

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 CHX. All submissions should refer to the File No. SR-CHX-98-23 and should be submitted by November 12, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40553; File No. 4-208]

Intermarket Trading System; Order Approving Thirteenth Amendment to the ITS Plan Relating to the Elimination of the Requirement That the Cincinnati Stock Exchange, Inc. Submit Proposed Rule Changes to its Rule 11.9 or the Description of NSTS Processing to Other ITS Participants for Review and Comment Prior to Filing Such Changes With the Securities and Exchange Commission, and Making Certain Technical Changes

October 14, 1998.

I. Introduction

On August 17, 1998, the Intermarket Trading System ("ITS") submitted to the Securities and Exchange Commission ("Commission") an amendment ("Thirteenth Amendment") to the Restated ITS Plan ("Plan")¹ pursuant to Section 11A of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")² and Rule 11Aa3-2 thereunder³ to eliminate the requirement that the Cincinnati Stock Exchange, Inc. ("CSE"), submit proposed rule changes to its Rule 11.9 or the description of National Securities Trading System ("NSTS") processing to other ITS Participants for review and comment prior to filing such changed with the Commission, and to make certain technical changes. The proposed plan

amendment was published for comment in the **Federal Register** on September 3, 1998.⁴ No comments were received on the proposal. For the reasons discussed below, the Commission is approving the proposal.

The ITS is a communications and order routing network linking eight national securities exchanges and the electronic over-the-counter ("OTC") market operated by the National Association of Securities Dealers, Inc. ("NASD"). The ITS was designed to facilitate intermarket trading in exchange-listed equity securities based on current quotation information emanating from the linked markets.

Participants to the ITS Plan include the American Stock Exchange, Inc., ("Amex"), the Boston Stock Exchange, Inc., ("BSE"), the Chicago Board Options Exchange, Inc. ("CBOE"), the Chicago Stock Exchange, Inc. ("CHX"), the CSE, the NASD, the New York Stock Exchange, Inc. ("NYSE"), the Pacific Exchange, Inc. ("PCX"), and the Philadelphia Stock Exchange, Inc. ("PHLX").

II. Description

The purpose of the amendment is to: (1) eliminate the requirement that the CSE submit proposed changes to its Rule 11.9 or the description of NSTS processing to other ITS Participants for review and comment prior to filing such changes with the Commission; (2) recognize the change in corporate name from the Pacific Stock Exchange, Inc. ("PSE") to the Pacific Exchange, Inc. ("PCX"); (3) change the corporate address of the CSE; and (4) make a technical correction to Section 8(e)(iv)(D).

The change concerning prior review of CSE rule changes responds to the Commission's request in its letter to all Participants, dated May 27, 1997.⁵

III. Discussion

The Commission finds that the proposed amendments to the Plan are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national market system plan, and, in particular, with the requirements of Section 11A.⁶ Specifically, the Commission believes the proposal is consistent with the requirements of Sections 11A(a)(1)(C)(ii) and (D)⁷ which provide for fair competition among the ITS Participants

and their members, and the linking of all markets for qualified securities through communications and data processing facilities which foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to the best execution of such orders. The Commission also finds that the amendment is consistent with Rule 11Aa3-2(c)(2)⁸ which requires the Commission to determine that the amendment is necessary and appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system or otherwise in furtherance of the purposes of the Act.

The ITS Plan currently provides a special right of review to ITS Participants for proposed rule changes involving the operating of the CSE's NSTS. NSTS, described in CSE Rule 11.9, is an electronic securities communications and execution system through which bids and offers of public orders and competing dealers are consolidated for review and execution. Under ITS Plan Section 8(e)(iii), any rule, interpretation, or amendment to CSE Rule 11.9, or the description of the NSTS, cannot be submitted by the CSE for Commission approval until other ITS Participants have been afforded a reasonable opportunity to review and comment on the interpretation or amendment. The Commission notes that when the NSTS-ITS link was approved in 1986, the novel nature of NSTS provided some support for this approach. The Commission believes, however, that eliminating the special right of review is appropriate because such review permits other Participants to hinder the CSE from improving its market without prior notice to and comment from its market competitors. Other markets do not have a similar impediment to adjusting their trading systems. The Commission further notes that any system changes to NSTS must be filed with the Commission, and market participants may present any views they have during the comment period.⁹ In addition, the Commission notes that the ITS Participants have acted to eliminate this review requirement in response to the Commission's request.¹⁰ Therefore, the Commission believes that the proposed

¹⁰ 17 CFR 200.30-3(a)(12).

¹ The ITS Plan is a National Market System ("NMS") plan approved by the Commission pursuant to Section 11A of the Act and Rule 11Aa3-2. Exchange Act Release No. 19456 (January 27, 1983), 48 FR 4938.

² 15 U.S.C. 78k-1.

³ 17 CFR 240.11Aa3-2.

⁴ Exchange Act Release No. 40373 (August 27, 1998), 63 FR 47050.

⁵ See letter from Jonathan G. Katz, Secretary, Commission, to ITS Participants, dated May 27, 1997 ("ITS Letter").

⁶ U.S.C. 78k-1.

⁷ U.S.C. 78k-1(a)(1)(C)(ii) and (D).

⁸ 17 CFR 240.11Aa3-2(c)(2).

⁹ The Commission wishes to point out that this filing requirement for systems changes applies equally to all self-regulatory organizations.

¹⁰ See ITS Letter, *supra* note 5.

change to the Plan to eliminate the special right of review of CSE rule changes is reasonable and consistent with the Act because it will eliminate an unfair and anti-competitive burden on the CSE.

The Commission also finds that the additional, technical amendments to the Plan provided in the proposal are reasonable and consistent with the Act.

IV. Conclusion

It is therefore ordered, pursuant to Section 11A(a)(3)(B) of the Act,¹¹ that the amendment be, and hereby is, approved.

For the Commission, by the Division of Market Regulations, pursuant to delegated authority.¹²

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40552; SR-DTC-98-16]

Self-Regulatory Organizations; The Depository Trust Company; Notice of a Proposed Rule Change Modifying the Initial Public Offering Tracking System

October 14, 1998

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on August 19, 1998, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by DTC. 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

Under the proposed rule change, DTC will modify its Initial Public Offering ("IPO") tracking system. Specifically, DTC will process resales by institutional customers of shares in new issues that are being tracked through the IPO tracking system without first determining the identity of the syndicate members that distributed the shares being resold. In addition, DTC will begin to fill stock loans of shares in new issues with shares purchased in the

secondary market prior to using shares received in the initial distribution.²

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

In its filing with the Commission, DTC 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. DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.³

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

1. Resales of IPO Shares by Institutions

The IPO tracking system⁴ allows lead managers of new issues to monitor "flipping"⁵ of shares in new issues that are distributed by book-entry through DTC rather than by use of certificates. When a lead manager in an IPO notifies DTC of its decision to use the IPO tracking system, the system establishes a database of information about the customers who purchased the IPO shares ("IPO database"). Before DTC processes a resale of IPO shares, the redelivering participant is required to provide information about its customer which is then compared with the customer detail in the IPO database so that DTC can determine and report to the lead manager the identity of the syndicate member(s) whose customer has resold IPO shares.

When IPO shares are sold by a retail customer, the customer detail used is

² DTC has prepared written procedures concerning resales by institutions and stock loans to implement the proposed rule change. The complete text of these procedures is attached as Exhibit 2 to DTC's filing, which is available for inspection and copying at the Commission's public reference room and through DTC.

³ The Commission has modified the text of the summaries prepared by DTC.

⁴ For a detailed description of the IPO tracking system, refer to Securities Exchange Act Release No. 37208 (May 13, 1996) (order approving proposed rule change).

⁵ Flipping occurs when a syndicate's lead manager is supporting an IPO with a stabilization bid (i.e., the lead manager is purchasing shares in the secondary market in order to keep the price of the issue from dropping below its initial offering price), and shares in the IPO that had been distributed to investors are resold by those investors in the secondary market to a syndicate member. The lead manager may wish to identify flipped transactions so that underwriting concessions (i.e., the discount from the offering price received by syndicate members) can be recovered from the appropriate syndicate members.

normally provided by the same participant that populated the IPO database (i.e., the syndicate member). Therefore, it is unlikely for the processing of a resale of IPO shares to be delayed because of a failure to match the identity of the reselling customer with any of the customers included in the IPO database.

When the IPO shares are distributed to an institutional customer, the syndicate member making the distribution is rarely the same participant that acts as an institution's agent for settlement. As a result, before DTC will process an institutional customer's resale of IPO shares, the IPO tracking system must match customer detail provided by the redelivering participant (i.e., the institution's agent) with customer detail included in the IPO database by the syndicate member.

DTC believes that many redeliveries of IPO shares for institutional customers during the period from three days prior to closing to three days after closing are not being processed efficiently because the customer detail provided by the institution's agent does not match any customer in the IPO database.⁶ Usually, a mismatch occurs because incorrect customer account information (e.g., missing digits or transposed characters) was entered into the IPO database and does not match the customer account information entered by the reselling institution's agent.⁷ A failure to match may also occur when on the day an issue closes an institution's agent attempts to redeliver IPO shares that were not distributed to its participant account until late in the processing day.⁸

Therefore, DTC is proposing to process resales by institutional customers of shares in new issues that are being tracked through the IPO tracking system without first determining the identity of syndicate members that distributed the shares being resold. DTC intends for the

⁶ Because shares in new issues can be traded on a when-issued basis, the IPO tracking system allows participants to enter redeliveries of IPO shares as early as three business days prior to the date the issue closes and is distributed through the depository.

⁷ In order for processing of the redelivery to be effected in a timely manner, the institution's agent must immediately react to the mismatch either by reclaiming the IPO shares to the syndicate member that distributed the shares to the institution and requesting that the customer account information be corrected or by making adjustments to the IPO database itself.

⁸ Ordinarily, assuming the agent has sufficient position in an issue, the redelivery would be effected. However, if an issue is being tracked, the redelivery will fail because account information relating to its reselling institutional customer is not yet resident in the IPO database.

¹¹ 15 U.S.C. 78k-1(a)(3)(B).

¹² CFR 200.30-3(a)(29).

¹ 15 U.S.C. 78s(b)(1).