

B. Self-Regulatory Organization's Statement on Competition

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The Association has neither solicited nor received written comments on the proposed rule change.

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

The foregoing rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule and, therefore, has become effective pursuant to Section 19(b)(3)(A)(i) of the Act⁵ and subparagraph (e) of Rule 19b-4 thereunder.⁶

At any time within sixty days of the filing of such 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 at the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-97-86 and should be submitted by January 21, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-39478; File No. SR-NASD-97-85)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to NASD Rule 2460 Concerning Payments for Market Making

December 22, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),¹ notice is hereby given that on December 1, 1997, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation") 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 NASD Regulation.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

NASD Regulation, pursuant to Section 19(b)(3)(A)(i) of the Act³ and Rule 19b-4(e)(i) under the Act,⁴ is proposing this interpretation of NASD Rule 2460 concerning payments for market

making. The text of the letter setting forth the interpretation is attached as Exhibit 1.

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

In its filing with the Commission, NASD Regulation included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule filing. The text of these statements may be examined at the places specified in Item IV below. NASD Regulation 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

NASD Regulation is proposing to issue a staff interpretation of NASD Rule 2460 to clarify the position of NASD Regulation with respect to the application of the rule to certain member broker-dealers that participate in a Freddie Mac Interdealer Cash Market Trading Initiative, as described below.

NASD Rule 2460—Payments for Market Making

On July 3, 1997, the SEC approved NASD Rule 2460 ("Rule"),⁵ which explicitly prohibits an NASD member or person associated with a member from accepting any payment or other consideration from issuers or the issuers' affiliates or promoters, directly or indirectly, for: (1) publishing a quotation, (2) acting as a market maker, or (3) submitting an application in connection therewith. The rule was intended, among other things, to assure that members act in an independent capacity when publishing a quotation or making a market in an issuer's securities.

NASD Regulation originally proposed this new rule and requested comment from members and the public in Notice to Members 96-83 ("NTM 96-83") in December 1996. As stated in NTM 96-83, it has been a longstanding policy and position of the NASD that a broker-dealer is prohibited from receiving compensation or other payments from an issuer for listing, quoting, or making a market in an issuer's securities or for covering the member's out-of-pocket

⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. § 78s(b)(1).

² The proposal was originally filed with the Commission on November 18, 1997, but was withdrawn on December 1, 1997. See Letter from Alden S. Adkins, Vice President and General Counsel, NASD Regulation, to Richard C. Strasser, Assistant Director, Division of Market Regulation, Commission. (File No. SR-NASD-97-84). On December 22, 1997, the NASD filed Amendment No. 1 with the Commission. See Letter from Alden S. Adkins, Vice President and General Counsel, NASD Regulation, to Richard C. Strasser, Assistant Director, Division of Market Regulation, Commission. In addition, several minor technical corrections authorized by NASD Regulation are included in this Notice. Telephone conversation between David A. Spotts, Office of the General Counsel, NASD Regulation, and Elaine M. Darroch, Office of Market Supervision, Division of Market Regulation, Commission (December 4, 1997).

³ 15 U.S.C. § 78s(b)(3)(A)(i).

⁴ 17 CFR 240.19b-4(e)(i).

⁵ 15 U.S.C. 78s(b)(3)(A).

⁶ 17 CFR 240.19b-4(e).

⁵ Securities Exchange Act Release No. 38812 (July 3, 1997), 62 FR 37105 (July 10, 1997) (File No. SR-NASD-97-29).

expenses for making a market, or for submitting an application to make a market in an issuer's securities.⁶ As stated in Notice to Members 75-16 (February 1975), such payments may be viewed as a conflict of interest since they may influence the member's decision as to whether to quote or make a market in a security and, thereafter, the prices that the member would quote.

In the past, certain broker-dealers have entered into arrangements with issuers to accept payments from the issuers, their affiliates or promoters to make a market in the issuer's securities, or for covering out-of-pocket expenses of the member incurred in the course of market making, or for submitting an application to act as a market maker. As stated above, NASD Regulation believes that such conduct may be viewed as a conflict of interest. NASD Regulation believes that a market maker should have considerable latitude and freedom to commence or terminate market making activities in an issuer's securities. The decision by a firm to make a market in a given security and the question of what price the firm will quote for that security generally are dependent on a number of factors, including, among others, supply and demand, the firm's expectations toward the market, its current inventory position, and exposure to risk and competition. This decision should not be influenced by payments to the member from issuers or promoters.

NASD Rule 2460 establishes a fair practice standard regarding a particular course of conduct of a member. Members should be mindful that certain actions of a member in accepting a fee from an issuer for making a market, or accepting an unsolicited payment from an issuer where the member makes a market in the issuer's securities, in addition to violating NASD Rule 2460, could also violate the anti-fraud provisions of the federal securities laws and NASD Rule 2120, an NASD anti-fraud provision. Further, the payment by an issuer to a market maker to facilitate market making activities could also violate the registration requirements of Section 5 of the Securities Act of 1933 ("Securities Act").⁷

Freddie Mac Interdealer Cash Market Trading Initiative

The Federal Home Loan Mortgage Corporation ("Freddie Mac") is a government-sponsored enterprise created pursuant to the Federal Home

Loan Mortgage Corporation Act, Title III of the Emergency Home Finance Act of 1970, as amended, to provide a continuous flow of funds for residential mortgages.⁸ To finance its mortgage purchase activities, Freddie Mac sells its securities to investors directly and through securities dealers. The primary financing vehicle for its mortgage purchases is the sale of Mortgage Passthrough Certificates ("PCs"). These securities are exempt from registration under the Securities Act and the Exchange Act. In 1990, Freddie Mac redesigned its fixed-rate PC structure and issues a new type of PC, called Gold PC. Since the Gold PCs were entirely new and a separate product, there was limited initial liquidity in the Gold PC market. As a result, dealers responded to the initial lack of liquidity in the Gold PC market, with its potential volatility, by maintaining primary Federal National Mortgage Association ("Fannie Mae") security positions, and by entering into synthetic transactions in the swap market.⁹

As a result of the above, Freddie Mac launched a program to encourage dealers to purchase Gold PCs directly, rather than through the swap market mechanism (the "Initiative"). Freddie Mac and The Bond Market Association ("BMA") submitted to the staff of NASD Regulation a letter dated October 7, 1997, regarding the application of NASD Rule 2460 to members participating in the Initiative.

⁸ Freddie Mac's statutory purpose is to, among other things, promote access to mortgage credit throughout the Nation by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing (12 U.S.C. § 1451(b)).

⁹ In the years following 1990, Freddie Mac has built a supply of tradable Gold PCs in an attempt to achieve a liquid market of 30-year Gold PCs (\$152 billion as of September 1, 1997). The dealer response, however, has primarily remained unchanged in maintaining Fannie Mae Mortgage-Backed Security ("MBS") positions and entering into synthetic transactions in the swap market despite the availability of a sizable amount of tradable Gold PCs. Broker-dealers primarily enter into Gold PC transactions synthetically as opposed to direct transactions in the Gold PC cash market. The synthetic transactions are structured generally as follows: A dealer will first purchase a 30-year Fannie Mae MBS in the cash market with a forward delivery (with a fixed settlement date in the future). The dealer will enter into another separate transaction in the swap market. The dealer will swap the obligation to buy the Fannie Mae MBS for a commitment to purchase (accept delivery at settlement) Gold PCs.

To gain an understanding of the relative size of the cash market for MBS, the following statistics are provided. In 1996, the average cash market volume on the interdealer broker screens for MBS was approximately \$20 billion per month. Of this, approximately 96% was conducted in Fannie Mae MBS transactions and approximately 4% was conducted directly in the cash market in 30-year Gold PCs.

The Initiative includes offering dealers "credits" for trading directly on the interdealer cash market, as opposed to the swap market. Freddie Mac has developed procedures and internal controls to calculate trading volume credits monthly to the dealers and assure proper administration of the program. According to the October 7, 1997 letter from Freddie Mac and the BMA, this Initiative is intended to be temporary, and the value of the credits were selected so as to provide a nominal economic incentive over the transaction costs on the swap market, while not providing so much of an incentive as to alter pricing of the securities in the open market.¹⁰ The credits awarded under this Initiative may only be redeemed through transactions with Freddie Mac, that is, the credits are utilized by participating broker-dealers to reduce the fees associated with future transactions with Freddie Mac.

Due to unique characteristics of the Initiative, Freddie Mac presented principally three arguments why NASD Rule 2460 was not intended to cover the Initiative: (1) The Initiative promotes Freddie Mac's statutory purpose; (2) the Initiative does not affect the integrity of the marketplace; and (3) the Initiative is intended to be temporary.

First, Freddie Mac represents that the Initiative appears to promote Freddie Mac's statutory purpose, in that, Freddie Mac was created by Congress to provide a conduit for ensuring a continuous supply of funds from the capital markets to the mortgage markets. Freddie Mac purchases mortgages daily and finances them primarily with the issuance of MBS. The prices Freddie Mac pays for its mortgage purchases is based directly on the prices at which it sells its PCs. Freddie Mac represents that this Initiative was developed to eliminate certain unnecessary costs in the mortgage finance system by improving interdealer PC liquidity through

¹⁰ To normalize the environment for dealers to accumulate credits) so as not to favor larger dealers who naturally conduct a higher volume business), a system for accumulation of credits was established that would be based on the individual dealer's level of participation. Credits are awarded on the current volume traded on the cash screens. Credits are awarded at an increasing rate when dealers exceed their previous monthly cash trading volume, as calculated since the beginning of the Initiative, that the dealers have traded on the cash screens. This feature was designed to limit the duration of the Initiative by creating momentum in moving dealers progressively away from the swap market.

Under this Initiative, credits are redeemable at a value of 1/4th of a point (or \$156.25 per million). This value was selected so as to provide nominal economic incentive over the additional 1/4th to 3/8ths of a 32nd (or \$78.13 to \$117.20 per million) in the transaction cost of executing a synthetic Gold PC in the MBS cash and swap markets.

⁶ See Notices to Members 75-16 (February 1975) and 92-50 (October 1992).

⁷ 15 U.S.C. § 77e.

encouraging dealers to purchase Gold PCs directly, as opposed to entering into transactions in the swap market.¹¹

Second, Freddie Mac represents that the Initiative does not appear to affect the integrity of the marketplace, since the nature and characteristics of the agency mortgage pass-through securities market is unique and appears outside of the intended scope of NASD Rule 2460. The dealers in this market trade PCs and similar securities essentially as fungible products and trade these securities indiscriminately on the interdealer broker screens to meet customer demand. As a result, the concept of market making a particular security in this market has little application. In addition, Freddie Mac represents that the incentives which lead a broker-dealer to make a quotation on a PC differ from traditional equity trading. Customer demand in fixed-income securities is based primarily on changes in interest rates, supply and demand, and the quality of the credit backing the security. In the agency MBS market, the credit of the three primary agencies (Freddie Mac, Fannie Mae and Government National Mortgage Association) is considered comparable, the supply of the securities is considered plentiful, and a well-developed forward trading market permits ready hedging of positions. This market differs from the characteristics of the traditional equity market. Accordingly, Freddie Mac represents that, given the number of comparable securities in the yield-driven debt market, it is unlikely that certain dealer credits to purchase Gold PCs would mislead market participants to purchase the Gold PCs versus other comparable securities.

Further, Freddie Mac represents that this Initiative is intended to be temporary. It is expected that dealer behavior will eventually become self-

sustaining and no further incentives will be required.

Based on the above information and representations presented by Freddie Mac, and the importance of the role of Freddie Mac in promoting liquidity of these instruments under statutory mandate, it is NASD Regulation's opinion that the participation of member firms in the Freddie Mac Initiative as described in the letter would not be deemed in violation of NASD Rule 2460.

NASD Regulation believes that this interpretation maintains investor protection and clarifies a member's obligations under NASD Rule 2460 while participating in the Freddie Mac Interdealer Cash market Trading Initiative. Accordingly, NASD Regulation believes that the interpretation is consistent with the provisions of Section 15A(b)(6) in that it protects investors and the public interest, and is designed to promote just and equitable principles of trade.

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

NASD Regulation 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 upon filing pursuant to Section 19(b)(3)(A)(i) of the Exchange Act¹² and Rule 19b-4(e)(1)¹³ thereunder in that it constitutes a stated policy, practice or interpretation with respect to the meaning, administration, or enforcement of an existing rule.

At any time within 60 days of the filing of the 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. 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-97-85 and should be submitted by January 21, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland,
Deputy Secretary.

Exhibit 1

November 25, 1997.

Ms. Gail Vance, Associate General Counsel,
Freddie Mac, 8200 Jones Branch Drive,
McLean, VA 22102-3110.

Mr. George P. Miller, Vice President and
Deputy General Counsel, The Bond Market
Association, 40 Broad Street, New York,
NY 10004-9400.

Re: Interpretive Guidance Under NASD Rule 2460.

Dear Ms. Vance and Mr. Miller: We are in receipt of your letter dated October 7, 1997 in which you request interpretive guidance of NASD Rule 2460 (Rule) and its potential application to Freddie Mac's Interdealer Cash Market Trading initiative ("Initiative"). As represented in your letter, Freddie Mac launched this Initiative on June 2, 1997 in an attempt to encourage dealers to purchase Gold PCs directly, as opposed to entering into swap market transactions.

Background

As stated in your letter, Freddie Mac is a government-sponsored enterprise created pursuant to the Federal Home Loan Mortgage Corporation Act, Title III of the Emergency Home Finance Act of 1970, as amended, to provide a continuous flow of funds for residential mortgages.¹ To finance its mortgage purchase activities, Freddie Mac sells its securities to investors directly and

¹¹ Currently, broker-dealers enter into gold PC transactions synthetically, first by conducting a transaction in a 30-year Fannie Mae MBS followed by a subsequent swap transaction into or out of Gold PCs. This process subjects Gold PCs to an additional bid-ask spread (that of the cash market and that of the swap market) of 1/8th to 1/4th of a 32nd (or up to \$78.13 per million). In addition, the two-step process results in broker fees for the trading on the interdealer screens of an additional 1/16th to 1/8th of a 32nd (or up to \$39.07 per million). Thus, this persistent trading pattern creates additional costs in the marketplace, preventing investors from obtaining up to 3/8ths of 1/32nd (or \$117.20 per million) of the true economic value of the Gold PCs that an efficient market would produce.

As of May 1997, the average monthly dollar volume of cash trades in Fannie Mae MBS and Gold PCs approximated \$19,239 million, \$1,021 million, respectively. As of that date, the average monthly swap trades in Gold PCs and MBS approximated \$4,177 million.

¹² 15 U.S.C. § 78s(b)(3)(A)(i).

¹³ 17 CFR 240.19b-4(e)(1).

¹⁴ 17 C.F.R. 200.30-3(a)(12).

¹ Freddie Mac's statutory purpose is to, among other things, promote access to mortgage credit throughout the Nation by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing (12 U.S.C. Section 1451(b)).

through securities dealers. The primary financing vehicle for its mortgage purchases is the sale of Mortgage Passthrough Certificates (PCs). These securities are exempt from registration under the Securities Act of 1933 and the Exchange Act of 1934. In 1990, Freddie Mac redesigned its fixed-rate PC structure and issued a new type of PC, called Gold PC. Since the Gold PCs were entirely new and a separate product, there was limited initial liquidity in the Gold PC market. As a result, dealers responded to the initial lack of liquidity in the Gold PC market, with its potential volatility, by maintaining primary Fannie Mae security positions, and by entering into synthetic transactions in the swap market.

As a result of the above, Freddie Mac launched this Initiative to encourage dealers to purchase Gold PCs directly, rather than through the swap market mechanism. The Initiative includes offering dealers "credits" for trading directly on the interdealer cash market, as opposed to the swap market. Freddie Mac has developed procedures and internal controls to calculate trading volume credits monthly to the dealers and assure proper administration of the program. According to your letter, this Initiative is intended to be temporary, and the value of the credits were selected so as to provide a nominal economic incentive over the transaction costs on the swap market, while not providing so much of an incentive as to alter pricing of the securities in the open market. More important, the credits awarded under this Initiative may only be redeemed through transactions with Freddie Mac.

Discussion

NASD Rule 2460 prohibits NASD members from receiving payments or other consideration from an issuer for publishing a quotation or acting as a maker in a security, or for submitting an application to make a market in the issuer's securities. The definition of "consideration" specifically includes offering securities products on terms that are more favorable than those granted or offered to the public. The Rule was intended to prevent certain conflicts of interest that may influence a broker-dealer's decision regarding whether to quote or make a market in a security and prices that are quoted and to prevent a misleading appearance of market activity based on such conflicts. Paragraph (b) of the Rule also provides an exemption, among others, for certain payment to members for "bona fide" services, including, but not limited to, investment banking services.

Due to unique characteristics of the Freddie Mac Initiative, you principally present three arguments why the Rule was not intended to cover your Initiative: (1) the Initiative promotes Freddie Mac's statutory purpose; (2) the Initiative does not affect the integrity of the marketplace; and (3) the Initiative is intended to be temporary.

First, you represent that the Initiative appears to promote Freddie Mac's statutory purpose, in that, Freddie Mac was created by Congress to provide a conduit for ensuring a continuous supply of funds from the capital markets to the mortgage markets. Freddie Mac purchases mortgages daily and finances

them primarily with the issuance of mortgage-backed securities. The prices Freddie Mac pays for its mortgage purchases is based directly on the prices at which it sells its PCs. It has been represented in your letter that this Initiative was developed to eliminate certain unnecessary costs in the mortgage finance system by improving interdealer PC liquidity through encouraging dealers to purchase Gold PCs directly, as opposed to entering into transactions in the swap market.

Second, you represent that the Initiative does not appear to affect the integrity of the marketplace, since the nature and characteristics of the agency mortgage pass-through securities market is unique and appears outside of the intended scope of the Rule. Since the dealers in this market trade these securities as fungible products (i.e., PCs, Mortgage-backed securities, Ginnie Maes) and trade on the interdealer broker screens daily as a matter of course to meet their customer's demand, the concept of market making a particular security has little application in this marketplace.

In addition, you represent that the incentives which lead a broker-dealer to make a quotation on a PC differ from traditional equity trading. Customer demand in fixed-income securities is based primarily on changes in interest rates, supply and demand, and the quality of the credit backing the security. In the agency mortgage-backed securities market, the credit of the three primary agencies (Freddie Mac, Fannie Mae and Ginnie Mae) is considered comparable, the supply of the securities is considered plentiful, and a well-developed forward trading market permits ready hedging of positions. This market differs from the characteristics of the traditional equity market. Accordingly your letter represents that, given the number of comparable securities in the yield driven debt market, it is unlikely that certain dealer credits to purchase Gold PCs would mislead market participants to purchase the Gold PCs versus other comparable securities.

Lastly, you represent that this Initiative is intended to be temporary. According to your letter, it is expected that dealer behavior will eventually become self-sustaining and no further incentives will be required.

Based on the above information and the representations presented by Freddie Mac, and the importance of the role of Freddie Mac in promoting liquidity of these instruments under statutory mandate, it is the staff's opinion that the participation of member firms in the Freddie Mac Initiative as described in your letter would not be deemed in violation of Rule 2460.

I hope this letter is responsive to your inquiry. Please note that the opinions expressed herein are staff opinions only and have not been reviewed or endorsed by the Board of Directors of NASD Regulation. This letter responds only to the issues that you have raised based on the facts as described, and does not address any other rule or interpretation of the Association, or all the possible regulatory and legal issues involved.

Sincerely,
David A. Spotts,
Office of General Counsel, NASD Regulation,
Inc.
[FR Doc. 97-33994 Filed 12-30-97; 8:45 am]
BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39477; File No. SR-PCX-97-43]

Self-Regulatory Organizations; Order Granting Accelerated Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 to Proposed Rule Change by the Pacific Exchange, Inc. Relating to Its Specialist Evaluation Program

December 22, 1997.

On November 17, 1997, the Pacific Exchange, Inc. ("PCX" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "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 extend its pilot program regarding the evaluation of its equity specialists until January 1, 1999, and to implement certain changes to the pilot program.

The proposed rule change was published for comment in Securities Exchange Act Release No. 39358 (November 25, 1997), 62 FR 64035 (December 3, 1997). No comments were received on the proposal. The Exchange filed Amendment No. 2 to the proposed rule filing on December 5, 1997.³ This order approves the proposed rule change, as amended, on an accelerated basis.

I. Description

On October 1, 1996, the Commission approved a nine-month pilot program for the evaluation of PCX equity specialists.⁴ On June 3, 1997, the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 2 states that the Equity Allocation Committee ("EAC") will consider mitigating circumstances on a case-by-case basis. The restrictions will apply in all cases in which the specialist fails to meet the standards; any failure to impose the restrictions should not be routine and should only occur in exceptional circumstances which demonstrate that imposing the restrictions is not justified. For example, the EAC may consider a systems problem to be a mitigating circumstance in a particular case. See letter from Jeffrey S. Norris, Manager, Regulatory Development, PCX, to Heather Seidel, Attorney, Market Regulation, Commission, dated December 4, 1997 ("Amendment No. 2").

⁴ Prior to the adoption of the pilot program, PCX Rule 5.37(a) provided that the Exchange's EAC evaluate all registered specialists on a quarterly