

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Amex proposes to amend Amex Rule 127 (Minimum Fractional Changes) to provide a significant expansion in the number of Amex securities traded in fractions of $\frac{1}{16}$ of \$1.00. In 1992, the Commission approved sixteenths trading for Amex securities selling under \$5 and above \$0.25.³ In 1995, the Commission approved an expansion of these parameters to allow sixteenths trading in Amex securities selling under \$10.⁴

The Exchange has determined to extend the benefits of trading in sixteenths to Amex equity securities priced at \$10 and over, which currently includes approximately 50% of Amex's equity list.⁵ The Exchange believes that trading in sixteenths will promote investor protection by, among other things, enhancing the already significant potential for price improvement available on the Amex to both retail and professional orders.

On March 18, 1997, the Amex discussed the proposed expansion of trading in sixteenths with the Intermarket Trading System ("ITS") participants and with the Securities Industry Automation Corporation ("SIAC"). The ITS Operating Committee voted unanimously to instruct SIAC to make necessary enhancements to the ITS host system to accommodate the proposed expanded sixteenths trading. SIAC also agreed to coordinate with the ITS participants regarding any required testing and changes to the participants' internal systems.⁶

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) ⁷ of the Act in general and furthers the objectives of Section 6(b)(5) ⁸ in particular in that it is designed to promote just and equitable principles of trade, to facilitate transactions in

securities and, in general, to protect investors and the public interest.

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

The Exchange believes the proposed rule change will impose no burden on competition. Indeed, the Exchange believes an expansion of trading in sixteenths will enhance competition by permitting trading in all Amex equity securities by all ITS participants in narrower trading fractions, with the potential for significant price improvement for investors. The proposed rule change will require SIAC to modify the host system and may require individual ITS participant markets to modify their own systems to permit trading in sixteenths via ITS in Amex securities priced \$10 and higher. No competitive issue is raised by these system changes, however, as expanded sixteenths trading will not commence until the SIAC and participant system changes have been effected.

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

The Exchange has neither solicited nor received written comments.

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

Within 35 days of the publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve the proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

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 available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Also, copies of such filing will be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-97-14 and should be submitted by April 22, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-38438; File No. SR-CBOE-96-57]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1, 2, and 3 Relating to a Minor Rule Violation Plan Amendment To Create a Settlement Procedure for Position Limit Fines

March 25, 1997.

I. Introduction

On September 25, 1996, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("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 its minor rule violation procedure to create an offer of settlement process for certain position limit violations.

The proposed rule change, together with the substance of the proposal, was published for comment in Securities Exchange Act Release No. 37787 (October 4, 1996), 61 FR 53472 (October 11, 1996). No comments were received on the proposed rule change. The CBOE filed Amendment Nos. 1, 2, and 3 with the Commission on January 21, March 4, and March 4, 1997, respectively.³ This

³ Securities Exchange Act Release No. 31118 (Aug. 28, 1992), 57 FR 40484 (Sept. 3, 1992) (approving SR-Amex-91-07).

⁴ Securities Exchange Act Release No. 35537 (Mar. 27, 1995), 60 FR 16894 (Apr. 3, 1995) (approving File No. SR-Amex-95-02).

⁵ Standard and Poor's Depository Receipts® ("SPDRs®") and S&P MidCap 400 SPDRs™ will continue to trade in $\frac{1}{64}$'s.

⁶ The Commission notes that the tests conducted March 22, 1997 involving the Amex, the Boston Stock Exchange, the Nasdaq Stock Market, and the Pacific Stock Exchange were successful. Amendment No. 1, *supra* note 2.

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

⁹ 17 C.F.R. 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 clarifies that the Exchange will report any Business Conduct Committee ("Committee") decision accepting a settlement offer under the proposed settlement procedure for position limit fines to the Commission on a current

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order approves the proposal, including Amendment Nos. 1, 2, and 3, on an accelerated basis.

II. Description

Section 19(d)(1) of the Act and Rule 19d-1(c)(1) thereunder require a self-regulatory organization ("SRO") to report any "final" disciplinary action taken to the Commission on a current basis. Rule 19d-1(c)(2) of the Act, which provides for the filing and approval of a minor rule violation reporting plan, states that any disciplinary action taken by an SRO for violation of the SRO's rules that has been designated a "minor rule violation" by the SRO pursuant to a plan approved by the Commission shall not be considered "final" for purposes of Section 19(d)(1) and Rule 19d-1(c)(1) of the Act if the sanction imposed consists of a fine that (1) does not exceed \$2,500 and (2) where the sanctioned person has not sought an adjudication, including a hearing, or otherwise exhausted his administrative remedies at the SRO with respect to the matter. Under Rule 19d-1(c)(2), these unadjudicated minor rule violations can be reported on a quarterly basis rather than on a current basis.⁴

CBOE Rule 17.50 sets forth the minor rule violation provisions adopted by CBOE in accordance with Section 19(d)(1) and Rule 19d-1(c)(2) of the Act. Under CBOE Rule 17.50(a), "[a]ny fine imposed pursuant to this Rule that (i) does not exceed \$2,500 and (ii) is not contested, shall be reported on a periodic, rather than a current, basis, except as may be otherwise required by Rule 19d-1 under the Securities Exchange Act of 1934 and by any other regulatory authority." The CBOE

currently processes position limit violations as minor rule violations pursuant to CBOE Rule 17.50 (i.e. summary fines) and can impose a fine, not exceeding \$5,000 for any one trade date, for such violations. An Exchange member may contest the fine(s) imposed under Rule 17.50 by following the procedures outlined in Rule 17.50(c), which include filing a written answer and requesting a hearing, if the member so desires. At that time the matter becomes subject to review by the Business Conduct Committee ("Committee") because it becomes a disciplinary proceeding subject to Chapter XVII of the CBOE's rules and, where applicable, the current reporting provisions of Rule 19d-1(c)(1) of the Act.

Members with significant position limit summary fines do not presently have access to the settlement resolution process available to respondents under Exchange Rule 17.8 for regular disciplinary matters pending before the Committee, including making offers of settlement and personal appearances. According to the CBOE, some members who proceeded to a contested fine hearing admitted that the violations occurred, and used the hearing forum solely to request that the fines be reduced or removed. Based upon this past experience with contested position limit summary fine matters, as well as an internal regulatory focus study, the Exchange is proposing a new procedure so that members with significant position limit violations meeting certain criteria will have an opportunity within the minor rule violation procedure to present one settlement offer before the Committee.

The proposed rule change adds language describing the settlement offer procedure to Interpretation and Policy .01 under Exchange Rule 17.50. The additional language defines the threshold levels of position limit summary fines that trigger access to the new settlement procedure. The original filing stated that the CBOE will treat (a) position limit violations resulting in any one-day fine in excess of \$2,500, or (b) position limit violations resulting in an aggregate fine in excess of \$10,000 and involving five or more consecutive trade dates, as appropriate for an offer of settlement opportunity before the Committee. Under Amendment No. 1, the CBOE adds upper limits to the threshold levels, so that the settlement procedure can be used for (a) position limit violations resulting in any one-day fine in excess of \$2,500 but not exceeding \$5,000; or (b) position limit violations resulting in an aggregate fine greater than \$10,000 and not more than

\$5,000 in any one day. This amendment makes the CBOE's proposed rule consistent with the limits for commencing an action under CBOE's minor rule plan; for example, violations which would result in a fine exceeding \$5,000 a day cannot be processed under CBOE's minor rule plan.⁵

Amendment No. 1 also clarifies several aspects of the settlement process under the minor rule violation procedure. Members who meet the threshold position limit fine level have the opportunity to submit one written offer of settlement in accordance with Rule 17.8(a), except that the Interpretations and Policies of Rule 17.8 will not apply and the member must submit the settlement offer within thirty (30) days of the date of service of the written statement informing them of the fine(s) imposed. Amendment No. 1 also states that a member may personally appear before the Committee in order to make an oral statement in support of the offer. In addition, Amendment No. 1 adds language to the rule change stating that a decision accepting an offer of settlement under this process will be reported on a current basis pursuant to Rule 19d-1 of the Act.⁶ Amendment No. 2 adds additional language to proposed Interpretation and Policy .01 of Rule 17.50 stating that members whose offer of settlement is accepted by the Committee shall report the acceptance of the settlement offer on the member's broker-dealer form under the Act ("Form BD") as a decision in a contested Exchange disciplinary proceeding. Amendment No. 3 further amends the language of proposed Interpretation and Policy .01 of Rule 17.50 to state that members whose offer of settlement is accepted by the Committee shall report the acceptance on the uniform application for securities industry registration or transfer ("Form U-4") as a decision in a contested Exchange disciplinary proceeding.⁷

The CBOE is only proposing to apply the new settlement procedures to fines imposed under Rule 17.50 for position limit violations at this time. In this regard, the CBOE noted that it has not experienced significant accumulations of fines by members for minor rule violations under Exchange Rule 17.50 other than position limit violations.

⁵ See note 4, supra.

⁶ This will be the case irrespective of whether the accepted settlement offer is below \$2,500.

⁷ If the offer of settlement is not accepted, the minor rule violation process will continue as if the offer was never made; the member will be able to either contest the violation under Rule 17.50(c) or pay the fine. Phone conversation between Margaret G. Abrams, Senior Attorney, CBOE, and Heather Seidel, Attorney, Market Regulation, Commission, on February 25, 1997.

basis. Amendment No. 1 also clarifies the settlement offer time frame and procedure. Amendment No. 2 changes the language of proposed Interpretation and Policy .01 of Rule 17.50 to state that members whose offer of settlement is accepted by the Committee must report the acceptance of the settlement offer on the members' broker-dealer form under the Act ("Form BD") as a decision in a contested Exchange disciplinary hearing. Amendment No. 2 also makes a technical change to proposed Interpretation and Policy .01 of Rule 17.50 by lettering paragraphs as (a) and (b). Amendment No. 3 further changes the language of proposed Interpretation and Policy .01 of Rule 17.50 to state that members whose offer of settlement is accepted by the Committee must report the acceptance of the settlement offer on the uniform application for securities industry registration or transfer ("Form U-4"). See letters from Margaret G. Abrams, Senior Attorney, CBOE, to Sharon Lawson, Senior Special Counsel, Market Regulation, Commission, dated January 15, 1997 ("Amendment No. 1"), February 12, 1997 ("Amendment No. 2"), and February 26, 1997 ("Amendment No. 3"), respectively.

⁴ Under CBOE's minor rule plan and Rule 17.50(a), the Exchange can impose fines up to \$5,000 for minor rule violations. Fines above \$2,500 must, however, be reported on a current basis.

III. Discussion

The proposed rule change is consistent with and furthers the objectives of Section 6(b)(5) of the Act⁸ in that it is designed to refine and enhance the Exchange's minor rule violation procedure as applied to position limit violations, while retaining adequate enforcement measures for violations of such rules, thereby removing impediments to a free and open market and protecting investors and the public interest.⁹

The Commission finds that by adopting formal procedures for the settlement of certain position limit summary fines that are separate from a full disciplinary hearing, the proposed rule change should increase the efficiency of the Exchange's disciplinary process by saving the time and expense of both members and Exchange staff in preparing for hearings, while continuing to ensure that position limit rules are effectively enforced. Under the CBOE's proposed rule, violations settled using new procedures, irrespective of whether the settlement amount is under \$2,500, will be subject to immediate, rather than quarterly, reporting to the Commission.¹⁰ The Commission believes this result is appropriate and makes CBOE's new rule consistent with the CBOE's minor rule reporting plan and Rule 19d-1(c)(2),¹¹ due to the fact that the members are contesting the fine amounts and have sought an adjudication on the violation which includes the opportunity to have a hearing.

For the same reasons, the CBOE has also amended their new rule to state that the acceptance of settlement offers under this new procedure must be reported on the Form BD¹² and Form U-4. Both Form BD and Form U-4 require broker-dealers to report violations of an SRO's rules, except for violations designated as "minor rule violation[s]," under a plan approved by the Commission. However, the definition of a "minor rule violation" on

Form BD and Form U-4 states that rule violations may be designated as "minor" under a plan if the sanction imposed consists of a fine of \$2,500 or less, and if the sanctioned person does not contest the fine. The Commission believes that because under the proposed rule change, the person submitting the settlement offer is contesting the fine amount, the acceptance of a settlement offer under the new procedures being adopted herein must be reported on Form BD and Form U-4 just like any decision in a contested Exchange disciplinary proceeding, even if the settlement amount does not exceed \$2,500. Amendments Nos. 2 and 3 adequately address this concern by requiring the acceptance of a settlement offer to be reported on Form BD and Form U-4 as a contested Exchange disciplinary proceeding.

In summary, the Commission believes that the development of the interim step of a settlement procedure for contesting the fine amount for position limit minor rule violations should help to make the CBOE's entire disciplinary process more efficient by avoiding unnecessarily burdening the formal disciplinary process with such actions, while still retaining adequate enforcement measures for violations of the position limit rules contained in the minor rule plan. In addition, the fact that acceptance of settlement offers under the new settlement process will be reported currently, rather than on a quarterly basis, ensures that the Commission receives adequate notice of these contested fines.

The Commission finds good cause to approve Amendment Nos. 1, 2, and 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Specifically, as stated above in greater detail, by requiring current reporting of the acceptance of settlement offers under the new settlement procedure for position limit violations, Amendment No. 1 will ensure that the Commission receives adequate notice of contested fines which have been settled, while still providing a mechanism for effectively enforcing position limit violations. Similarly, Amendment Nos. 2 and 3 ensure that the accepted settlement offers will be reported on Form BD and Form U-4, leading to greater protection of the investors and the public interest, by clarifying that the acceptance of a settlement offer is a decision in a contested Exchange disciplinary proceeding for purposes of the Form BD and Form U-4. Accordingly, the Commission believes

that it is consistent with Section 6(b)(5) of the Act to approve Amendment Nos. 1, 2, and 3 to the proposal on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 1, 2, and 3 to the proposed rule change. 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 rules change that are filed with the Commission, and all written communications relating to Amendment Nos. 1, 2, and 3 between the Commission and any persons, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available at the principal office of the Exchange. All submissions should refer to File No. SR-CBOE-96-57 and should be submitted by April 22, 1997.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-CBOE-96-57), including Amendment Nos. 1, 2, and 3, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-38439; File No. SR-CHX-96-31]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Inc., To Amend Articles IV, VII, and XII of the Exchange's Rules To Modify the Exchange's Disciplinary Procedures

March 25, 1997.

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 December 9, 1996,¹

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).

¹ The Exchange filed Amendment No. 1 with the Commission on February 18, 1997, the substance of

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⁸ 15 U.S.C. 78(f)(b)(5).

⁹ 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).

¹⁰ Amendment No. 1 specifically changes the text of CBOE's proposed rule to state that "[a] decision by the Business Conduct Committee accepting an offer of settlement hereunder shall be reported on a current basis pursuant to Rule 19d-1 under the Securities Exchange Act of 1934."

¹¹ See discussion earlier regarding the content and operation of Rules 19d-1(c)(1) and 19d-1(c)(2) of the Act and of CBOE's Rule 17.50.

¹² Form BD requires broker-dealers to report violations of Commission and Exchange rules, as well as certain criminal, civil and administrative penalties, and this information is then made available to the public and investors.