

option position; (iv) a stock position resulting from the exercise of a market-maker long position; (v) a net long position in a security (other than an option) in which a market-maker; or (vii) an offset position as defined in Appendix A of SEC Rule 15c3-1.

In addition to the changes described above which were proposed in the First Margin Filing, the Exchange is also proposing to permit a market-maker to receive market-maker margin treatment on transactions in options or other derivative securities effected on an exchange of which he is not a member and on which he is not registered as a market-maker if the options or other derivative securities are dually listed on the exchange on which he is a registered market-maker, or if the transactions are recognized offsets as defined by Rule 15c3-1.

These transactions may be maintained by a carrying broker-dealer on a margin basis mutually satisfactory to the concerned parties, provided that the member, in the same calendar quarter, executes 80% of his total volume in the options class, product group or other SEC recognized offset group on the exchange where he is registered as a market-maker, and provided that such transactions are effected for the purpose of hedging, reducing the risk of, rebalancing, liquidating open positions of the market-maker, or for the purpose of effecting transactions pursuant to the "trade or fade" rules of any options exchange.⁶ This requirement will ensure that transactions effected by order in markets where the member is not registered as a market-maker are in fact reasonably related to his or her market-making function and are not effected for the purpose of speculation on a margin basis which is applicable only to market-makers and specialists.

A change is also being made to allow facsimile notice of a deficit condition in an account. This change is consistent with the Commission's Rule 15c3-1.

Interpretation to Rule 12.3

Interpretation .04 addresses the manner in which the carrying firm may comply with its responsibility to extend credit properly to market-maker permitted offset transactions effected on an exchange where the market-maker is not registered. If a market-maker fails to specify to which account such an order should be placed and the resulting transaction clears in a market-maker account, and not a customer account, it will be presumed that the market-maker elected market-maker margin treatment

for the position effected on an exchange of which he is not a member. The clearing firm may rely on this in good faith unless the clearing firm knows, or has reason to know, that the market-maker is not or will not be in compliance with the requirement to effect 80% of his transactions in a particular class or product offset group on the exchange where he is registered as a market-maker. Clearing firms are, however, responsible for implementing adequate procedures to ensure that such orders are recorded accurately and cleared into the appropriate accounts.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5) that an exchange have rules that are 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 protect 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.

The proposed rule change: (1) Permits a market-maker to receive market-maker margin treatment on transactions in options and other securities and (ii) allows certain defined strategies involving options to be carried in a cash account. The Exchange believes that the proposed rule change is consistent with, and furthers, the objectives of Section 6(b)(5) of the Act, in that it is designed to perfect the mechanisms of a free and open market and to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The CBOE does not believe that the proposed rule change will impose any burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period: (i) As the Commission may designate up to 90 days of such date if it finds such

longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. 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. Copies of all such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to file number SR-CBOE-97-18 and should be committed by May 12, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 97-10160 Filed 4-18-97; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38501; File No. SR-CBOE-97-17]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to Changes to Its Margin Rules

April 14, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 21,

¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

⁶ CBOE Rule 8.51(b) sets forth the trade or fade requirements applicable to CBOE market-makers.

1997, the Chicago Board Options Exchange, Incorporated ("CBOE" or the "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The CBOE proposes to make revisions to its rules governing margin that will: (i) Establish CBOE rules to govern areas of margin regulation that will no longer be addressed by Regulation T ("Regulation T") of the Board of Governors of the Federal Reserve System ("Federal Reserve Board" or "Board"), (ii) conform certain CBOE margin rules to those of the New York Stock Exchange ("NYSE"), and (iii) correct or clarify current provisions of the CBOE margin rules. The text of the proposed rule change is available at the Office of the Secretary, CBOE and at the Commission.

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

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

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

1. Purpose

The Exchange is proposing changes to its margin rules at this time because of recent amendments to the Federal Reserve Board's Regulation T, the regulation that covers extensions of credit by and to brokers and dealers.³ Among other things, the amendments to Regulation T will modify or delete certain Board rules regarding options transactions in favor of rules that must be adopted by the options exchanges and approved by the Commission. The new options provisions in Regulation T will not become effective until June 1,

1997. In the course of amending its rules to accommodate the changes necessary because of the Regulation T amendments, the Exchange has found it necessary for the sake of clarity to propose changes to the margin rules that would conform certain CBOE rules to the rules of the NYSE and to make clarifying changes to its existing provisions. The Exchange is also submitting concurrently separate changes to its margin rules in another rule filing. See SR-CBOE-97-18. That second filing will be referred to herein as the "Second Margin Filing." This present filing will be referred to as the "First Margin Filing."

Definition Section

The Exchange is proposing the addition of a definition section in new paragraph (a) of Rule 12.3. The first definition that is being added is a definition of the term "current market value," which is used throughout the Rule. The proposed definition is consistent with the NYSE rules⁴ and the current definition of the term contained in CBOE Rule 24.11, which governs margin for index options. However, the Exchange is also proposing to add an interpretation to Rule 12.3 covering situations where there is no closing price or where trading was halted and not reopened before the normal end of the trading day or where the closing price was outside the last bid and offer that was established after the closing price. In such situations, a member organization may use a reasonable estimate of the market value of the security based upon the then current bids and offers in determining the "current market value" of a security, including an option. The Exchange believes that this interpretation will allow member organizations to arrive at a more reasonable estimate of the current market value in general, and particularly where the underlying securities may be trading or quoted in other markets or in cases where the underlying security re-opens for trading and the options remain closed.

The term "escrow agreement" is also defined in new paragraph (a) of Rule 12.3. The proposed definition is nearly identical to the definition in Regulation T except that the CBOE definition is more restrictive as to the entities that may issue approved escrow receipts. The CBOE definition requires the issuer to be a U.S. bank or trust company supervised and examined by state or federal authority. The Regulation T definition allows the issuer to be a bank or any person designated as a control

location under paragraph (c) of Rule 15c3-3 under the Act. The CBOE is concerned that certain control locations, such as transfer agents, are not appropriate issuers of escrow receipts and that Exchange rules should continue to limit issuers of receipts to entities such as banks, as currently set forth in Rule 24.11(d). The Exchange will, however, continue to study this issue.

Finally, the Exchange is revising its definition of "exempted security" by adopting the Regulation T definition.⁵

Customer Margin Accounts

The Exchange is also proposing to reorganize Rule 12.3 so that all provisions concerning customer margin accounts are in the same sections of the Rule. Currently, customer margin provisions appear throughout the Rule. Paragraph (b) will set forth the default margin requirements on long and short positions in customer margin accounts. Paragraph (c) will set forth the specific margin treatment for particular types of securities and positions held in customer margin accounts.

The margin treatment of "exempted securities" is proposed to be moved from current paragraph (b)(3) of the Rule to new paragraph (c)(3), and amended so that it is consistent with the NYSE's margin rule, Rule 431.⁶ Specifically, the treatment for exempted securities is being revised so that obligations of the United States (as specified in the rule) will be subject to a margin requirement of from 1% to 6%, depending on the years to maturity for the obligation. Zero coupon bonds will be subject to a margin requirement of 3% for bonds with five years or more to maturity. All other exempted securities will be subject to an initial and maintenance margin requirement of 15% of the current market value or 7% of the principal amount, whichever amount is greater. Currently, the rule requires margin of 5% on obligations of the United States and margin of 15% of the principal amount or 25% of the current market value of other exempted securities, whichever amount is lower.

The Exchange is also adopting a margin treatment for nonconvertible debt securities which is consistent with the margin treatment in NYSE Rule 431,⁷ except that the Exchange is not adopting the special exemptions relating to mortgage related securities at this time because this provision is currently

⁵ The Commission notes that the text of the CBOE's rule filing refers to the definition contained in Section 3(a)(12) of the Act rather than the definition contained in Regulation T.

⁶ See NYSE Rule 431(e).

⁷ *Id.*

³ See 61 FR 20386 (May 6, 1996).

⁴ See NYSE Rule 431(a)(1).

the subject of discussion by an industry committee and may be changed. The rule will require margin to be maintained equal to 20% of the current market value or 7% of the principal amount of the non-convertible debt, whichever amount is greater.

The next section, labeled "Security Offsets," combines two current provisions from Rule 12.3 that deal with the margin treatment of short securities offset against: (i) Long positions in a security exchangeable or convertible into the security held in a short position and (ii) long positions in the same security as the short position. The convertible or exchangeable provision is the same as in the current rule (12.3(b)(1)(A)) except that an incorrect parenthetical referring to options is being deleted because options cannot be and never have been considered convertible securities. The Exchange notes that the rules of the other self-regulatory organizations ("SROs") and Regulation T do not refer to options as convertible securities. The provision dealing with offsets between long and short positions in the same security is being moved from 12.3(b)(2)(D) of the current Rule, and the margin requirement is being revised from 10% to 5% of the current market value of the "long" securities to conform the CBOE rule to a similar provision in NYSE Rule 431.⁸

The next provision under new paragraph (c) of Rule 12.3, which deals with exceptions to the default margin treatment for positions in a customer margin account, is the treatment for a short equity call option position offset by a warrant to purchase the underlying security. The proposed treatment is new to Rule 12.3 and is consistent with a provision of Regulation T.⁹ The provision requires no margin for this position if the warrant to purchase the underlying security does not expire on or before the expiration date of the short call, and if the amount (if any) by which the exercise price of the warrant exceeds the exercise price of the short call is deposited in the account.

The next provision, which requires margin to be deposited and maintained equal to 100% of the current market value of long positions in listed equity options, is consistent with current Rule 12.5 and Regulation T and is being added to Rule 12.3 for the sake of clarity.

The provision detailing the margin requirements for short listed equity options is the same as that found in paragraph (a)(5) of the current Rule 12.3

with three exceptions. First, the provision has been moved. Second, the treatment of over-the-counter ("OTC") options has been deleted from the provision because the Exchange is adopting the more extensive OTC margin provisions of the NYSE. Third, the Exchange is proposing the addition of a provision that would cap the margin on short puts that are out-of-the-money at a percentage of the exercise price of the short put. The reason for this cap is that, under the general rule, margin is required equal to the options market value plus 10% of the current market value of equivalent units of the underlying security for an option dealt in on the exchange. However, as the market value of the underlying security increases above the strike price, at some point the put becomes farther out-of-the-money and the risk of the position decreases. Without the cap, the margin requirement would also continue to increase at the same time that the risk of the position is decreasing.

The Exchange is also clarifying the margin treatment of interest rate put options under Rule 23.23¹⁰ and the margin treatment of put warrants under Rule 30.53. The treatment is the same as that for short uncovered put options as described above.

The provisions governing margin treatment for various related securities positions involving listed options carried in a customer margin account have been revised and rearranged. This became necessary after various changes that were made over time rendered the provisions difficult to follow. The Exchange believes that the changes being proposed will simplify the provisions and make them easier for members to follow.¹¹ The treatment for a covered call writing position where the underlying security is a convertible security is similar to that currently describe in 12.3(b)(1)(C) but has been revised to be consistent with Rule 431.¹² The treatment for covered puts is similar to the treatment under current Rule 12.3; however, the language has been revised to conform the CBOE rule to the language in Regulation T. The language regarding covered calls has been reworded from what currently appears in paragraph (b)(1)(C)(1).

¹⁰ The Commission notes that the CBOE's margin rule for interest rate option contracts is 23.13 and not 23.12 as indicated in the CBOE's filing.

¹¹ Telephone conversation between Diane Malley, Supervisor, Department of Financial Compliance, CBOE, Timothy Thompson, Senior Attorney, Legal Department, CBOE, and Chester McPherson, Staff Attorney, Division of Market Regulation, Commission, April 10, 1997.

¹² See NYSE Rule 431(f)(2)(H)(i).

In the case of both short calls and short puts, the amount of margin is reduced when a short option contract is hedged with a long option contract of the same type. The treatment of short option contracts offset by long option contracts where the long option expires with or after the short option is the same as that required currently under Rule 24.11 for index options. In the case where the long call option (or short put option) strike price is less than or equal to the exercise price of the offsetting short call option (or long put option), no margin is required; however, the long position must be paid for in full. When the exercise price of the long call option (or short put option) is greater than the exercise price of the offsetting short call option (or long put option) the amount of margin required is the lesser of: (1) The margin required under the general short listed equity option rule or (2) the difference in aggregate exercise prices.

The treatment for a straddle (a short call option and a short put option the same underlying interest) requires margin on the put or call, whichever amount is greater, plus the current market value of the other option. The margin treatment for straddles is merely being moved from current paragraph (a)(5) of Rule 12.3.

The rules governing the margin requirements for OTC options have been adopted from NYSE Rule 431¹³ except that the Exchange has made a slight change to cap the minimum margin on OTC short puts. A chart submitted with the filing sets forth the initial and/or maintenance margin required for options on various types of underlying securities. The amount of margin required is the percentage of the current market value of the underlying component times the multiplier, if any, (set forth in the chart) plus any "in-the-money-amount." The amount of the margin required to be maintained may be reduced for a short put or call by any "out-of-the-money." The amount to which the margin required may be reduced is set forth in a separate column.

The Exchange is proposing to add margin treatment for related securities positions involving OTC options held in a customer margin account. The Exchange is proposing to add special margin treatment for covered write convertibles, covered calls/puts, spreads, and straddles involving OTC options. The proposed margin treatment is the same treatment that is set forth in NYSE Rule 431 except for the change to cap the minimum margin on short puts.

¹³ See NYSE Rule 431(f)(2)(D)(iii).

⁸ *Id.*

⁹ See Regulation T, Section 220.4(b).

Customer Cash Account

The Exchange is proposing to add a provision to Rule 12.3 detailing the circumstances under which a customer may carry short equity options in a cash account, *i.e.*, an account in which no credit is extended. This provision is consistent with a provision in Regulation T and is being added so that the CBOE rule is more complete, thus enabling its members to rely on such rules for all aspects of margin regulation. The proposed rule would permit either a call option contract or a put option contract held in a short position to be carried in a cash account if the option contract is covered, *i.e.*, if the account contains one of the specified offsets.

In the case of a short call, allowable offsets include: (i) The underlying security, in an amount equal to or greater than that underlying the option, provided the option premium is held in the account until full cash payment for the underlying security is received; (ii) a security immediately convertible without the payment of money into an equal or greater quantity of the security underlying the option, if such security is held or purchased in the account, on the same day provided that the option premium is held in the account until full cash payment for the convertible security is received and the ability to convert does not expire before the expiration of the short call option; or (iii) an escrow agreement issued by a bank and either held in the account at the time the call is written or received in the account promptly thereafter.

In the case of a short put option, allowable offsets include (i) Cash or cash equivalents as defined in Regulation T of not less than the aggregate put exercise amount; or (ii) an escrow agreement issued by a bank which is obligated to deliver the required cash in the event of assignment of the short put.

CBOE Rule 24.11A currently permits certain debit put spreads to be carried in a cash account.¹⁴ The Exchange is proposing to move certain provisions from Rule 24.11A into Rule 12.3. In addition, the Exchange will propose the expansion of the types of strategies that may be carried in a cash account in the Second Margin Filing.

Market Maker and Specialist Accounts

The CBOE rules and the rules of the other regulatory bodies have always distinguished the margin treatment for

market-makers and specialists from that applicable to customers and other broker-dealers because of the unique position of market-makers and specialists in maintaining liquid markets. The rules recognize that options market-makers and specialists must engage in various hedging transactions to manage the risk involved in fulfilling their role. Specific provisions governing permitted offset treatment for market-makers and specialists are being deleted from Regulation T, which as a result will defer to the rules of the SROs.

The proposed rule sets forth various permitted offset positions which may be cleared and carried by a member organization on behalf of one or more registered specialists, registered market-makers, or Designated Primary Market-Makers (hereinafter referred to generically as "market-makers") upon a margin basis satisfactory to the concerned parties. A permitted offset position will be defined to mean, in the case of an option in which a market-maker makes a market, a position in the underlying instrument or other related instrument, and in the case of other securities in which a market-maker makes a market, a position in options overlying the securities in which a market-maker makes a market, if the account holds the following positions: (i) A long position in the underlying instrument offset by a short option position which is "in- or at-the-money"; (ii) a short position in the underlying instrument offset by a long option position which is "in- or at-the-money"; (iii) a stock position resulting from the assignment of a market-maker short option position; (iv) a stock position resulting from the exercise of a market-maker long position; (v) a net long position in a security (other than an option) in which a market-maker makes a market; (vi) a net short position in a security (other than an option) in which the market-maker makes a market; or (vii) an offset position as defined in SEC Rule 15c3-1.

For purposes of the rule, "in- or at-the-money" means the current market price of the underlying security is not more than two standard exercise price intervals below (with respect to a call option) or above (with respect to a put option) the exercise price of the option. In determining the types of instruments which are entitled to be carried in a permitted offset position, reference can be made to the definition of "related instrument" which is set forth in the rule. "Related instrument" within an option class or product group is any related derivative product that meets the offset level requirements for product

groups under Rule 15c3-1, including its appendices (the net capital rule) of the Act, or any applicable SEC staff interpretations or no-action positions (hereinafter referred to collectively as "SEC Rule 15c3-1"). The term "product group" means two or more option classes, related instruments, and qualified stock baskets for which it has been determined that a percentage of offsetting profits may be applied to losses in the determination of net capital as set forth in SEC Rule 15c3-1.

The Exchange is also proposing to add a provision regarding trading in an account in a deficit. The addition generally states that nothing shall prohibit the carrying firm from effecting hedging transactions in the deficit account with the prior written approval of the carrying firm's SEC designated examining authority.

The Exchange is also proposing in the Second Margin Filing to permit a market-maker to receive market-maker margin treatment on transactions in options or other derivative securities effected on an exchange of which that market-maker is not a member and on which that market-maker is not registered as a market-maker if the options or other derivative securities are dually listed on the exchange on which that market-maker is a registered market-maker, or if the transactions are recognized offsets as defined by Rule 15c3-1 under certain conditions specified in the proposed rule.

Broker-Dealer Account

The Exchange is also proposing to add a provision that would provide margin relief to accounts held by non-market-maker broker-dealers. Under the new provision, a member organization may carry the proprietary account of another registered broker-dealer upon a margin basis which is satisfactory to both parties, provided the requirements of Regulation T are adhered to and the account is not carried in a deficit equity condition. The amount of any deficiency between the equity maintained in the account and the margin required by the other provisions of this Rule shall be deducted in computing the net capital of the member organization under Rule 15c3-1 of the Act. This new provision is similar to the provision of NYSE Rule 431(e)(6), and would permit the proprietary accounts of all registered broker-dealers to be carried on a "good faith" margin basis for purposes of maintenance margin. Broker-dealers would still be subject to initial margin requirements under Exchange rules and Regulation T.

¹⁴ The Commission notes that CBOE Rule 24.11A relates to debit put spread cash account transactions, and not Rule 24.11 as indicated in the rule filing.

Interpretations to Rule 12.3

The Exchange is proposing to add four interpretations to Rule 12.3. Also, current Interpretation .01 to Rule 12.3 is proposed to be deleted because the interpretation concerns SuperShares, which the Exchange no longer trades. The Exchange is also proposing to delete interpretation .07 of Rule 24.11 because it also concerns SuperShares. New Interpretation .01 would set forth in a chart form the margin requirements applicable to short positions in listed options and in index and foreign currency warrants. The general requirement is that margin is required equal to the current market value of the option/warrant plus the applicable percentage of the underlying instrument (set forth in the chart). The margin required may be reduced by any "out-of-the money" amount, as defined in the rule. However, the margin may not be reduced below the option market value plus a different specified percentage of the current market value of the underlying instrument as set forth in the chart. The determination of the "out-of-the-money amount" is also set forth in a separate chart.

As described above, Interpretation .02 describes how a member organization may determine "current market value" in the event there is no closing price or trading has been halted.

Interpretation .03 specifies that for purposes of the CBOE margin rules, index warrants should be treated as if they were index options unless the rules specify otherwise. The Exchange states that this interpretation is consistent with the position of the Commission and recognizes that the two types of products are essentially equivalent from a market risk standpoint.

Changes to Rule 12.11

The Exchange is proposing a minor change to Rule 12.11. Rule 12.11 allows a member organization that is a member of the NYSE to elect to be bound by the rules of the NYSE instead of the requirements set forth in Rules 12.3 to 12.10. The Exchange is changing Rule 12.11 to allow the member organization to exempt themselves from Rules 12.3 to 12.9, but not from 12.10. Rule 12.10 establishes that the margin requirements set forth in the rule are minimum requirements and authorizes the Exchange to impose higher margin requirements when it deems such higher requirements to be advisable. The Exchange has determined that it is necessary to clarify that the Exchange may still impose higher margin requirements on its members when the Exchange believes such higher

requirements are warranted, even when those members have elected to generally be subject to the margin rules of the NYSE. The Exchange believes that because it will be in the best position to determine when higher margin requirements may be required for positions in Exchange-traded products it should not allow a member to exempt itself from this provision. The change to Rule 12.11 also makes it clear that if a member organization chooses to be bound by NYSE margin rules it will be exempt not only from CBOE margin rules in Chapter 12, but also from those margin rules in other chapters of the Exchange's rules.

Changes to Rule 24.11

The Exchange is proposing to add to Rule 24.11 (which covers margin requirements for index options) a provision setting forth the margin requirements for covered calls and covered puts that is essentially identical to the provision applicable to equity options.¹⁵ In addition, the Exchange is proposing to add a definition of "qualified stock basket" to Rule 24.11. This definition is used to describe allowable offsets in customer accounts for covered calls and covered puts. In addition, the Exchange makes a cross-reference to the provision of Rule 12.3 that governs the cash account treatment of short index options offset by long index options. Finally, the Exchange is proposing to change Interpretation .04 that defines "cash equivalent." Instead of specifically defining cash equivalent as it is currently defined in the rule, the Exchange has decided to defer to the definition in Regulation T because the Exchange expects that the definition in Regulation T may change from time to time.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5) that an exchange have rules that are 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 protect 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.

The proposed rule change: (i) Establishes CBOE rules to govern areas of margin regulation that will no longer

be addressed by Regulation T of the Board of Governors of the Federal Reserve System, (ii) conforms certain CBOE margin rules to those of the NYSE, and (iii) corrects or clarifies current provisions of the CBOE margin rules. The Exchange believes that the proposed rule change, is consistent with, and furthers, the objectives of Section 6(b)(5) of the Act.

B. Self-Regulatory Organization's Statement on Burden on Competition

The CBOE does not believe that the proposed rule change will impose any burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. 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 all such filing will also be available for inspection and copying at the principal office of the CBOE. All

¹⁵ See, e.g., NYSE Rule 431(f)(2)(H)(i).

submissions should refer to the file number SR-CBOE-97-17 and should be submitted by May 12, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-10161 Filed 4-18-97; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38513; File No. SR-NASD-97-26]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to an Expansion of the Pilot for the NASD's Rule Permitting Market Makers To Display Their Actual Quotation Size

April 15, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on April 11, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the extension.

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

The NASD proposes to amend NASD Rule 4613(a)(1)(C) to allow market makers to quote their actual size by reducing the minimum quotation size requirement for market makers in certain securities listed on The Nasdaq Stock Market ("Nasdaq") to one normal unit of trading ("Actual Size Rule"). As discussed below, the Actual Size Rule presently applies to a group of fifty Nasdaq securities on a pilot basis. The text of the proposed rule change is as follows. (Additions are italicized; deletions are bracketed.)

* * * * *

NASD Rule 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 [July 18] *December 19, 1997*,¹ 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 prior to February 24, 1997* 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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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the NASD 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. The NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Introduction and Background

On August 29, 1996, the Commission promulgated a new rule, the Limit Order Display Rule² and adopted amendments to the Quote Rule,³ which together are designed to enhance the quality of published quotations for securities and promote competition and pricing efficiency in U.S. securities markets (these rules are collectively referred to hereinafter as the "Order Execution Rules").⁴ With respect to securities

¹ In File SR-NASD-97-25, the NASD proposed to extend the pilot program to July 18, 1997. See Securities Exchange Act Release No. 38512 (April 15, 1997).

² 17 CFR 240.11Ac1-4.

³ 17 CFR 240.11Ac1-1.

⁴ See Securities Exchange Act Release No. 37619A (September 6, 1997), 61 FR 48290 (September 12, 1996) ("Order Execution Rules Adopting Release")

included on Nasdaq ("Nasdaq securities"), the Order Execution Rules are being implemented according to a phased-in implementation schedule. Fifty Nasdaq securities became subject to the rules on January 20, 1997 ("first fifty"); fifty more securities became subject to the rules on February 10, 1997 ("second fifty"); and an additional fifty securities became subject to the rules on February 24, 1997. The remaining Nasdaq securities will become subject to the rules according to time tables established by the Commission.⁵

In particular, the SEC's Limit Order Display Rule requires the display of customer limit orders, that: (1) Are priced better than a market maker's quote;⁶ or (2) add to the size associated with a market maker's quote when the market maker is at the best price in the market.⁷ By virtue of the Limit Order Display Rule, investors now have the ability to directly advertise their trading interest to the marketplace, thereby allowing them to compete with market maker quotations and affect the size of bid-ask spreads.⁸ The Order Execution Rules also included amendments to the SEC's Quote Rule, the most significant of which requires market makers to display in their quote any better priced orders that the market maker places into an electronic communications network ("ECN") such as SelectNet or Instinet ("ECN Rule"). Alternatively, instead of updating its quote to reflect better priced orders entered into an ECN, a market maker may comply with the display requirements of the ECN Rule through the ECN itself, provided the ECN: (1) ensures that the best priced orders entered by market makers into the ECN are included in the public quotation; and (2) provides brokers and dealers access to orders entered by

⁵ See, e.g., Securities Exchange Act Release No. 38490 (April 9, 1997).

⁶ For example, if a market maker's quote in stock ABCD is 10-10¹/₄ (1000x1000) and the market maker receives a customer limit order to buy 200 shares at 10¹/₈, the market maker must update its quote to 10¹/₈-10¹/₄ (200x1000).

⁷ For example, if a market maker receives a customer limit order to buy 200 shares of ABCD at 10 when its quote in ABCD is 10-10¹/₄ (1000x1000) and the NBBO for ABCD is 10-10¹/₈, the market maker must update its quote to 10-10¹/₄ (1200x1000).

⁸ There are eight exceptions to the immediate display requirement of the Limit Order Display Rule: (1) customer limit orders executed upon receipt; (2) limit orders placed by customers who request that they not be displayed; (3) limit orders for odd-lots; (4) limit orders of block size (10,000 shares or \$200,000); (5) limit orders routed to a Nasdaq or exchange system for display; (6) limit orders routed to a qualified electronic communications network for display; (7) limit orders routed to another member for display; and (8) limit orders that are all-or-none orders. See Rule 11Ac1-4(c).

¹⁶ 17 CFR 200.30-3(a)(12).