

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38969; File No. SR-NASD-97-23]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Registration Category, Study Outline and Specification for Series 72 Examination, Government Securities Representative

August 25, 1997.

On April 11, 1997, the NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ to create a new category of representative registration, the Government Securities Representative (Series 72), and to conform the registration requirements of the existing Registered Options Representative (Series 42) category to take into consideration this new category.² Notice of the proposed rule change, together with the substance of the proposal, was published in the **Federal Register**.³ No comment letters were received. This order approves the proposed rule change.

I. Background

The Government Securities Act of 1986 ("1986 Act"), an amendment to the Act, required sole government securities broker-dealers to register with the SEC for the first time. The 1986 Act also granted the NASD authority to require associated persons of such firms to register with the NASD. However, the 1986 Act did not allow the NASD to apply its qualification examination standards to associated persons of government securities broker-dealers. Since January 1989, such associated persons have been required to register as Government Securities Representatives or Government Securities Principals, but have not been required to pass a

qualification examination. Under a 1993 amendment to the Act, the NASD was given authority to apply its qualification standards to Government Securities Representatives and Government Securities Principals.

The proposed rule change will establish an examination qualification requirement for government securities representatives. A person may qualify to sell government securities by passing the existing Series 7 examination or the new Series 72 examination. The proposed rule change replaces current Rule 1112, which was adopted in 1989.

NASD Regulation has determined to permit persons who have been registered with the NASD as a government securities representative for two years prior to the effective date of the rule will not have to take the examination unless they are subject to a statutory disqualification as defined in Section 3(a)(39) of the Act or in the last years have been subject to a suspension or fine of \$5,000 or more imposed by a securities or commodities regulator.

Currently, individuals who sell OTC options on government securities are not required to pass a qualification examination. The proposed rule change also will amend Rule 1032(d) for Registered Options Representatives to establish registration and qualification requirements for such individuals, and to add the Series 72 Examination to the list of the those examinations which prequalify an individual to take the Limited Representative—Options (Series 42) Examination. A person selling OTC options on government securities would be required to pass the new Series 72 examination and the existing Series 42 examination.

The Series 72 examination will consist of one hundred (100) questions. Candidates will have three hours to complete the examination. The passing score for the examination will be 70%. The NASD will not begin using the examination until September of 1997.

II. Discussion

The Commission believes that the proposed rule change is consistent with the provisions of Sections 15A(b)(6) and 15A(g)(3) of the Act in that the NASD is required to prescribe standards of training, experience and competence for persons associated with NASD members. Pursuant to this statutory obligation, the NASD develops and administers examinations to establish that persons associated with NASD members have attained specified levels of competence and knowledge.

Pursuant to this statutory obligation, NASD Regulation administers examinations developed by NASD

Regulation and other self-regulatory organizations Section 15A(g)(3) of the Act to prescribe standards of training, experience and competence for persons associated with NASD members.

The proposed rule change is consistent with the format of the other NASD limited registration categories. This proposed rule change will change the language of Rule 1032(d) Registered Option Representative so that it is similar to the language used in the other registration categories in Rule 1032.

This provision is consistent with previous practice in permitting persons who have achieved a certain level of experience in a segment of the securities industry to be "grandfathered" if a new qualification examination is adopted for that particular industry segment.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change, SR-NASD-97-23, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38975; File No. SR-NASD-97-59]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Short Sale Rule

August 26, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4² thereunder, notice is hereby given that on August 14, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

⁴ 17 CFR 200.30-3(a)(12)(1997).

¹ 15 U.S.C. § 78s(b)(1)(1994).

² 17 CFR 240.19b-4(1997).

¹ 15 U.S.C. § 78s(b)(1) (1994).

² On July 1, the NASD submitted a technical amendment. Technical amendments do not need to be published in the Federal Register. Letter from Craig L. Landauer, Associate General Counsel, NASD, to Karl J. Varner, Esq., SEC, dated July 1, 1997.

³ Securities Exchange Act Release No. 38566 (May 1, 1997), 62 FR 25683 (May 9, 1997).

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

The NASD is proposing to amend Rule IM-3350 to provide that a "legal" short sale must be effected at a price equal to or greater than the offer price when the inside spread is less than $\frac{1}{16}$. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

IM-3350 Short Sale Rule

(a) No Change.

(b)(1) Rule 3350 requires that no member shall effect a short sale for the account of a customer or for its own account in a Nasdaq National Market security at or below the current best (inside) bid when the current best (inside) bid as displayed by The Nasdaq Stock Market is below the preceding best (inside) bid in the security. The Association has determined that in order to effect a "legal" short sale when the current best bid is lower than the preceding best bid the short sale must be executed at a price of at least $\frac{1}{16}$ point above the current inside bid *when the current inside spread is $\frac{1}{16}$ point or greater*. The last sale report for such a trade would, therefore, be above the inside bid by at least $\frac{1}{16}$ of a point. *If the current spread is less than $\frac{1}{16}$ of a point, however, the short sale must be executed at a price equal to or greater than the current inside offer price.*

(2) Moreover, the Association believes that requiring short sales to be a minimum increment of $\frac{1}{16}$ point above the bid *when the current spread is $\frac{1}{16}$ or greater and equal to or greater than the offer when the current spread is less than $\frac{1}{16}$* ensures that transactions are not effected at prices inconsistent with the underlying purpose of the Rule. *It would be inconsistent with Rule 3350 for a member or customer to cause the inside spread for an issue to narrow when the current best bid is lower than the preceding best bid (e.g., lowering its offer to create an inside spread less than $\frac{1}{16}$) for the purpose of facilitating the execution of a short sale at a price less than $\frac{1}{16}$ above the inside bid.*

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 NASD 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 IV below. The NASD has prepared summaries, set forth in sections A, B and C below, of the most significant parts of such statements.

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

The NASD's short sale rule³ prohibits member firms from effecting short sales⁴ at or below the current bid as disseminated by Nasdaq whenever that bid is lower than the previous inside bid.⁵ The rule currently provides that a short sale is a "legal" short sale in a "down" bid situation if it is effected at a price at least $\frac{1}{16}$ above the inside bid ("Minimum Increment Rule"). The Minimum Increment Rule was implemented to ensure that short sales were not effected at prices so close to the inside bid during down markets that the short sales were inconsistent with the underlying purposes of the short sale rule (*i.e.* to prohibit market destabilizing and abusive short sales in declining markets).

Now that all Nasdaq stocks can potentially trade with a $\frac{1}{16}$ spread or less, due to, among other things, the new SEC Order Handling Rules, and in light of the movement toward smaller

³ The short sale rule was originally adopted in June of 1994 for Nasdaq National Market securities on a pilot basis with a termination date of March 5, 1996. Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994) [File No. SR-NASD-92-12]. The pilot was subsequently extended through October 1, 1997. Securities Exchange Act Release No. 37917 (November 1, 1996), 61 FR 57934 (November 8, 1996) [File No. SR-NASD-96-41]; *See also* Securities Exchange Act Release No. 36171 (August 30, 1995), 60 FR 46651 (September 7, 1995) [File No. SR-NASD-95-35]; Securities Exchange Act Release No. 37492 (July 29, 1996), 61 FR 40693 (August 5, 1996) [File No. SR-NASD-96-30]; Securities Exchange Act Release No. 37917 (November 1, 1996), 61 FR 57934 (November 8, 1996) [File No. SR-NASD-96-41]. On August 8, 1997, the NASD submitted a proposed rule change (SR-NASD-97-58) to the Commission to implement the short sale rule on a permanent basis.

⁴ A short sale is a sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. To determine whether a sale is a short sale, members must adhere to the definition of a "short sale" contained in Securities Exchange Act Rule 3b-3, 17 CFR 240.3b-3, which rule is incorporated into Nasdaq's short sale rule as NASD Rule 3350(k)(1).

⁵ Nasdaq calculates the inside bid or best bid from all market makers in the security (including bids on behalf of exchanges trading Nasdaq securities on an unlisted trading privileges basis), and disseminates symbols to denote whether the current inside bid is an "up bid" or a "down bid." Specifically, an "up bid" is denoted by a green "up" arrow and "down bid" is denoted by a red "down" arrow. Accordingly, absent an exemption from the rule, a member cannot effect a short sale at or below the inside bid for a security in its proprietary account or a customer's account if there is a red arrow next to the security's symbol on the screen.

minimum quotation variations generally, consideration was given to modifying the Minimum Increment Rule for stocks with an inside spread less than $\frac{1}{16}$.

Accordingly, the NASD is proposing an amendment to the Minimum Increment Rule to provide that a "legal" short sale must be effected at a price equal to or greater than the offer price when the inside spread is less than $\frac{1}{16}$. There would be no change to the current definition for stocks with a spread of $\frac{1}{16}$ or greater. For example, if the inside market for ABCD is $10\frac{1}{4}$ – $10\frac{5}{16}$, a legal short sale in a down market would have to be effected at a price to or greater than $10\frac{5}{16}$ (*i.e.*, $\frac{1}{16}$ above the current inside bid). However, if the inside market is $5\frac{1}{32}$ – $5\frac{2}{32}$, a legal short sale in a down market could be effected at a price equal to the inside offer $5\frac{2}{32}$.

In addition, to help ensure that market participants do not adjust their quotations to circumvent the short sale rule, the NASD is proposing an amendment to the Minimum Increment Rule to provide that a market maker or customer could not bring about or cause the inside spread for a stock to narrow in a declining market (*e.g.*, lowering its offer to create an inside spread less than $\frac{1}{16}$) for the purpose of facilitating the execution of a short sale at a price less than $\frac{1}{16}$ above the inside bid.

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act.⁶ 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, and to remove impediments to and perfect the mechanism of a free and open market. Given the existence of the short sale rule, the proposed rule change is necessary to preserve the short sale rule's underlying purpose and effect when the inside spread is less than $\frac{1}{16}$.

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

The NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

⁶ 15 U.S.C. § 78o(b)(6) (1994).

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

Written comments were neither solicited nor received.

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

Within 35 days of the date of 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 NASD consents, the Commission will:

(A) By order approve such 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. People making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 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 in the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the NASD's principal offices. All submissions should refer to File No. SR-NASD-97-59 and should be submitted by September 24, 1997.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁷

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38979; File No. SR-NASD-97-58]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Requesting Permanent Approval of the NASD's Short Sale Rule

August 26, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4² thereunder, notice is hereby given that on August 11, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The NASD is proposing to implement its short sale rule ("Rule") on a permanent basis. The text of the proposed rule change is as follows. Additions are italicized; deletions are bracketed.

* * * * *

NASD Rule 3350

* * * * *

(k)(3)[(A) Until February 1, 1996, the term *qualified market maker* shall mean a registered Nasdaq market maker that has maintained, without interruption, quotations in the subject security for the preceding 20 business days. Notwithstanding the 20-day period specified in this subsection, after an offering in a stock has been publicly announced, a registration statement has been filed, or a merger or acquisition involving two issues has been announced, no market maker may register in the stock as a qualified market maker unless it meets the requirements set forth below:

(i) For secondary offerings, the offering has become effective and the market maker has been registered in and maintained quotations without interruption in the subject security for 40 calendar days;

(ii) For initial public offerings, the market maker may register in the

offering and immediately become a qualified market maker; provided however, that if the market maker withdraws on an unexcused basis from the security within the first 20 days of the offering, it shall not be designated as a qualified market maker on any subsequent initial public offerings for the next 10 business days;

(iii) After a merger or acquisition involving an exchange of stock has been publicly announced and not yet consummated or terminated, a market maker may immediately register in either or both of the two affected securities as a qualified market maker pursuant to the same-day registration procedures in Rule 4611; provided, however, that if the market maker withdraws on an unexcused basis from any stock in which it has registered pursuant to this subsection within 20 days of so registering, it shall not be designated as a qualified market maker pursuant to this subparagraph (3) for any subsequent merger or acquisition announced within three months subsequent to such unexcused withdrawal.

(B) for purposes of this subparagraph (3), a market maker will be deemed to have maintained quotations without interruption if the market maker is registered in the security and has continued publication of quotations in the security through the Nasdaq on a continuous basis; provided however, that if a market maker is granted an excused withdrawal pursuant to the requirements of Rule 4619, the 20 business day standard will be considered uninterrupted and will be calculated without regard to the period of the excused withdrawal. Beginning February 1, 1996, t]The term *qualified market maker* shall mean a registered Nasdaq market maker that meets the criteria for a Primary Nasdaq Market Maker as set forth in Rule 4612.

[(l) This section shall be in effect until October 1, 1997.]

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

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¹ 15 U.S.C. § 78s(b)(1) (1994).

² 17 CFR 240.19b-4 (1997).

⁷ 17 CFR 200.30-3(a)(12) (1997).