

selected securities with the largest decline in the number of market makers. From an economic and statistical basis, this introduces severe statistical problems and a bias toward those securities with the largest number of market makers. This selection, under any circumstance, would find the largest absolute changes in the number of market makers.

In further support of its proposal, the NASD continues to rely on studies previously submitted to the Commission in support of the amendments to SOES.¹⁸ In its order approving both the January 1995 and March 1995 Amended SOES Rules, however, the Commission expressed its belief that this data submitted by the NASD demonstrated neither significant improvement to nor serious deterioration in the quality of the Nasdaq market subsequent to the adoption of the January 1994 Amended SOES Rules.¹⁹ The information submitted since does not alter the Commission's original assessment. The Commission, therefore, continues to believe that the data submitted by the NASD demonstrates neither a significant improvement to nor serious deterioration in the quality of the Nasdaq market subsequent to the adoption of the January 1994 Amended SOES Rules.²⁰ Moreover, the Commission believes this is true whether the amended SOES rules are viewed collectively or individually. Thus, the Commission's evaluation of the data submitted by the NASD does not change its determination to approve the proposal to extend the March 1995 Amended SOES Rules through January 31, 1996.

V. Conclusion

As indicated above, the Commission has determined to approve the October 1995 Amended SOES Rules through January 31, 1996. In light of the balance of factors described above and the limited duration of the current proposal, the Commission believes extension of the reduction in the minimum exposure limit, the limitation of the exposure limit to unpreferred orders, and the

¹⁸ Securities Exchange Act Release No. 35080 (Dec. 9, 1994), 59 FR 65109 (Dec. 16, 1994) and letter from John F. Olson, Counsel for the NASD, Gibson, Dunn & Crutcher, to Jonathan Katz, Secretary, SEC (Dec. 30, 1994) (submitting in connection with File No. SR-NASD-94-68 analysis entitled *The Association Between the Interim SOES Rules and Nasdaq Market Quality* prepared by Dean Furbush, Ph.D., Economists Incorporated (Dec. 30, 1994)).

¹⁹ Securities Exchange Act Release No. 35275 (Jan. 25, 1995), 60 FR 6327 (Feb. 1, 1995).

²⁰ Nonetheless, the Commission continues to be interested in data and studies demonstrating the effect, if any, of the SOES rule changes on the Nasdaq market.

addition of an automatic quotation update feature is consistent with the Act.

The Commission, in the exercise of the authority delegated to it by Congress, and in light of its experience regulating securities markets and market participants, has determined that approval of these temporary changes to the SOES Rules until January 31, 1996 is consistent with maintaining investor protection and fair and orderly markets, and that these goals, on balance, outweigh possible anti-competitive effects on order entry firms and their customers.

Accordingly, the Commission finds that the rule change is consistent with the Act and the rules and regulations thereunder applicable to the NASD and, in particular, Sections 15A(b)(6), 15A(b)(9), and 15A(b)(11). In addition, the Commission finds that the rule change is consistent with the Congressional objectives for the equity markets, set out in Section 11A, of achieving more efficient and effective market operations, fair competition among brokers and dealers, and the economically efficient execution of investor orders in the best market.

It is Therefore Ordered, pursuant to Section 19(b)(2) of the Act, that the instant rule change SR-NASD-95-34 be, and hereby is, approved, effective October 3, 1995 through January 31, 1996.

By the Commission.
Jonathan G. Katz,
Secretary.
[FR Doc. 95-24909 Filed 10-5-95; 8:45 am]
BILLING CODE 8010-01-M

[Release No. 34-36323; File No. SR-BSE-95-14]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Boston Stock Exchange, Inc., Relating to its Competing Specialist Pilot Program

September 29, 1995.

I. Introduction

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 September 25, 1995, the Boston Stock Exchange, Inc. ("BSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change, and on

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1994).

September 27, 1995, Amendment No. 1 thereto,³ as described in Items 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.

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

The BSE seeks to extend the current pilot program for competing specialists on its floor until March 29, 1996, and to adopt clarifying language for limit order execution under the pilot. The Exchange also proposes to expand the program to four competing specialists that may trade up to 100 stocks each.

III. 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

The purpose of the proposed rule change is to extend the current pilot program for competing specialists until March 29, 1996 and to clarify the priority rule regarding the execution of limit orders on the central limit book.⁴

³ See letter from Karen Aluisse, Assistant Vice President, BSE, to Glen Barentine, Senior Counsel, SEC, dated September 27, 1995. Amendment No. 1 amended the request for an extension through June 28, 1996, to an extension through March 29, 1996.

⁴ The language of the proposed rule change is as follows, with additions to the current rule in italics and deletions in brackets:

Because there is only one Exchange market in a security subject to competition, all limit [Limit] orders sent to the Exchange will be maintained by the BEACON System's central limit book and will be [entrusted to each competing specialist are to be represented and] executed strictly according to time priority as to receipt of the order in the BEACON System, irrespective of firm order routing procedures.

This rule change previously was published for public comment in Securities Exchange Act Release No. 36100 (August 14, 1995), 60 FR 43628 (August 22, 1995), as an amendment to a BSE request for permanent approval of the competing specialist program. See File No. SR-BSE-95-02.

This competing specialist program has been operating on a pilot basis since May 18, 1994.⁵ In addition to extending the pilot until March 29, 1996, the Exchange proposes to expand the pilot. The program currently provides for up to two competing specialists in a stock on the floor of the Exchange in addition to the regular specialists. The Exchange is seeking to increase the number of competitors from two to four. The Exchange also proposes to increase the number of stocks per competing specialist firm from 20 to 100 for the duration of the pilot program.

The Exchange believes that these increases are reasonable and will enable the Exchange to further evaluate the effectiveness of the program on a wider scale to determine if any changes are necessary to improve the program and the Exchange's market-making function generally. The Exchange believes the program has proven to provide adequate protection of customer orders sent to the Exchange and has maintained a true agency auction market for customer orders.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)(5) of the Act in that it furthers the objectives 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; and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The Exchange has neither solicited nor received comments on the proposed rule change.⁶

⁵ See Securities Exchange Act Release No. 34078 (May 18, 1994), 59 FR 27082 (May 25, 1994).

⁶ The Commission received two comment letters regarding the BSE's request for permanent approval of the competing specialist program. See letter from Paula Gavin, Chair, NYSE Individual Investors

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, 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 at the Commission's Public Reference Section, 450 Fifth Street NW., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the BSE. All submissions should refer to File No. SR-BSE-95-14 and should be submitted by October 27, 1995.

V. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

A. Description

The BSE normally assigns one specialist to each stock traded on the Exchange floor (the "regular" specialist). The competing specialist program allows the Exchange to approve additional specialists for a particular stock ("Competing Specialists"), who compete with each other and the regular specialist on the trading floor of the Exchange.⁷ The competing specialist pilot currently limits the number of specialists that can compete in a stock to three—one regular specialist and up to two Competing Specialists. The pilot also limits each Competing Specialist to a maximum of 10 stocks unless the

Advisory Council, to Chairman Arthur Levitt, SEC, dated July 17, 1995 ("Gavin Letter") (asserting that preferencing programs deny orders the benefits and protections of auction market trading); and letter from Robert Jennings, Faculty Fellow and Professor of Finance, Indiana University School of Business, to Jonathan Katz, Secretary, SEC, dated June 30, 1995 (containing a preliminary draft of an academic paper from Indiana University that studied the short term effects of preferencing on market quality and found any such effects to be minimal). These letters are available at the Commission in File No. SR-BSE-95-02.

⁷ The Commission notes that the Competing Specialists must conduct their activity on the floor of the Exchange. There are no existing Exchange rules that allow specialists to operate off the floor of the Exchange. Such a change in operations would require Commission approval.

Market Performance Committee approves an increase of up to 20 stocks per applicant firm. The BSE proposes to expand these limitations to allow up to four Competing Specialists that may compete in up to 100 stocks each.

Under the pilot program, Competing Specialists have the same affirmative and negative market making obligations as regular specialists.⁸ The regular specialist, however, remains responsible for (1) updating all quotations,⁹ (2) coordinating all openings and reopenings to ensure that they are unitary, (3) inputting quotations on the Intermarket Trading System ("ITS") to reflect the best BSE quote among all the specialists,¹⁰ and (4) coordinating trading halts.

Under the competing specialist program, the Exchange's rules governing the auction market principles of priority, parity, and precedence remain unchanged for quotes at the ITS/BBO.¹¹ Specialists quoting at the ITS/BBO have priority over specialists not quoting at the ITS/BBO. Under the rules, if two or more specialists are quoting at the ITS/BBO, the earliest bid/offer at that price has time priority and will be filled first up to its specified size. If the specialists are on both price and time parity at the ITS/BBO, all bids/offers equal to or greater than the size of the contra-side order are on parity and entitled to precedence over smaller orders.

When none of the specialists are quoting at the ITS/BBO, the competing specialist program permits orders to be directed to a particular specialist for execution (*i.e.*, there is no priority between quotes outside of the ITS/BBO).¹² If a particular specialist is not

⁸ Among the obligations imposed upon specialists by the Exchange, and by the Act and rules thereunder, is the maintenance of fair and orderly markets. See, *e.g.*, 17 CFR 240.11b-1; BSE Rules, Ch. XV, Section 2.

⁹ The BSE needs to implement system upgrades that will allow the Competing Specialists to enter their own quotes into BEACON. The system will coordinate the aggregation and dissemination of quotations, but the regular specialist will continue to coordinate openings, reopenings, and trading halts. See *infra* text accompanying note 28.

¹⁰ See *id.* Regardless of the number of specialists competing in a stock, the BSE displays only one consolidated quotation (the best quote among all the specialists) to other markets in the National Market System at all times.

¹¹ See BSE Rules, Ch. II, Section 6.

¹² For example, assume that the ITS/BBO is 20 bid to 20 $\frac{1}{8}$ offered, and specialist A is bidding 19 $\frac{3}{4}$ while specialist B is bidding 19 $\frac{1}{2}$. A market order to sell may be directed to specialist B for execution even through specialist A has a better bid because neither specialist is bidding at the ITS/BBO. Under the competing specialist program, specialist B would execute the order at 20 (the ITS best bid) or better. If specialist A had been bidding 20 (the ITS best bid), specialist A would have had priority to execute the order even though it was directed to specialist B.

specified, the order is directed to the regular specialist unless the routing firm is affiliated with a Competing Specialist.¹³ In that case, the order is routed automatically to that member firm's affiliated specialist, thereby preventing member firms affiliated with a specialist from routing non-profitable orders through the BSE's automated order routing system ("BEACON") to another specialist when market conditions are unfavorable.

All limit orders in BEACON are represented and executed strictly according to time priority, irrespective of firm routing procedures.¹⁴ BEACON (which handles approximately 95% of all order flow on the BSE) automatically executes incoming orders against any contra-side orders on the limit order book. Prior to automatic execution, however, all market and marketable limit orders are exposed to the designated specialist for 15 seconds for possible price improvement.¹⁵ Only where there is no contra-side order on the limit order book (and no other specialist has a priority quote at the ITS/BBO) is the incoming order routed to the designated specialist for execution.

The BSE represents that it is in the process of developing additional enhancements to BEACON to assist the efficiency of the competing specialist program. First, at the outset of the pilot only the regular specialist was sent quote alerts¹⁶ and trade alerts¹⁷ in a given security. The BSE represents that BEACON has been modified so that such alerts are currently sent to the Competing Specialist.¹⁸ Additionally, BEACON recently was enhanced to alert the regular specialist to trade-throughs of the BSE market.¹⁹ The Exchange anticipates providing this alert to

Competing Specialists as well.²⁰ In addition, the regular specialist currently must coordinate pre-openings with Competing Specialist verbally. The BSE expects to implement shortly improvements to BEACON that enable each specialist to directly enter pre-opening trading interest into BEACON.²¹

In addition, Competing Specialists currently do not have the capability to enter their own quotes into BEACON, but rather must communicate them orally to the regular specialist who then enters the quote into BEACON on the Competing Specialist's behalf. In order to encourage competitive quoting by all specialists making markets in a security, the BSE has been working to modify BEACON so that the system will accept quotes from Competing Specialists. Because there currently is only one quote entered into the system by the regular specialist, BEACON presently routes orders as directed without systematically determining whether another specialist may have a priority quote at the ITS/BBO. Once the system is enhanced so that BEACON accepts quotes from each specialist directly, the BSE will also reprogram BEACON to route incoming orders to the specialist with priority on the Exchange at the ITS/BBO, or, if no such priority has been established, to the designated specialist.²²

B. Discussion

The Commission finds that the BSE's proposal to extend its competing specialist pilot program, as amended, to March 29, 1996, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,²³ which requires that the rules of an exchange be designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts, 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.

In its original pilot approval order, the Commission expressed concerns regarding what impact the competing specialist program might have on the BSE market. To this end, the Commission requested that the BSE submit quarterly data reports and a

report analyzing such data.²⁴ The BSE has filed these interim reports with the Commission.²⁵

The data submitted by the BSE indicates that the volume of orders directed to the BSE in the stocks with multiple specialists increased steadily during the pilot. In addition, the depth of the limit order book for the stocks increased, indicating that firms are sending both market and limit orders to their affiliated specialists.

Finally, while the BSE has provided evidence that the competing specialist program has increased order flow to the Exchange, the data regarding quote competition between specialists in a particular security is mixed. The data shows an increase in the volume of the BSE's incoming ITS commitments for the securities traded pursuant to the competing specialist program. The data also indicates, however, that there is a lack of interaction by the regular specialist with incoming orders directed to a competing specialist. Specifically, directed orders are almost always executed by the designated specialist. Under the program's rules, if the specialists were quoting at the ITS/BBO, they would at times have priority over the designated specialist and intercept some of the directed order flow. While this data is inconclusive, the Commission believes that certain system enhancements may facilitate quote competition on the BSE.²⁶

In addition, an extension of the pilot will enable the BSE to provide additional data for a more thorough analysis of the effects of multiple specialists on the BSE market and the national market system. Accordingly, during the extension of the pilot, the Commission requests that the BSE continue to submit the quarterly reports described in the pilot approval order.²⁷ The Commission also requests that the BSE include in future reports data identifying the percentage of BSE quotes that either match or better the ITS/BBO. This data should isolate stocks in which there are multiple specialists and be compared to statistics for stocks with only one specialist.²⁸

²⁴ See Securities Exchange Act Release No. 34078, *supra* note 5.

²⁵ See Competing Specialist Initiative January 1995 Report, submitted to the Commission on February 13, 1995 ("BSE January Report"); and letter from Karen Aluise, Assistant Vice President, BSE, to N. Amy Bilbija, Attorney, SEC, dated April 28, 1995 ("BSE April Report"). These reports are available in the public file for SR-BSE-95-02.

²⁶ See *infra* note 28.

²⁷ See Securities Exchange Act Release No. 34078, *supra* note 5.

²⁸ As discussed above, see *supra* text accompanying note 9, the BSE needs to adopt enhancements to BEACON to permit Competing

¹³ As noted above, however, if the Competing Specialist is quoting the ITS/BBO and clearly has established priority on the BSE floor, then the Competing Specialist will fill the order despite the default routing to the regular specialist.

¹⁴ The BSE is proposing to codify this policy in Chapter XV, Section 18, of the BSE Rules.

¹⁵ See BSE Rules, Ch. II, § 6.

¹⁶ Quote alerts are messages sent by BEACON to a BSE specialist when a quote from among the ITS participants occurs at or through the price at which there is a limit order on the BSE book.

¹⁷ Trade alerts are messages sent by BEACON to the BSE specialist when a trade occurs among the ITS participants at the price of an outstanding limit order on the specialist's book.

¹⁸ Conversation between George Mann, General Counsel and Senior Vice President, BSE, and N. Amy Bilbija, Attorney, Commission, on June 23, 1995.

¹⁹ A "trade-through" of the BSE market occurs whenever another ITS Participant initiates the purchase of a security at a price that is higher than the price at which the security is being offered (or initiates the sale at a price lower than the price at which the security is being bid) at the time of purchase (or sale) on the BSE.

²⁰ See BSE January Report, *infra* note 25.

²¹ See *id.*

²² See *infra* note 38.

²³ 15 U.S.C. 78f(b)(5) (1988).

More importantly, the Commission is interested in exploring whether broader market structure initiatives can address the commenters' concerns regarding order interaction and the effects of referencing on the NMS in general, and on order execution quality in particular. In this regard, the Commission recently proposed rules that attempt to address, among other things, the order interaction and best execution issues presented by referencing of order flow.²⁹ Extension of the BSE pilot will allow the Commission an opportunity to study the implications of these proposals for the BSE's competing specialist pilot.

The Commission finds good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. The Commission believes that accelerated approval of the proposal to extend the pilot is appropriate in order to avoid an unnecessary interruption to the pilot while the Commission conducts its market structure rulemaking and continues to collect data. Moreover, the Commission received only minimal comment on the BSE proposal to adopt the pilot on a permanent basis, making it unlikely that additional comment would be submitted regarding the extension. The Commission also believes that accelerated approval of the clarifying language to the limit or order execution rule is appropriate. The rule, which merely clarifies the existing practice, was previously published for public comment for the full statutory period³⁰ and no comments were received on the proposal.

Finally, the Commission believes that accelerated approval of the proposed expansion of the program to four Competing Specialists that may compete in up to 100 securities is appropriate. Expansion of the program will provide the Commission with additional data upon which to decide whether the program should be permanently approved. In addition, the Commission published the BSE's request for permanent approval, which contained no restrictions on the number of specialist or the number of stocks in which they could compete, for the full

Specialists to enter their own quotes into the system and to enable orders to be automatically routed to the specialist with priority under the rules. During the pilot extension, the Commission expects the BSE to continue developing these system enhancements, and expects progress to be made toward implementation of direct quote entry capability and systematic routing of orders.

²⁹ See Securities Exchange Act Release No. 36310 (September 29, 1995).

³⁰ See *supra* note 4.

statutory period.³¹ Only one comment letter that criticized the proposal was received.³² The Commission will consider that comment when deciding either to approve the BSE's request to make the competing specialist program permanent.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2),³³ that the proposed rule change to extend the BSE's competing specialist program as amended, through March 29, 1996, is hereby approved on an accelerated basis.

By the Commission.

Jonathan G. Katz,

Secretary.

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[Release No. 34-36321; File No. SR-NASD-95-36]

Self-Regulatory Organizations; Order Granting Accelerated Approval to Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to Schedule B to the NASD By-Laws

September 29, 1995.

On August 22, 1995, 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 Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder.² The proposed rule change amends Schedule B to the NASD By-Laws³ to delete informational text on the number of members of the NASD Board of Governors ("Board") elected from each district.

Notice of the proposed rule change, together with the substance of the proposal, was provided by issuance of a Commission release (Securities Exchange Act Release No. 36153, August 25, 1995) and by publication in the Federal Register (60 FR 45506, August 31, 1995). No comment letters were received. This order grants accelerated approval to the proposed rule change.

Article VII, Section 4(b) of the By-Laws requires that each district shall

³¹ See Securities Exchange Act Release No. 35404 (February 22, 1995), 60 FR 10882 (February 28, 1995).

³² See Gavin Letter, *supra* note 6.

³³ 15 U.S.C. 78s(b)(2) (1988)

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ NASD Manual, Schedules to the By-Laws, Schedule B (CCH) ¶ 1772.

elect one Board member, authorizes the Board to determine which districts, if any, shall elect more than one Governor, and—in general—authorizes the Board to make appropriate changes in the number or boundaries of the districts or the number of Governors elected by each district to provide fair representation of members and districts. Pursuant to Article VII, Section 4(b), a total of 15 current members have been elected by the districts.

Schedule B currently provides that two members shall be elected from two of the districts and three members shall be elected from one of the districts. The NASD has stated that inclusion of the text regarding district representation on the Board in Schedule B to the NASD By-Laws was intended to be informational only. The NASD also has stated that it believes that the informational language in Schedule B to the NASD By-Laws specifying the number of Governors from each district unnecessarily limits the ability of the Board to act under Section 4(b) to make changes in the composition of the Board.

The NASD's proposal also may assist the NASD in adopting certain recommendations recently made by the NASD Select Committee on Structure and Governance ("Select Committee"). The Select Committee recently issued a report ("Committee Report") recommending changes in the NASD's existing governance structure.⁴ The Committee Report recommended, among other things, that the NASD increase public representation on its governing bodies, reform its disciplinary procedures and act to regulate broker-dealers and their personnel separately from regulation of the over-the-counter market, including The Nasdaq Stock Market ("Nasdaq").⁵ The NASD Board has agreed in principle to increase its public representation as recommended in the Committee Report.

Therefore, the NASD proposed to amend Schedule B to the NASD By-Laws to delete provisions that specify the number of members of the Board currently approved to be elected from each district in order to ensure that the Board has flexibility to act with respect to the composition of the Board of Governors.

The Commission finds that the proposed rule change is consistent with the provisions of Section 15A(b)(4) of the Act.⁶ Section 15A(b)(4) requires that

⁴ NASD, Report of The NASD Select Committee on Structure and Governance to the NASD Board of Directors (September 19, 1995).

⁵ See *id.* at C-21-22.

⁶ 15 U.S.C. 78o-3.