options. The Commission believes that Amendment No. 1 helps establish uniformity among the Exchange's rules and procedures relating to halts and delays in index options trading. Accordingly, the Commission believes it is consistent with Section 6(b)(5) of the Act¹⁰ to approve Amendment No. 1 to the proposed rule change on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1 to the proposed rule change. 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 submissions, 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 persons, 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, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-CBOE-97-36 and should be submitted by January 21, 1998.

⁸ Uncertainty regarding the nature of the 20% fixed test dates back to 1988 when the Commission approved a proposed rule change that modified Exchange Rule 24.7. The Commission allowed the Exchange to revise its trading halt policy so that the 20% benchmark would no longer be the primary test but, instead, one of the facts to be considered when deciding whether to halt trading in index options. Although the Commission permitted the Exchange to reconfigure Exchange Rule 24.7 to make the 20% fixed test permissive, rather than mandatory, the Commission said it "believes the proposed amendment does not reflect a change in CBOE's trading halt policy." See Securities Exchange Act Release No. 26198 (Oct. 19, 1988), 53 FR 41637 (Oct. 24, 1988).

⁹ The October 1987 Market Break: A Report by the Division of Market Regulation, February, 1988, at 8-22.

¹⁰ 15 U.S.C. § 78f(b)(5).

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-CBOE-97-36), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-34060 Filed 12-30-97; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39482; File No. SR-NASD-97-86]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Small Order Execution System Tier Classification

December 22, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on December 12, 1997, the National Association of Securities Dealers ("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 self-regulatory organization.² The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The NASD is submitting this filing to effectuate The Nasdaq Stock Market, Inc.'s ("Nasdaq") periodic reclassification of Nasdaq National Market ("NNM") securities into appropriate tier sizes for purposes of

determining the maximum size order for a particular security eligible for execution through Nasdaq's Small Order Execution System ("SOES").

Specifically, under the proposal, 544 NNM securities will be reclassified into a different SOES tier size effective January 1, 1998. Since the NASD's proposal is an interpretation of existing NASD rules, there are no language changes.

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 and a copy of the Notice-to-Members 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

1. Purpose

The purpose of the rule change is to effectuate Nasdaq's periodic reclassification of NNM securities into appropriate tier sizes for purposes of determining the maximum size order for a particular security eligible for execution through SOES. Nasdaq periodically reviews the SOES tier size applicable to each NNM security to determine if the trading characteristics of the issue have changed so as to warrant a tier size adjustment. Such a review was conducted using data as of September 30, 1997, pursuant to the following established criteria.³

NNM securities with an average daily non-block volume of 3,000 shares or more a day, a bid price less than or equal to \$100, and three or more market makers are subject to a minimum quotation size requirement of 1,000 shares and a maximum SOES order size of 1,000 shares;

NNM securities with an average daily non-block volume of 1,000 shares or more a day, a bid price less than or equal to \$150, and two or more market makers are subject to a minimum quotation size requirement of 500 shares and a maximum SOES order size of 500 shares; and

NNM securities with an average daily non-block volume of less than 1,000 shares a day, a bid price less than or equal to \$250, and two or more market makers are subject to a

minimum quotation size requirement of 200 shares and a maximum SOES order size of 200 shares.

Pursuant to the application of this classification criteria, 544 NNM securities will be reclassified effective January 1, 1998. These 544 NNM securities are set out in the NASD's Notice to Members 97-90 (December, 1997).

In ranking NNM securities pursuant to the established classification criteria, Nasdaq followed the changes dictated by the criteria with three exceptions. First, an issue was not moved more than one tier size level. For example, if an issue was previously categorized in the 1,000-share tier size, it would not be permitted to move to the 200-share tier even if the reclassification criteria showed that such a move was warranted. In adopting this policy, Nasdaq was attempting to maintain adequate public investor access to the market for issues in which the tier size level decreased and help ensure the ongoing participation of market makers in SOES for issues in which the tier size level increased. Second, for securities priced below \$1 where the reranking called for a reduction in tier size, the tier size was not reduced. Third, for the top 50 Nasdaq securities based on market capitalization, the SOES tier sizes were not reduced regardless of whether the reranking called for a tier-size reduction.

2. Statutory Basis

The NASD believes the proposed rule change is consistent with Section 15A(b)(6) of the Act.⁴ 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 believes that the reassignment of NNM securities within SOES tier size levels will further these ends by providing an efficient mechanism for small, retail investors to execute their orders on Nasdaq and by providing investors with the assurance that they can effect trades up to a certain size at the best prices quoted on Nasdaq.

¹¹ 15 U.S.C. § 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² See letter from Robert E. Aber, Vice President and General Counsel, Nasdaq, to Katherine England, Assistant Director, SEC, dated Dec. 11, 1997 ("Amendment No. 1"). The Exchange initially submitted the proposal on December 4, 1997. However, at the Commission's request, the Exchange filed Amendment No. 1 to the proposed rule change on December 12, 1997. Amendment No. 1 corrects a typographical error in the SOES tier-size classification criteria used by the Nasdaq. Amendment No. 1 also clarifies that, despite the typographical error, the correct criteria set out in NASD Rules 4613(a)(2) and 4710(g) was used by Nasdaq in reclassifying the SOES tier sizes. The correction was also made in the Notice to Members 97-90.

³ The classification criteria are set forth in NASD Rule 4613(a)(2) and the footnote to NASD Rule 4710(g).

⁴ 15 U.S.C. § 78o-3.