

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,¹¹ that the portion of Amendment No. 4 to the proposed rule change, SR-NASD-98-26, that extends the suspension of the current PMM standards to October 1, 1998, be and hereby is approved on an accelerated basis.¹²

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40139; File No. SR-NASD-97-26]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval to Amendment No. 5 Relating to an Extension of the Pilot for the NASD's Rule Permitting Market Makers To Display Their Actual Quotation Size

June 26, 1998.

I. Background

On June 25, 1998, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly-owned subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission" or "SEC") Amendment No. 5 to a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),¹ and Rule 19b-4 thereunder,² to amend NASD Rule 4613(a)(1)(C), seeking to extend through July 31, 1998, the pilot program in which market makers may quote their actual size (*i.e.*, one normal unit of trading) in 150 Nasdaq stocks ("Actual Size Rule").

The Commission is publishing this notice to solicit comments from interested persons and is approving

Amendment No. 5 on an accelerated basis.

II. Proposed Rule Change

The NASD proposes to amend NASD Rule 4613(a)(1)(C) to extend the Actual Size Rule through July 31, 1998. The text of the proposed rule change is as follows. (Additions are italicized; deletions are bracketed.)

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4613. Character of Quotations

(a) Two-Sided Quotations

(1) No Change

(A)-(B) No Change

(C) As part of a pilot program implemented by The Nasdaq Stock Market, during the period January 20, 1997 through at least [June 30, 1998] *July 31, 1998*, a registered market maker in a security listed on the Nasdaq Stock Market that became subject to mandatory compliance with SEC Rule 11Ac1-4 on January 20, 1997 or identified by Nasdaq as being otherwise subject to the pilot program as expanded and approved by the Commission must display a quotation size for at least one normal unit of trading (or a larger multiple thereof) when it is not displaying a limit order in compliance with SEC Rule 11Ac1-4, provided, however, that a registered market maker may augment its displayed quotation size to display limit orders priced at the market maker's quotation.

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III. Discussion

On August 29, 1996, the Commission promulgated a new rule, the Limit Order Display Rule³ and adopted amendments to the Quote Rule,⁴ which together are designed to enhance the quality of published quotations for securities and promote competition and pricing efficiency in U.S. securities markets (collectively, the "Order Handling Rules").⁵ To facilitate implementation of the Order Handling Rules and accommodate changes in the Nasdaq market that these rules brought about, the Commission later approved a variety of amendments to NASD Rules concerning Nasdaq's Small Order Execution System ("SOES") and the SelectNet Service ("SelectNet").⁶

³ 17 CFR 240.11Ac1-4.

⁴ 17 CFR 240.11Ac1-1.

⁵ See Exchange Act Release No. 37619A (September 6, 1997) 64 FR 48290 (September 12, 1996).

⁶ See Exchange Act Release No. 38156 (January 10, 1997) 62 FR 2415 (January 16, 1997) (order partially approving SR-NASD-96-43).

In particular, the Commission temporarily approved a pilot program⁷ whereby Nasdaq market makers in the first 50 stocks subject to the Commission's Order Handling Rules were only required to display a minimum quotation size of one normal unit of trading when quoting solely for their own proprietary accounts.⁸ For non-pilot Nasdaq stocks, the minimum quotations size requirements of 1,000, 500, or 200 shares remained the same.⁹

Although the first 50 stocks were chosen to provide a broad cross section of the most liquid Nasdaq stocks, on October 29, 1997, the Commission approved an NASD proposal to amend NASD Rule 4613(a)(1)(C) to expand the pilot program to 150 Nasdaq stocks. The Commission also extended the pilot until March 28, 1998.¹⁰ The additional 100 stocks were part of an enhanced sample designed to better represent the entire Nasdaq market. The Commission approved the expansion in response to comment letters suggesting that the first 50 stocks did not sufficiently represent the Nasdaq market because all 20 of the largest Nasdaq stocks were subject to the 100 share minimum. Thus, some commenters suggested that it was difficult to gauge the Actual Size Rule's effect on large Nasdaq stocks since there were no sufficiently large non-pilot stocks with which to compare those in the pilot.

The NASD has concluded an analysis of an expanded pilot, and on March 5, 1998, it filed with the Commission a proposed rule change to apply permanently the Actual Size Rule to all Nasdaq Stocks.¹¹ As part of that filing, the NASD published a 127-page economic study of the 150-stock pilot ("March 1998 Study").

In the March 1998 Study, the NASD concluded that:

- The Actual Size Rule did not affect the market quality—in terms of spreads, volatility, depth, or liquidity—of pilot stocks.
- The Actual Size Rule has not altered the ability of investors to access market maker capital. For pilot stocks,

⁷ *Id.*

⁸ The Actual Size Rule does not affect a market maker's obligation to display the full size of a customer limit order. If a market maker is required to display a customer limit order for 200 or more shares, it must display a quote size reflecting the size of the customer's order, absent an exception from the Limit Order Display Rule. Market makers may display a greater quotation size if they so choose or if required to do so by the Limit Order Display Rule.

⁹ See NASD Rule 4613(a)(2).

¹⁰ See Exchange Act Release No. 39285 (October 29, 1997), 62 FR 59932 (November 5, 1997).

¹¹ See Exchange Act Release No. 39760 (March 16, 1998) 63 FR 13894 (March 23, 1998) (SR-NASD-98-21).

¹¹ 15 U.S.C. 78s(b)(2).

¹² In partially approving the proposal, the Commission has considered the approved portion's impact on efficiency, competition, and capital formation. Moreover, the pilot program, if fully implemented, likely will provide the Commission with data necessary to enable it to evaluate the impact of the proposed PMM standards on the Nasdaq market and market participants. 15 U.S.C. 78c(f).

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

retail investors continued to have substantial and reasonable access to dealer capital via both SOES and marker maker proprietary automatic execution systems.

- There was no evidence of any material difference in market quality of pilot stocks and peer non-pilot stocks during the market stress on October 27 and 28, 1997.

To provide the Commission with sufficient time to review the public comments before determining whether to expand the Actual Size Rule to all Nasdaq stocks on a permanent basis, the NASD proposes to extend the current 150-stock pilot through July 31, 1998.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange Act. 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-97-26 and should be submitted by July 27, 1998.

V. Commission's Findings and Order Granting Accelerated Approval of Amendment No. 5 to the Proposed Rule Change

The Commission approved the Actual Size Rule on a pilot basis so that its effects could be assessed. In doing so, the Commission stated that it believed that a reduction in the quotation size requirement could reduce the risks that market makers must take, produce accurate and informative quotations, and encourage market makers to maintain competitive prices even in the changing market conditions resulting from the Order Handling Rules.

As discussed above, the NASD has produced an extensive economic analysis of the pilot. The data appears to suggest that the pilot has not resulted

in harm to the Nasdaq market. Indeed, as discussed above, the Actual Size Rule appears to be an appropriate adjustment of market making obligations in light of the changing market dynamics resulting from the Order Handling Rules.

Nevertheless, the pilot report is lengthy and the Commission has received hundreds of comment letters on both the report and the NASD's proposal to adopt permanently the Actual Size Rule.¹² Extending the pilot through July 31, 1998, should provide the Commission with sufficient time to review the public comments before determining whether to expand the Actual Size Rule to all Nasdaq stocks on a permanent basis.

For the reasons discussed above, the Commission finds that the NASD's proposal is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities association and has determined to approve the extension of the pilot through July 31, 1998. The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of the filing in the **Federal Register** to permit the NASD to continue the pilot on an uninterrupted basis for an additional month.

Accordingly, the Commission believes that the proposed rule change (SR-NASD-97-26) is consistent with Sections 15A(b)(6) and (b)(9) of the Exchange Act¹³ and

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,¹⁴ that the proposed rule change, SR-NASD-97-26, be and hereby is approved through July 31, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,

Deputy Secretary.

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¹² *Id.*

¹³ In approving this rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. The proposed rule change will provide the Commission with additional time to review the public comments before determining whether to expand the Actual Size Rule to all Nasdaq stocks on a permanent basis. Since the Commission believes that the data discussed above indicates that the pilot has not harmed the Nasdaq market thus far, the net effect of approving the proposed rule change will be positive. 15 U.S.C. 78c(f).

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40132; File No. SR-OCC-97-02]

Self-Regulatory Organizations; the Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Regarding the Issuance, Clearance, and Settlement of Options on Unit Investment Trust Interests and Investment Company Shares That Hold Portfolios or Baskets of Common Stock

June 25, 1998.

On February 21, 1997, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-OCC-97-02) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").¹ On February 21, 1997, May 14, 1997, and June 11, 1998, OCC amended the proposed rule change. Notice of the proposal was published in the **Federal Register** on June 9, 1997.² No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

The rule change amends OCC's existing by-laws and rules to accommodate the issuance, clearance, and settlement of options on exchange listed securities representing units of beneficial interests in open-end unit investment trusts ("trust units") and in open-end management investment companies ("fund shares") that hold securities based on an index or a portfolio of common stocks, such as shares that have been proposed for trading by the American Stock Exchange ("Amex").³ The Amex currently trades trust units known as Portfolio Depository Receipts ("SPDRs") based on the Standard & Poor's ("S&P") 500 index and on the S&P MidCap 400 index. SPDRs are trust units that represent beneficial ownership in the SPDR trust⁴

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 38706 (June 2, 1997), 62 FR 31468.

³ Securities Exchange Act Release No. 38308 (February 19, 1997), 62 FR 8467 [File No. SR-Amex-96-44]. The Chicago Board Options Exchange has filed a proposed rule change to trade similar products. Securities Exchange Act Release No. 38342 (February 26, 1997), 62 FR 10098 [File No. SR-CBOE-97-03].

⁴ The SPDR trust was established to accumulate and hold a portfolio of common stocks that is intended to track the price performance and dividend yield of a particular S&P index.