

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. On October 10, 1995 the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>1</sup> 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 Exchange, pursuant to Rule 19b-4 of the Act, proposes to make a technical correction to Rule 16 of Article XXXIV of the CHX's rules relating to the utilization of exempt credit by market makers.

#### 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

The purpose of the proposed change is to make a technical change to Interpretations and Policies .02, Rule 16, Article XXXIV. Presently, Interpretations and Policies .02 to Rule 16 of Article XXXIV incorrectly indicates that the Best System is described in Rule 34 of Article XX.<sup>2</sup> The Best System is actually described in Rule 37 of Article XX. This proposed rule change corrects the incorrect cross-reference.

<sup>1</sup> See letter from David Rusoff, Foley & Lardner, to Glen Barrentine, Senior Counsel, SEC, dated October 3, 1995. Amendment No. 1 corrects the original filing by referencing Rule 16 of Article XXXIV as the rule being amended in the filing.

<sup>2</sup> The BEST System specifies certain conditions under which Exchange specialists are required to accept and guarantee executions of market and limit orders.

#### 2. Statutory Basis

The proposed rule change is consistent with Section 6(b)(5) of the Act<sup>3</sup> in that it is designed to promote just and equitable principles of trade, 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.

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

The Exchange does not believe that the proposed rule change will impose a burden on competition.

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

No comments were solicited or received.

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

The foregoing rule change constitutes a stated policy, practice or interpretation with respect to the meaning, administration or enforcement of an existing rule of the Exchange and therefore has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>4</sup> and subparagraph (e) of Rule 29b-4 thereunder.<sup>5</sup> At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purpose of the Act.

#### 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

<sup>3</sup> 15 U.S.C. 78f(b)(5).

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(e).

available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to file No. SR-CHX-95-22 and should be submitted by November 13, 1995.

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

Margaret H. McFarland,  
Deputy Secretary

[FR Doc. 95-26183 Filed 10-20-95; 8:45 am]

BILLING CODE 8010-01-M

[Release No. 34-36381; File No. SR-CBOE-95-38]

#### Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving Proposed Rule Change Relating to the Listing and Trading of Warrants on the CBOE Technology 50 Index

October 17, 1995.

On August 1, 1995, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to list and trade warrants based on the CBOE Technology 50 Index ("Tech 50 Index" or "Index"). The Exchange subsequently filed Amendment No. 1 to the proposal on August 2, 1995,<sup>3</sup> Amendment No. 2 on August 3, 1995,<sup>4</sup> and Amendment No. 3 on August 29, 1995.<sup>5</sup>

Notice of the proposed rule change and Amendment Nos. 1, 2, and 3 thereto were published for comment and appeared in the Federal Register on

<sup>1</sup> 15 U.S.C. § 78s(b)(1) (1988 & Supp. V 1993).

<sup>2</sup> 17 CFR 240.19b-4 (1994).

<sup>3</sup> As a result of the Commission's approval of the Exchange's Generic Warrant Listing Standards (as defined herein), Amendment No. 1 has been rendered moot.

<sup>4</sup> In Amendment No. 2, as discussed herein, the CBOE amended certain of the objective standards set forth in the section of its proposal entitled "Classification of the Index as Broad-Based." See Letter from Timothy Thompson, CBOE, to Michael Walinskas, SEC, dated August 3, 1995 ("Amendment No. 2").

<sup>5</sup> In Amendment No. 3, as discussed herein, the Exchange amended the composition of the Index to, in the Exchange's opinion, provide better balance between the technology industry subsectors represented in the Index. See Letter from William Speth, Jr., Senior Research Analyst, Research Department, CBOE, to Brad Ritter, Senior Counsel, SEC, dated August 29, 1995 ("Amendment No. 3").

September 15, 1995.<sup>6</sup> No comments were received on the proposal. This order approves the proposal, as amended.

#### I. Description of the Proposal

The purpose of the proposed rule change is to permit the Exchange to list and trade cash-settled index warrants based on the Tech 50 Index ("Index Warrants"). On August 29, 1995, the Commission approved an Exchange proposal that established uniform listing and trading guidelines for stock index, currency and currency index warrants ("Generic Warrant Listing Standards Approval Order").<sup>7</sup> The Exchange states that the listing and trading of warrants based on the Tech 50 Index will comply in all respects with the Generic Warrant Listing Standards Approval Order.

#### Index Design

The Exchange represents that the Tech 50 Index is a broad-based index comprised of stocks of 50 of the largest domestic technology companies, representing various industry groups. The Index was designed by and will be maintained by the CBOE. The Index is price-weighted and reflects changes in the prices of the component stocks relative to the Index base date, January 3, 1995, when the Index was set to an initial level of 200.00.

On August 15, 1995, the 50 stocks in the Index ranged in market capitalization from a low of approximately \$829.28 million to a high of approximately \$82.47 billion. Total market capitalization for the Index on August 15, 1995, was approximately \$578.53 billion. The highest weighted stock in the Index on that date accounted for 5.62% of the weight of the Index and the lowest weighted security in the Index accounted for 0.68% of the weight of the Index. In aggregate, the five highest weighted components on that date accounted for 21.45% of the weight of the Index. Currently, the Exchange represents that all of the component stocks are eligible for the listing of standardized options on the Exchange pursuant to CBOE Rule 5.3.

As of August 15, 1995, the Exchange represents that the industry breakdown for the Index, by weight, was as follows: (1) Computer hardware—8.20%; (2) computer software—14.63%; (3) computers systems and services—11.12%; (4) integrated circuit components—10.43%; (5) semiconductors—12.66%; (6) precision

instrumentation—3.15%; (7) medical technology—8.74%; (8) network and server systems—10.14%; (9) telecommunication components—12.62%; and (10) telecommunications—8.31%.<sup>8</sup>

#### Warrant Terms

Index Warrants will be direct obligations of their issuer, subject to cash-settlement in U.S. dollars and either exercisable throughout their life (*i.e.*, American-style) or exercisable only immediately prior to their expiration date (*i.e.*, European-style). Upon exercise (or at the warrant expiration date in the case of warrants with European-style exercise), the holder of an Index Warrant structured as a "put" will receive payment in U.S. dollars to the extent that the value of the Index has declined below a pre-stated cash settlement value. Conversely, upon exercise (or at the warrant expiration date in the case of warrants with European-style exercise), the holder of an Index Warrant structured as a "call" will receive payment in U.S. dollars to the extent that the Index value has increased above a pre-stated cash settlement value. Index Warrants that are out-of-the-money at the time of expiration will expire worthless.

#### Maintenance of the Index

The Index will be maintained by the Exchange and will be reviewed monthly.<sup>9</sup> The CBOE may change the composition of the Index at any time to reflect changes affecting the components of the Index or the various technology industry subsectors represented in the Index. If it becomes necessary to remove a stock from the Index (*e.g.*, because of a takeover or merger), the CBOE will take into account the capitalization, liquidity, volatility, and name recognition of any proposed replacement security.<sup>10</sup>

The Exchange intends to maintain the Index with 50 components, however, the Exchange may increase the number

<sup>8</sup> *Id.*

<sup>9</sup> These reviews are mainly for the purpose of determining whether to make composition changes to the Index and generally are not for the purpose of applying the proposed objective standards for ensuring that the Index remains broad-based (see "Classification of the Index as Broad-Based," *infra*). Telephone conversation among Timothy Thompson, CBOE, Eileen Smith, CBOE, and Brad Ritter, SEC, on August 3, 1995.

<sup>10</sup> Whenever a new component is added to the Index, the CBOE will apply those objective standards proposed for ensuring that the Index remains broad-based (see "Classification of the Index as Broad-Based," *infra*) that could be affected by the addition of a new component security to the Index. Telephone conversation between Timothy Thompson, CBOE, and Brad Ritter, SEC, on August 4, 1995.

of components in the Index by up to 33%, *i.e.*, 66 stocks.<sup>11</sup>

#### Calculation and Dissemination of the Value of the Index

The Index value will be calculated by the CBOE or its designee on a real-time base using last-sale prices, and will be publicly disseminated every 15 seconds. If a component stock is not currently being traded, the most recent price at which the stock traded will be used in the Index value calculation. The value of the Index as of the close of trading on September 29, 1995, was 335.22.

The Index is price-weighted and reflects changes in the prices of the component stocks relative to the base date of January 3, 1995, when the Index was set to an initial value of 200.00. Specifically, the Index value is calculated by adding the prices of the component stocks and then dividing this sum by the Index divisor.<sup>12</sup> The Index divisor is adjusted to reflect non-market changes in the prices of the component securities as well as changes in the composition of the Index. Changes that may result in divisor changes include, but are not limited to, stock splits and dividends (other than ordinary cash dividends), spin-offs, certain issuances, and mergers and acquisitions.

#### Classification of the Index as Broad-Based

The CBOE has designed the Index to meet certain objective criteria which it believes are appropriate to classify the Index as broad-based for warrant trading.<sup>13</sup> To ensure that the Index remains representative of a broad spectrum of the various high technology industries and is comprised of relatively actively-traded stocks, the Exchange will maintain the Index according to the following guidelines: (1) Each underlying security selected for inclusion in the Index must have an average daily trading volume of at least 75,000 shares during the preceding six months; (2) each underlying security included in the Index must thereafter maintain an average daily trading volume of at least 50,000 shares during

<sup>11</sup> The Commission notes that the Exchange will be required to distribute a circular to members notifying them of any change in the components of the Index. Further, if the Exchange determines to maintain the Index with some number of components other than 50, the Exchange will be required to change the name of the Index. In such an event, the Exchange should immediately notify the Commission to determine whether a rule filing pursuant to Section 19(b) of the Act will be required.

<sup>12</sup> As of August 15, 1995, the share prices of the Index components ranged from a high of \$158.13 to a low of \$19.00. See Amendment No. 3.

<sup>13</sup> See Amendment No. 2.

<sup>6</sup> See Securities Exchange Act Release No. 36207 (Sept. 8, 1995), 60 FR 47970.

<sup>7</sup> See Securities Exchange Act Release No. 36169 (August 29, 1995).

the preceding six months; (3) no underlying security will represent more than 15% of the total weight of the Index; (4) the five most heavily weighted securities in the Index will not represent more than 40% of the total weight of the Index; (5) the Index will be comprised of at least ten technology industry subsectors (*i.e.*, Standard Industry Classification ("SIC") codes) representing a total of no less than 50 underlying securities; and (6) at least 75% of the total weight of the Index will be represented by underlying securities that are eligible for the listing of standardized options pursuant to CBOE Rule 5.3. The Exchange will conduct semi-annual reviews of the underlying securities included in the Index to assure that the Index continues to meet the standards set forth above. The Exchange represents that the above guidelines are similar to the requirements set forth in Interpretation .01 to Rule 7.3 of the Pacific Stock Exchange ("PSE") regarding the designation of the PSE's High Technology Index as a broad-based index for purposes of the trading of standardized options.<sup>14</sup>

#### *Warrant Listing Standards and Customer Safeguards*

As discussed earlier, the Exchange has established Generic Warrant Listing Standards.<sup>15</sup> The Exchange represents that the Generic Warrant Listing Standards will be applicable to the listing and trading of index warrants generally, including Tech 50 Index warrants. These standards will govern all aspects of the listing and trading of index warrants, including, issuer eligibility,<sup>16</sup> position and exercise

limits,<sup>17</sup> reportable positions,<sup>18</sup> automatic exercise,<sup>19</sup> settlement,<sup>20</sup> margin,<sup>21</sup> and trading halts and suspensions.<sup>22</sup>

Additionally, these warrants will be sold only to accounts approved for the trading of standardized options<sup>23</sup> and, the Exchange's options suitability standards will apply to recommendations in Index warrants.<sup>24</sup> The Exchange's rules regarding discretionary orders will also apply to transactions in Index warrants.<sup>25</sup> Finally, prior to the commencement of trading, the Exchange will distribute a circular to its membership calling attention to certain compliance responsibilities when handling transactions in Tech 50 Index warrants.

#### II. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5) of the Act.<sup>26</sup> Specifically, the Commission finds that the trading of warrants based on the Tech 50 Index will serve to protect investors, promote the public interest, and help to remove impediments to a free and open securities market by providing investors

holding positions in some or all of the securities underlying the Index with a means to hedge exposure to market risk associated with their portfolios.<sup>27</sup> The trading of warrants based on the Tech 50 Index should provide investors with a valuable hedging vehicle that should reflect accurately the overall movement of technology industry securities.

Nevertheless, the trading of warrants on the Tech 50 Index raises several concerns related to index design, customer protection, surveillance, and market impact. The Commission believes, however, for the reasons discussed below, that the CBOE has adequately addressed these concerns.

#### *A. Index Design and Structure*

The Commission finds that it is appropriate and consistent with the Act for the CBOE to designate the Index as a broad-based index for warrant trading. First, the high-technology sector is a substantial segment of the U.S. equities market, and the Index reflects that segment. Second, the Index includes multiple industries within the high-tech sector, such as medical technology, telecommunications and telecommunication components, and does not rely solely on computer-related companies. Third, the Index consists of 50 actively traded stock (all options eligible), of which 25 trade on Nasdaq and 25 trade on the NYSE. Fourth, the market capitalization of the stocks comprising the Index are very large. Specifically, the total capitalization of the Index, as of August 15, 1995, was approximately \$578.5 billion, with the market capitalization of the individual stocks in the Index ranging from a high of \$82.47 billion to a low of \$829.28 million, with a mean value of \$11.57 billion. Fifth, no one particular stock or group of stocks dominates the weight of the Index. Specifically, as of August 15, 1995, no single stock accounted for more than 5.62% of the Index's total value, and the percentage weighting of the five largest issues in the Index accounted for 21.45% of the Index's value. Additionally, the lowest weighted stock in the Index accounted for 0.68% of the Index's value. Accordingly, the Commission believes it is appropriate to classify the Index as broad-based so that the CBOE may list

<sup>17</sup> See CBOE Rule 30.35. In particular, under CBOE Rule 30.35, no member can control an aggregate position in a stock index warrant issue, or in all warrants issued on the same stock index, on the same side of the market, in excess of 15,000,000 warrants (12,500,000 warrants with respect to warrants on the Russell 2000 Index) with an original issue price of ten dollars or less. Stock index warrants with an original issue price greater than ten dollars will be weighted more heavily in calculating position limits.

CBOE Rule 30.35 also establishes exercise limits on stock index warrants which are analogous to those found in stock index options. The rule prohibits holders from exercising, within any five consecutive business days, long positions in warrants in excess of the base position limit set forth above.

<sup>18</sup> See CBOE Rules 30.50(d) and 4.13.

<sup>19</sup> See CBOE Rule 31.5E(6).

<sup>20</sup> See CBOE Rule 31.5E(5).

<sup>21</sup> See CBOE Rule 30.53. In general, the margin requirements for long and short positions in stock index warrants are the same as margin requirements for long and short positions in stock index options. Accordingly, all purchases of warrants will require payment in full, an short sales of stock index warrants will require initial margin of: (i) 100 percent of the current value of the warrant plus (ii) 15 percent of the current value of the underlying broad stock index less the amount by which the warrant is out of the money, but with a minimum of ten percent of the index value.

<sup>22</sup> See CBOE Rules 30.36 and 24.7.

<sup>23</sup> See CBOE Rules 30.52(c) and 9.7.

<sup>24</sup> See CBOE Rules 30.52(d) and 9.9.

<sup>25</sup> See CBOE Rule 30.50, Interpretation .03 (requiring that the standards of Rule 9.10 be applied to index warrant transactions).

<sup>26</sup> 15 U.S.C. 78f(b) (5).

<sup>27</sup> Pursuant to Section 6(b) (5) of the Act, the Commission must predicate approval of any new securities product upon a finding that the introduction of such product is in the public interest. Such a finding would be difficult with respect to a warrant that served no hedging or other economic function, because any benefits that might be derived by market participants likely would be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns.

<sup>14</sup> Securities Exchange Act Release No. 29994, 56 FR 63536 (Dec. 4, 1991).

<sup>15</sup> See *supra* note 7 and accompanying text.

<sup>16</sup> See CBOE Rule 31.5E (1) and (4). Issuers are required to have a minimum tangible net worth in excess of \$250 million or, in the alternative, have a minimum tangible net worth in excess of \$150 million, provided that the issuer does not have (including as a result of the proposed issuance) issued and outstanding warrants where the aggregate original issue price of all such warrant offerings (combined with offerings by its affiliates) listed on a national securities exchange or securities association exceeds 25% of the issuer's net worth.

warrants for trading pursuant to the Generic Warrant Listing Standards.<sup>28</sup>

### B. Customer Protection

Special customer protection concerns are presented by Tech 50 Index warrants because they are leveraged derivative securities. The CBOE has addressed these concerns, however, by applying the special suitability, account approval, disclosure, and compliance requirements adopted in the Generic Warrant Listing Standards Approval Order. Moreover, the CBOE plans to distribute a circular to its membership identifying the specific risks associated with Tech 50 Index warrants. Finally, pursuant to the Exchange's listing guidelines, only substantial companies capable of meeting CBOE index warrant issuer standards will be eligible to issue Index warrants.

### C. Surveillance

The Commission believes that a surveillance sharing agreement between an exchange proposing to list a security index derivative product and the exchange(s) trading the securities underlying the derivative product is an important measure for surveillance of the derivative and underlying securities markets. Such agreements ensure the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the security index product less readily susceptible to manipulation.<sup>29</sup> In this regard, the CBOE, NYSE, and NASD are all members of the Intermarket Surveillance Group, which provides for the exchange of all necessary surveillance information.<sup>30</sup>

<sup>28</sup> See *supra* note 7 and accompanying text.  
<sup>29</sup> Securities Exchange Act Release No. 31243 (September 28, 1992), 57 FR 45849 (October 5, 1992).

<sup>30</sup> The Intermarket Surveillance Group ("ISG") was formed on July 14, 1983 to, among other things, coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets. See Intermarket Surveillance Group Agreement, July 14, 1983. The most recent amendment to the ISG Agreement, which incorporates the original agreement and all amendments made thereafter, was signed by ISG members on January 29, 1990. See Second Amendment to the Intermarket Surveillance Group Agreement, January 29, 1990. The members of the ISG are: the American Stock Exchange, Inc.; the Boston Stock Exchange, Inc.; CBOE; the Chicago Stock Exchange Inc.; the National Association of Securities Dealers, Inc. ("NASD"); the NYSE; the Pacific Stock Exchange, Inc.; and the Philadelphia Stock Exchange, Inc. Because of potential opportunities for trading abuses involving stock index futures, stock options, and the underlying stock and the need for greater sharing of surveillance information for these potential intermarket trading abuses, the major stock index futures exchanges (e.g., the Chicago Mercantile Exchange and the Chicago Board of Trade) joined the ISG as affiliate members in 1990.

### D. Market Impact

The Commission believes that the listing and trading of Tech 50 Index warrants on the CBOE will not adversely impact the underlying securities. First, the existing index warrants surveillance procedures of the CBOE will apply to warrants on the Index. In addition, the Commission notes that the Index is broad-based and diversified and includes highly capitalized securities that are actively traded. Additionally, the CBOE has established reasonable position and exercise limits for stock index warrants, which will serve to minimize potential manipulation and other market impact concerns.

*It Therefore is Ordered*, pursuant to Section 19(b) (2) of the Act,<sup>31</sup> that the proposed rule change (SR-CBOE-95-38) is approved, as amended.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>32</sup>

[FR Doc. 95-26182 Filed 10-20-95; 8:45 am]

BILLING CODE 8010-01-M

[Release No. 34-36374; File No. SR-NASD-95-41]

### Self-Regulatory Organizations; Notice of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to an Expansion of the NASD's Short-Sale Rule to Include Nasdaq SmallCap Market Securities

October 16, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on September 22, 1995, 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.

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

The NASD is proposing to expand the scope of its short-sale rule to include Nasdaq SmallCap Market<sup>®</sup> ("SCM") securities. Consistent with the current short-sale rule applicable to Nasdaq National Market<sup>®</sup> ("NNM") securities, the NASD proposes to implement the

<sup>31</sup> 15 U.S.C. § 78s(b) (2) (1988).

<sup>32</sup> 17 CFR 200.30-3(a) (12) (1994)≤

<sup>1</sup> 15 U.S.C. § 78s(b)(1) (1988).

short-sale rule for SCM securities on a pilot basis until June 3, 1996.

The text of the proposed rule change is available at the Office of the Secretary of the NASD 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 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

On June 29, 1994, the SEC approved a new short sale rule for NNM securities traded on The Nasdaq Stock Market<sup>SM</sup> ("Nasdaq").<sup>2</sup> The NASD's short sale rule, which became effective on September 6, 1994 for an eighteen-month pilot period,<sup>3</sup> prohibits member firms from effecting short sales<sup>4</sup> at or below the current inside bid as disseminated by the Nasdaq system whenever that bid is lower than the previous inside bid.

Nasdaq calculates the best bid from all market makers in the security (including bids on behalf of exchanges trading Nasdaq securities on an unlisted trading privileges basis), and disseminates symbols to denote whether the current inside bid is an "up bid" or a "down bid." Specifically, an "up bid" is denoted by a green "up" arrow symbol and a "down bid" is denoted by a red "down" arrow. Accordingly, absent and exemption from the rule, a member can not effect a short sale of or below the inside bid in a security in its proprietary account or an account of a customer if there is a red arrow next to

<sup>2</sup> See Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994).

<sup>3</sup> The Commission subsequently approved a NASD proposal extending the pilot period until June 3, 1996. Securities Exchange Act Release No. 36171 (Aug. 30, 1995), 60 FR 46651 (Sept. 7, 1995).

<sup>4</sup> A short sale is a sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. To determine whether a sale is a short sale members must adhere to the definition of a "short sale" contained in SEC Rule 3b-3, which rule is incorporated into Nasdaq's short sale rule by Article III, Section 48(l)(1) of the NASD Rules of Fair Practice.