SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39936; File No. SR–NASD–98–26]

Self-Regulatory Organization; Notice of Filing and Order Granting Accelerated Partial Approval to Amendment No. 3 to Proposed Rule Changes by the National Association of Securities Dealers, Inc. to Institute, on a Pilot Basis, New Primary Nasdaq Market Maker Standards for Nasdaq National Market Securities

April 30, 1998.

I. Introduction

On March 19, 1998, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association''), through its wholly-owned subsidiary The Nasdaq Stock Market, Inc. (''Nasdaq''), submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'') [1] and Rule 196–4 thereunder,[2] proposed rule changes to: (a) Implement, on a pilot basis, new Primary Nasdaq Market Maker (''PMM'') standards for all Nasdaq National Market (''NNM'') securities; (b) extend the NASD's Short Sale Rule pilot until November 1, 1998; and (c) extend the suspension of existing PMM standards until May 1, 1998. On March 30, 1998, the Commission issued notice of the filing and approved, on an accelerated basis, the portions of the filing extending the NASD's Short Sale Rule pilot and the suspension of existing PMM standards.[3]

On April 29, 1998, Nasdaq filed Amendment No. 3 to the proposal,[4] proposing to: (a) Extend the comment period by 30 days to May 27, 1998; (b) continue to suspend the current PMM standards until July 1, 1998; (c) extend the NASD's Short Sale Rule pilot until January 4, 1999; (d) change the dates during which the PMM pilot will run to July 1, 1998, through January 4, 1999. Nasdaq also is proposing to amend subparagraph (g) of NASD Rule 4612 to change the method for determining how market makers that are not managers or co-managers in an underwriting syndicate of a secondary offering may qualify as PMMs. Nasdaq has requested accelerated approval of the suspension of the current PMM standards.

Background

Present, NASD Rule 4612 provides that a member registered as a Nasdaq market maker pursuant to NASD Rule 4611 may be deemed a PMM if that member meets certain threshold standards. The implementation of new Order Execution Rules [5] and the concurrent move towards a more order-driven, rather than a quote-driven, market raised questions about the continued relevance of those PMM standards. As a result, such standards were suspended beginning in early 1997.[6] Currently, all market makers are designated as PMMS.

Since February 1997, Nasdaq has worked to develop PMM standards that are more meaningful in an increasingly order-driven environment and that better identify firms engaged in responsible market making activities deserving of the benefits associated with begin a PMM, such as being exempt from NASD Rule 3350, the NASD's short sale rule. The NASD now proposes to suspend the existing PMM standards and to implement new standards on a pilot basis from July 1, 1998, until January 4, 1999. The NASD intends the new standards to better evaluate whether a market maker providers meaningful liquidity to the market. To determine whether a particular market maker is such a provider liquidity, Nasdaq will analyze that market maker's trading activity using a new test.

For the reasons discussed below, the Commission has determined to grant accelerated approval of Nasdaq's request to continue to suspend the current PMM standards until July 1, 1998, as requested in Amendment No. 3. Further, given the proposal's complexity and the Commission's desire to give the public sufficient time to consider the proposal, the Commission has extended the comment period for the proposed rule changes, as amended, to May 27, 1998.

II. Proposed Rule Changes

As discussed in detail in Exchange Act Release No. 39819, Nasdaq is proposing a new set of PMM standards. In the current filing, Nasdaq is proposing an adjustment to the PMM standards with respect to markets that are not managers or co-managers in an underwriting syndicate of a secondary offering. In particular, Nasdaq proposes to amend subparagraph (g)(2) of NASD Rule 4612 to change the method for determining how market makers that are not managers or co-managers in an underwriting syndicate of a secondary offering may qualify as PMMs. Under the previous rule, a market maker could become a PMM after the secondary offering had been announced or a registration statement had been filed with the Commission if the market maker was registered in the security and satisfied the PMM standards for 40 days or until the registration became effective, whichever occurred first. Thus, for secondary offerings the rule contained a variable ''review period,'' during which a market maker was required to meet PMM standards. Due to technological constraints and the fact that PMM calculations under the proposed rule are more complex than they were under the previous rule, Nasdaq, in developing the PMM pilot, has been unable to build a system that is able to make the PMM calculation using a variable review period. Additionally, it has become clear that the existing rule for secondary public offerings may be rendered less meaningful because PMM status under the proposed new standards is determined by comparing and examining market makers' share volume and number of trades during definite time periods. Thus, introducing a variable time period could have consequences that were not foreseen when the new standards were crafted.

Nasdaq recognizes, however, that market makers should be held to a more stringent standard before they may trade secondary offerings as PMMs. Accordingly, Nasdaq proposes to amend NASD Rule 4612 so that a market maker that wishes to register and become a PMM in a secondary offering will have to fulfill the following two conditions. First, the market maker must register and become a market maker in a security for 40 days or until the registration becomes effective, whichever occurs first. Second, at the time the registration becomes effective or 40 days passes, the market maker

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

[2] 17 CFR 240.19b–4.

[3] Exchange Act Release No. 39819 (March 30, 1998) 63 FR 16841 (April 6, 1998).

[4] *See* letter from Robert E. Aber, Senior Vice President and General Counsel, Nasdaq, to Richard Strasser, Assistant Director, Division of Market Regulation, SEC, dated April 29, 1998. Exchange Act Release No. 39819 discussed Amendment No. 1 and Amendment No. 2 to the filing, which were filed with the Commission on March 25 and 26, 1998, respectively.

[5] On August 29, 1996, the Commission promulgated a new rule, the Limit Order Display Rule (Exchange Act Rule 11Ac1–4) and adopted amendments to the Quote Rule (Exchange Act Rule 11Ac1–1), which together are designated to enhance the quality of published quotations for securities and promote competition and pricing efficiency in U.S. securities markets (collectively, the ''Order Execution Rules''). *See* Securities Exchange Act Release No. 37619A (September 6, 1996) 61 FR 48290 (September 12, 1996) (''Order Execution Rules Adopting Release'').

[6] *See* Exchange Act Release No. 38294 (February 14, 1997) 62 FR 8289 (February 24, 1997) (approving temporary suspension of PMM standards); Exchange Act Release No. 39198 (October 3, 1997) 62 FR 53365 (October 14, 1997) (extending suspension through April 1, 1998); Exchange Act Release No. 39819 (March 30, 1998) 63 FR 16841 (April 6, 1998) (extending suspension through May 1, 1998).

must be a PMM in 80% or more of the Nasdaq National Market securities in which it is registered (''80% Firm''). This proposal provides a meaningful measure as to whether a market maker should be a PMM after a secondary offering has been announced because it will require market makers to register and be in a stock for a meaningful time period (which may be as long as 40 days) and to be an 80% Firm before it may qualify as a PMM. Furthermore, Nasdaq notes that this approach is in line with the provisions of NASD rule 4612 regarding initial registration situations and initial public offerings (''IPO'').

Nasdaq also proposes to amend subparagraph (g)(2)(B) of NASD rule 4612, to clarify the timing for the imposition of a 10 day prohibition from participating in an IPO (''Over 10 Day Penalty''). This amendment would codify an interpretation of subparagraph (g)(2)(B) of NASD Rule 4612, that was announced in a *For Your Information* included in the June 1996 edition of the NASD's *Notice to Members.* Specifically, the amendment would clarify that if a PMM in an IPO withdraws on an unexcused basis in the first review period, the 10 Day Penalty will commence on the next business day after the unexcused withdrawal. Additionally, if a PMM in an IPO fails to meet the applicable PMM thresholds during the first review period, the 10 Day Penalty will begin on the day the market loses its PMM designation (the third business day of a month).

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The proposed rule language follows. Additions are italicized; deletions are bracketed.

Rule 4612

(a)–(f) No Change

(g) In registration situations:

(1) No Change

(2) Notwithstanding paragraph (g)(1) above, after an offering in a stock has been publicly announced or a registration statement has been filed *with the Securities and Exchange Commission,* no market maker may register in the stock as a Primary Nasdaq Market Maker unless it meets the requirements set forth below:

(A) For secondary offerings[:

(i)], the secondary offering has become effective [and the market maker has satisfied the qualification criteria in the time period between registering in the security and the offering becoming effective] *or 40 days have elapsed since the market maker registered in the security (whichever occurs first), and at such time, the market maker is a Primary Nasdaq Market Maker in 80% or more of the Nasdaq National Market Maker securities in which it is registered;* provided, however, that if the member is a manager or co-manager of the underwriting syndicate for the secondary offering and it is a [PMM] *Primary Nasdaq Market Maker* in 80% or more of the Nasdaq National Market securities in which it is registered, the member is eligible to become a [PMM] *Primary Nasdaq Market Maker* in the 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[; or

(ii) the market maker has satisfied the qualification criteria for 40 calendar days].

(BN) For initial public offerings (IPOs):

(i) the market maker may register in the offering and immediately become a Primary Nasdaq Market Maker if it is a Primary Nasdaq Market Maker in 80% of the securities in which it has registered; provided however, that if[, at the end of the first review period,] the Primary Nasdaq Market Maker has withdrawn on an unexcused basis from the security *at any time during the first review period* or has not satisfied the [qualification criteria] *applicable thresholds at the end of the first review period,* it shall not be afforded a Primary Nasdaq Market Maker designation on any subsequent initial public offerings for the next 10 business days *following the unexcused withdrawal or the next 10 business days following the day on which the Primary Nasdaq Market Maker is notified that it failed to satisfy the applicable thresholds for the first review period (as applicable);* or

(ii) No Change.

(C) No Change.

(3) No Change

(h) [The Board of Governors may modify the threshold standards set forth in paragraphs (a) and (b) above if it finds that maintenance of such standards would result in an adverse impact on a class of investors or on Nasdaq.] *This rule shall be in effect beginning July 1, 1998, and remain in effect until January 4, 1999.*

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NASD Rule 3350

(a)–(k) No Changes

(1) This Rule shall be in effect until [November 1, 1998] *January 4, 1999.*

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III. Discussion

After careful consideration, the Commission has concluded, for the reasons set forth below, that the extension of the current suspensions of existing PMM standards through July 1, 1998, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder. As the Commission discussed in its previous order relating to the PMM pilot,[7] extending the suspension of the current PMM standards to accommodate implementing the new pilot is consistent with Section 15A(b)(6)[8] of the Exchange Act. Section 15A(b)(6) of the Exchange Act requires that the NASD's rules be designed, among other things, to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade. The Commission believes that continued suspension of the current PMM standards will facilitate Nasdaq's efforts in implementing more meaningful PMM standards which should help to enhance market liquidity by rewarding those market makers that meet the new standards. As a result, continuing the suspension of the current PMM standards is consistent with Section 15A(b)(6) of the Exchange Act.

In finding that the suspension of the existing PMM standards is consistent with the Exchange Act, the Commission reserves judgment on the merits of the Short Sale Rule, any market maker exemptions to that rule and the proposed new PMM standards. The Commission recognizes that the current Short Sale Rule already has generated significant public comment. Such commentary, along with any further comment on the interaction of the Short Sale Rule with the proposed new PPM standards, will help guide the Commission's evaluation of the Short Sale Rule and new PMM standards. During the PMM pilot period, the Commission anticipates that the NASD will continue to address the Commission's questions and concerns and provide the Commission staff with any relevant information about the practical effects and the operation of the revised PMM standards and possible interaction between those standards and the NASD's Short Sale Rule.

As proposed, the new PMM standards will become effectively July 1, 1998, when the suspension of the existing PMM standards, under Amendment No. 3, expires. Nasdaq notes that currently all market makers registered in a security are PMMs due to the suspension of the previous PMM standards, and will continue to be so

[7] *See* Exchange Act Release No. 39819 (March 30, 1998) 63 FR 16841 (April 6, 1998) (extending suspension through May 1, 1998).

[8] 15 U.S.C. 78o–3(b)(6).

designed on the pilot's proposed start date of July 1, 1998. Under the one-month look-back provision in the PMM pilot program, Nasdaq will consider the previous calendar month and the current month to determine a market maker's continued PMM eligibility if the market maker attained PMM status in a security during the previous month, but fails to meet the applicable thresholds for the current month. Nasdaq recognizes that once the pilot begins on July 1, 1998, PMMs will not have the ability to avail themselves of the one-month look-back provision because there will be no meaningful trading to analyze prior to July 1, 1998. Thus, to give PMMs the full benefit of the one-month look-back period and to allow market makers time to adjust their trading activity to the new standards, Nasdaq proposes to implement the new standards so that no market maker that is designated as a PMM when the pilot begins on July 1, 1998, will lose its PMM status—based on a failure to meet the new PMM standards—until September 3, 1998. Nasdaq believes, and the Commission agrees, that it is fair to give market makers this time to make necessary adjustments to their trading activity to help them maintain their PMM designation, particularly since PMM standards have been suspended for more than a year and the new PMM standards are more stringent than the previous standards. The PMM pilot, pursuant to Amendment No. 3, would run until January 4, 1999.

The Commission finds good cause for approving the extension of the suspension of existing PMM standards prior to the 30th day after the date of publication of notice of filing thereof. It could be disruptive to market making to reintroduce outdated PMM standards for a brief period prior to implementing a new PMM pilot. Further, the current PMM standards have been suspended until May 1, 1998, at which time the old PMM standards—which are not a meaningful measure of a market maker's liquidity-providing activity—would be used again to determine market makers' PMM status. To ensure continuity in the PMM standards and the regulation of short selling activity, to maintain orderly markets, and to avoid confusion, it is necessary to continue the suspension of the prior PMM standards until the new standards are implemented on July 1, 1998.

IV. Solicitation of Comments

Given the proposal's complexity and the Commission's desire to give the public sufficient time to consider the proposal, the Commission hereby grants Nasdaq's request to extend the comment period for the proposed rule changes, as amended, to May 27, 1998. Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule changes are consistent with the Exchange Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, DC 20549. Copies of the submissions, 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 such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR–NASD–98–26 and should be submitted by May 27, 1998.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,[9] that Amendment No. 3 to the proposed rule change, SR–NASD–98–26, which extends, on an accelerated basis, the suspension of the current PMM standards to July 1, 1998, be and hereby is approved.[10]

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[11]

Jonathan G. Katz,

Secretary.

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[9] 15 U.S.C. 78s(b)(2).

[10] In approving the proposal, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. The proposal likely will provide the Commission with data necessary to enable it to evaluate the impact of the proposed PMM standards on the Nasdaq market and market participants. 15 U.S.C. 78c(f).

[11] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39934; File No. SR–PCX–98–20]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. To Discontinue the Exchange's SCOR Marketplace

April 30, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on April 16, 1998, the Pacific Exchange, Inc. (''PCX'' or ''Exchange'') 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 Exchange.[3] The Exchange has designated this proposal as one that does not significantly affect the protection of investors or the public interest, does not impose any significant burden on competition, and by its terms does not become operative for 30 days after the date of the filing. In addition, the Exchange gave the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change. As a result, the proposal is effective upon filing under Exchange Act Section 19(b)(3)(A)(iii) and Rule 19b–4(e)(6) thereunder. 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 Exchange is proposing to discontinue its Small Corporate Offering Registration (''SCOR'') Marketplace and to remove its rules on the SCOR Marketplace from the Rules of the Exchange. The text of the proposed rule change is attached as Exhibit A.

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

[2] 17 CFR 240.19b–4.

[3] The Exchange also submitted a technical amendment to the proposed rule change to correct typographical errors in the original filing. *See* Letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, Exchange, to Jeffrey Schwartz, Special Counsel, Division of Market Regulation, Commission, dated April 28, 1998.