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Self-Regulatory Organizations; the American Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Restrictions on Specialists

March 22, 1996.

I. Introduction

On December 19, 1995, the American Stock Exchange, Inc. ("Amex" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Exchange Rules 190 and 950 regarding restrictions on specialists.

The proposed rule change was published for comment in Securities Exchange Act Release No. 36726 (Jan. 17, 1996), 64 FR 1953 (Jan. 24, 1996). No comments were received on the proposal.

II. Background

The Amex adopted most of its restrictions on the activities of specialists in the early 1960s. The effect of these restrictions was to limit the business activities of specialists (and their affiliates) to acting as a "broker's broker" and as a dealer on the Exchange Floor. These restrictions also precluded specialists from making public statements regarding their specialty securities. In 1973, the Exchange added a commentary on the public statement restriction, prohibiting specialists from making, "an advertisement identifying a firm as a specialist in any security."³ Even though the New York Stock Exchange ("NYSE") and Amex generally have comparable rules with respect to restrictions on specialists, the NYSE never adopted the 1973 commentary.

In 1975, with the implementation of trading in standardized options, the Exchange generally extended the restriction on stock specialists to options specialists. It modified, however, the prohibition on business transactions between specialists and the issuer of a specialty security (Rule 190(a)), to prohibit material business transactions between an options

specialist and the issuer of the security underlying a specialty option (Rule 950(k)).⁴

In 1987, the Chicago Board Options Exchange ("CBOE") instituted its Designated Primary Market-Maker ("DPM") system for trading listed options.⁵ While the CBOE adopted a number of the restrictions applicable to Amex options specialists, it did not apply any of the restrictions applicable to Amex specialist communications to its DPMs.⁶

The discrepancy between the rules of the Amex and the CBOE regarding specialist communications had little practical significance prior to the general implementation of multiple options trading. The Exchange is now finding, however, that the disparate regulation of specialists and DPMs has placed it at a disadvantage in the competition for order flow in a multiple trading environment.

III. Description of Proposal

The Amex, accordingly, proposes to amend its rules to lift the prohibition against "popularizing" an option or a derivative security. It will leave in place the restriction against popularizing the underlying security, subject to the exceptions that have long been contained in Amex Rule 950. This will better conform the Amex rules to those applicable to DPMs at the CBOE regarding communications concerning specialty securities.

In addition, the Exchange is also proposing two other changes to the restrictions on popularizing by specialists. The Exchange seeks to conform its rules to those of the NYSE to eliminate generally the prohibition on communications that simply identify a firm as the specialist in a particular security. Finally, the Exchange seeks to amend its rules regarding equity

⁴ Since the Options Clearing Corporation ("OCC") is the issuer of all listed options and the "business transaction" prohibition was intended as a prophylactic measure to prevent the passage of non-public information between specialist and issuer, the policy reason behind Rule 190(a) would not have been advanced had the Exchange simply prohibited business transactions between the OCC and an options specialist.

⁵ Like a specialist, a DPM has primary market making responsibilities.

⁶ See CBOE Rules 8.80 and 8.81, and Securities Exchange Act Release Nos. 24934 (September 22, 1987), 52 FR 36122 (September 25, 1987) and 25151 (November 23, 1987), 52 FR 45417 (November 27, 1987). The CBOE's rules provide that an integrated broker-dealer affiliated with a DPM must establish an exchange approved "Chinese Wall" between the upstairs firm and the DPM and make certain disclosures if it intends to issue recommendations or research reports regarding DPM securities and the underlying. There are no specific restrictions, however, on DPM communications regarding their specialty securities.

derivative⁷ specialists to harmonize them with restrictions on options specialists. Thus, the Exchange would amend its rules to prohibit material business transactions between certain equity derivative specialists and the issuer of the security underlying the equity derivative.⁸

All options specialists would remain subject to the rules regulating the conduct and public communications of members generally (e.g. Exchange Rule 991, the "options advertising" rule). In addition, all other restrictions applicable to specialists and their affiliates would remain in place. Thus, specialists and their affiliates still would be prohibited from trading a specialist security outside the specialist function (Rules 170(e) and 950(n)), holding or granting an option on a specialty stock (Rule 175), engaging in a material business transaction with either the issuer of a specialty security or the underlying security in the case of options (Rules 190(a) and 950(k)), and accepting orders from the issuer of a specialty security, its insiders and enumerated institutional investors (Rules 190(b) and 950(k)).⁹

The Exchange represents that the respective proposed rule changes either seek to conform the Exchange's rules to those of the CBOE and NYSE, or represent a rational harmonization of the regulation of listed options and equity derivatives. In addition, the Exchange believes that changes in market structure, the rule of the specialist in the secondary market, and enhanced surveillance capabilities over the last thirty years have eliminated the need for continuation of at least certain of the original specialist prohibitions. This is most clearly true with respect to the wholesale application of the restrictions on stock specialists to options specialists, due to the derivative pricing of the specialty securities. This is most clearly demonstrated by the experience of the CBOE, which has been able to adequately regulate its DPMs without the use of such wholesale restrictions. Finally, the Exchange

⁷ The term "equity derivative" refers to an underwritten security the value of which is determined by reference to another security, or to a currency, commodity, interest rate or index of the foregoing. Such securities are commonly listed pursuant to Amex Company Guide ("Guide") Sections 106 ("Index and Currency Warrants"), 107 ("Other Securities"), 118 ("Investment Trusts"), or Amex Rule 1002 ("Portfolio Depository Receipts").

⁸ It is in the case of listings under Sections 107 and 118A of the Guide that the underlying can be a single security, so that restrictions analogous to those applicable to equity options are appropriate.

⁹ Exchange Rule 193 permits the affiliates of specialists to obtain an exemption from most specialist restrictions through the use of an Exchange-approved "Chinese wall".

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Commentary to Amex Rule 190.

believes that the experience of the NYSE demonstrates that with respect to all specialists there is no need to go so far as to preclude even the public identification of a particular firm as the specialist in particular securities.

IV. Discussion

The Commission finds that the Amex's proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.¹⁰ In particular, and for the reasons set forth below, the Commission believes that the proposal is consistent with the Section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general to protect investors and the public interest.¹¹ The proposal also is consistent with the Section 6(b)(8) requirement that an Exchange have rules that do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.¹²

The Commission believes that the Amex's proposal to lift the prohibition against "popularizing" an option or equity derivative security and to lift the prohibition that prevents an equity or options specialist from identifying itself as a specialist in its assigned securities is appropriate and will make the Amex's rules consistent with those that are applicable on other exchanges.

The Commission believes that Amex's rules relating to dealings and communications by specialists with regard to their speciality securities (and in the case of options or equity derivatives specialists, the underlying securities related to their speciality securities), continue to adequately address and prohibit inappropriate conduct in this area. Notably, the Amex will leave in place the restriction against popularizing the underlying security, subject to the exceptions contained in Amex Rule 950. Moreover, all options specialists will remain subject to the rules regulating the conduct and public communications of members generally (e.g. Exchange Rule 991, the "options advertising" rule). In addition, all other restrictions applicable to specialists and their affiliates will remain in place. Thus, specialists and their affiliates still will be prohibited from trading a specialist security outside the specialist function (Rules 170(e) and 950(n)),

holding or granting an option on a speciality stock (Rule 175), engaging in a material business transaction with either the issuer of a speciality security or the underlying security in the case of options (Rules 190(a) and 950(k)), and accepting orders from the issuer of a speciality security, its insiders and enumerated institutional investors (Rules 190(b) and 950(k)).¹³

The Commission also believes that the established restrictions on material business transactions entered into by an equity derivative specialist and the issuer of the security underlying the equity derivative are reasonably designed to prevent a potential conflict of interest.¹⁴

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-Amex-95-54) is hereby approved.

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

Jonathan G. Katz,
Secretary.

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Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Boston Stock Exchange, Incorporated Relating to Distribution of Interim Reports to Both Registered and Beneficial Shareholders

March 26, 1996.

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 March 18, 1996, the Boston Stock Exchange, Incorporated ("BSE" or "Exchange")

¹³ Exchange Rule 193 permits the affiliates of specialists to obtain an exemption from most specialist restrictions through the use of an Exchange-approved "Chinese wall."

¹⁴ Absent these restrictions, a conflict of interest could arise between the equity derivative specialist's market making obligations and any status he or she might attain through business dealings with the issuer or an officer, director, or 10% stockholder of any such company. The Commission recognizes that certain business transactions between equity derivative specialists and issuers may exert an improper influence over equity derivative specialists. The Commission believes, however, that a specialist may engage in certain nonmaterial business dealings with an issuer that would not give rise to the potential conflict of interest described above.

¹⁵ 15 U.S.C. § 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).

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

The Exchange seeks to amend its rules to provide that corporations that distribute interim financial reports to shareholders should distribute such reports to both registered and beneficial shareholders. The text of the proposed rule change is available at the Exchange and 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 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 III 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 ensure equal treatment of record and beneficial shareholders in the distribution of interim financial reports. It is based on the findings and recommendations of the Securities Industry Association.

2. Statutory Basis

The basis under the Act for the proposed rule change is the requirement under Section 6(b)(5) that an Exchange have rules that are designed to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

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

The proposed rule change will impose no burden on competition.

¹⁰ 15 U.S.C. § 78f(b).

¹¹ 15 U.S.C. § 78f(b)(5).

¹² 15 U.S.C. § 78f(b)(8).