

exchange. The Commission notes that the trading of standardized exchange-traded options occurs in an environment that is designed to ensure, among other things, that: (1) the special risks of options are disclosed to public customers; (2) only investors capable of evaluating and bearing the risks of options trading are engaged in such trading; and (3) special compliance procedures are applicable to options accounts. Accordingly, because the Index options and Index long-term full-value and reduced-value options will be subject to the same regulatory regime as the other standardized index options currently traded on CBOE, the Commission believes that adequate safeguards are in place to ensure the protection of investors in Index options and full-value or reduced-value Index long-term options.

**C. Surveillance.** The Commission believes that a surveillance sharing agreement between an exchange proposing to list a stock index derivative product and the exchange(s) trading the stocks 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 stock index product less readily susceptible to manipulation.<sup>11</sup> In this regard, the Commission notes that the CBOE, NYSE, and NASD are all members of the ISG. The Commission believes that this arrangement ensures the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the Index options and full-value and reduced-value long-term Index options less readily susceptible to manipulations.<sup>12</sup>

**D. Market Impact.** The Commission believes that the listing and trading of Index options, including full-value and reduced-value Index LEAPS on the CBOE, will not adversely affect the underlying securities markets. First, because of the equal-weighting method that will be used, no one security or group of securities represented in the Index will dominate the weight of the Index immediately following a quarterly rebalancing. Second, the Index maintenance criteria ensure that the Index will be comprised solely of

securities that satisfy the Exchange's listing standards for standardized options trading, and that one or a few stocks do not dominate the Index. Third, the currently applicable 9,000 contract position and exercise limits will serve to minimize potential manipulation and market impact concerns. Fourth, the risk to investors of contra-party non-performance will be minimized because the Index options and Index long-term options will be issued and guaranteed by the Options Clearing Corporation just like any other standardized option traded in the United States.

Lastly, the Commission believes that settling expiring Index options (including full-value and reduced-value long-term Index options) based on the opening prices of component securities is reasonable and consistent with the Act. As has been noted previously, valuing index options for exercise settlement on expiration based on opening rather than closing prices of Index component securities may help to reduce adverse effects on markets for such securities.<sup>13</sup>

It therefore is ordered, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-CBOE-96-11) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

Margaret H. McFarland,  
*Deputy Secretary.*

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[Release No. 34-37208; File No. SR-DTC-95-27]

### Self-Regulatory Organizations; The Depository Trust Company; Order Approving a Proposed Rule Change Implementing the Initial Public Offering Tracking System

May 13, 1996.

On January 2, 1996, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-DTC-95-27) under Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> seeking to implement the Initial Public Offering ("IPO") Tracking System. On January 31, 1996, DTC amended the proposed rule

change.<sup>2</sup> Notice of the proposal was published in the Federal Register on March 6, 1996.<sup>3</sup> On March 7, 1996, DTC filed a second amendment to the proposed rule change.<sup>4</sup> The Commission received one comment letter in response to the filing.<sup>5</sup> For the reasons discussed below, the Commission is approving the proposed rule change.

#### I. Description

DTC is implementing its IPO Tracking System to allow lead managers (also referred to as managing underwriters) and syndicate members<sup>6</sup> of equity underwritings to monitor "flipping"<sup>7</sup> of new issues. Currently, many IPOs are distributed entirely in physical, certificated form outside the depositories so that tracking may be accomplished by using certificate numbers to monitor the movements of the securities. DTC's IPO Tracking System provides a means for lead managers to track IPOs in a book-entry environment and thus eliminates the need to distribute newly underwritten equity securities through the use of physical certificates.

Currently, securities to be listed on an exchange or quoted through the Nasdaq Stock Market ("Nasdaq") must be made depository eligible.<sup>8</sup> Furthermore, the

<sup>2</sup> Memo from Richard B. Nesson, Executive Vice President and General Counsel, DTC, to Christine Sibille, Commission (January 31, 1996).

<sup>3</sup> Securities Exchange Act Release No. 36897 (February 27, 1996), 61 FR 8992.

<sup>4</sup> Letter from Richard B. Nesson, Executive Vice President and General Counsel, DTC, to Christine Sibille, Senior Counsel, Division of Market Regulation, Commission (March 4, 1996). The amendment provides that DTC will provide thirty days notice prior to implementing the IPO Tracking System. Because the amendment did not change the substance of the filing, the Commission did not republish the proposed rule change for comment.

<sup>5</sup> Letter from Carl H. Hewitt, Managing Director and General Counsel, Spear, Leeds & Kellogg, to Commission (May 3, 1996).

<sup>6</sup> Syndicate members are a group of broker-dealers that agree to purchase a new issue of securities from an issuer under an underwriting agreement. The selling group is a group of broker-dealers that market the new issue to the public. Selling group broker-dealers may purchase from a syndicate member or may be a syndicate member.

<sup>7</sup> Flipping occurs when a syndicate's lead manager is supporting the IPO with a stabilization bid (*i.e.*, the lead manager is purchasing shares in the secondary market in order to keep the price of the issue from dropping below its initial offering price), and securities of the IPO that had been distributed to investors are sold by those investors in the secondary market and are purchased by a syndicate member. The lead manager may wish to identify flipped transactions so that underwriting concessions (*i.e.*, the discount from the offering price received by syndicate members) can be recovered from the appropriate syndicate members.

<sup>8</sup> Under the rules of most national securities exchanges and the National Association of Securities Dealers ("NASD"), in order to be listed for trading on a national securities exchange or to

Continued

<sup>11</sup> See Securities Exchange Act Release No. 31243 (September 28, 1992), 57 FR 45849.

<sup>12</sup> See, *e.g.*, Securities Exchange Act Release No. 31243 (September 28, 1992), 57 FR 45849 (order approving the listing of index options and index LEAPS on the CBOE Biotech Index).

<sup>13</sup> See Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992).

<sup>14</sup> 15 U.S.C. § 78s(b)(2) (1988).

<sup>15</sup> 17 CFR § 200.30-3(a)(12).

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

NASD and most exchanges have rules which require transactions in depository eligible securities between financial intermediaries and between a financial intermediary and a customer with delivery versus payment privileges to be settled by book entry.<sup>9</sup> Due to the need to distribute new issues in physical form (*i.e.*, without using book entry movements) for tracking purposes, these rules provide that prior to the availability of a flipping tracking system a managing underwriter can delay the date a security is deemed depository eligible for up to three months after trading has commenced in the security. Once a flipping tracking system becomes available, managing underwriters will no longer have the option to delay an issue's depository eligible date and will be unable to distribute Nasdaq quoted or exchange listed new issues in physical certificate form outside the depositories. DTC will provide notice of the IPO Tracking system's availability date at least thirty calendar days prior to its availability.<sup>10</sup>

Under DTC's proposed rule change, the lead manager will be required to notify DTC of its decision to use the IPO Tracking System to track an issue by 4:00 p.m. two days prior to the date of the initial distribution of securities ("closing date"). On the closing date, DTC's underwriting department will place the IPO shares in the IPO control account of the lead manager.<sup>11</sup> Allocation of these shares by the lead manager depends upon the nature of the ultimate buyer (*i.e.*, retail or institutional).

#### *Retail Trade*

For a retail distribution, the lead manager moves the securities from its IPO control account directly to the IPO

be eligible for inclusion in the Nasdaq and issuer must represent that the CUSIP number identifying the security to be listed of such exchange or to be eligible for inclusion in Nasdaq is included in the file of eligible issues maintained by a securities depository registered as a clearing agency under Section 17A of the Act. *E.g.*, New York Stock Exchange ("NYSE") Rule 227 and NASD Uniform Practice Code Section 11. Securities Exchange Act Release No. 35798 (June 1, 1995), 60 FR 30909.

<sup>9</sup> Securities Exchange Act Release No. 32455 (June 11, 1993), 58 FR 33679. *E.g.*, NYSE Rule 226, NASD By-laws, Schedule D, Part II, Section 1(c)(23) and Uniform Practice Code Section 11.

<sup>10</sup> *Supra* note 3.

<sup>11</sup> IPO control accounts are restricted accounts established for DTC participant broker-dealers in which their IPO shares are kept separate from other shares held by the participants and from which limited account movements may be made without a "flip" being reported. These unreported movements include: (i) the movement of shares from the lead manager (or comanager when there are shares to be distributed to foreign brokers) to a DTC participant and (ii) the movement of shares from a DTC participant to a custodian for an institution.

control account of the selling group broker-dealer for the retail customer.<sup>12</sup> While broker-dealers are not required to provide customer level detail, selling group broker-dealers may populate the IPO database with information for retail accounts (*e.g.*, internal customer identification numbers) either directly into the IPO Tracking System by using the "Add Customer-Level Detail" function or into the IPO Tracking System through submissions of daily formatted trade files. Broker-dealers also may change such information using the IPO Customer Level Adjustment function.

Upon the subsequent sale of a position that was established in the initial distribution, the selling group broker-dealer releases the shares from its IPO control account to its free account by using the IPO release capability through DTC's participant terminal system ("PTS"), computer-to-computer facilities ("CCF"), or main frame dual host ("MDH"). The release instructions must include number of shares, trade date, and price. If the broker-dealer has previously assigned a customer internal account number to the IPO shares, the release instructions must include such number which must match a previously established IPO database entry or the transaction will be rejected. Upon DTC's acceptance of the release instructions, the shares are moved from the broker-dealer's IPO control account to its free account. It is this movement that marks the activity as a flip. All deliveries and Continuous Net Settlement ("CNS") short positions are satisfied from the participant's free account.

#### *Institutional Trade*

For an institutional customer, the lead manager moves the shares from its IPO control account directly into the selling group broker-dealer's IPO account at DTC by using an initial distribution deliver order ("DO"). The selling group broker-dealer then distributes the institutional portion of the initial distribution to the institution's custodian, which is either an agent bank or prime broker,<sup>13</sup> through DTC's Institutional Delivery ("ID") system or by submitting a DO with an ID agent bank identifier.<sup>14</sup> The DO or ID confirm

<sup>12</sup> Share movements out of the selling group broker-dealer's IPO control account will be reported as a flip.

<sup>13</sup> A prime broker is a broker-dealer that acts as custodian for institutional customers and uses DTC's ID system (*i.e.*, the prime broker acts as an agent bank).

<sup>14</sup> Alternatively, the lead manager may deliver directly to the custodian of the selling group member's institutional client. This process is referred to as directed concessions.

will contain the Agent Internal Account ("AIA") number and the Broker Internal Account ("BIA") number,<sup>15</sup> which will be stored in the IPO database.

Agents banks do not have IPO control accounts; therefore, all activity into and out of the agent banks' free accounts is monitored to keep track of customer purchases and sales. When an ID confirm is generated for a sale in a tracked issue, DTC matches the AIA number on the confirm against the AIA number in the IPO database. A warning message is produced on the confirmation and on the affirmed confirmation when an AIA number does not match any AIA number contained in the IPO database. Similarly, settlement authorization or DO processing is prohibited if a match to an AIA number in the IPO database is not found.<sup>16</sup> In order to settle the transaction, the agent bank must either change the AIA number in the IPO database using the IPO Customer-Level Adjustment function or submit a DO with an AIA number that matches the IPO database.

Unlike agent banks, prime brokers will have IPO control accounts at DTC. Shares from an initial distribution are moved into the prime broker's IPO control account, and the IPO database is updated with AIA and BIA numbers from the ID trade confirmation. The IPO Tracking System automatically releases IPO positions to the prime broker's free account for affirmed ID trades of secondary market transactions when the AIA number on the confirmation matches an AIA number contained in the IPO database. It is the release of the IPO position that results in a report of a flip.

When an institutional customer has positions in the same security purchased both in an IPO and in the secondary market, the system uses the secondary market position to complete a delivery before using shares received during the initial distribution. Also, when a customer has received shares from multiple broker-dealers and subsequently sells such shares, the system assigns the "flipped" shares on a prorated basis among the selling group members servicing that customer.

#### *Correspondent Relationships*

When an introducing broker (*i.e.*, not a DTC participant) is acting as a selling group member, its shares are held by its designated clearing agent, which may be a broker-dealer or agent bank. When

<sup>15</sup> The AIA number is the internal number used by the custodian to identify the institutional client. The BIA number is the internal account number that the selling group broker-dealer uses to identify the institutional client.

<sup>16</sup> As a result, the transaction is marked as a fail.

distribution these shares, the lead manager identifies the transaction as a correspondent delivery by entering the Correspondent Account ("CA") number on the DO.<sup>17</sup> The IPO Tracking System captures the CA number from the delivery to the clearing agent. The CA number is stored in the IPO database with the clearing agent's participant number to fully identify a correspondent (*i.e.*, the introducing broker) as a selling group member.<sup>18</sup> Subsequent share movements for correspondents, either sales or account transfers, require use of the CA number and are subject to the same release rules that apply to direct DTC participants.

#### *Physical Certificates*

DTC does not accept deposits of physical certificates in tracked issues. Participants may request a physical certificate through a withdrawal-by-transfer ("WT") request, which will be processed beginning on the first settlement day of the issue.<sup>19</sup> For shares held by agent banks, the bank must input into the automated WT system the AIA, CA, and ID agent bank numbers. If the numbers entered do not match those in the IPO database, the WT request will be rejected. If a WT request exceeds the position in the agent bank's account, the request will be rejected, and an error message will be generated. The IPO Tracking System will process WT requests first using shares which were not part of the initial distribution and then using shares which were part of the initial distribution provided there is sufficient position.

For shares held by broker-dealers, the WT request must include the customer identification number. DTC will process WT requests using shares in the IPO control account with a matching customer number. When there is a customer number match in the IPO database, DTC generates a release from the IPO account and reports it on the lead manager's and selling group member's reports as a WT even if the WT is not processed. The released IPO shares are combined with free account shares, and the WT is processed from

the free account. If the broker-dealer's IPO control account does not contain shares with a matching customer number, the WT is processed using shares from the free account provided there is sufficient position.

#### *Stock Loan*

Participants may process stock loan DOs using stock loan reason codes. Participants do not have to enter individual account numbers (*e.g.*, AIA numbers) to match the IPO database. For brokers, IPO tracked shares do not have to be released by participants to execute stock loans because the IPO system automatically releases these shares. Stock loans will be reported to the lead manager as separate items from flipped shares.

#### *Customer Account Transfer*

When a customer account includes shares in a tracked issue, the transfer of such shares cannot occur through the National Securities Clearing Corporation's ("NSCC") normal Automated Customer Account Transfer ("ACAT") system processing. While the initial processing at NSCC will remain the same, at the end of the settlement process NSCC will issue a trade-for-trade ticket for shares in a tracked issue, and the shares will not be delivered through NSCC's Continuous Net Settlement System.<sup>20</sup> Instead, customer shares in a tracked issue must be processed by DTC's new IPO customer account transfer function. The function allows the deliverer (*i.e.*, the broker-dealer or agent bank) to enter the customer internal account number associated with the shares to be delivered, its participant number, and customer internal account number of the broker-dealer to which the shares are to be delivered. The shares are then moved from the IPO control account of the delivering broker-dealer to the IPO control account of the receiving broker-dealer.

#### *Reclamation*

Initial distribution deliveries (*i.e.*, deliveries from the lead manager to a selling group member) that are reclaimed and matched will return to the account from which they originated (*i.e.*, the lead manager's IPO control account). Reclamations done for shares which were released from a selling group broker-dealer's IPO control

account or a prime broker's IPO control account to a free account to satisfy an obligation on the secondary market will be returned to the delivering participant's free account, and such shares will still be registered as flipped. When a reclamation occurs for an agent bank, the reclaimed DO will be matched to the original delivery, and the information in the IPO database will be reversed (*i.e.*, no flip will be registered).

#### *Oversubscription*

Generally, when an issue is oversubscribed the lead manager will purchase securities in the secondary market. These shares will reside in the lead manager's free account. The lead manager will have the option of delivering oversubscribed shares from its free account to selling group members' IPO control accounts or to its IPO control account for its own customers' shares.

#### *Memo Segregation*

Participants may enter memo segregation instructions with share quantities that represent the combined total of their free and IPO shares.<sup>21</sup> As DTC processes DOs, the share quantity of the memo segregation instruction will be subtracted from the combined share total of the free account and the IPO account and then compared against the quantity on the DO to determine if the delivery can take place. The shares to be delivered will be removed from the participant's free account.

#### *Termination of Tracking*

During the tracking period, the lead manager and selling group members are able to obtain information on the flipping of shares through hard copy or machine readable daily reports or through a new PTS inquiry function.<sup>22</sup> DTC discontinues tracking an IPO on the earlier of the business day following DTC's receipt of a termination request from the managing underwriting or 120 calendar days from the date trading commenced. Once IPO tracking is discontinued, any shares remaining in a broker-dealer's IPO control account are moved to its free account.<sup>23</sup>

<sup>17</sup> The CA number is the clearing firm's internal number for the introducing broker.

<sup>18</sup> When the ultimate purchaser is a retail customer, clearing agents may enter customer-level details into the IPO database on behalf of correspondents. When the ultimate purchaser is an institution, clearing agents are able to use the ID system or a properly identified DO to deliver shares as part of the initial distribution to a custodian.

<sup>19</sup> A WT is used when participants need to withdraw physical stock or registered bond certificates from DTC registered in a name other than DTC's nominee name, Cede & Co. DTC permits participants to withdraw securities in round lots, odd lots, or mixed lots registered in a name designated by the participant.

<sup>20</sup> For a complete description of customer account transfers of IPOs in the ACAT system, refer to Securities Exchange Act Release No. 36931 (March 6, 1996), 61 FR 10050 [File No. SR-NSCC-96-05] (notice of filing of proposed rule change modifying the ACAT service to facilitate the transfer of shares being tracked in the IPO Tracking System).

<sup>21</sup> The memo segregation function creates a memo position within the participant's account enabling participants to protect customer securities.

<sup>22</sup> The lead manager's report combined with market conditions will assist the lead manager in determining when to instruct DTC to discontinue IPO tracking.

<sup>23</sup> DTC will automatically release the shares from the IPO control account to the participant's memo segregation account at the close of the tracking period when requested in writing as a standing instruction by individual participants that use the memo segregation service. Without this standing

At the close of the tracking period the lead manager receives a final report detailing the selling group members (including the clearing agents) whose customers have flipped. The report includes sale price, trade date, and number of shares as well as the clearing agent's participant number and the CA number. The report also shows: (1) Outstanding CNS short positions for selling group members long in the IPO control account, (2) a total aggregate of all open CNS commitments, (3) WT transfers, and (4) outstanding stock loans by agent banks or broker-dealers. The lead manager's report does not include customer level detail information (*i.e.*, BIA numbers, AIA numbers, or customers internal account numbers).

Selling group members and lead managers, as part of the syndicate, receive a report of their institutional or retail customers' sale transactions.<sup>24</sup> Such report includes the original BIA number, the identity of any prime brokers or agent banks, and the AIA numbers or the customer internal account numbers. This provides sufficient information for selling group members to identify the clients that have potentially flipped shares during the tracking period.

## II. Comment Letter

The Commission received one comment letter in response to the proposed rule change.<sup>25</sup> The commenter believes that the proposal is too broad because the IPO Tracking System will allow tracking of all new issues regardless of whether the issues are subject to a stabilization bid. The commenter is concerned that DTC's IPO Tracking System will encourage syndicates to monitor secondary market sales of all IPOs. The commenter believes such use of the IPO Tracking System will place a burden on the marketplace by restricting trading in the secondary market and will infringe upon the anonymous nature of trading.

## III. Discussion

The Commission believes that DTC's proposal is consistent with Section 17A of the Act<sup>26</sup> and specifically with Sections 17A(b)(3) (A) and (F) thereunder.<sup>27</sup> Sections 17A(b)(3) (A) and (F) require that a clearing agency be

instruction, DTC will release shares residing in the IPO control account directly into the participant's free account at the end of the tracking period.

<sup>24</sup> Syndicate members will not see information regarding customers of their selling group broker-dealers.

<sup>25</sup> *Supra* note 5.

<sup>26</sup> 15 U.S.C. 78q-1 (1988).

<sup>27</sup> 15 U.S.C. 78q-1(b)(3) (A) and (F) (1988).

organized and its rules be designed to facilitate and to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in the custody or control of DTC or for which it is responsible. By facilitating a lead manager's ability to track flipping of IPOs in a book-entry environment, DTC's IPO Tracking System should further efficiencies and safety in the clearance and settlement of securities transactions by reducing the number of transactions that are settled outside the national clearance and settlement system.

Book-entry settlement of securities transactions has been a goal since Congress enacted the Securities Acts Amendments of 1975.<sup>28</sup> In Section 17A(e),<sup>29</sup> Congress directed the Commission to use its authority to end the physical movement of securities certificates in connection with the settlement among brokers and dealers of transactions in securities. Since 1975, substantial progress has been made in reducing the flow of physical certificates for settlement of interdealer and institutional securities transactions.<sup>30</sup> Approval of the present rule change should further aid in the efficiencies of the clearance and settlement system because the IPO Tracking System should reduce costs, risks, and delays associated with the physical delivery of certificates.

The one commenter has suggested that the IPO Tracking System is overly broad. It is true that the IPO Tracking System may facilitate the tracking of more issues than the method currently used. However, the increase in the amount of information available to the lead manager does not, in itself, create the problems cited by the commenter. Any use of the IPO Tracking System would need to be consistent with federal securities laws in effect at that time, including, if adopted, recent proposals designed to address concerns

<sup>28</sup> Pub. L. No. 94-29, 89 Stat. 97 (1975) (codified at 15 U.S.C. 77-80h [1988]).

<sup>29</sup> 15 U.S.C. 78q-1(e) (1988).

<sup>30</sup> *E.g.*, Securities Exchange Act Release Nos. 22021 (September 23, 1983), 48 FR 45167 (order granting full registration to nine clearing agencies); 19698 (April 15, 1983), 48 FR 17604 (order implementing DTC's Fast Automated Securities Transfer program); 30283 (January 23, 1992), 57 FR 3658 (order implementing DTC's Deposit/Withdrawal at Custodian program); 30505 (March 20, 1992), 57 FR 10683 (order eliminating DTC's Certificate on Demand service for most corporate issues); 31645 (December 23, 1992), 57 FR 62407 (order approving rule change requiring that most interdealer transactions in municipal securities be settled by book-entry through a depository); 32455 (June 11, 1993), 58 FR 33679 (order approving uniform book-entry settlement rules); and 35798 (June 1, 1995), 60 FR 30909 (order approving depository eligibility requirements).

about post-offering activities by underwriters.<sup>31</sup> Therefore, the Commission does not believe that the gathering of information by the IPO Tracking System will be detrimental to public policy.

The commenter also stated that the IPO Tracking System prevents anonymity in the securities market. The Commission believes that the IPO Tracking System generally does not provide any more information than is obtained through the current method of tracking with physical certificates. In a retail trade, the selling group broker-dealer is not required to populate the IPO database with retail customer information. In instances where customer information is provided either in a retail or institutional trade, only the selling group broker-dealer, and not the lead manager, will receive reports identifying the customer. This process mirrors the flow of information in physical tracking where a lead manager can identify the selling group broker-dealer by the certificate number, and the selling group broker-dealer can identify its customer by the certificate number. Further, the Commission disagrees that the proposal will restrict secondary market sales. The system may in practice actually make it easier for retail customers to resell through any broker-dealer because an investor can immediately request issuance of physical certificates in her name or request a transfer to another broker-dealer through the ACAT service, which generally provides a more expedient method to transfer an account because the transfer is conducted through book entry movements. Finally, the Commission believes the efficiencies of the IPO Tracking System outweigh the potential for misuse of the system and finds the system to be an effective alternative to the present method of tracking IPO shares in certificate form.

Furthermore, the IPO Tracking System will not impede an investor's ability to obtain physical certificates through a WT transaction. The modifications to the automated WT system allow participants to withdraw physical certificates of tracked issues without causing the withdrawals to show as flipped transactions.<sup>32</sup> Similarly, investors will be able to loan or to pledge stock or to transfer their accounts between broker-dealers during the tracking period.

<sup>31</sup> Securities Exchange Act Release No. 37094 (April 11, 1996), 61 FR 17108.

<sup>32</sup> The system will report the withdrawal of a certificate to the lead manager which may request further clarification from the selling group broker-dealer as to the nature of the transaction.

However, the Commission notes that while a delivery reclaimed by an agent bank on behalf of an institution will be matched to the original delivery and the reclamation will not be recorded as a flip, a reclamation done for shares delivered from a selling group broker-dealer's IPO control account will be registered as flipped. This distinction could possibly result in discrimination between retail customers, who typically hold through broker-dealers, and institutional customers. The Commission understands that this distinction is a result of systems limitations.<sup>33</sup> The Commission urges DTC to monitor this situation once the system is operational to determine whether the limitation has a discriminatory effect. If so, DTC should consider systems modifications to address this concern.

#### IV. Conclusion

The Commission finds that DTC's proposal is consistent with the requirements of the Act and particularly with Section 17A and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-95-27) be and hereby is approved. As stated, DTC has agreed to notify self-regulatory organizations and managing underwriters at least thirty calendar days prior to the general availability of the IPO Tracking System.<sup>34</sup>

For the Commission by the Division of Market Regulation, pursuant to delegated authority,<sup>35</sup>

Margaret H. McFarland,  
Deputy Secretary.

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[Release No. 34-37211; International Series Release No. 978; File No. SR-NYSE-96-05]

### Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Listing Standards

May 14, 1996.

On March 18, 1996, the New York Stock Exchange, Inc. ("NYSE" 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")<sup>1</sup> and Rule 19b-4

<sup>33</sup> Because all movements out of an agent bank's account are monitored, DTC is able to determine exactly which shares are reclaimed. In contrast, shares are removed from a broker-dealer's free account without regard to their origin.

<sup>34</sup> *Supra* note 3.

<sup>35</sup> 17 CFR 200.30-3(a)(12) (1995).

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

thereunder,<sup>2</sup> a proposed rule change that would permit companies domiciled in Canada, Mexico, and the United States ("North America")<sup>3</sup> to include holders and trading volume in North America toward meeting the stockholder and trading volume requirements for listing on the Exchange pursuant to the domestic listing criteria.

The proposed rule change was published for comment in Securities Exchange Act Release No. 37055 (Apr. 1, 1996), 61 FR 15546 (Apr. 8, 1996). No comments were received on the proposal.

Under the current NYSE rules, companies applying to list on the Exchange must meet the applicable listing criteria. For equity listings, there are two different standards: domestic criteria, which are available to all companies, ("domestic standards") and criteria available solely to non-U.S. companies ("worldwide standards"). Non-U.S. companies may elect to qualify for listing under the Exchange's domestic numerical standards or worldwide numerical standards. Non-U.S. companies, however, must meet all of the criteria within the standard under which they seek to qualify for listing.

Paragraph 102.01 of the NYSE's *Listed Company Manual* ("Manual") sets forth the standards for domestic companies that want to list their equity securities on the Exchange. These standards require applicants to satisfy certain minimum numerical criteria.<sup>4</sup> Under these requirements for listing, the company must have, among things, (a) 2,000 round-lot holders; (b) 2,200 total stockholders, together with an average monthly trading volume of 100,000 shares for the most recent six months; or (c) 500 total stockholders, together with an average monthly trading volume of 1,000,000 shares for the most recent 12 months.<sup>5</sup> The domestic criteria require that these standards be met only through holders and trading volume occurring in the U.S.

The Exchange proposes to amend these initial listing standards to provide that for listing applications from North American companies the Exchange will

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

<sup>3</sup> For purposes of this rule, a company is "domiciled" in the country under the laws of which it is organized.

<sup>4</sup> In deciding whether to approve the listing of an equity security, the NYSE also takes qualitative factors into consideration. These factors include whether the company is a going concern or a successor thereto, the degree of national interest in the company, the character of the market for its products, its relative stability and position in its industry.

<sup>5</sup> In determining the number of holders for the above distribution standards, the NYSE considers both beneficial and record owners.

include all North American holders and North American trading volume in applying the minimum stockholder and trading volume requirements in Paragraph 102.01 of the Manual. The Exchange believes that with continuing integration of the North American market, this market should be viewed as a whole in reviewing a company's eligibility for listing. Moreover, the Exchange believes that this will foster internationalization of the securities markets by enhancing the access of U.S. investors to the trading of Canadian and Mexican securities.

Pursuant to the proposed rule change, the Exchange would look at the number of beneficial holders resident in North America in applying the initial listing criteria of Paragraph 102.01 to North American companies. In computing trading volume, the Exchange will look to the reported volume (i) on U.S. stock exchanges, (ii) in the U.S. over-the-counter market, and (iii) on Canadian or Mexican stock exchanges.<sup>6</sup> The total volume reported from these sources must satisfy the NYSE's initial listing standards. For American Depositary Receipts ("ADRs") to be listed on the NYSE, volume in the ordinary shares would be adjusted to be on an ADR-equivalent basis.<sup>7</sup> Finally, the proposed rule change would make conforming changes to Paragraph 103.00 of the Manual, which establishes alternate initial listing criteria for non-U.S. companies.

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, with the

<sup>6</sup> According to the NYSE, the NYSE would consider an "exchange" to be a trading market that is regulated as a stock exchange by home-country regulators. The NYSE believes that the Bolsa Mexicana de valores is the only market in Mexico that would be considered an "exchange" for this purpose. In Canada, the NYSE believes that there currently are five stock exchanges that satisfy this test: The Montreal Exchange and the Toronto, Vancouver, Winnipeg, and Alberta Stock Exchanges. See letter from Michael J. Simons, Milbank, Tweed, Hadley & McCloy, to Glen Barrentine, Senior Counsel, Division of Market Regulation, SEC, dated April 1, 1996.

<sup>7</sup> For example, assume that a Mexican company has ADRs trading in the United States and ordinary shares trading in Mexico, with each ADR representing 10 ordinary shares. If the company were to apply to list its U.S.-traded ADRs on the NYSE, the Exchange would divide the Mexican share volume by 10 in determining whether the combined ADR/share volume meets the requirements of the listing criteria. For Companies that have multiple series of shares or ADR's the Exchange will include the volume only in the specific ordinary shares and overlying ADRs that would be listed on the exchange.