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The Office of the Secretary at (202) 942-7070.

Dated: January 21, 1997.

Jonathan G. Katz,
Secretary.

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[Release No. 34-38169; File No. SR-CBOE-96-72]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to RAES Order Size for Interest Rate Options

January 14, 1997.

On November 26, 1996, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Exchange Rule 23.7, "RAES," to increase the maximum size of interest rate option orders eligible for entry into the CBOE's Retail Automated Execution System ("RAES") from 10 or fewer contracts to 100 or fewer contracts.

The proposed rule change was published for comment in the Federal Register on December 12, 1996.³ No comments were received on the proposal.⁴

The CBOE proposed to amend CBOE Rule 23.7(ii) to increase the maximum size of orders in CBOE interest rate options which are eligible for execution through RAES from 10 or fewer contracts to 100 or fewer contracts. The proposed increase in the maximum size of RAES-eligible interest rate option

orders will apply to all classes of interest rate options.⁵

The proposed rule change is designed to allow the Exchange to compete effectively with other markets that trade interest rate derivatives.⁶ According to the CBOE, much of the trading in interest rate derivatives currently occurs in markets where transaction sizes are larger than are eligible for automatic execution through RAES at the CBOE.

Specifically, the CBOE notes that because the TYX interest rate contract offered to the CBOE represents approximately one-tenth (1/10th) of the value of the underlying government securities, the current eligible order limit of ten contracts is essentially equivalent in value to only one U.S. Treasury Bond option. The Exchange believes that the proposed increase in the maximum size of orders for CBOE interest rate options, such as the TYX, that are eligible for execution through RAES (essentially a "10-lot" in the Treasury Bonds themselves), will provide a more meaningful limit for institutional customers.

The CBOE believes that the proposed rule change will not impose any significant burdens on the operation and capacity of RAES, but instead will increase the efficiency of the Exchange's operations by expanding the number of orders that are eligible for automatic execution and by reducing manual processing. Finally, the CBOE believes that the rule change will not have a negative impact on the capacity, security or integrity of RAES.

By expanding the maximum size of orders in CBOE interest rate options which are eligible for execution through RAES from 10 or fewer contracts to 100 or fewer contracts, the Exchange believes that the proposed rule change will better serve the needs of the CBOE's public customers and the Exchange members who make a market for such customers. The CBOE believes that the proposed rule change is consistent with section 6(b) of the Act, in general, and furthers the objectives of section 6(b)(5), in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest.

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, the requirements of Section 6 and Section 11A.⁷ Specifically, the Commission finds that the CBOE's proposal will facilitate transaction in securities and protect investors and the public interest.⁸ The Commission believes that providing for the automatic execution of larger customer orders in interest rate options will provide for more efficient handling and reporting of orders in interest rate options, thereby improving order processing and turnaround time.⁹ In addition, the Commission believes that public customers may benefit from the proposal because their interest rate option orders for up to 100 contracts may be executed automatically at the displayed market quote. Public customers also will have the benefit of receiving nearly instantaneous executions and confirmations for interest rate option orders of up to 100 contracts.

The CBOE has stated that the proposal will allow the Exchange to compete more effectively with other markets that trade interest rate derivatives. Accordingly, the Commission believes that the proposal may help the CBOE to attract order flow, thereby increasing the depth and liquidity of the CBOE's market for interest rate options, to the benefit of all market participants. In addition, the proposal may benefit investors by providing them with additional financial products with which to implement their trading strategies.

The Commission notes that it has approved proposals by other options exchanges allowing comparable increases in the number of option contracts eligible for automatic execution.¹⁰

⁷ 15 U.S.C. 78f and 78k-1 (1988).

⁸ In approving the rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁹ The CBOE expects that, initially, the increased RAES order size eligibility will be utilized only for TYX options. Telephone conversation between Debora E. Barnes, Senior Attorney, CBOE, and Yvonne Fraticelli, Attorney, Office of Market Supervision, Division, Commission, on January 13, 1997.

¹⁰ See e.g., Securities Exchange Act Release Nos. 36601 (December 18, 1995), 60 FR 66817 (December 26, 1995) (order approving File No. SR-PHLX-95-39) (increasing the maximum automatic execution order size eligibility for public customer orders for all equity and index options to 50 contracts); 33476 (January 13, 1994), 59 FR 3140 (January 20, 1994) (order approving File No. SR-Amex-93-33) (increasing the size of Japan Index option orders eligible for automatic execution to 99 contracts); 30290 (January 27, 1992), 57 FR 4072 (February 3, 1992) (order approving File No. SR-Amex-91-27)

Continued

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1996).

³ See Securities Exchange Act Release No. 38022 (December 5, 1996), 61 FR 65422.

⁴ The CBOE supplemented its proposals with a letter explaining that the proposed rule change is designed to encourage customer demand in interest rate options and to allow the CBOE to compete effectively with markets for other interest rate derivatives, which fill orders to a depth of 100 contracts. See Letter from Debora E. Barnes, Senior Attorney, CBOE, to Yvonne Fraticelli, Attorney, Options and Derivatives Regulation, Division of Market Regulation ("Division"), Commission, dated December 13, 1996 ("December 13 Letter").

⁵ Currently, the CBOE offers four interest rate options, including the following: IRX (3-month Treasury Bill); FVX (5-year Treasury Note); TNX (10-year Treasury Note); and TYX (30-year Treasury Bond).

⁶ See December 13 Letter, *supra* note 4.

In addition, the Commission has approved a CBOE proposal to increase to 100 the firm quote contract size minimum applicable to Designated Primary Market Makers in classes of interest rate options for which Public Automated Routing System ("PAR") workstations are available.¹¹ The Commission believes that the CBOE's current proposal is consistent with the Exchange's earlier proposal to increase the firm quote contract size for classes of interest rate options for which PAR workstations are available.

Finally, based on representations from the CBOE, the Commission believes that increasing the size of the interest rate option orders eligible for execution through RAES will not expose the CBOE's options markets to risk of failure or operational breakdown. In particular, the CBOE represents that the proposal will not impose significant burdens on the operation and capacity of RAES, nor will it have a negative impact on the security or integrity of RAES.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹² that the proposed rule change (SR-CBOE-96-72) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 97-1560 Filed 1-22-97; 8:45 am]

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[Release No. 34-38175; File No. SR-NASD-96-55]

**Self-Regulatory Organizations;
National Association of Securities
Dealers, Inc.; Order Granting
Accelerated Approval and Notice of
Filing and Order Granting Accelerated
Approval of Amendment No. 1 of
Proposed Rule Change Relating to
Primary Market Maker Standards**

January 15, 1997.

I. Introduction

On December 23, 1996, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange

(providing for automatic execution of public customer orders of up to 100 MidCap 400 Index option contracts); 25950 (July 28, 1988), 53 FR 29293 (August 3, 1988) (order approving File No. SR-Amex-87-20) (increasing the number of Institutional Index options eligible for automatic execution to 100 contracts).

¹¹ See Securities Exchange Act Release No. 34876 (October 21, 1994), 59 FR 54226 (October 28, 1994) (order approving File No. SR-CBOE-94-17).

¹² 15 U.S.C. 78s(b)(2).

¹³ 17 CFR 200.30-3(a)(12).

Commission ("Commission" or "SEC") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder² a proposed rule change to waive the Nasdaq Primary Market Maker standards for the remainder of the current pilot period of the Nasdaq Short Sale Rule.³ The proposed rule change was published for comment in Securities Exchange Act Release No. 38091 (December 27, 1996), 62 FR 778 (January 6, 1997) ("Notice of Proposed Rule Change").⁴ On January 10, 1997, the NASD submitted Amendment No. 1 to waive the Nasdaq Primary Market Maker standards on a phase-in schedule.⁵ This order approves the proposed rule change, including Amendment No. 1, on an accelerated basis.

II. Description of the Proposal

The NASD has proposed to suspend the use of the Primary Nasdaq Market Maker ("PMM") qualification criteria found in Rule 4612 (a) and (b) of the Nasdaq market maker Requirements of the NASD Rules. Under existing Rule 4612, a registered Nasdaq market maker may be deemed to be a PMM in a National Market Security if the market maker meets two of three criteria: (1) The market maker maintains the best bid or best offer as shown on Nasdaq no less than 35% of the time; (2) a market maker maintains a spread no greater than 102% of the average dealer spread; and (3) no more than 50% of a market maker's quotation changes occur without a trade execution. In addition, if a registered market maker meets only one of the above criteria, it may nevertheless qualify as a PMM if the market maker accounts for volume at least 1½ times its proportionate share of overall volume in the stock. The review period for meeting any of these criteria is one calendar month. The PMM qualification criteria is reviewed by Nasdaq to determine which Nasdaq market makers will receive the PMM

¹ 15 U.S.C. 78s (b)(1).

² 17 CFR 240.19b-4.

³ On November 1, 1996, the Commission extended the pilot period of the NASD Short Sale Rule, Rule 3350, through October 1, 1997. Securities Exchange Act Release No. 37917 (November 1, 1996) 61 FR 57934 (November 8, 1996).

⁴ The Nasdaq Board has unanimously approved the filing of the proposed rule change regarding the suspension of Primary Market Maker standards. See Letter to Holly Smith, Associate Director, Division of Market Regulation, SEC, from Eugene A. Lopez, the Nasdaq Stock Market, Inc., dated January 9, 1997.

⁵ See Letter to Holly Smith, Associate Director, Division of Market Regulation, SEC, from Robert E. Aber, The Nasdaq Stock Market, Inc., dated January 14, 1997.

designation. The PMM designation allows a Nasdaq market maker to avail itself of the short sale exemption under NASD Rule 3350(c)(1). The NASD has proposed, on a phase-in basis, to suspend the PMM qualification criteria for Nasdaq National Market ("NNM") securities and, accordingly, deem all registered market makers in such securities a PMM.

III. Discussion

In August 1996, the Commission adopted a new rule and amendments to an existing rule that are scheduled to go into effect on January 20, 1997.⁶ Upon commencement of the Order Execution Rules, over-the-counter ("OTC") market makers will be representing certain customer limit orders in their quotations and frequently executing customer limit orders in a manner very different from today. Moreover, under an amendment to the Quote Rule, electronic communications networks ("ECNs") will be entering quotations and executions in the Nasdaq Stock Market in a manner which heretofore was reserved for registered market makers.⁷ The Commission has acknowledged that the Order Execution Rules represent a major change in the way OTC market makers display and execute orders in the Nasdaq Stock Market.

While the Order Execution Rules are anticipated to contribute to more vigorous quotation competition, the additional quotations will alter the data used in determining the PMM designation. A quote reflecting a customer limit order will be indistinguishable from a proprietary quote of a market maker. Inclusion of customer limit orders in a market maker's quote can narrow the market maker's spread, as well as the number of quotation changes the market maker effects. The display of ECN prices into the Nasdaq montage, which also will

⁶ See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) adopting Rule 11Ac1-4 ("Limit Order Display Rule") and amendments to Rule 11Ac1-1 ("Quote Rule") (collectively the "Order Execution Rules"). See also Securities Exchange Act Release Nos. 38110 (January 2, 1997), 62 FR 1279 (January 9, 1997) (revising the effective date of the Order Execution Rules to January 13, 1997); and 38139 (January 8, 1997) (revising the effective date of the Order Execution Rules until January 20, 1997).

⁷ Rule 11Ac1-1(c)(5) requires a market maker to display in its quote any better priced order the market maker places into an electronic communications network ("ECN Amendment"). Alternatively, the ECN Amendment provides an exception to the market maker's display obligation that depends upon the ECN itself displaying its best-priced orders, entered therein by a market maker or specialist, and allowing brokers and dealers to access such orders ("ECN Display Amendment").