

to appeal a ruling with which they may not agree. The current provisions are limited to defining who shall serve as Floor Officials and general jurisdiction of Floor Official authority. The Exchange seeks to explain in more detail the day-to-day functioning of the Floor Official in deciding issues that arise in regard to transactions on the floor or through Intermarket Trading System ("ITS").³ First, the Exchange proposes to add Supplementary Material .30, which states that the Board of Governors delegates authority to Floor Officials. Proposed Supplementary Material .30 also indicates that Floor Officials have numerous responsibilities regarding various rules, policies, and interpretations governing trading on the Exchange. In addition, the Exchange proposes to add Supplementary Material .40, which addresses the exclusion of Floor Officials from the ruling process due to conflicts of interest. Proposed Supplementary Material .50 and .60 refer to Floor Officials' responsibilities to keep apprised of new rules and policy determinations and to consult with other Floor Officials in making fair and consistent rulings. The Exchange also proposes to add Supplementary Material .70, which provides members with the ability to appeal an unfavorable decision by a Floor Official with which the member disagrees, or to bring changes in circumstances to the attention of the Floor Official involved in the ruling. Finally, Proposed Supplementary Material .80 deems the failure to comply with a Floor Official ruling to be a violation of the Rules of the Board of Governors. Although these provisions apply today in practice, the Exchange believes that their codification as part of the Exchange rules will clearly delineate member rights and obligations. The Exchange has further represented that the Rules are similar to practices established by the New York Stock Exchange concerning the authority and responsibilities of its floor officials.⁴

The basis for the proposed rule change is Section 6(b)(5) of the Act,⁵ in that the proposed rule change is designed 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; and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition.

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

No written comments were solicited or received with respect to the proposed rule change.

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

Because the foregoing proposed rule change: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from June 18, 1997, the rule change proposal has become effective pursuant to Section 19(b)(3)(A) of the Act⁶ and Rule 19b-4(e)(6)⁷ thereunder. In particular, the Commission believes the proposal qualifies as a "noncontroversial filing" in that the proposed standards do not significantly affect the protection of investors or the public interest and do not impose any significant burden on competition. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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, 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 at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the BSE. All submissions should refer to SR-BSE-97-03 and should be submitted by July 31, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38812; File No. SR-NASD-97-29]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Amendments No. 1 and No. 2 Thereto Relating to Prohibition on Members Receiving any Payment To Publish a Quotation, Make a Market in an Issuer's Securities or Submit an Application to Make a Market in an Issuer's Securities

July 3, 1997.

On April 18, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") 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 prohibit members from receiving any payment to publish a quotation, make a market in an issuer's securities or submit an application to make a market in an issuer's securities. On May 19, 1997 and May 21, 1997, the NASD submitted two amendments ("Amendment No. 1" and

⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

³ The ITS, a communications and order routing network linking eight national securities exchanges and the electronic over-the-counter ("OTC") market operated by the NASD, is a National Market System plan approved by the Commission pursuant to Section 11A of the Act and Rule 11Aa3-2 thereunder.

⁴ NYSE Floor Official Manual, pp. 1-3 (June 1996).

⁵ 15 U.S.C. § 78f(b)(5).

⁶ 15 U.S.C. § 78s(b)(3)(a).

⁷ 17 CFR 240.19-4(e)(6).

"Amendment No. 2"), respectively, to the proposed rule change.³

The proposed rule change and Amendments No. 1 and No. 2 thereto were published for comment in Securities Exchange Act Release No. 38670 (May 22, 1997), 62 FR 29382 (May 30, 1997). No comments were received on the proposal. This order approves the proposed rule change.

I. Introduction

It has been a longstanding policy and position of the NASD that a broker-dealer is prohibited from receiving compensation or other payments from an issuer for quoting, making a market in an issuer's securities or for covering the member's out-of-pocket expenses for making a market, or for submitting an application to make a market in an issuer's securities. As stated in Notice to Members 75-16 (February 20, 1975), such payments may be viewed as a conflict of interest since they may influence the member's decision as to whether to quote or make a market in a security and, thereafter, the prices that the member would quote.

On October 27, 1994, the United States Court of Appeals, Tenth Circuit, reversed, in part, an SEC decision in the matter of General Bond & Share Co. ("General Bond").⁴ The NASD had held that General Bond had, among other things, violated Article III, Section 1 of the Association's Rules of Fair Practice (currently NASD Rule 2110) by accepting payments from issuers in return for listing itself as a market maker for the securities in the National Quotation Bureau, Inc. ("NQB") Pink Sheets ("Pink Sheets"). The NASD position was based on NASD policy as articulated to the members in Notice to Members 75-16 (February 20, 1975). The SEC, in affirming the NASD decision, agreed with the NASD that this conduct was inappropriate and in violation of NASD rules.⁵

The Tenth Circuit decision held that the NASD rules at the time did not

prohibit a member firm from accepting issuer-paid compensation for making a market in a security.⁶ Although the NASD had previously stated that such specific conduct was prohibited, the Court held that the NASD was required by statute to submit a filing with the SEC amending NASD rules in this respect. The NASD is proposing this rule to clarify the application of NASD rules to situations involving the acceptance of compensation for market making activities.

II. Description of the Proposal

The NASD proposes to add Rule 2460 to prohibit receipt by a broker-dealer of "any payment or other consideration" from a prohibited party for publishing a quotation, acting as a market maker, or submitting an application in connection therewith. It is intended to cover any form of payment in cash, non-cash items, or securities. The term "consideration" would include, for example, granting or offering of securities products on terms more favorable than those granted or offered to the public. This term would include the granting of options in any security, where the options are exercisable at a price that is discounted from the prevailing market price. The rule also would cover the purchase of securities by a member from a prohibited party at a discount from the prevailing market. Such payments are intended to be prohibited because they may, as discussed in Notice to Members 75-16, create a conflict of interest that would influence the member to enter a quotation or make a market in a security.

The proposed rule prohibits payments that are made "for publishing a quotation, acting as a market maker in a security, or submitting an application in connection therewith." This language would apply the prohibitions of the rule to the entry of a quotation in a security, making a market in a security, and the entry of a quotation or the quotation of a security at a particular price.⁷ The definition of "quotation" is drawn from Rule 15c2-11 of the Act⁸ and includes indications of interest.⁹ The proposed

rule also specifies that a member may not impose a fee or accept a payment for submitting an application to enter quotations or make a market in an issuer's securities, e.g., a NASD Form 211 application to enter a quotation in the OTC Bulletin Board or NQB Pink Sheets.

The proposed rule would apply to payments by an issuer, an affiliate of the issuer, or a promoter, whether received directly or indirectly through another party. Whether a person is considered an affiliate would be determined under the provisions of NASD Rule 2720 that relate to the existence of a control relationship between an issuer and a member. For purposes of NASD Rule 2720, the term "affiliate" shall mean "a company which controls, is controlled by or is under common control with a member." In addition, the term "affiliate" is also presumed under certain circumstances in which a member or company is presumed to control, or presumed to be under common control, when the respective entities beneficially own ten percent or more of the outstanding voting securities of the other entity.¹⁰

The concept of "promoter" is broadly defined to encompass all persons other than the issuer and its affiliates who would have an interest in influencing a member to make a market in a security. Thus, the definition includes not only the organizer of the issuer's business, but also any director, employee, consultant, account, or attorney of the issuer. In addition, certain categories of securityholders are also within the definition, since these persons are considered to have an interest greater than that of the average securityholder in ensuring the existence of an active market. The categories in the definition, however, are intended to be illustrative only, and the proposed rule would prohibit payments by any similar person with an interest in promoting the entry of quotations or market making in the issuer's securities.

The proposed rule change does not specifically cover member-to-member payments in the express language of the proposed rule.¹¹ The reason for the exclusion of member-to-member conduct in the express language of the rule are as follows. This member-to-

published in any interdealer quotation system, or any publication or electronic communication network or device which is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy and sell at a stated price or otherwise, or invitations or offers to buy or sell. See Amendments No. 1 and No. 2, *supra* note 3.

¹⁰ See NASD Rule 2720(b)(1)(B) (i), (ii) and (iii).

¹¹ See Amendment No. 1, *supra* note 3.

³ In Amendment No. 1, the NASD made technical corrections to the text of the rule, provided an explanation for not expressly prohibiting member-to-member payments for making a market, and added an explanatory footnote concerning the rule's coverage. Letter from Alden Adkins, Vice President and General Counsel, NASD Regulation, to Elaine Darroch, Attorney, Division of Market Regulation, SEC (May 16, 1997). Amendment No. 2 corrected a minor omission in Amendment No. 1. Letter from Alden Adkins, Vice President and General Counsel, NASD Regulation, to Elaine Darroch, Attorney, Division of Market Regulation, SEC (May 19, 1997).

⁴ *General Bond & Share Co. v. Securities and Exchange Commission*, 39 F. 3d 1451 (10th Cir. 1994).

⁵ In the Matter of General Bond & Share Co., Securities Exchange Act Release No. 32291 (May 11, 1993), 54 SEC Docket 129.

⁶ The Court reversed the SEC's finding of violation that related to the firm's acceptance of issuer-paid compensation, but sustained all of the SEC's other findings of violation by General Bond. *General Bond*, 39 F.3d at 1458, 1461.

⁷ NASD Notice to Member 75-16 states that questionable payments to a market maker have the potential to influence the member's "decision to make a market and thereafter, perhaps, the prices it would quote." NASD Notice to Members, *supra* note 5.

⁸ 17 CFR 240.15c2-11(e)(3)

⁹ The proposed rule would apply to any situation in which member broker-dealer quotations are

member conduct arguably is already covered by other provisions of the proposed rule, provisions of another proposed Conduct Rule, and an existing Conduct Rule.¹² First, the definition of a promoter could apply to payments by one member to another member to publish a quote, make a market, or file an application therewith for a particular security for the purpose of promoting interest in a particular security.¹³ In addition, such payments may also fall within the scope of proposed conduct rule interpretation IM-2110-5 (SR-NASD-97-37),¹⁴ which would prohibit certain anticompetitive conduct of member broker-dealers. In particular, the proposed rule interpretation would prohibit certain "coordinated" activity among member broker-dealers regarding prices (including quotations), trades, or trade reports. Thus, certain coordinated efforts in publishing quotations or setting prices may be subject to the provisions of the proposed rule. Furthermore, member-to-member payments in some cases may also be covered by NASD Conduct Rule 2110 as conduct that is inconsistent with high standards of commercial honor and just and equitable principles of trade. In addition, member-to-member payments not specifically prohibited under the provisions above may involve legitimate broker-dealer activity for which exemptions from the proposed rule would have to be crafted. Crafting appropriate exemptions would complicate the proposed rule unnecessarily in light of the absence of a history of abusive conduct in member-to-member payments.

The proposed rule also is intended to prohibit indirect payments by the issuers, affiliates, or promoters through other members. Thus, members may not accept payments from other members that originate from an issuer, affiliate, or promoter of the issuer.

In addition, the proposed rule contains a general exception that permits payments to a member by prohibited persons for "*bona fide* services." Such *bona fide* services are intended to include, but not be limited to, investment banking services, including traditional underwriting compensation and fees. The proposed rule contains a further exemption for reimbursement of fees imposed by the SEC and the states, and listing fees imposed by self-regulatory organizations. Such fees have been

generally considered costs of the issuer, even when paid by a broker-dealer.

The proposed rule is intended to apply a fair practice standard to a particular course of conduct of a member as described below. In addition, however, the action of a member in charging an issuer a fee for making a market, or accepting an unsolicited payment from an issuer where the member makes a market in the issuer's securities, could also subject the member to violations of the antifraud provisions of federal securities laws and NASD Rule 2120.¹⁵ Further, the payment by an issuer to a market maker to facilitate market making activities also may cause the member to contribute to violations of Section 5 of the Securities Act of 1933.¹⁶

The proposed rule as originally proposed for public comment¹⁷ included a third exception,¹⁸ which was intended to encourage members to conduct an initial Rule 15c2-11 review¹⁹ of the issuer and the security by permitting reimbursement of the member's reasonable out-of-pocket expenses related to this review. The third exception was eliminated from the proposed rule due to concerns that such payments could violate Section 17(b) of the Securities Act of 1933²⁰ and could

¹⁵ Rule 2120 prohibits members from effecting transactions in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive, or other fraudulent device or contrivance.

¹⁶ The insertion of quotations for a security in an interdealer quotation system in exchange for a payment by an issuer may result in a violation of Section 5 of the Securities Act of 1933 based on the issuer's interest in facilitating the subsequent sale. This "second sale" theory was articulated by the SEC and upheld by the court in *SEC v. Harwyn Industries, Inc.*, 326 F. Supp. 943 (S.D.N.Y. 1971). See Letter from Kenneth S. Spierer, Attorney, Division of Market Regulation, SEC, to Jack Rubens, Monroe Securities, Inc. (May 4, 1973).

¹⁷ NASD Notice to Members 96-83 (December 1996).

¹⁸ The third exception to the original proposed rule stated: (b) The provisions of paragraph (a) shall not preclude a member from accepting: * * * (3) reimbursement of reasonable out-of-pocket expenses on an accountable basis, not including the member's overhead, in connection with the member's initial review process in determining whether to agree to publish a quotation or to act as a market maker in a particular security.

¹⁹ Rule 15c2-11 imposes an "affirmative review" obligation on a broker-dealer to form a reasonable belief that the information submitted in connection with an application to enter a quotation is accurate in all material respects and that the sources of the information are reliable. See Securities Exchange Act Release No. 29094 (April 17, 1991), 56 FR 19148 (April 25, 1991).

²⁰ Section 17(b) of the Securities Act of 1933 explicitly makes it unlawful for any person receiving consideration, directly or indirectly from an issuer, to publish or circulate any material which describes such issuer's securities without fully disclosing the receipt of such consideration, whether past or prospective, and the amount thereof.

be used inappropriately to avoid the limitations of the proposed rule.

III. Discussion

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 association, and, in particular, with the requirements of Section 15A(b) of the Act.²¹ Among other things, Section 15A(b)(6) of the Act 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, and in general, to protect investors and the public. The Commission believes that the proposed rule change in designed to prevent fraudulent and manipulative acts, to promote just and equitable principles of trade, and to protect investors and the public.²²

Specifically, the Commission finds that the rule preserves the integrity of the marketplace by ensuring that quotations accurately reflect a broker-dealer's interest in buying or selling a security. The decision by a firm to make a market in a given security and the question of price generally are dependent on a number of factors, including, among others, supply and demand, the firm's expectations toward the market, its current inventory position, and exposure to risk and competition. This decision should not be influenced by payments to the member from issuers or promoters. Public investors expect broker-dealers' quotations to be based on the factors described above. If payments to broker-dealers by promoters and issuers were permitted, investors would not be able to ascertain which quotations in the marketplace are based on actual interest and which quotations are supported by issuers or promoters. This structure would harm investor confidence in the overall integrity of the marketplace. The Commission finds that the proposed rule supports a longstanding policy and position of the NASD²³ and establishes a clear standard of fair practice for member firms.

²¹ 15 U.S.C. § 78f(b).

²² In approving this rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. § 78c(f).

²³ NASD Notice to Members 75-16 (February 20, 1975). See also Letter from Kenneth S. Spierer, Attorney, Division of Market Regulation, SEC, to Mr. Jack Rubens, Monroe Securities, Inc. (May 4, 1973) (regarding acceptance of a fee or service charge from issuers in connection with making a market).

¹² *Id.*

¹³ *Id.*

¹⁴ Securities Exchange Act Release No. 38715 (June 4, 1997), 62 FR 31845 (June 11, 1997) (notice of proposed rule change (SR-NASD-97-37)).

The Commission notes that the rule does not specifically prohibit member-to-member payments to make a market. Nevertheless, the Commission agrees with the NASD that the definition of a promoter in NASD Rule 2460 being approved today, is broad enough to cover payments by one member to another member to publish a quote, make a market, or file an application therewith for a particular security for the purpose of promoting an interest in a particular security. In addition, another proposed rule, IM-2110-5 (SR-NASD-97-37),²⁴ would prohibit certain anticompetitive conduct of broker-dealers. In particular, the rule would prohibit certain "coordinated" activity among member broker-dealers regarding prices (including quotations), trades, or trade reports. Thus, certain coordinated efforts in publishing quotations or setting prices may be subject to the provisions of the proposed rule. The Commission notes that the NASD was concerned that if all member-to-member payments were prohibited, then activity which involved legitimate broker-dealer activity would have to become subject to an exemption. The Commission agrees with the NASD that crafting appropriate exemptions would complicate the rule unnecessarily, when other provisions of the rule and other proposed rules cover the prohibited conduct.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁵ that the proposed rule change (SR-NASD-97-29) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁶

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-18090 Filed 7-9-97; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38813; File No. SR-PCX-97-13]

Self-Regulatory Organizations; Pacific Exchange; Order Approving Proposed Rule Change Relating to the Use of the Internet for Providing Market Quotations or Advertising to the General Public and Notice of Filing and Order Granting Accelerated Approval of Amendment Thereto

July 3, 1997.

I. Introduction

On April 23, 1997, the Pacific Exchange, Inc., ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") 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 relating to the use of the internet for providing market quotations or advertising to the general public. The proposed rule change was published for comment in Securities Exchange Act Release No. 38620 (May 13, 1997), 62 FR 27641 (May 20, 1997). The Commission received no comments on the proposal. On June 26, 1997, the Exchange amended the proposed rule change ("Amendment No. 1") to narrow its scope to market quotations or advertising appearing only on the internet.³ This order approves the proposed rule change and grants accelerated approval to Amendment No. 1.

II. Description of the Proposal

The Exchange is proposing to add three provisions to the text of Rule 9.24, "Radio, Television, Telephone Reports."⁴ The first provision provides that Members and Member

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, PCX, to Margaret J. Blake, Division of Market Regulation, Commission (June 26, 1997). As originally filed, the proposed rule change applied to market quotations or advertising appearing on the internet or "similar electronic networks." Amendment No. 1 removed all references to "similar electronic networks."

⁴ Rule 9.24 currently provides that Member firms desiring to broadcast Exchange quotations on radio or television programs, or in public telephone market reports, or to make use of radio or television broadcasts for any business purpose, shall first obtain the consent of the Exchange by submitting an outline of the program. The rule further provides that the text of all commercials and program material (except lists of market quotations) about securities or investing sponsored by member firms on radio, television, or public telephone market reports, or program material supplied to these media shall be sent to the Exchange promptly following the program in which it is used.

Organizations desiring to make use of the internet for the purpose of providing market quotations or advertising to the general public, must first obtain the consent of the Exchange by submitting an outline of the program to the Exchange.

The second provision provides that the text of all commercials and program material (except lists of market quotations) about securities or investing sponsored by Member or Member Organizations on the internet, or program material supplied to such media, must be sent to the Exchange promptly following the program in which it is used.

Finally, the Exchange is proposing to clarify the limited scope of Rule 9.24 by stating expressly that it only applies to Members and Member Organizations for which the Exchange is the designated examining authority ("DEA").

The Exchange believes that the proposal is consistent with Section 6(b) of the Act, and Section 6(b)(5) of the Act⁵ in particular, in that it promotes just and equitable principles of trade and protects investors and the public interest.

III. Discussion

The Commission believes PCX's proposed rule change is consistent with Section 6(b)(5) of the Act.⁶ Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, and, in general, to further investor protection and the public interest.⁷

PCX proposes requiring Members and Member Organizations to obtain the consent of the Exchange prior to making use of the internet for providing market quotations or advertising to the general public. The Commission believes that Exchange review of market quotations or advertising intended for the general public is necessary for investor protection and overall public interest. The Commission believes that Exchange review of market quotations or advertising appearing on the internet will ensure the accuracy of such information and result in a higher level of investor protection. Similarly, the Commission believes that the text of commercials and program material about securities or investing sponsored by Members or Member Organizations on the internet should be sent to the Exchange promptly following the

⁵ 15 U.S.C. § 78f(b)(5).

⁶ 15 U.S.C. § 78f(b)(5).

⁷ 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).

²⁴ Securities Exchange Act Release No. 38715 (June 4, 1997), 62 FR 31854 (June 11, 1997) (notice of proposed rule change (SR-NASD-97-37)).

²⁵ 15 U.S.C. § 78s(b)(2).

²⁶ 17 CFR 200.30-3(a)(12).