SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–38756; File No. SR-NASD–97–30]

Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the National Association of Securities Dealers, Inc., Relating to an Amendment to the NASD's Rule Governing the Eligibility of Members To Become Primary Market Makers in Issues Subject to a Secondary Offering

June 23, 1997.

On April 24, 1997, the Nasdaq Stock Market, Inc. (''Nasdaq''), a wholly owned subsidiary of the National Association of Securities Dealers, Inc. (''NASD'' or ''Association''), filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder. [2] The rule change amends NASD Rule 4612(g) to permit a member who is a manager or co-manager of a secondary offering to be eligible to become a Primary Nasdaq Market Maker (''PMM'') in that issue prior to the effective date of the secondary offering regardless of whether the member was a registered market maker in the stock before the announcement of the secondary offering. Notice of the proposed rule change, together with the substance of the proposal, was provided by issuance of a Commission release and by publication in the **Federal Register**.[3] No comment letters were received. The Commission is approving the proposed rule change.

I. Description of Rule Change

The NASD and Nasdaq evaluated the current rules governing its members' eligibility to become a PMM and determined, as explained below, to amend NASD Rule 4612(g). As amended, Rule 4612(g) would permit a member who is a manager or co-manager of a secondary offering to be eligible to become a PMM in that issue prior to the effective date of the secondary offering, regardless of whether the member was a registered market maker in the stock before the announcement of the secondary offering.[4] The amendment to Rule 4612(g) would only apply to members that are a PMM in 80% or more of the securities in which they are registered.[5]

Presently, NASD Rule 4612(g)(2)(A) provides that unless a market maker is registered in a security prior to the time a secondary offering in that stock has been publicly announced or a registration statement has been filed, it cannot become a PMM in the stock unless: (1) the secondary offering has become effective and the market maker has satisfied the PMM standards between the time the market maker registered in the security and the time the offering became effective or (2) the market maker has satisfied the PMM standards for 40 calendar days (''Secondary Offering PMM Delay Rule'').[6] This aspect of the PMM standards was first adopted because the time period after secondary offerings have been announced is sensitive to short selling pressure.[7] Specifically, in these situations, the stock of the issuer is currently being traded and the ''overhang'' on the market of the new stock coming into the market from the offering makes the security particularly susceptible to manipulative short selling. The result of such short selling can adversely impact the capitalization of the issuer, particularly smaller issuers, whose securities often have less liquid secondary markets. Thus, Nasdaq is concerned with dealers entering the market after secondary offerings have been announced in order to take advantage of the market maker exemption from the short sale rule.

There have been instances, however, where managers and co-managers of secondary offerings that have not previously been registered in the issue have been precluded from becoming a PMM in the issue prior to the effective date of the secondary offering. The NASD is aware of numerous instances in which this has occurred after an issuer has changed its investment bankers. When this happens, the issuer's new investment banker often erects an informational barrier between its employees who are working on the secondary offering and its employees who make markets in Nasdaq stocks. This is done to reduce the changes that insider trading, or other misuse of the information received from the issues, will occur. Consequently, the firm's employees who make markets in Nasdaq stocks normally do not learn of the secondary offering until just prior to the announcement or effective date of the secondary offering. This is usually not enough time for the firm to qualify as a PMM under the standards set forth in NASD Rule 4612(g).

Accordingly, because of the inherent commitment of managers and co-managers to the issues that they underwrite as well as the additional liquidity that these members can provide, Nasdaq believes it would be appropriate for managers and co-managers of secondary offerings to be eligible to register as PMMs in such issues before the secondary offering is effective. The amendment to Rule 4612(g), however, would only apply to members that are a PMM in 80% or more of the securities in which they are registered.

II. Discussion

The Commission finds the proposed rule change is consistent with Section 15A(b)(6) and the Act.[8] 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, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to

[1] 15 U.S.C. § 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 38611 (May 12, 1997), 62 FR 27093 (May 16, 1997).

[4] *See* SR–NASD–97–31, Securities Exchange Act Release No. 38757 (June 23, 1997), amending NASD Rule 4611(d) to permit managers and co-managers of an underwriting syndicate participating in a secondary offering of a security listed and traded on Nasdaq to register as a market maker in such issue on a same-day basis on the day of the secondary offering.

[5] The NASD filed an amendment (''Amendment No. 1'') to clarify that a firm is not precluded from being a manager or co-manager of a secondary offering if it is not a PMM in 80% or more of the stocks in which it makes a market. *See* Letter from Thomas R. Gira, Associate General Counsel, the Nasdaq Stock Market, Inc., to Katherine England, Assistant Director, Office of Market Supervision, Division of Market Regulation, Commission, dated May 7, 1997.

[6] The PMM standards are used to determine the eligibility of market makers to an exemption from the NASD's short-sale rule. Previously, a market maker was required to satisfy at least two of the following four quantitative standards to be a PMM: (1) the market maker must be at the best bid or best offer as shown on Nasdaq no less than 35 percent of the time; (2) the market maker must maintain a spread no greater than 102 percent of the average dealer spread; (3) no more than 50 percent of the market maker's quotation updates may occur without being accompanied by a trade execution of at least one unit of trading; or (4) the market maker executes 1½ times its ''proportionate'' volume in the stock. *See* NASD Rule 4612 (a) and (b). Because of changes to market maker quotation and trading activity since implementation of the SEC's Order Handling Rules, the Commission approved an NASD proposal to waive the PMM standards until October 1, 1997, to afford Nasdaq an opportunity to develop new PMM standards. *See* Securities Exchange Act Release No. 38294 (February 14, 1997), 62 FR 8289 (February 24, 1997).

[7] These requirements are unaffected by the waiver, until October 1, 1997, of the four quantitative PMM standards contained in NASD Rule 4612 (a) and (b).

[8] 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).

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. Specifically, by permitting managers and co-managers of secondary offerings who did not previously make a market in such issues to become PMMs in such issues prior to the effective date of the secondary offering, the Commission finds the proposed rule change will enhance market liquidity, facilitate greater competition among market makers, and promote the capital formation process. At the same time, the requirement that such firms be a PMM in 80% or more of stocks in which they are registered ensures that managers and co-managers availing themselves of this opportunity can begin making markets efficiently and effectively as soon as they become PMMs in the issue.[9] Consequently, the Commission finds that the proposal will not compromise the regulatory purposes underlying the ''Secondary Offering PMM Delay Rule.''

III. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR–NASD–97–30) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[10]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97–16915 Filed 6–26–97; 8:45 am]

BILLING CODE 8010–01–M

[9] A firm is not precluded from being a manager or co-manager of a secondary offering if it is not a PMM in 80% or more of the stocks in which it makes a market.

[10] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–38757; File No. SR–NASD–97–31]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to an Amendment to the NASD's Rule Governing Market Maker Registration

June 23, 1997.

On April 24, 1997, the Nasdaq Stock Market, Inc. (''Nasdaq''), a wholly owned subsidiary of the National Association of Securities Dealers, Inc. (''NASD'' or ''Association''), filed with the Securities and Exchange Commission(''Commission'' or ''SEC'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder.[2] The rule change amends NASD Rule 4611(d) to permit managers and co-managers of an underwriting syndicate participating in a secondary offering of a security listed and traded on Nasdaq to register as a market maker in such issue on a same-day basis on the day of the secondary offering. Notice of the proposed rule change, together with the substance of the proposal, was provided by issuance of a Commission release and by publication in the **Federal Register**.[3] No comment letters were received. The Commission is approving the proposed rule change.

I. Description of Rule Change

The NASD and Nasdaq evaluated the current rules governing members registering as Nasdaq market makers by entering a registration request ''on-line'' via a Nasdaq terminal and determined, as explained below, to amend NASD rule 4611(d). As amended, Rule 4611(d) would permit managers and co-managers of an underwriting syndicate participating in a secondary offering of a security listed and traded on Nasdaq to register as a market maker in such issue on a same-day basis on the day of the secondary offering.[4]

Presently, for issues that have been trading on Nasdaq for more than five days, ''on-line'' registrations pursuant to Rule 4611(d) are not effective until the day after the registration request is made (''One-Day Delay Rule''). This one-day delay for market maker registration in non-initial public offerings is designed to minimize the potential for ''fair weather'' market making. Specifically, the one-day delay helps to assure that members registering as market makers are making a legitimate commitment of their capital to the issue for the betterment of the market, not just to capture short-term trading profits during brief periods of favorable market conditions.

Nasdaq continues to believe that the one-day delay in market maker registration serves to minimize the potential for ''fair weather'' market makers. There have been instances, however, where managers and co-managers of an underwriting syndicate for a secondary offering have been precluded from trading the issue on the day of the secondary offering because they did not submit a market maker registration request on the day before the offering. The NASD is aware of numerous instances in which this has occurred after an issuer has changed its investment bankers. When this happens, the issuer's new investment banker often erects an informational barrier between its employees who are working on the secondary offering and its employees who make markets in Nasdaq stocks. This is done to reduce the chances that insider trading, or other misuse of the information received from the issues, will occur. Consequently, the firm's employees who make markets in Nasdaq stocks, and who are responsible for completing the on-line registration, normally do not learn of the secondary offering until just prior to the announcement or effective date of the secondary offering.

Accordingly, because of the inherent commitment of managers and co-managers of underwriting syndicates to their issues, the need for these members to make a market in the stock to manage their risk, and the additional liquidity and pricing efficiency that these market makers can provide, Nasdaq believes it would be appropriate to amend NASD Rule 4611(d) to permit managers and co-managers of a secondary offering to register in that issue on a same-day basis on the day of the secondary offering.

II. Discussion

The Commission finds the proposed rule change is consistent with Section 15A(b)(6) of the Act.[5] 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, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. Specifically, by permitting managers and co-managers of secondary offerings to become registered market makers in such issues on the day of the secondary offering, the Commission finds the

[1] 15 U.S.C. § 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 38610 (May 12, 1997), 62 FR 27094 (May 16, 1997).

[4] *See* SR–NASD–97–30, Securities Exchange Act Release No. 38756 (June 23, 1997), amending NASD Rule 4612(g) to permit a member who is a manager or co-manager of a secondary offering to be eligible to become a Primary Nasdaq Market Maker (''PMM'') in that issue prior to the effective date of the secondary offering regardless of whether the member was a registered market maker in the stock before the announcement of the secondary offering.

[5] 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).