availability of information needed to fully investigate a potential manipulation if it were to occur. For foreign stock index derivative products, these agreements are especially important to facilitate the collection of necessary regulatory, surveillance and other information from foreign jurisdictions. In order to address the above concerns, the Commission notes that the Index will be maintained in accordance with CBOE Rule 31.5(E)(7), which states that foreign country securities or ADRs that are not subject to a comprehensive surveillance agreement and have less than 50% of their global trading volume in dollar value in the United States, cannot, in the aggregate, represent more than 20% of the weight of an index.

For the reasons discussed above, the Commission finds good cause to approve Amendment No. 2 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Specifically, Amendment No. 2 provides that the Index value will be disseminated every 15 seconds and will be calculated based on real-time prices, for all of the component stocks, including those foreign stocks that are traded during CBOE trading hours. With respect to foreign stock components that trade during CBOE trading hours, each Index calculation will use the most recent last sale price from the appropriate home market. For foreign stocks that do not trade during CBOE trading hours, the closing price will be used to calculate the Index value. In addition, Amendment No. 2 clarifies that component securities will be replaced or supplemented only under the events discussed below. Absent unusual circumstances involving a merger or consolidation, conversion into another class of securities, a spin-off, or the termination of a depositary receipt program, the Exchange will adhere to the following procedures: (1) in the event of a merger or consolidation (whether between component stocks or between one component stock and one non-component stock), the original component stock will be replaced by the new security; (2) in the event of a conversion into another class of security, the original component stock will be replaced by the new security; (3) in the event of a spin-off of a subsidiary, both the subsidiary issue and the original parent security will be included in the Index, unless the subsidiary is an insignificant percentage of the original security, in which case the CBOE will consult with the SEC prior to omitting the subsidiary issuer from the Index; and (4) should a depositary receipt program be terminated, for any reason, after an ADR had already been included in the Index, the CBOE in consultation with the SEC staff will evaluate the appropriate procedure to be employed to ensure continuity of the Index. The Commission notes that no comments were received when the original notice of the proposed rule change was published and that no new regulatory issues are presented in Amendment No. 2.

Accordingly, the Commission believes that it is consistent with Sections 6(b)(5) and 19(b)(2)[19] of the Act, to find good cause exists to approve Amendment No. 2 on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, 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–98–17 and should be submitted by July 10, 1998.

For the foregoing reasons, the Commission finds that the CBOE's proposal to list and trade warrants based on the Index is consistent with the requirements of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR–CBOE–98–17), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[20]

Jonathan G. Katz,

Secretary.

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comprehensive surveillance agreement require that the parties to the agreement provide each other, upon request, information about market trading activity, clearing activity and customer identity. *See* Securities Exchange Act Release No. 31529 (November 27, 1992).

[19] 15 U.S.C. 78s(b)(2).

[20] 17 CFR 200.30–3(a)(12) (1994).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40087; File No. SR–NASD–98–23]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc; Order Granting Approval and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 and Amendment No. 2 to Proposed Rule Change Relating to an Amendment to the NASD's Options Position Limit Rule

June 12, 1998.

I. Introduction

On March 10, 1998, NASD Regulation, Inc. (''NASD Regulation'') submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'' or ''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend Rule 2860(b) of the National Association of Securities Dealers, Inc. (''NASD'') or ''Association'') to: (1) increase the position limits on conventional equity options to three times the basic position limits for standardized equity options on the same security; (2) disaggregate conventional equity options from standardized equity options and FLEX Equity Options for position limit purposes; and (3) provide that the OTC Collar Aggregation Exemption shall be available with respect to an entire conventional equity options position, not just that portion of the position that is established pursuant to the NASD's Equity Option Hedge Exemption.

The proposed rule change was published for comment in Exchange Act Release No. 39893 (April 21, 1998), 63 FR 23317 (April 28, 1998) NASD Regulations submitted an amendment to the proposed rule change on April 29, 1998.[3] A second amendment to the

[1] 15 U.S.C. 78s(b)(1) (1988).

[2] 17 CFR 240.19b–4 (1994).

[3] *See* Letter to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, from John M. Ramsay, Vice President and Deputy General Counsel, NASD Regulation, dated April 29, 1998 (''Amendment No. 1''). Amendment No. 1 makes certain technical corrections to the text of the proposed rule change.

proposed rule change was submitted on June 3, 1998.[4] One comment letter was received on the proposal[5] This order approves the proposed rule change, as amended.

II. Description

NASD Rule 2860(b)(3) provided that the position limit[6] for each equity option is determined according to a five-tiered system whereby more actively traded securities with larger public floats are subject to higher position limits and less actively traded stocks are subject to lower limits.[7] Presently, conventional and standardized equity options are subject to the same position limits, and all equity options overlying a particular equity security on the same side of the market are aggregated for position limit purposes, regardless of whether the option is a conventional, standardized or FLEX Equity Option.[8] On September 9, 1997, the Commission approved a two-year pilot program (''Pilot Program'') to eliminate position and exercise limits for FLEX Equity Options, which are traded on the American Stock Exchange, Inc. (''AMEX''), the Chicago Board Options Exchange, Inc. (''CBOE''), and the Pacific Exchange, Inc. (''PCX'') (collectively ''Options Exchange'').[9] In light of the Pilot Program, NASD Regulation is proposing to amend its rules governing position and exercise limits for conventional equity options. NASD Regulation previously has filed a proposed rule change to eliminate position and exercise limits on FLEX Equity Options to make its rules consistent with the Pilot Program.[10] NASD Regulation believes the proposed rule change herein is necessary to foster competition between the over-the-counter (''OTC'') market and the Options Exchanges.

FLEX Equity Options are exchange-traded options issued by the OCC that give investors the ability, within specified limits, to designate certain terms of the option (*i.e.*, the exercise price, exercise style, expiration date, and option type). Because they are non-uniform and individually negotiated, FLEX Equity Options closely resemble and are economically equivalent to conventional equity options. Accordingly, to align more closely the NASD's position limit rules for conventional equity options with the rules for FLEX Equity Options, NASD Regulation proposes to amend Rule 2860(b)(3) to provide that: (1) position limits on conventional equity options shall be increased to three times the basic position limits for standardized equity options on the same security, (2) conventional equity options shall be disaggregated from standardized equity options FLEX Equity Options for position limit purposes; and (3) the OTC Collar Aggregation Exemption shall be available with respect to an entire conventional equity options position, not just that portion of the position that is established pursuant to the NASD's Equity Option Hedge Exemption.

The NASD's Equity Option Hedge Exemption[11] provides for an automatic exemption from equity option limits for accounts that have established hedged positions on a limited one-for-one basis (*i.e.*, 100 shares of stock for one option contract). Under the Equity Option Hedge Exemption, the largest options position that may be established (combining hedged and unhedged positions) may not exceed three times the basic position limit. The OTC Collar Aggregation Exemption[12] provides that positions in conventional put and call options establishing OTC collars need not be aggregated for position limit purposes. An OTC collar transaction involves the purchase (sale) of a put and the sale (purchase) of a call on the same underlying security to hedge a long (short) stock position.

At the present time, NASD Regulation believes that the prudent regulatory approach is to increase position limits on conventional equity options in conjunction with continued availability of the Equity Option Hedge Exemption and OTC Collar Aggregation Exemption. NASD Regulation proposes an incremental approach and in this case believes increasing position limits for conventional equity options to three times the position limits for standardized equity options is appropriate. These proposed limits correspond to the position limits in effect for FLEX Equity Options prior to the Pilot Program.

NASD Regulation also believes that conventional equity options positions should not be aggregated with standardized and FLEX Equity Options on the same securities for position limit purposes. It believes that disaggregation of conventional and other options is necessary to give full effect to the proposed increase in position limits for conventional equity options. Without disaggregation, positions in FLEX Equity Option or standardized option positions would reduce or potentially even eliminate (in the case of FLEX

[4] *See* Letter to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, from Gary L. Goldsholle, Assistant General Counsel, NASD Regulation, dated June 2, 1998 (''Amendment No. 2''). Amendment No. 2 corrects a deficiency in the language of the proposed rule change by clarifying that the tripling aspect of the proposal will apply to all conventional equity options. Under the current rules, the position limits for conventional equity options overlying a security for which there is no standardize equity options contract is set at 4,500 contracts, or such higher limit for which the underlying security would qualify. As now written, the proposed rule language establishes position limits for conventional equity options at ''three times the applicable position limit established for standardized equity options overlying the security,'' but does not take into account the circumstance where there is no standardized equity option contract overlying the security. Amendment No. 2 proposes language that triples the position limits for all conventional equity options, including those for which there is no standardize equity option contract overlying the security.

[5] *See* Letter to Jonathan G. Katz, Secretary, Commission, from Deutsche Bank Securities, Inc., Merrill Lynch, Pierce Fenner & Smith, Inc., Morgan Stanley & Co., Inc., Salomon Brothers Inc./Smith Barney, Inc., and SBC Warburg Dillon Read, Inc., dated June 2, 1998 (''Firms' Letter''). The letter supports the approval of SR–NASD–98–23, as amended.

The Commission notes that it received a comment letter on a separate NASD rule filing (SR–NASD–97–80) on January 23, 1998, that is relevant to present filing. The letter supported the approval of SR–NASD–97–80, as well a SR–NASD–97–67, which was substantively very similar to the present filing. SR–NASD–97–67, was withdrawn and replaced by the present filing. *See* Letter to Jonathan G. Katz, Secretary, Commission, from Bear, Stearns & Co., Deutsche Morgan Grenfell, Inc., Goldman, Sachs & Co., Lehman Brothers, Inc., Merrill Lynch, Pierce Fenner & Smith, Inc., Morgan Stanley & Co., Inc., Natwest Securities Corporation, Salomon Brothers, Inc., SBC Warburg Dillon Read, Inc., and Smith Barney, Inc., dated January 23, 1998.

[6] Position limits impose a ceiling on the number of option contracts in each class on the same side of the market (*i.e.*, aggregating long calls and short puts or long puts and short calls) that can be held or written by an investor or group of investors acting in concert. Exercise limits restrict the number of options contracts that an investor or group of investors acting in concert can exercise within five consecutive business days. Under NASD Rules, exercise limits correspond to position limits, such that investors in options classes on the same side of the market are allowed to exercise, during any five consecutive business days, only the number of options contracts set forth as the applicable position limit for those options classes. *See* NASD Rules 2860(b) (3) and (4).

[7] Currently, the five tiers are for 4,500, 7,500, 10,500, 20,000, and 25,000 contracts NASD rules do not specifically govern how a specific equity option falls within one of the five position limit tiers. Rather, the NASD's position limit established by an options exchange(s) for a particular equity option is the applicable position limit for purpose of the Government's rule.

[8] Standardized options are exchange-traded options issued by the Options Clearing Corporation (''OCC'') that have standard terms with respect to strike prices, expiration dates, and the amount of the underlying security. A conventional option is any other option contract not issued, or subject to issuance by, OCC.

[9] *See* Exchange Act Release No. 39032 (September 9, 1997) 62 FR 48683 (September 16, 1997).

[10] SR–NASD–98–15. The Commission notes that SR–NASD–98–15 was approved on March 19, 1998. *See* Exchange Act Release No. 39771 (March 19, 1998), 63 FR 14743 (March 26, 1998).

[11] Rule 2860(b)(3)(A)(vii).

[12] 2860(b)(3)(A)(viii).

Equity Options) the available position limits for conventional equity options.

To illustrate how these proposed amendments would work, consider the following example of stock ABCD, which is subject to a position limit of 25,000 standardized equity option contracts. In this example, a market participant could establish a position of 25,000 standardized option contracts on ABCD and an additional 75,000 conventional option contracts on ABCD on the same side of the market, since conventional and standardized option positions would be disaggregated. In addition, the market participant also may have a position of any size in FLEX Equity Options overlying ABCD, since such FLEX Equity Options would not be aggregated with either the conventional equity options or standardized equity options overlying ABCD. Further, by taking advantage of the Equity Option Hedge Exemption, which permits a market participant to assume a hedged options position that is three times the otherwise applicable position limit, a market participant could increase the number of conventional equity options to 225,000 contracts.

NASD Regulation proposes to modify the terms of the OTC Collar Aggregation Exemption to apply to an entire conventional equity option position, not just the portion that is established pursuant to the Equity Option Hedge Exemption. NASD Regulation believes such an amendment is consistent with the economic logic underlying the OTC Collar Aggregation Exemption, *i.e.*, that if the terms of the exemption are met, the segments of an OTC collar will never both be in-the-money at the same time or exercised. Under current rules, assuming that stock ABCD is subject to a basic position limit of 25,000 contracts, a market participant taking advantage of the Equity Option Hedge Exemption could establish a hedged position on ABCD involving a total of 75,000 conventional equity option contracts (three times the basic limit), including 50,000 contracts that are established under the Equity Option Hedge Exemption. A market participant using the OTC Collar Aggregation Exemption could then establish a conventional position of 50,000 long (short) calls and 50,000 short (long) puts, for a total of 125,000 contracts overlying ABCD. The proposed rule change to the OTC Collar Aggregation Exemption would allow a market participant to establish a collar consisting of two segments, each of which involves a position three times greater than the basic position limit. Consequently, using the example above, a market participant could establish an OTC collar on ABCD involving 75,000 long (short) calls and 75,000 short (long) puts, for a total of 150,000 contracts.[13]

If, however, the basic position limits for conventional options were tripled, as proposed above, the permissible options position established under the OTC Collar Aggregation Exemption would be correspondingly increased. For example, if the market participate in the above example had increased the size of its conventional options position to 225,000 contracts pursuant to the Equity Option Hedge Exemption as proposed above (based upon a limit of three times the 75,000 conventional equity options position limit), the market participant could establish an OTC collar on ABCD involving 225,000 long (short) calls and 225,000 short (long) puts, for a total of 450,000 contracts.

Finally, in addition to the proposed rule changes discussed above, the NASD is proposing to clarify and update the examples contained in IM–2860–1 so that they are consistent with the instant proposal and prior increases in the hedge exemption.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the Association, and, in particular, with the requirements of Section 15A(b)(6).[14] Specifically, the Commission believes that the proposed rule change is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission also believes that the proposed rule changes is consistent with Section 11A of the Act in that it will increase the position limits on conventional equity options, disaggregate conventional equity options from exchange-traded equity options for position limit purposes, and provide that the OTC Collar Aggregation Exemption may be utilized with respect to any conventional equity options position, not just that part of the position that is established pursuant to the NASD's Equity Option Hedge Exemption, and thereby allow market participants in the OTC options market to compete effectively with the participants using standardized options or with entities not subject to position limit rules.

Since the inception of conventional equity options trading, the NASD has had rules imposing limits on the aggregate number of options contracts that a member or customer could hold or exercise.[15] These rules are intended to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulation[16] and for corners or squeezes of the underlying market. In addition, they serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.

The Commission has been careful to balance two competing concerns when considering a self-regulatory organization's position and exercise limits. The Commission has recognized that the limits must be sufficient to prevent investors from disrupting the market for the underlying security by acquiring and exercising a number of options contracts disproportionate to the deliverable supply and average trading volume of the underlying security. At the same time, the Commission has realized that limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market makers from adequately meeting their obligations to maintain a fair and orderly market.[17]

The Commission believes that the proposed rule change will improve the conventional equity options market for several reasons. First, the Commission notes that the NASD's current reporting requirements for all conventional equity options transactions establishing large options positions will apply to such transactions effectuated under the new rule. Rule 2860(b)(5)(ii) imposes

[13] While the OTC Collar Aggregation Exemption is self-effectuating with respect to the hedged components of conventional options positions, NASD Regulation has also permitted members to include non-hedged positions within OTC collars under the terms of the OTC Collar Aggregation Exemption on a pre-approval basis. Accordingly, the instant rule change would turn this pre-approval process for non-hedged components of OTC collars into a self-effectuating process.

[14] 15 U.S.C. 78o–3(b)(6).

[15] As stated earlier, under NASD rules conventional and standardized equity options currently are subject to the same position limits, and all equity options overlying a particular equity security on the same side of the market are aggregated for position limit purposes, regardless of whether the option is a conventional, standardized of FLEX Equity Option.

[16] Mini-manipulation is an attempt to influence, over a relatively small range, the price movement in a stock to benefit a previously established derivatives position.

[17] *See* H.R. Rep. No. IFC–3, 96th Cong., 1st Sess. at 189–91 (Comm. Print 1978) (''Options Study'').

reporting obligations on ''each account in which the member has an interest * * * and each customer account, which has established an aggregate position of 200 or more option contracts * * *.'' Information reported to the NASD is used by the NASD Regulation Market Regulation staff as part of their ongoing market surveillance operations and helps to minimize the risk of any market manipulation or disruption related to the accumulation or disposition of large options positions. It also enables NASD Regulation to identify large positions held or written by a member that could pose a financial risk to the member or its clearing firm.

Second, the tripling of the position limits on conventional equity options will help those investors who utilize conventional equity options, typically large, sophisticated institutional investors, or persons of extremely high net worth, with their extensive hedging needs.[18]

Third, the Commission also believes that the proposed tripling of position limits for conventional equity options will expand the depth and competitiveness of the conventional equity option market without significantly increasing concerns regarding intermarket manipulations or disruptions of the options or the underlying securities. Broker-dealers and banks act as dealers in the OTC derivatives market, and compete with each other for counterparty business. The proposal will enable broker-dealers to compete more effectively with banks that are not subject to NASD rules for OTC options transactions. It will also enable NASD members to accommodate better their clients' risk management strategies. The Commission recognizes, however, that the proposal presents substantial increases in OTC options transactions. It will also enable NASD members to accommodate better their clients' risk management strategies. The Commission recognizes, however, that the proposal present substantial increases in OTVC options positions. Although the proposed rule change increases threefold the position limits for conventional equity options, those markets that are relatively less active and not as deep in trading interest will remain subject to the lowest existing position limit, *i.e.*, 4,500×3, or 13,500 option contracts. Moreover, as noted above, the large positions will be reported to the NASD for monitoring. Finally, the Commission notes that the proposed positions for conventional equity options are still capped at a fixed level, whereas there are no position limits for FLEX Equity options.

Fourth, the Commission believes that the disaggregation of conventional equity options from standardized equity options is warranted given that the tripling provision will otherwise be of limited effect. That is, if an investor has reached the limit for standardized equity options and is required to aggregate those options with his conventional equity options, he will reach the total position limit for conventional equity options sooner than if the standardized and conventional equity options were not aggregated. The Commission also notes that, under the rules of the Options Exchanges, FLEX Equity Options, which are very similar to conventional equity options, are not aggregated with standardized equity options for position limit purposes.[19]

Fifth, the Commission notes that in September 1997, it approved the elimination of position and exercise limits for FLEX Equity Options on a two year pilot basis.[20] As stated above, FLEX Equity Options are exchange-traded options issued by the OCC that give investors the ability, within specified limits, to designate certain terms of the option (*i.e.*, the exercise price, exercise style, expiration date, and option type). Conventional equity options are very similar to FLEX Equity Options given that they are also non-uniform and individually negotiated.[21] Traditionally, the Commission has taken a gradual, evolutionary approach toward expansion of position and exercise limits. The Commission believes that increasing position limits for conventional equity options to three times the position limits for standardized equity options is appropriate given the Commission's previous approach to the expansion of position and exercise limits. The Commission also believes that the proposed rule change will help to foster competition between the OTC market and the Options Exchanges, as well as ensure that OTC market participants are not placed at a competitive disadvantage vis-à-vis the Options Exchanges.

The Commission finds good cause to approve Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register.** Amendment No. 1 makes minor technical changes to the text of the proposed rule. Specifically, Amendment No. 1 clarifies in the rule language that the Equity Option Hedge Exemption program was approved by the Commission on a pilot basis only until December 31, 1998. Amendment No. 1 also makes certain clerical corrections. Accordingly, the Commission believes that it is consistent with Section 15A(b)(6) of the Act to approve Amendment No. 1 to the proposed rule change on an accelerated basis.

The Commission finds good cause to approve Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No 2 corrects a deficiency in the text of the proposed rule. Specifically, Amendment No. 2 clarifies in the rule language that position limits for conventional equity for which there is not standardized equity option contract overlying the security are also to be tripled. Under the current rules, the position limits for conventional equity options overlying a security for which there is no standardized equity options contract is set at 4,500 contracts, or such higher limit for which the underlying security would qualify. As now written, the proposed rule language establishes position limits for conventional equity options at ''three times the applicable position limit established for standardized equity options overlying the security,'' but does not take into account the circumstance where there is no standardized equity option contract overlying the security. Amendment No. 2 proposes language that triples these limits. The Commission believes that accelerated approval of Amendment No. 2 is appropriate given that it clarifies the application of the new position limits in a manner that is consistent with the approach established in the original rule filing. Accordingly, the Commission believes that it is consistent with Section 15A(b)(6) of the Act to approve Amendment No. 2 to the proposed rule change on an accelerated basis.

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1 and Amendment No. 2 to the proposed rule change, including whether the amendments are consistent

[18] In the Firms' Letter, the commenters indicate that they ''have experienced an overwhelming interest by institutional and other accredited investors to enter into collar transactions and other hedging transactions involving conventional options.'' On several occasions they have been unable ''to meet the demand for this hedging activity due to the relatively low [applicable] conventional option position limits.'' *See* Firms' Letter, *supra*, note 5.

[19] Positions in FLEX Index Options generally are also not aggregated with options on any stocks included in the index or with FLEX Index Option positions on another index. *See, e.g.*, CBOE Rule 24A.7(c).

[20] *See supra* note 9.

[21] Conventional equity options are not, however, issued or subject to issuance by OCC.

with the Act. 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 will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR–NASD–98–23 and should be submitted July 10, 1998.

IV. Conclusion

For the foregoing reasons, the Commission finds that NASD Regulation's proposal, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[22] that the proposed rule change (SR–NASD–98–23) is approved, as amended.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[23]

Jonathan G. Katz,

Secretary.

[FR Doc. 98–16351 Filed 6–18–98; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40086; File No. SR–NSCC–98–4]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of a Proposed Rule Change Adopting an Interpretation of the Board of Directors Regarding NSCC's Obligation to Continuously Review Participants to Determine if Participants Are Required to Reapply for Membership Due to a Material Change in Conditions

June 12, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on April 24, 1998, the National Securities Clearing Corporation (''NSCC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change (File No. SR–NSCC–98–4) as described in Items I, II, and II below, which items have been prepare primarily by NSCC. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

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

The proposed rule change would add Addendum T to NSCC's Rules and Procedures regarding NSCC's obligation to continuously review participants to determine if they are required to reapply for membership due to a material change in conditions. A copy of proposed Addendum T is attached as Exhibit A to the rule filing.

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.[2]

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

Under the proposed rule change, NSCC will be permitted to (i) reexamine a participant who has undergone a material change in circumstances,[3] (ii) reconsider the participant's continuing status as a participant as if such entity was initially applying for membership when conditions originally in existence at the time a participant was accepted for membership have materially changed, and (iii) require the participant to satisfy any concerns NSCC may have as to the participant's ongoing membership in NSCC as part of such reevaluation. In addition, Addendum T explicitly states that participants have the affirmative obligation to advise NSCC if such material change occurs.

Under the Act and the rules and regulations thereunder, NSCC is obligated to safeguard securities and funds in the possession and control. NSCC believes that this obligation, coupled with the fact that NSCC is the guarantor of participants' transaction submitted to it for clearance and settlement, require that NSCC have flexibility to consider material changes pertaining to such participants and have the ability to take appropriate steps in light of such changes.

When a material change occurs with respect to an existing participant's ownership, control or management, mix of business, use of third party service provides, or regulatory history, among other areas, NSCC is faced with a different risk perspective than that which it faced at the time it approved such participant's application for membership. The NSCC board has concluded that it is in the best interests of NSCC and its membership as a whole that NSCC address these types of changes, including the ability to require the participants to reapply for membership, as if the participant was not already a participant.

NSCC believes that participants change their business mix as their focus in the financial industry change. According to NSCC, enter new businesses, discontinue old ones, change management, change risk policies, or take other actions or steps which could result in an entirely different entity (other than changing the corporate name of such entity) from the one which was approved for NSCC membership. NSCC believes that if it did not have the ability to continually reexamine participants' status, the purpose behind scrutinizing applications and the comfort level provided by such process, would be undermined.

NSCC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder because it will clarify the rules of NSCC relating to the continuing standards required for membership and NSCC's obligation to safeguard securities and fund within its control.

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

NSCC does not believe that the proposed rule change will impact or impose a burden on competition that is

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[22] 15 U.S.C. 78s(b)(2).

[23] 17 CFR 200.30–3(a)(12) (1994).

[1] 15 U.S.C. 78s(b)(1).

[2] The Commission has modified the text of the summaries prepared by NSCC.

[3] Proposed Addendum T sets forth three categories where changes may warrant reconsideration: (1) material changes in ownership, control of management, (2) material changes in business lines, including but not limited to, new business lines undertaken, or (3) participation as a defendant in litigation which could reasonably have a direct negative impact on the participant's business. Proposed Addendum T states that these categories are listed as examples and should not be viewed as exclusive in the process.