

the disciplining of members and persons associated with members in that it is appropriate to treat two consecutive trade dates of position limit overage in the same manner as a member with a single trade date overage for the first three violations. A member with a two consecutive trade date overage may unintentionally violate the position limit on the first trade date and, upon becoming aware of the overage, begin to take action to reduce the position. Market conditions and the size of the overage may then prevent the member from reducing the overage until the end of the second trade date. During the initial three violations, issuing letters of caution or conducting a staff interview should educate a member to avoid future violations. Thus, the Commission believes that treating two consecutive trade date occurrences as one violation is not warranted for the fourth and succeeding violations.

The Commission also believes that using a more graduated scale for calculation of multiple position limit summary fines may effectively deter multiple violations. By creating a fining level of \$2.50 per contract between the \$1.00 per contract fining level and the \$5.00 per contract fining level, the proposed rule change will deter multiple position limit violations though the use of increasingly higher fines.

The Commission also finds that using a rolling 12 month period of review, rather than a calendar year, for multiple position limit violations occurring in member and non-member accounts will deter repeat violations. Using the rolling 12 month period to calculate position limit violations will prevent a firm from repeating multiple position limit violations at the end of a calendar year and continuing its position limit violations through the beginning of the succeeding calendar year without incurring a fine.

The Commission finds good cause for approving Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice of the filing of the proposed rule change in the **Federal Register** to allow the Exchange to review multiple position limit violations occurring in non-member accounts under CBOE Rule 17.50(g)(1)(a) using the same rolling 12 month period used for violations occurring in member accounts under CBOE Rule 17.50(g)(1)(b), without further delay.

The Commission also believes that Amendment No. 2 does not raise any significant new issues that require public notice prior to approval because

Amendment No. 2 only changes the Exchange's review period of multiple position limit violations occurring in non-member accounts to the same rolling 12 month period used for violations occurring in member accounts and no comments were received on the substance of the original proposal. The Commission also believes that delaying for three months after the approval date of SR-CBOE-97-19 the change to the rolling 12 month review period for multiple position limit violations will ensure that any CBOE members have adequate notice prior to the change from a calendar year to a rolling 12 month period. Accordingly, the Commission believes it is consistent with Section 6 of the Act to approve Amendment No. 2 to the proposed rule change on an accelerated basis.

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2. 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 CBOE. All submissions should refer to File No. SR-CBOE-97-19 and should be submitted by July 30, 1997.

*It is therefore Ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change, SR-CBOE-97-19, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97-17940 Filed 7-8-97; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38804; File No. SR-NASD-97-46]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to an Extension of the Effectiveness of the NASD's Excess Spread Rule Until September 30, 1997

July 1, 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 July 1, 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 and is approving the proposal on an accelerated basis.

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

The NASD proposes to amend NASD Rule 4613(d) to extend the effectiveness of its current excess spread rule applicable to Nasdaq National Market ("NNM") securities through September 30, 1997. The excess spread rule applicable to NNM securities provides that a registered market maker in a security listed on The Nasdaq Stock Market ("Nasdaq") shall be precluded from being a registered market maker in that issue for twenty (20) business days if its average spread in the security over the course of any full calendar month exceeds 150 percent of the average of all dealer spreads in such issue for the month. The text of the proposed rule change is as follows. (Additions are italicized; deletions are bracketed.)

\* \* \* \* \*

NASD Rule 4613 Character of Quotations

\* \* \* \* \*

#### (d) Reasonably Competitive Quotations

A registered market maker in a Nasdaq National Market security will be withdrawn as a registered market maker and precluded from re-registering as a market maker in such issue for 20 business days if its average spread in the security over the course of any full

<sup>6</sup> 17 CFR 200.30-3(a)(12).

calendar month exceeds 150 percent of the average of all dealer spreads in such issue for the month. This subparagraph shall not apply to market makers in Nasdaq SmallCap securities.

(1) If a registered market maker has not satisfied the average spread requirement set forth in this subparagraph (d) for a particular Nasdaq National Market security, its registration in such issue shall be withdrawn commencing on the next business day following the business day on which the market maker was sent notice of its failure to comply with the requirement. A market maker may request reconsideration of the withdrawal notification. Requests for reconsideration will be reviewed by the Market Operations Review Committee, whose decisions are final and binding on the members. A request for reconsideration shall not operate as a stay of the withdrawal or toll the twenty business day period noted in subparagraph (d) above.

(2) Grounds for requests for reconsideration shall be limited to claims that Nasdaq's calculation of the market maker's average spread for the month was in error.

(3) This subparagraph (d) shall be in effect until *September 30, 1997* [July 1, 1997].

## 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

Prior to January 20, 1997, Nasdaq's Excess Spread Rule provided that registered market makers in Nasdaq securities could not enter quotations that exceeded 125 percent of the average of the three narrowest market maker spreads in that issue, provided, however, that the maximum allowable spread could never be less than  $\frac{1}{4}$  of a point ("125% Excess Spread Rule"). The Rule was originally designed to bring a measure of quality to the Nasdaq market by preventing firms from holding themselves out as market

makers without having a meaningful quote in the system. Despite the regulatory objectives underlying the rule, however, many market participants believed the rule produced a variety of unintended consequences that undermined the integrity of Nasdaq. Most notably, the SEC found in its 21(a) Report on the NASD and Nasdaq that "the interdependence of quotes mandated by the rule may deter market makers from narrowing their dealer spreads, because, once the spread is tightened, the rule in some instances precludes a market maker from widening the spread to earlier levels."<sup>1</sup> As a result the SEC found that the Excess Spread Rule created an economic incentive for market makers to discourage one another from narrowing their quotes, thereby interfering with the "free flow of prices in the market and imped[ing] attempts by the market to reach the optimal competitive spread."<sup>2</sup> Accordingly, the SEC requested that the NASD "modify the rule to eliminate its undesirable effects, or to repeal it."<sup>3</sup>

In response to the SEC's 21(a) Report, the NASD submitted a proposal that was approved by the SEC that amended the Excess Spread Rule on a pilot basis through July 1, 1997.<sup>4</sup> Under the revised Excess Spread Rule, a registered market maker in a Nasdaq security is precluded from being a registered market maker in that issue for twenty business days if its average spread in the security over the course of any full calendar month exceeded 150 percent of the average of all dealer spreads in such issue for the month ("150% Excess Spread Rule").<sup>5</sup>

<sup>1</sup> See Appendix to Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and The Nasdaq Stock Market ("21(a) Report"), SEC, August 8, 1996, at p. 98.

<sup>2</sup> *Id.* at p. 99.

<sup>3</sup> *Id.*

<sup>4</sup> See Securities Exchange Act Release No. 38180 (January 16, 1997), 62 FR 3725 ("Pilot Program Approval Order").

<sup>5</sup> On February 28, 1997, the SEC approved the NASD's proposal to exclude Nasdaq Small-Cap Securities from the Excess Spread Rule. This rule change was necessary because, unlike with Nasdaq National Market securities, Nasdaq does not presently calculate and display through the Nasdaq system the average spread of all market makers in a particular issue or a comparison of the size of an individual market maker's quoted spread relative to the average spread of all market makers. Thus, Nasdaq does not presently afford market makers in SmallCap securities with any indication as to whether they are satisfying the requirements of the 150% Excess Spread Rule. Market makers in Nasdaq National Market securities are able to assess whether they are satisfying the 150% Excess Spread Rule on a daily basis through use of the "Primary Market Maker (PMM) Window" of Nasdaq Workstation II. Under the NASD's instant proposal, Nasdaq SmallCap securities would continue to be excluded from the Excess Spread Rule. See Securities Exchange Act Release No. 38354 (February 28, 1997), 62 FR 11245.

In formulating the 150% Excess Spread Rule, Nasdaq Committees and Nasdaq staff felt that it was important to strike a reasonable balance between the need to eliminate any constraints that the Excess Spread Rule places on firms to adjust their quotations and the need to avoid fostering a market environment where registered market makers can maintain inordinately wide spreads and still receive the benefits of being a market maker (e.g., affirmative determination exemption and preferential margin treatment). Nasdaq also believed it was critical to transform the Excess Spread Rule into a performance standard used to determine market maker eligibility, instead of a strict regulatory requirement applicable to every quote update in a Nasdaq security, violations of which were punishable by disciplinary action. In addition, Nasdaq believed it was important to eliminate the 125% Excess Spread Rule prior to implementation of the SEC's order handling rules. Specifically, because Nasdaq believed that spreads would likely narrow as a result of the display of customer limit orders, Nasdaq believed that the average of the three narrowest market maker spreads would commensurately narrow after implementation of the SEC's rules. As a result, Nasdaq believed that concerns with the interdependence of market maker quotations would be exacerbated unless the rule was amended.

While the Commission approved the 150% Excess Spread Rule on a pilot basis, in its approval order for the new rule, the SEC states that "[a]lthough the amended excess spread rule may reduce some of the anticompetitive concerns outlined in the 21(a) Report, the Commission believes that the amendment \* \* \* may not completely satisfy the NASD's obligations under the Commission's Order with regard to the excess spread rule. Specifically, it may not remove completely the anticompetitive incentives for market makers to refrain from narrowing quotes because the market makers' quotation obligation continues to be dependent to some extent upon quotations of other market makers in the stock."<sup>6</sup>

Based on experience with the 150% Excess Spread Rule, the Nasdaq Board recently concluded that the Rule has helped to ensure that market makers maintain at least a minimal level of commitment to their issues, without contributing to or fostering the same unintended consequences created by the former 125% Excess Spread Rule.

<sup>6</sup> Pilot Program Approval Order, *supra* note 4, 62 FR at 3726.

Accordingly, the Nasdaq Board approved a resolution to implement the 150% Excess Spread Rule for all Nasdaq securities on a permanent basis. On June 26, 1997, the Board of Governors of the NASD ratified the resolution adopted by the Nasdaq Board. The NASD's filing requesting permanent approval of the 150% Excess Spread Rule will be submitted to the Commission in the very near future. Accordingly, in the interim before the Commission has had an opportunity to solicit comment and take action on the NASD's proposal for permanent approval of the Rule, the NASD is proposing that the pilot program for the Rule be extended until September 30, 1997.

Nasdaq and the NASD believes that the proposed rule change is consistent with Sections 15A(b)(6), 15A(b)(9), 15A(b)(11) and 11A(a)(1)(C) of the Exchange Act. Among other things, 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)(9) provides that the rules of the Association may not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 15A(b)(11) empowers the NASD to adopt rules governing the form and content of quotations relating to securities in the Nasdaq market. Such rules must be designed to produce fair and informative quotations, prevent fictitious and misleading quotations, and promote orderly procedures for collecting and distributing quotations. 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. Specifically, because Nasdaq and the NASD believe the 150% Excess Spread Rule has helped to ameliorate the adverse consequences that the former 125% Excess Spread Rule had on the competitiveness and independence of quotations displayed on the Nasdaq market, Nasdaq and the NASD believe the proposal to extend the pilot program

for the Rule for an additional three months is consistent with the Exchange Act. In particular, Nasdaq and the NASD believe that the 150% Excess Spread Rule promotes the integrity of quotations on the Nasdaq market and enhances competition among market makers, thereby contributing to greater market liquidity, improved price discovery, and the best execution of customer orders. At the same time, while Nasdaq and the NASD believe the 150% Excess Spread Rule has removed a constraint on market maker quote movements, Nasdaq and the NASD also believe that the Rule has helped to ensure that all registered market makers are providing some threshold level of market making support in their issues. Nasdaq and the NASD also believe that the 150% Excess Spread Rule has helped to avoid fostering a market environment where registered market makers can maintain inordinately wide spreads and still receive the benefits of being a market maker. Accordingly, the NASD and Nasdaq believe that it would be consistent with all of the above-cited sections of the Act for the Commission to approve an extension of the effectiveness of the 150% Excess Spread Rule for an additional three months while the Commission considers permanent approval of the Rule.

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

The NASD believes that the proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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

Comments were neither solicited nor received.

### **III. 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 such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to file number SR-NASD-97-46 and should be submitted by July 30, 1997.

### **IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change**

The Commission has determined to approve the extension of the 150% Excess Spread Rule pilot until September 30, 1997. As noted previously, the Commission had identified anticompetitive concerns associated with the 125% Excess Spread Rule in place prior to January 20, 1997. The NASD has an obligation, pursuant to the 21(a) Report, to eliminate these concerns on or before August 8, 1997. The Commission, in the Pilot Program Approval Order, recognized that the 150% Excess Spread Rule may reduce, to some degree, the Commission's concerns regarding the 125% Excess Spread Rule. Although the Commission has not yet considered whether the 150% Excess Spread Rule is sufficient to satisfy the NASD's obligations under the Commission's Order on a permanent basis, the Commission believes that the current rule should continue to operate on a temporary basis while the issue is examined.<sup>7</sup> Consequently, an extension will ensure that the Rule remains in effect on an uninterrupted basis until the Commission has had an opportunity to fully evaluate the NASD's permanent solution regarding the excess spread rule.<sup>8</sup>

In addition, the Commission believes that the temporary rule can remain limited to National Market securities. Due to Nasdaq's current systems limitations, market makers in Nasdaq SmallCap securities are unable to monitor compliance with the Rule. However, the NASD has stated that it anticipates that market makers in Nasdaq SmallCap securities will be subject to the same excess spread requirements, if any, as market makers in Nasdaq National Market securities when a permanent resolution is reached.

Accordingly, the Commission finds that the NASD's proposal is consistent with Sections 11A and 15A of the Exchange Act and the rules and regulations thereunder applicable to the

<sup>7</sup> As mentioned in the Pilot Program Approval Order, one of the alternatives for a permanent solution could be elimination of the excess spread rule in its entirety.

<sup>8</sup> As noted above, the NASD has until August 8, 1997, to comply with this undertaking.

NASD and, in particular, Sections 11A(a)(1)(C), 15A(b)(6), 15A(b)(9), and 15A(b)(11). Further, the Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the day of publication in the **Federal Register**. In addition to the reasons discussed above, the Commission believes that accelerated approval of the NASD's proposal is appropriate given the fact that the proposal is a temporary extension of the 150% Excess Spread Rule that has been in effect since January 1997. An uninterrupted application of the 150% Excess Spread Rule for a short period of time should be less disruptive to market makers while the NASD prepares its proposal regarding market maker standards.<sup>9</sup>

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change (SR-NASD-97-46) is approved through September 30, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97-17938 Filed 7-8-97; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38807; File No. SR-NASD-97-40]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Incorporated Amending the Surcharge on Members Named as Respondents in Arbitration Proceedings

July 1, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on June 13, 1997, the National Association of Securities Dealers, Incorporated ("NASD" or "Association") 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 by the self-regulatory organization. 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

NASD Regulation is proposing to amend Rule 10333 of the NASD's Code of Arbitration Procedure ("Code") to increase the member surcharge on arbitration matters and to further graduate the rate of member surcharges to reflect more closely the costs associated with resolving controversies involving varying amounts in dispute.

#### 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 self-regulatory organization 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 self-regulatory organization 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. Purpose

###### Background and Introduction

In January 1996, the NASD's Arbitration Policy Task Force ("Task Force") released its report on Securities Arbitration Reform. The Task Force's report made numerous recommendations to improve the arbitration process. Some of the recommendations, such as early appointment of arbitrators and selection of arbitrators by a list selection method, involve significant changes in the way NASD Regulation's Office of Dispute Resolution ("Office") administers arbitration cases and their implementation will result in significant increases in cost. Other recommendations, including increased arbitrator compensation, also involve significant increases in cost.

Since the report was released, NASD Regulation has been engaged in a major effort to implement the numerous Task Force recommendations. In addition,

the Office has other initiatives underway to improve the arbitration process, such as improving case processing and administration by, among other things, upgrading its computerized case tracking system and hiring additional staff. Finally, the growth rate in NASD Regulation's arbitration case load over the last ten years, and the increasing length and complexity of arbitration cases, are generating additional cost pressures on the Office in its continuing efforts to meet the needs of users of the dispute resolution service.<sup>1</sup>

**Operating Costs.** The Office's arbitration service has never been self-funding. The revenues generated from filing and hearing session fees and, more recently, the member surcharge, have never covered more than approximately 70 percent of the arbitration service's operating costs. Originally a voluntary program that handled a few hundred cases each year, the arbitration service now handles more than 6,000 cases annually. Since its inception, the NASD has subsidized a large portion of the cost out of revenue obtained from members through the general assessment on member income. As the number of cases has grown and the cost and complexity of arbitration proceedings have increased, NASD Regulation has sought to increase the fees charged to the users of the service and to reduce the general assessment subsidy in order to shift the costs of the program to the service users.

Among its recent initiatives, the Office also has begun to appoint arbitrators earlier in the process, one of the Task Force's recommendations. In addition, list selection of arbitrators will be implemented in 1998 (subject to SEC approval), and updating the Office's arbitration case tracking system is in progress. The costs of these initiatives and others are increasing operating expenses significantly. For example, in 1996, the costs of the dispute resolution program exceeded revenue by \$11.3 million. The revenue shortfall is expected to reach \$20.0 million in 1997, a 77 percent increase. After incorporating planned increases in arbitrator compensation, the revenue shortfall is projected to be \$25.0 million in 1998, a 121 percent increase over 1996.<sup>2</sup>

<sup>1</sup> The number of cases filed with NASD Regulation's Office of Dispute Resolution in the first three months of 1997 is up 15 percent over the same period in 1996. The number of cases filed has risen from 2,886 in 1987 to an estimated 6,356 for 1997 based on the number filed in the first three months, a 120 percent increase.

<sup>2</sup> See Exhibit 2 to the rule filing.

<sup>9</sup> The Commission notes that a failure to extend the 150% Excess Spread Rule would result in no excess spread standard for Nasdaq market makers. Without deciding that the 150% Excess Spread Rule is preferable to no excess spread standard, the Commission concludes that it is not unreasonable to continue the pilot uninterrupted for a short period to allow the Commission to reach a conclusion on this matter.

<sup>10</sup> 17 CFR 200.30-3(a)(12).