

help reduce the risk to GSCC that a member will fail after it has received a FOS payment from GSCC but before it has satisfied its clearing fund deficiency call. Thus, the proposal should enhance GSCC's risk management process.

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A 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 (File No. SR-GSCC-98-01) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40197; File No. SR-MSRB-98-04]

Self-Regulatory Organizations, Municipal Securities Rulemaking Board; Order Granting Approval of Proposed Rule Change Relating to Rule G-32, on Disclosures in Connection with New Issues

July 14, 1998.

I. Introduction

On March 25, 1998, the Municipal Securities Rulemaking Board ("Board" or "MSRB") submitted to the Securities and Exchange Commission ("Commission" or "SEC"), 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 amend Rule G-32, on disclosures in connection with new issues. The proposed rule change provides an alternate method of compliance by brokers, dealers and municipal securities dealers with their obligation to deliver official statements in final form to customers by settlement for certain new issues of variable rate demand obligations. Notice of the proposed rule change appeared in the

Federal Register on April 28, 1998.³ The Commission received one comment letter which endorsed the proposed rule change.⁴ This order approves the proposed rule change.

II. Description of the Proposal

The Board amended Rule G-32, on disclosures in connection with new issues, that would permit brokers, dealers and municipal securities dealers ("dealers"), selling variable rate demand obligations ("VRDO's") to customers during the underwriting period, to deliver a preliminary official statement by no later than settlement and to send the official statement in final form within one business day of receipt from the issuer, provided these VRDOs qualify for the exemption provided under subparagraph (d)(1)(iii) of Rule 15c2-12 under the Act ("Rule 15c2-12").

In 1989, the Commission promulgated Rule 15c2-12,⁵ which requires underwriters in primary offerings subject to the rule, among other things, to contract with issuers to receive final official statements within seven business days after any final agreement to purchase, offer or sell municipal securities and to receive these statements in sufficient time to accompany any confirmation that requests payment from any customer. Commenters questioned applying this provision of the rule to VRDOs. In response, the Commission provided an exemption to the rule for obligations that can be tendered by their holders for purchase by the issuer or its agent at least as frequently as every nine months and that are in authorized denominations of \$100,000 or more ("Exempt VRDOs"). This exemption reflects the fundamental structural differences between VRDOs and other traditional municipal securities. For most VRDO issues, particularly those that fall within the Exempt VRDO category, the purchase contract is not executed until the issue closing date or the immediately preceding day.⁶ Thus, in the vast majority of these issues, the Bond Delivery Period, the period between the purchase date and the

closing date, is at most one business day. As issuers typically do not authorize the printing of the official statement in final form until the execution of the purchase contract, underwriters usually do not receive the official statement in final form until the closing date at the earliest and, in many instances, the printed version is not available until after the closing date, at which point the issuer has already delivered the Exempt VRDOs to the underwriters.

At the time Rule 15c2-12 was drafted, the industry's standard Bond Delivery Period was two or more weeks.⁷ For example, the seven business day time frame of paragraph (b)(3) of Rule 15c2-12 presumably anticipated a typical Bond Delivery Period of at least one and one-half weeks, because the final official statement is generally expected to be available at least by closing of the underwriting transaction. Presumably, Rule G-32's official statement delivery obligation was premised, at least in part, on this industry standard.

In 1997, the Board launch a review of the underwriting process which focused on, among other things, the manner and timeliness of delivery of official statements from issuers to underwriters under Rule 15c2-12 and from underwriters to the Board of Rule G-36.⁸ The Board found that, in some instances, issuers do not meet their contractual obligations entered into with underwriters pursuant to Rule 15c2-12 deliver official statements within seven business days after the date of final agreement to purchase, offer or sell the municipal securities. The Board noted that, if issuers are not meeting the current delivery requirement under Rule 15c2-12, it is possible that final official statements also are not being prepared in time to deliver to customers by settlement as required under Rule G-32.

Thus, the Board determined that, because the Bond Delivery Period for Exempt VRDOs is at most one business day, it is often not possible for dealers to settle with customers, who expect to receive delivery of their securities on the issue date, without causing a violation of the requirement that they deliver the official statement in final form to such customers by settlement. As a result, the Board amended Rule G-32 to permit a dealer, selling new issue Exempt VRDOs, to deliver the official statement in preliminary form to the

³ See Securities Exchange Act Rel. No. 39900 (April 22, 1998), 63 FR 23315.

⁴ See letter from Sarah M. Starkweather, Vice President and Associate General Counsel, The Bond Market Association ("TBMA"), to Jonathan G. Katz, Secretary, SEC, dated May 19, 1998.

⁵ Securities Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28700 (July 10, 1989).

⁶ This compressed time frame arises as a result of the fact that, as securities bearing short-term yields sold at par, the market dictates that pricing (*i.e.*, the setting of the interest rate borne by the securities during the initial rate period) and settlement occur on a same-day or next-day basis.

⁷ Standard industry practice dictated that issuers deliver the securities to the underwriters two or more weeks after the sale date for the securities.

⁸ See MSRB Reports, Vol. 17, No. 2 (June 1997) at 3-16.

⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² CFR 240.19b-4.

customer by settlement, together with a written notice that the official statement in final form will be sent to the customer within one business day of receipt. Thereafter, once the dealer receives the official statement in final form, it must send a copy to the customer within one business day of receipt. If no official statement in preliminary form is being prepared, the dealer would only be obligated to deliver by settlement the written notice regarding the official statement in final form and to send the official statement in final form upon receipt.⁹

The amendment provides an alternate method of compliance with Rule G-32 in the case of Exempt VRDOs where the final official statement is either unavailable or incomplete. However, in those limited circumstances where dealers may in fact receive the official statement in final form in sufficient time to deliver it to customers by settlement (e.g., if an issuer approves completion of the official statement in final form prior to execution of the purchase contract), dealers must comply with the existing provision of the rule by delivering the official statement in final form to the customer by settlement. If the final official statement is available or if the issuer approves the final official statement prior to settlement, then the existing provision of the rule would control. The dealer's compliance in this case would not be optional.

III. Discussion

The Commission believes the proposed rule change is consistent with the Act and the rules and regulations promulgate thereunder.¹⁰ Specifically, the Commission believes that approval of the proposed rule change is consistent with Section 15B(b)(2)(C).¹¹

⁹ As in the current rule, if no official statement in final form is being prepared, such dealer would deliver to the customer by settlement the official statement in preliminary form, if any, and written notice to the effect that an official statement in final form is not being prepared. If neither a final nor a preliminary official statement is being prepared, the dealer would only be obligated to deliver by settlement the written notice to the effect that no official statement in final form is being prepared.

¹⁰ The Commission has considered the proposed rule's impact on efficiency, competition and capital formation. The amendment conforms the requirements of MSRB Rule G-32 with those of SEC Rule 15c2-12. Making the rules consistent lessens the dealers' burden of complying with one rule while attempting to avoid violating the other. Also, the dealer's procedural and operational efficiency should be enhanced as the date for determining compliance will be that of receipt of some type of notification from the issuer, which should make for ease of recordkeeping and review. 15 U.S.C. 78c(f).

¹¹ Section 15B(b)(C) requires the Commission to determine that the Board's rules are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination

of the Act. This proposed rule change should remove any potential timing discrepancies concerning dealer and customer receipt of official statements. The rule clarifies dealers' disclosure requirements; if a dealer receives an official statement from the issuer, concerning exempt VRDOs, then it must deliver this official statement within one business day of receipt.

The Commission recognizes the Board's effort to make the disclosure requirements in Rule G-32 consistent with the requirements delineated in Rule 15c2-12 under the Act. The Commission understands that the use of securities with a demand feature (e.g. VRDOs) allows issuers to acquire the necessary financing while protecting against interest rate risk. These types of obligations permit the issuer to convert outstanding debt from short-term variable rate notes to long-term fixed rates.¹² It is possible that the maturities or reset dates of these VRDOs could be so brief (i.e., one day) that the issuer is unable to provide an official statement at settlement. Given the sophisticated nature of these instruments and the rapidity with which they can be converted, the Commission urges dealers to facilitate full and timely disclosure to investors. While the requirements of Rule 15c2-12 are inapplicable to these obligations, sound business practice and general antifraud provisions of the federal securities laws should dictate access to and disclosure of information covered by this rule.

IV. Conclusion

For the above reasons, the Commission believes that the proposed rule change is consistent with the provision of the Act, and in particular with Section 15B(b)(2)(C).

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-MSRB-98-04), is hereby approved.

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

Margaret H. McFarland,

Deputy Secretary.

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with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.

¹² See *supra* note 5 at p. 28810.

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40211; File No. SR-NASD-98-21]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving a Proposed Rule Change to Permanently Expand the NASD's Rule Permitting Market Makers to Display Their Actual Quotation Size

July 15, 1998.

I. Introduction

On March 5, 1998, the National Association of Securities Dealers, Inc. ("NASD" or "Association") through its wholly-owned subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission" or "SEC") 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) permanently to allow market makers to quote their actual size by reducing the minimum quotation size requirement for all Nasdaq securities to one normal unit of trading ("Actual Size Rule" or "ASR").³ The Commission issued the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Concurrent with the March 5, 1998, filing, NASD Economic Research published an economic study entitled "Evidence from the Pilot Expansion on November 10, 1997, and the Market Stress of October 27 and 28, 1997" ("March 1998 Study"). This study followed an earlier study the NASD conducted to analyze the effects of the Actual Size Rule entitled "Effects of the Removal of Minimum Sizes for Proprietary Quotes in The Nasdaq Stock Market, Inc." ("June 1997 Study"). The findings the NASD made in each of these studies are discussed below. Both studies were made publicly available through the NASD's web site.

On January 10, 1997, the Commission approved an NASD proposal to implement the Actual Size Rule on a pilot basis from January 20, 1997 through April 18, 1997. Exchange Act Release No. 38156, 62 FR 2415 (January 16, 1997) (SR-NASD-96-43). Under the initial three-month pilot, Nasdaq market makers could quote in minimum sizes of 100 shares in the 50 Nasdaq securities subject to mandatory compliance with Exchange Act Rule 11Ac1-4 ("Limit Order Display Rule"). The remaining Nasdaq securities were still subject to the existing minimum quotation display requirements for proprietary quotes.

On April 15, 1997, the Commission approved an NASD proposal that extended the 50-stock pilot from April 18, 1997 to July 18, 1997. Exchange Act Release No. 38512, 62 FR 19373 (April 21, 1997) (SR-NASD-97-25). On July 18, 1997, the Commission approved the NASD's request to extend the 50-stock pilot from July 18, 1997 to December 31, 1997. Exchange Act Release No. 38851, 62 FR 39565 (July 23, 1997) (SR-NASD-97-49).

On October 29, 1997, the Commission approved the NASD's proposal to extend the pilot from December 31, 1997 through March 27, 1998, and to