

This conclusion rebuts some commenters' assertions that it is difficult to fill orders over 100 shares close to the inside market without multiple executions, potentially occurring at different price levels.¹⁴⁹ The NASD concluded in the March 1998 Study, however, that 98.5% of SOES orders (98.3% of volume) were fully executed at a single price for pilot stocks after implementation of the Actual Size Rule. For non-pilot stocks, 98.9% of orders (98.8% of volume) were executed at a single price during this period. Multiple price SOES executions are rare for both groups; only 1.3% and 0.9% of SOES orders (1.5% and 1.1% of volume) were executed at multiple prices for the pilot stocks and non-pilot stocks, respectively, post-implementation. Clearly, the Actual Size Rule has had no measurable impact on SOES order disposition. (Footnotes omitted.)¹⁵⁰

The March 1998 Study also made important findings that rebutted claims that investors' access to automatic executions was compromised by the Actual Size Rule. The March 1998 Study found that

As with Nasdaq's SOES system, proprietary autoexecution systems provide investors with immediate access to market maker capital through automatic executions at the inside market. Unlike SOES, however, these systems often automatically execute orders for sizes well above 1,000 shares, which is the largest SOES tier size. Also unlike SOES, these systems are operated at the discretion of the market maker, which generally sets size parameters for proprietary autoexecution systems. Parameters usually vary by stock and customer. Further, market makers determine which customers may use the systems. Accordingly, these systems are not perfect substitutes for SOES. The importance of these systems to individual investors should not be underestimated, however, because a number of the largest national brokerage houses use them to provide immediate, automated access to market maker capital.¹⁵¹

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Like Nasdaq's SOES system, proprietary autoexecution systems provide investors immediate access to market maker capital. Indeed, the analysis of data provided by Participant Firms underscores the importance of these systems to the marketplace. The survey conducted by NASD Economic Research and empirical analysis of these data demonstrates that the Actual Size Rule has not impacted these important systems in any way.¹⁵²

In sum, the Commission approved the NASD's rule change (to require Nasdaq market makers to quote at least 1,000 shares) in 1990 out of concern that

market maker quotations at that time did not provide a realistic picture of execution size available and the depth of the market. The NASD's data shows that this is no longer the case. Thus, in light of the changes brought about by the Order Handling Rules, which have served to make the Nasdaq market significantly more order-driven, and the empirical research indicating no material adverse impact of the Actual Size Rule on investors or the Nasdaq market, and after carefully considering all of the comment letters, the Commission has concluded that minimum quotation sizes are no longer necessary and should be removed for all Nasdaq stocks.

The Commission therefore finds that the proposed rule change is consistent with the Exchange Act, including Sections 11A(a)(1)(C), 15A(b)(6), and 15A(b)(11). Specifically, Section 11A(a)(1)(C) provides that it is in the public interest to, among other things, assure the economically efficient execution of securities transactions and the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities. 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, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. Section 15A(b)(11) requires that the rules of a national securities association be designed to produce fair and informative quotations and to prevent fictitious or misleading quotations, among other things.

As discussed above, the Commission believes that the Actual Size Rule should not have a material adverse impact on market spreads, volatility, depth, liquidity, or investor access. In addition, the Actual Size Rule should give market makers more flexibility to manage their risk. Removing the current minimum size requirements enables market makers to reflect size in their quotations based on market and business factors instead of a regulatory-imposed minimum. This should increase the information content of market makers' quotes. Finally, by removing the current regulatory size requirements, the Actual Size Rule removes a barrier to entry for making

markets in Nasdaq securities. The Commission believes that the net long-term results of the Actual Size Rule should benefit market makers and investors without adversely affecting market quality.

V. Conclusion

For the reasons discussed above, the Commission finds that the NASD's proposal is consistent with the Exchange Act (specifically, Sections 11A and 15A of the Exchange Act) and the rules and regulations thereunder applicable to a national securities association and has determined to approve the NASD's proposal to amend NASD Rule 4613(a)(1)(C) permanently to allow Nasdaq market makers to quote their actual size by reducing the minimum quotation size requirement for Nasdaq market makers in all Nasdaq securities to one normal unit of trading.¹⁵³

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,¹⁵⁴ that the proposed rule change, SR-NASD-98-21, be and hereby is approved.

By the Commission.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[(Release No. 34-40200; File No. SR-NASD-98-33)]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Amendment 1 Thereto Relating to Exemptions From Fidelity Bonding Requirements

July 14, 1998.

I. Introduction

On April 20, 1998, the National Association of Securities Dealers, Inc., ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities

¹⁵³ In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. As discussed above, the proposed rule likely will produce more accurate and informative quotations, increase competition, and encourage market makers to maintain competitive prices.

¹⁵⁴ 15 U.S.C. 78s(b)(2).

¹⁴⁹ See, e.g., R. Chung Letter; Eisner Letter; Meurer Letter; Sanbeg Letter; Sherwood Letter; Wieser Letter; Wilson Letter; and Zatorski Letter.

¹⁵⁰ March 1998 Study at 87-88.

¹⁵¹ *Id.* at 89.

¹⁵² *Id.* at 90.

Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder² to grant authority to NASD staff to adjust the fidelity bond required of a member in certain circumstances. By letter dated May 27, 1998, the Association filed Amendment 1 to the proposed rule change.³ The proposed rule change and Amendment 1 were published for comment in the **Federal Register** on June 10, 1998.⁴ No comments were received. This order approves the proposal.

II. Description of the Proposal

Rule 3020 of the Conduct Rules of the NASD specifies that members are required to maintain fidelity bonds to insure against certain losses and the potential effect of such losses on firm capital. The rule applies to all members with employees who are required to join the Securities Investor Protection Corporation and who are not covered by the fidelity bond requirements of a national securities exchange. The amount of coverage a member is required to maintain is linked to the member's net capital requirements under Rule 15c3-1 under the Act.⁵ Under paragraph (c) of Rule 3020, each member must annually review the adequacy of its fidelity bond coverage and maintain coverage that is adequate to cover its highest net capital requirement during the preceding 12 months. For example, even if a full-service member divests its clearing business, so that it no longer holds customer funds or securities, it would still be required to maintain bond coverage that is based on the higher net capital requirement that applied during the preceding year.

The proposed rule change would amend Rule 3020 to permit staff of NASD Regulation, Inc., ("NASD Regulation") to adjust the fidelity bond requirements to reflect changes in a member's business. Requests for exemption would be considered under recently adopted Procedures for Exemption in the 9600 Series of Rules in the Code of Procedure. Under the procedures, NASD Regulation staff issues written determinations that are subject to review by the National Adjudicatory Council.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of Section 15A(b)(6) of the Act,⁶ which provides, among other things, that the rules of a national securities association be designed to protect investors and the public interest.⁷ The Commission believes that the proposed rule change will allow members to be relieved from maintaining unnecessarily high fidelity bond coverage without compromising investor protection.

The rule change applies a "good cause" standard that will require a member to demonstrate that a modification from the bonding requirement is justified by the level of loss exposure that may be expected from the member. The premiums are changed from time to time to reflect changes in loss experience and to ensure that sufficient funds are available to pay any losses reported to the insurer. NASD Regulation represents that it will apply this authority only where it is clear that an exemption will not have any unintended impact on the insurance pool, and the modified coverage will adequately protect the member against potential losses. In addition, the proposed rule change will permit NASD Regulation staff to include conditions in an exemption to ensure that any subsequent increase in capital requirements is accompanied by a corresponding increase in coverage.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,⁸ that the proposed rule change (SR-NASD-98-33) is approved.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40205; File No. SR-OCC-97-12]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving a Proposed Rule Change Regarding Initial and Minimum Net Capital Requirements for Futures Commission Merchants

July 15, 1998.

On July 15, 1997, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-OCC-97-12) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").¹ Notice of the proposal was published in the **Federal Register** on February 19, 1998.² No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

The proposed rule change amends OCC's initial and ongoing minimum net capital requirements and early warning notice provisions to establish additional requirements for clearing members that are also registered futures commission merchants ("FCMs"). Currently, OCC's rules require its members to satisfy initial and ongoing minimum net capital requirements of \$1,000,000 and \$750,000, respectively.³ Under the proposed rule change, the initial and ongoing minimum net capital of OCC members that are also FCMs must exceed the greater of the following standards: OCC's current initial and ongoing minimum net capital requirements or that required by the clearing organization of the FCM member's designated self-regulatory organization ("DSRO").⁴

The proposed rule change also modifies OCC's early warning notice provisions to require OCC members that are also FCMs to notify OCC if that member's net capital falls below OCC's requirements or if its net capital falls below the minimum net capital required by the clearing organization of the FCM member's DSRO.

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 39648 (February 11, 1998), 63 FR 8509.

³ OCC Rules 301 and 302.

⁴ Robert C. Rubenstein from OCC in a letter dated September 3, 1997, to the Commission stated that according to OCC, the terms clearing organization and SRO shall have the meanings ascribed to them in the General Regulation of the Commodity Exchange Act, 17 CFR 1.3(d) and 17 CFR.1.3(ff) (1) and (2).

¹ 15 U.S.C. 78s(b)(1) (1994).

² 17 CFR 240.19b-4 (1997).

³ Amendment 1 revised the last sentence of proposed new paragraph (c)(4) of Rule 3020. See Letter from Elliott R. Curzon, Assistant Chief Counsel, NASD Regulation, to Lisa Henderson, Attorney, SEC, dated May 27, 1998.

⁴ Securities Exchange Act Release No. 40065 (June 3, 1998), 63 FR 31819.

⁵ 17 CFR 240.15c-1 (1997).

⁶ 15 U.S.C. 78f(b)(6).

⁷ In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).