

Section 15A(b)(9) provides that the rules of the Association may not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature apply across the board and do not target any particular user or participant, as all dealers may set their exposure limits at two times the tier size and all dealers may elect to utilize the automated quote update feature. Accordingly, the NASD believes that these rule changes are not anticompetitive, as they are uniform in application and they seek to preserve the ability of SOES to provide fair and efficient automated executions for small investor orders, while preserving market maker participation in SOES and market liquidity.

Section 15A(b)(11) empowers the NASD to adopt rules governing the form and content of quotations relating to securities in the Nasdaq market. Such rules must be designed to produce fair and informative quotations, prevent fictitious and misleading quotations, and promote orderly procedures for collecting and distributing quotations. The NASD is seeking to continue the effectiveness of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature so that SOES activity may not result in misleading quotations in the Nasdaq market. Market makers place quotes in the Nasdaq system and these quotes comprise the inside market and define the execution parameters of SOES. When volatility in the SOES environment causes market makers to widen spreads or to change quotes in anticipation of waves of SOES orders, quotes in the Nasdaq market become more volatile and may be misleading to the investing public. Accordingly, absent continuation of the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature, the quotations published by Nasdaq may not reflect the true market in a security and, as a result, there may be short-term volatility and loss of liquidity in Nasdaq securities, to the detriment of the investing public. Further, the continuation of the automated refresh feature will ensure that a market maker's quotation is updated after an exposure limit is exhausted. Uninterrupted use of this function will maintain continuous quotations in Nasdaq as market makers exhausting their exposure limits in SOES will not be subject to a "closed quote" condition or an unexcused withdrawal from the market.

Finally, the NASD believes that the proposed rule change is consistent with significant national market system objectives contained in Section 11A(a)(1)(C) of the Act. This provision states it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure, among other things: (i) economically efficient execution of securities transactions; (ii) fair competition among brokers and dealers; and (iii) the practicality of brokers executing investor orders in the best market. Specifically, the SOES Minimum Exposure Limit Rule and the SOES Automated Quotation Update Feature advance each of these objectives by preserving the operational efficiencies of SOES for the processing of small investors' orders, by maintaining current levels of market maker participation through reduced financial exposure from unpreferred orders, and by reducing price volatility and the widening of market makers' spreads in response to the practices of order entry firms active in SOES.

In addition, for the same reasons provided by the SEC when it approved the Interim SOES Rules that are cited above in the text accompanying footnotes 7 through 14, the NASD believes that the proposed rule change is consistent with Sections 15A(b)(6), 15A(b)(9), 15A(b)(11) and 11A(a)(1)(C) of the Act.

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

The NASD believes that the proposed rule change will not result in 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

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 approve 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. 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 January 27, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁹

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-38092; File No. SR-NASD-96-52]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Reporting of Short Sale Transactions by Market Makers Exempt from the NASD's Short Sale Rule

December 27, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on December 17, 1996, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. The Commission is publishing this notice to

²⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

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 NASD is proposing to amend its Automated Confirmation Transaction ("ACT") Service rules to require all Primary Market Makers ("PMMs") to mark their ACT reports to denote when they have relied on the PMM exemption to the NASD's short sale rule.² In order to afford NASD members ample time to modify their automated systems to comply with the proposed rule change, the NASD proposes to establish an effective date for the rule change in a Notice-to-Members announcing Commission approval of the proposal, which Notice-to-Members shall be published within thirty days of Commission approval of the proposal and which effective date shall be no longer than three weeks after the date of publication of the Notice. The text of the proposed rule change is as follows. (Deletions are bracketed.)

* * * * *

NASD Rule 6130

* * * * *

(d) Trade Information To Be Input

Each ACT report shall contain the following information:

(1)–(5). No change.

(6) A symbol indicating whether the transaction is a buy, sell, sell short, sell short exempt [*] or cross;

(7)–(12). No change.

[* The "sell short" and "sell exempt" indicators must be entered for all customer short sales, including cross transactions, and for short sales effected by members that are not qualified market makers pursuant to Rule 3350.]

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.

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

On June 29, 1994, the SEC approved the NASD's short sale rule applicable to short sales in Nasdaq National Market ("NNM") securities on an eighteen-month pilot basis through March 5, 1996.³ The NASD's short sale rule prohibits member firms from effecting short sales at or below the current inside bid as disseminated by Nasdaq whenever that bid is lower than the previous inside bid.⁴ The rule is in effect during normal domestic market hours (9:30 a.m. to 4:00 p.m., Eastern Time).

In order to ensure that market maker activities that provide liquidity and continuity to the market are not adversely constrained when the short sale rule is involved, the rule provides an exemption to "qualified" Nasdaq market makers. Even if a market maker is able to avail itself of the qualified market maker exemption, it can only utilize the exemption from the short sale rule for transactions that are made in connection with bona fide market making activity. If a market maker does not satisfy the requirements for a qualified market maker, it can remain a market maker in the Nasdaq system, although it cannot take advantage of the exemption from the rule.

To be a "qualified" market maker, a market maker must satisfy the Nasdaq Primary Market Maker ("PMM") Standards. Under the PMM Standards, a market maker must satisfy at least two

of the following four criteria to be eligible for an exemption from the short sale rule: (1) The market maker must be at the best bid or best offer as shown on Nasdaq no less than 35 percent of the time; (2) the market maker must maintain a spread no greater than 102 percent of the average dealer spread; (3) no more than 50 percent of the market maker's quotation updates may occur without being accompanied by a trade execution of at least one unit of trading; or (4) the market maker executes 1½ times its "proportionate" volume in the stock.⁵ If a market maker is a PMM for a particular stock, there is a "P" indicator next to its quote in that stock.

If a member firm is a PMM in 80 percent or more of the securities in which it has registered, the firm may immediately become a PMM (i.e., a qualified market maker) in an NNM security by registering and entering quotations in that issue. Otherwise, it may become a PMM in a stock only after it has registered in the stock as a regular Nasdaq market maker and satisfied the PMM qualification standards for the next review period. The ability of a member firm to achieve and maintain PMM status in 80 percent of the NNM issues in which it is registered also has other corollary effects in market maker registration situations involving initial public offerings, secondary offerings, mergers and acquisitions.

In order to enhance the NASD's ability to surveil for compliance with the short-sale rule, when the Commission approved the NASD's short-sale rule it also approved an NASD proposal to require NASD members to append a designator to their ACT reports to denote whether their sale transactions were long sales, short sales, or exempt short sales. However, market makers exempt from the short-sale rule are not required to append "sell short" or "sell short exempt" to their ACT reports.⁶ Accordingly, in order to enhance the NASD's ability to surveil for potential abuses of the market maker exemption and examine and monitor the market impacts of the market maker exemption, the NASD is

³See Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994) ("Short Sale Rule Approval Order"). The termination date for the pilot program has subsequently been extended through October 1, 1997. See Securities Exchange Act Release Nos. 36171 (August 30, 1995), 60 FR 46651; 36532 (November 30, 1995), 60 FR 62519; 37492 (July 29, 1996), 61 FR 40693; and 37919 (November 1, 1996), 61 FR 57934.

⁴Nasdaq calculated the inside bid or best bid from all market makers in the security (including bids on behalf of exchanges trading Nasdaq securities on an unlisted trading privileges basis), and disseminates symbols to denote whether the current inside bid is an "up bid" or a "down bid." Specifically, an "up bid" is denoted by a green "up" arrow and a "down bid" is denoted by a red "down" arrow. Accordingly, absent an exemption from the rule, a member cannot effect a short sale at or below the inside bid for a security in its proprietary account or a customer's account if there is a red arrow next to the security's symbol on the screen. In order to effect a "legal" short sale on a down bid, the short sale must be executed at a price at least a 1/16th of a point above the current inside bid. Conversely, if the security's symbol has a green up arrow next to it, members can effect short sales in the security without any restrictions.

⁵Specifically, the proportionate volume test requires a market maker to account for volume of at least 1½ times its proportionate share of overall volume in the security for the review period. For example, if a security has 10 market makers, each market maker's proportionate share volume is 10 percent. Therefore, the proportionate share volume is one-and-a-half times 10, or 15 percent of overall volume.

⁶Specifically, the footnote to NASD Rule 6130(d)(6) provides that "[t]he 'sell short' and 'sell short exempt' indicators must be entered for all customer short sales, including cross transactions, and for short sales effected by members that are not qualified market makers pursuant to Rule 3350."

²A short sale is a sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. To determine whether a sale is a short sale members must adhere to the definition of a "short sale" contained in SEC Rule 3b-3, which rule is incorporated into Nasdaq's short sale rule by NASD Rule 3350(k)(1).

proposing to delete the footnote to NASD Rule 6130(d)(6), thereby requiring all exempt market makers to mark their ACT reports to denote when they have relied on the market maker exemption.⁷ In this connection, the NASD also notes that SEC staff has expressed preliminary concerns with the fact that the NASD's short sale rule does not apply uniformly to all market participants by virtue of the market maker exemption. As a result, to justify retention of the market maker exemption, SEC staff has indicated that the NASD must, among other things, conduct a thorough analysis of the use and effects of the market maker exemption.

The NASD believes the short-sale information that would be gathered upon approval of this rule filing would be a necessary and critical component of such an analysis of the market maker exemption.

The NASD believes the proposed rule change is consistent with Sections 15A(b)(6) of the Act.⁸ 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, and to remove impediments to and perfect the mechanism of a free and open market. Specifically, the NASD believes that requiring exempt market makers to mark their ACT reports to denote when they have relied on the market maker exemption will help to enhance the ability of NASD Regulation, Inc. to monitor whether market makers are abusing the exemption and facilitate the NASD's ability to examine the market impacts of the market maker exemption from the short sale rule.

⁷ In this connection, consistent with SEC statements regarding the intraday netting obligations of firms under SEC Rule 3b-3, the NASD notes that it will be permissible for firms to conduct a "firm-wide netting" of long and short positions once a day. Accordingly, the NASD believes it would be permissible for a Nasdaq trading desk to receive a stock position report at the opening and net those trades effected by the Nasdaq trading desk against this position throughout the day to determine whether particular sale was long or short. Of course, if a firm has developed the capability to continuously net its positions throughout that day, that firm would have to rely on such updated position reports to determine whether a particular sale was long or short. See Securities Exchange Act Release No. 27938 (April 23, 1990), 55 FR 17949, 17950.

⁸ 15 U.S.C. § 78o-3(b)(6).

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

The NASD believes that the proposed rule change will not result in 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

Comments were neither solicited nor received.

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

The NASD requests that the proposed rule change be approved on an accelerated basis. The NASD believes that good cause exists to accelerate approval of the proposal because of the NASD's need to commence capturing exempt sales by exempt market makers through ACT for a sufficient time in advance of the expiration of the pilot program for the rule on October 1, 1997. With the information collected, the NASD's Economic Research Department can conduct a meaningful and statistically significant study on, among other things, the market impact of the market maker exemption from the rule.

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, NW., Washington, DC 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-96-52, and should be submitted by January 27, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

⁹ 17 CFR 200.30-3(a)(12) (1996).

Margaret H. McFarland,
Deputy Secretary.
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[Release No. 34-38091; File No. SR-NASD-96-55]

Self-Regulatory Organizations; Notice of Proposed Rule Changes by the National Association of Securities Dealers, Inc. Relating to Primary Market Maker Standards

December 27, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on December 23, 1996, 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. 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, a wholly owned subsidiary of the National Association of Securities Dealers, Inc. ("NASD" or "Association"), proposes to temporarily waive NASD Rule 4612, regarding primary Nasdaq market maker standards for the remainder of the current pilot period of the Nasdaq Short Sale Rule² or until new primary market maker standards can be devised.

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.

¹ 15 U.S.C. § 78s(b)(1) (1988).

² On November 1, 1996, the Commission extended the pilot period of the NASD Short Sale Rule through October 1, 1997. Securities Exchange Act Release No. 37917 (November 1, 1996), 61 FR 57934 (or approving on an accelerated basis an extension to the NASD's Short Sale Rule through October 1, 1997).