

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39723; File No. SR-CHX-97-25]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change, and Amendments Nos. 1 and 2 by the Chicago Stock Exchange, Incorporated, Amending the Minor Rule Violation Plan

March 5, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on October 1, 1997, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") a proposed rule change. The Exchange subsequently filed Amendment No. 1 clarifying the statutory basis of the rule change.² On February 12, 1998, the Exchange filed Amendment No. 2 to the proposed rule change modifying the recommended fine schedule. The proposed rule change, as amended, is described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organizations Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Article XII, Rule 9, its Minor Rule Violation Plan to include Article XX, Rule 7, interpretation and policy .05, which requires limit orders to be reflected in the specialist's quotation.³ Proposed new language is italicized.

Article XII

Rule 9.

(h)(ii)(18) *Failure to display a limit order in the quotation (Article XX, Rule 7, interpretation and policy .05)*

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

In its filing with the Commission, CHX 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. CHX has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

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

1. Purpose

On May 30, 1996 the Commission approved a proposed rule change that established a CHX Minor Rule Violation Plan (the "Plan").⁴ The Exchange is now proposing to add the failure to display a limit order in the quotation⁵ to the section of the Plan relating to Floor Decorum and Minor Trading Rule Violations. The Exchange believes that it is appropriate to add the Limit Order Display Rule to the Plan because violations of the rule are either objective and technical in nature or are easily verifiable. Moreover, the Exchange believes that because the Limit Order Display Rule is built upon a comparable Commission Rule,⁶ violations of such rule require sanctions that are more severe than a warning or cautionary letter.

The Exchange is also proposing recommended fines for failure to display a limit order in the quotation (Article XX, Rule 7, interpretation and policy .05) to be \$1,000 for the first violation and all subsequent violations. Because of the time and effort expended by the Commission in adopting the Limit Order Display Rule, together with the Commission's and the industry's recent focus on the display of limit orders, the Exchange believes that it is appropriate to adopt the \$1000 recommended fine for violations of this rule (rather than the \$100 recommended fine for violations of other rules that are part of the minor rule violation plan). The Exchange notes that the minor rule plan violation schedule is merely a recommended fine schedule and that fines of more or less than the

recommended fines can be imposed (up to a \$2500 maximum) in appropriate circumstances. Moreover, the Exchange may proceed with formal disciplinary action, rather than procedures under the Plan, whenever it finds that a violation of the Limit Order Display rules was more than inadvertent.

2. Statutory Basis

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, with the requirements of Section 6(b)(1),⁷ 6(b)(6),⁸ 6(b)(7)⁹ and 19(d) of the Act. The proposal is consistent with the Section 6(b)(6) requirement that the rules of an exchange provide appropriate discipline for violations of Commission and Exchange rules. The proposal provides an efficient procedure for appropriate disciplining of the members for rule violations that are objective in nature. Moreover, because CHX Article XII, Rule 9 provides procedural rights to the person fined and permits a disciplined person to request a full hearing on the matter, the proposal provides a fair procedure for the disciplining of members and persons associated with members, consistent with Sections 6(b)(7) and 6(d)(1) of the Act. The proposal provides an alternative means by which to deter violations of CHX rules included in the Plan, thus furthering the purposes of Section 6(b)(1) of the Act.

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

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

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

No written comments were solicited or 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 reason for so finding or (ii) as to which the self-regulatory

¹ 15 U.S.C. § 78s(b)(1).

² See Letter from David T. Russof, Foley & Lardner, to Katherine A. England, Division of Market Regulation, Commission, dated October 31, 1998.

³ See Securities Exchange Act Release No. 39540 (January 12, 1998), 63 FR 2708.

⁴ Rule 19d-1(c)(2) under the Act authorizes national securities exchanges to adopt minor rule violation plans for the summary discipline and abbreviated reporting of minor rule violations by exchange members and member organizations. See Securities Exchange Act Release No. 21013 (June 1, 1984), 49 FR 23828 (approving amendments to paragraph (c)(2) of Rule 19d-1 under the Act). The CHX's Plan was approved by the Commission in 1996. See Securities Exchange Act Release No. 37255 (May 30, 1996), 61 FR 28918 (approving File No. SR-CHX-95-25).

⁵ CHX Article XX, Rule 7 ("Limit Order Display Rule").

⁶ See 17 CFR 240.11Ac1-4 ("Limit Order Display Rule").

⁷ 15 U.S.C. § 78f(b)(1).

⁸ 15 U.S.C. § 78f(b)(6).

⁹ 15 U.S.C. § 78f(b)(7).

organization 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, including whether the proposed rule change is consistent with the Act. Persons making a written submission 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 Room. Copies will also be available for inspection and copying at the principal office of CHX. All submissions should refer to file number SR-CHX-97-25 and should be submitted by April 2, 1998.

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

Jonathan G. Katz,

Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39718; File No. SR-NASD-98-17]

Self-Regulatory Organizations; Notice of Filing of Amendment No. 1 to a Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to an Integrated Order Delivery and Execution System

March 4, 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 February 19, 1998, the National Association of Securities Dealers, Inc.

("NASD"), through its wholly-owned subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq.³ On March 3, 1998, the NASD filed Amendment No. 1 to the proposed rule change.⁴ 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

Nasdaq is proposing new rules and amendments to existing rules of the NASD to establish an integrated order delivery and execution system, featuring a voluntary limit order book and market maker sponsored direct access by non-members. The text of the proposed rule change is contained in an Exhibit attached to this notice.

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

In its filing with the Commission, Nasdaq 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 in Item IV below. Nasdaq has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

³ On December 22, 1997, the NASD filed a proposal (SR-NASD-97-93) that was substantially similar to the proposal discussed in this filing. The NASD withdrew that filing when it filed this proposal. See letter from Robert E. Aber, Senior Vice President and General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, dated February 18, 1998. On February 20, 1998, the NASD filed a technical amendment adding certain language regarding handling of non-directed orders. See fax from Andrew S. Margolin, Senior Attorney, Office of General Counsel, Nasdaq, to Jeffrey R. Schwartz, Special Counsel, Division of Market Regulation, dated February 20, 1998. This technical amendment is discussed in footnote 42 below.

⁴ See letter from Robert E. Aber, Vice President and General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, dated March 3, 1998 ("Amendment No. 1"). Amendment No. 1 corrected several technical errors and added language to Section D.3.b. noting that SR-NASD-98-05 changed the manner in which Nasdaq handles SOES orders.

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

A. General

Nasdaq is proposing a new integrated order delivery and execution system ("System"). The System responds to the demands of investors and NASD members for a marketplace that provides for fast and efficient access to the best prices in the market and effective integration of price discovery, execution, and trade reporting. When combined with a broadly accessible voluntary limit order file featuring order anonymity and full display of limit order interest, Nasdaq's new System will further enhance the satisfaction of a wide range of market participant needs. The System represents a logical evolution of Nasdaq in light of the changes and growth in trading behavior, particularly as a result of the new SEC Order Handling Rules.⁵ The System is designed to leverage the benefits of these rules while complementing Nasdaq's competing dealer market structure.

While Nasdaq seeks to incorporate more order-driven features in the Nasdaq environment, Nasdaq will retain the benefits of a competitive dealer network by maintaining incentives for market makers that also contribute significantly to Nasdaq's liquidity. These incentives include a reduction in market maker exposure to unintended multiple executions through Nasdaq's systems, enhanced compliance with the Firm Quote Rule, the ability for certain market makers to sponsor access by institutional customers, and a means of reducing the cost of capital by providing a low cost limit order book sponsored by Nasdaq. Importantly, because the design of the System is based on the ability of market makers to quote their actual size, Nasdaq also believes that a disincentive for some market makers would be removed, thus attracting more liquidity and pricing efficiency in the Nasdaq market.⁶

These incentives and benefits are important, in that Nasdaq continues to

⁵ See Exchange Act Release No. 37619A (September 6, 1996) 61 FR 48290 (September 12, 1996) ("Adopting Release").

⁶ Indeed, the Commission noted in its approval of the Actual Size Rule pilot (discussed further in Section B.3. below) that "the 1000 share minimum quote size represents a barrier to entry for market making. Lowering this barrier to entry could attract more market makers, thereby increasing liquidity and competition across the market." See Exchange Act Release No. 38156 (January 10, 1997) 62 FR 2415, at 2425 (January 16, 1997) (order approving certain changes related to implementation of the SEC Order Handling Rules).

¹⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.