Finally, the Commission notes that CSE has submitted surveillance procedures for the trading of PDRs, specifically SPDRs and MidCap SPDRs, and believes that those procedures, which incorporate and rely upon existing CSE surveillance procedures governing equities, are adequate under the Act.

The Commission finds that CSE's proposal contains adequate rules and procedures to govern the trading of PDR securities, including trading SPDRs and MidCap SPDRs pursuant to UTP. Specifically, PDRs are equity securities that will be subject to the full panoply of CSE rules governing the trading of equity securities on CSE, including, among others, rules governing the priority, parity and precedence of orders and the responsibilities of specialists. In addition, CSE has developed specific listing and delisting criteria for PDRs that will help to ensure that the markets for PDRs will be deep and liquid. As noted above, CSE's proposal provides for trading halt procedures governing PDRs. Finally, the Commission notes that CSE has stated that Rule 3.7, Recommendations to Customers, will apply to the trading of PDRs in general, and SPDRs and MidCap SPDRs, in particular.

The Commission finds good cause for approving the proposed rule change prior 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 is appropriate because it is very similar to CHX's previously approved proposal covering the listing and trading of PDRs in general, and SPDRs and MidCap SPDRs, in particular.[36] As such, the Commission believes that the proposed rule change does not raise any new regulatory concerns or issues.

*It is therefore ordered,* pursuant to Section 19(b)(2) [37] that the proposed rule change is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[38]

**Margaret H. McFarland,**

*Deputy Secretary.*

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[36] *See supra* note 11.

[37] 15 U.S.C. 78s(b)(2).

[38] 17 CFR 200.30–3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–39266; File No. SR–NASD–97–42)]**

## Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change to Amend NASD Rule 2320(g) to Provide Authority to the Staff of NASD Regulation to Grant Exemptions From Such Provision

October 22, 1997.

### I. Introduction

On June 17, 1997, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') submitted to the Securities and Exchange commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend NASD Rule 2320(g) to provide the staff of NASD Regulation authority to grant exemptions from such provision.

Notice of the proposed rule change, together with the substance of the proposal, was published for comment in Securities Exchange Act Release No. 38936 (August 14, 1997), 62 FR 44503 (August 21, 1997). Two comment letters were received on the proposal.[3]

### II. Description

NASD Rule 2320(g) (''The Three Quote Rule'' or ''Rule'') was adopted on May 2, 1998 [4] as an amendment to the NASD's best execution interpretation [5] under Article III, Section 1 of the NASD's Rules of Fair Practice.[6] The Three Quote Rule was adopted in connection with the NASD's efforts to develop a nationwide automated market surveillance program for non-Nasdaq, over-the-counter (''OTC'') securities, commonly referred to as ''pink sheet'' stocks, and was designed to create a standard to help assure that members would fulfill their best execution responsibilities to customers in non-Nasdaq securities, especially transactions involving relatively illiquid securities with non-transparent prices.

The Rule expanded a member's best execution obligation to customers by setting forth additional requirements for customer transactions in non-Nasdaq securities. In particular, the Rule requires members that execute transactions in non-Nasdaq securities on behalf of customers to contact a minimum of three dealers (or all dealers if there are three or less) to obtain quotations to enable them to determine the best inter-dealer market. Each member is generally required to use reasonable diligence to ascertain this best inter-dealer market for a security, and to buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.[7]

Concurrent with these activities, the Commission also approved Schedule H to the NASD's By-Laws, which established an electronic system of mandatory price and volume reporting for the OTC non-Nasdaq securities.[8] On May 1, 1990, the Commission issued an order approving the operation of the NASD's OTC Bulletin Board Display Service (''OTC Bulletin Board'') for a pilot term of one year.[9] The NASD introduced the OTC Bulletin Board to allow NASD eligible members to enter, update and retrieve quotation information on a real-time basis in non-Nasdaq securities.[10]

Since the establishment of the OTC Bulletin Board, significant market, regulatory and technology related improvements have occurred in the non-Nasdaq marketplace.[11] In

[1] 15 U.S.C. 78s(b)(1)

[2] 17 CFR 240.19b–4.

[3] See letter from Leonard Mayer, President, Mayer & Schweitzer, Inc., to Jonathan G. Katz, Secretary, Commission, dated September 12, 1997 (''Mayer letter''), and letter from Paul Chalmers, Senior Vice President, International Trading, Canaccord Capital, to Jonathan G. Katz, Secretary, Commission, dated September 17, 1997 (''Canaccord letter'').

[4] See Securities Exchange Act Release No. 25637 (May 2, 1988), 53 FR 16488 (May 9, 1988).

[5] ''Interpretation of the Board of Governors—Execution of Retail Transactions in the Over-the-Counter Market.''

[6] The best execution interpretation in Article III, Section 1 of the NASD's Rules of Fair Practice was converted into NASD Rule 2320 in connection with the NASD's Manual revision project. See Securities Exchange Act Release No 36698 (January 11, 1996), 61 FR 1419 (January 19, 1996.)

[7] See NASD Rule 2320(a).

[8] Schedule H of the By-laws required NASD members executing principal transactions in non-Nasdaq securities to report price and volume data for the days on which their sales or purchases exceeded 50,000 shares or $10,000. In 1993, member obligations under Schedule H were modified or eliminated as a result of the NASD adopting real-time reporting of transactions for non-Nasdaq securities. See Securities Exchange Act Release No. 32647 (July 16, 1993), 58 FR 39262 (July 22, 1993).

[9] On March 31, 1997, the SEC granted permanent approval of the OTC Bulletin Board. See Securities Exchange Act Release No. 38456 (March 31, 1997), 62 FR 16635 (April 7, 1997).

[10] See Securities Exchange Act Release No. 27975 (May 1, 1990), 55 FR 19123 (May 8, 1990).

[11] These changes include: requiring that all priced quotations entered by market makers in domestic securities be firm for at least one trading unit (see Securities Exchange Act Release No. 29261 (May 31, 1991), 56 FR 29297 (June 26, 1991)); calculating inside quotes for individual securities and disseminating this information through vendors;

Continued

particular, the NASD has implemented enhancements to the OTC Bulletin Board to increase the reliability of information contained therein. Most recently, in July 1993, the Commission approved an NASD rule change to implement real-time trade reporting for members' OTC transactions in certain non-Nasdaq equity securities,[12] and in April 1994, the NASD commenced realtime dissemination of transaction reports through the Nasdaq network and the networks of commercial vendors, providing member firms and their customers access to last-sale price and volume information for these securities throughout the business day.

The OTC Bulletin Board meets the requirements of an ''automated quotation system'' as the characteristics of such system Ware described in Section 17B of the Exchange Act.[13] As such, the OTC Bulletin Board has assisted NASD broker-dealers in complying with certain disclosure regulations under Section 15(g) of the Exchange Act (''the Penny Stock Rules'').[14] The OTC Bulletin Board was also designed to help deter fraudulent and manipulative trading practices in penny stocks, [15] in part through real-time transaction reporting. Technological improvements to the OTC Bulletin Board have enhanced the NASD's surveillance capabilities to, among other things, permit computerized analyses of market markers' quotation entries and reported transactions.

The proposed change to Rule 2320(g) will provide for general exemptive authority under the Rule. The NASD Regulation staff, upon written request and taking into consideration all relevant factors, will be able to exempt from Rule 2320 any transaction or class of transactions, either unconditionally or on specified terms, if the exemption is consistent with the purposes of the Rule, protection of investors and the public interest. The decision may be appealed to the National Business Conduct Committee (''NBCC''). NASD Regulation has not yet determined whether any particular class of transactions should be exempted.

The NASD noted in its filing that the staff could consider, in determining whether to grant an exemptive request: (1) The number of firms publishing firm quotations and the period of time during which such quotations were published; (2) the size of the customer order in relation to the minimum size of the market makers' quotations; (3) the transaction volume of the security in question; and (4) the number of dealers publishing quotations through an electronic quotation medium in comparison to dealers in the security that do not publish such quotes. The NASD also stated that it expects the range of circumstances in which exemptions may be granted would be limited to those circumstances in which it can be shown that the Three Quote Rule would, in fact, hinder a member's best execution obligation.

The Office of the General Counsel of NASD Regulation (''the Office'') will be responsible for strict compliance with discharging this exemptive authority. Member broker-dealers will be instructed to submit all requests for exemptions to the Office and will be required to limit the requests to actual contemplated transactions or situations. The NASD Regulation staff will not provide exemptions in response to hypothetical situations or transactions. The request should be detailed and include all relevant information necessary for the staff to reach a determination on the request. If a particular exemption involves a particular class of transactions or class of customers that may be relevant to other member broker-dealers, the NASD Regulation staff will also publish such results to the membership through a Notice to Members or similar publication or broadcast. NASD Regulation staff determinations will be subject to review by the NBCC.

## III. Summary of Comments

The Commission received two comment letters on the proposal, both of which supported the proposal. One commenter supported the ability of the NASD Regulation staff to have discretionary authority to grant, where appropriate, exemptions from the Three Quote Rule both for a particular fact situation or as to a class of securities or transactions.[16] Both commenters agreed that in certain situations the Three Quote Rule may hinder, rather than help, a firm in meeting its best execution obligations. One commenter stated that, in particular, the exemption should be available for foreign securities and agreed with the reasoning in the proposing release.[17]

## IV. Discussion

The Commission believes that the proposed rule change is consistent with Sections 15A(b)(6) [18] and 15A(b)(9) [19] of the Exchange Act. Section 15A(b)(6) requires that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to remove impediments to and perfect the mechanism of a free and open market and a national market system and in general to protect investors and the public interest. Section 15A(b)(9) requires that rules of an association not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[20]

The Commission believes that the proposed rule change is consistent with the Exchange Act because it will give NASD Regulation the authority to grant exemptions from the Three Quote Rule in situations where complying with the rule would hinder, rather than assist, best execution. The Commission believes that providing general exemptive authority under the Rule is appropriate in order to provide flexibility to respond to changing market conditions and to particular fact situations,[21] as well as instances when certain classes of transactions or certain securities on OTC Bulletin Board may warrant an exemption from the Three Quote Rule.

The Commission notes that one situation where exemptive relief might be applied would be trading in certain foreign securities.[22] In some

and establishing larger minimum-size requirements for market makers' quotes in domestic securities.

[12] See Securities Exchange Act Release No. 32647 (July 16, 1993), 58 FR 39262 (July 22, 1993).

[13] On October 15, 1990, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (''Reform Act'') was signed into law. Among other things, the Reform Act amended the Exchange Act by adding Section 17B, which requires the Commission to facilitate the development of one or more automated quotation systems for the collection and dissemination of information for penny stocks.

[14] See Rules 15g–1 through 15g–9 under the Exchange Act, 17 CFR 240.15g–1 through 240.15g–9.

[15] ''Penny Stock'' is defined under Rule 3a51–1 of the Exchange Act, 17 CFR 240.3a51–1.

[16] See Mayer letter, *supra* note 3.

[17] See Canaccord letter, *supra* note 3.

[18] 15 U.S.C. 78*o*–3(b)(6).

[19] 15 U.S.C. 78*O*–3(b)(9).

[20] In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[21] In its proposal, the NASD stated that some member broker-dealers who are active in the non-Nasdaq market claim that adherence to the three quote requirement may, in certain situations, have a negative impact on a member's ability to satisfy its best execution obligations, due to time delays involved in contacting and collecting quotations from three separate dealers. In addition, the NASD noted that some members question whether the Three Quote Rule should continue to apply to all customer transactions in non-Nasdaq securities in light of the technological and regulatory improvements to the non-Nasdaq marketplace and to the OTC Bulletin Board, over the past seven years. However, there are many non-Nasdaq securities that only trade in the Pink Sheets.

[22] The Three Quote Rule applies to transactions in all non-Nasdaq securities. A non-Nasdaq security is defined in NASD Rule 6710 as ''any equity

circumstances the foreign exchange market may constitute the best market for the securities that are listed on that market, and the time delay involved in contacting three dealers in advance of a customer transaction could hinder obtaining the best execution for the customer.

The Commission believes that the exemptive process provided by the rule change is reasonable under the Exchange Act. The Commission stresses that the NASD Regulation staff would not be able to grant an exemption (either for a particular market maker in a particular security, or for all market makers in a particular security or a class of securities) unless a market maker can demonstrate that adherence to the Rule could serve as an impediment to satisfying its best execution obligations with regard to a particular situation. The NASD Regulation Staff will not provide exemptions in response to hypothetical situations. The Commission also notes that if a particular exemption involves a particular class of transactions or class of customers that may be relevant to other member broker-dealers. The NASD Regulation staff will also publish such results to the membership through a Notice to Members or similar publication or broadcast. Further, the Commission notes that the grant of an exemption to the Three Quote Rule should not in any way limit a member's best execution obligation. Finally, the NASD Regulation staff determinations are subject to review by the NBCC.[23]

## V. Conclusion

*It is therefore ordered,* pursuant to Section 19(b)(2) of the Exchange Act,[24] that the proposed rule change (SR–NASD–97–42) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[25]

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security that is neither included in the Nasdaq Stock Market nor traded on any national securities exchange * * *. Therefore, the rule by its terms applies to transactions effected on any foreign exchange. The term ''national securities exchange'' is not defined in NASD rules, but the requirements to qualify are set forth in Sections 6(a) and 19(a) of the Exchange Act.

[23] After the NASD gains experience with this exemptive authority, the Commission expects the NASD to codify, to the extent possible, exceptions to the Rule. In particular, the NASD should amend the rule to incorporate exemptions provided to broad classes or types of transactions.

[24] 15 U.S.C. 78s(b)(2).

[25] 17 CFR 200.30–3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–39264; File No. SR–NYSE–97–26]**

## Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the New York Stock Exchange, Inc. Relating to Listing Fees for Short-Term Instruments

October 22, 1997.

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 18, 1997, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Commission is published this notice to solicit comments on the proposed rule change from interested persons. The Commission is also granting accelerated approval to this proposed rule change.

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

The Exchange is proposing to amend its rule regarding listing fees for short-term instruments contained in Paragraph 902.03 of the Listed Company Manual. Currently, the Exchange charges reduced listing fees for short term instruments with terms of less than five years. Pursuant to the proposed rule change, the Exchange will charge such reduced listing fees for instruments with a term of up to seven years.

The Exchange requests the Commission to find good cause, pursuant to Section 19(b)(2) of the Act, for approving the proposed rule change prior to the thirtieth day after publication in the **Federal Register** because this rule change will benefit issuers and investors by reducing listing fees on certain short-term instruments and that accelerated approval will provide such benefits in an expedited fashion.

### 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 Exchange has listing standards for a variety of short-term special purpose securities (*e.g.*, index warrants, foreign current warrants, contingent value rights). By their terms, these are instruments that will be listed on the Exchange for only a short period of time. Accordingly, in 1990 the Exchange adopted reduced listing fees for such short-term securities and defined such securities as having a term of less than five years.[1] Issuers now are seeking to list special purpose securities with a life of up to seven years. Thus, the purpose of this filing is to amend the definition of short-term securities to cover securities with a life of seven years or less. This effectively will reduce the listing fees for instruments with a term of five to seven years.

2. *Statutory Basis*

The Exchange believes that the basis under the Act for this proposed rule change is the requirement under Section 6(b)(4)[2] that an exchange have rules that provide for the equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities.

*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.

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

No written comments were either solicited or received.

### III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W.,

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[1] File No. SR–NYSE–91–01.

[2] 15 U.S.C. 78f(b)(4).