

SOES market makers update their quotes promptly after executions, the proposal should help to produce fair and informative quotations and prevent fictitious and misleading quotations.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change (SR-NASD-97-50) be, and hereby is, approved.⁹

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39497; File No. SR-NYSE-97-28]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the New York Stock Exchange, Inc. Amending Exchange Rule 431 to Establish Margin and Net Capital Requirements for Joint Back Office Arrangements

December 29, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on October 2, 1997, the New York Stock Exchange, Inc. ("Exchange" or "NYSE") filed with the Securities and Exchange Commission ("Commission") the proposed rule change, as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The Exchange seeks to amend Exchange Rule 431, "Margin Requirements." The modifications relate to: (a) joint back office ("JBO")

arrangements, (b) margin requirements for broker-dealer accounts, (c) margin requirements for specialists' and market makers' accounts, and (d) control and restricted securities.

The text of the proposed rule change is available at the Office of the Secretary, the Exchange, and at the Commission.

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 Exchange 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 Exchange 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

In April, 1996, the Exchange established the Rule 431 Committee ("the Committee") to review all aspects of Rule 431 and make recommendations to the Exchange in the wake of recent changes to federal margin regulations and changing industry conditions. The Committee created various subcommittees to review specific provisions of Rule 431 utilizing the expertise of industry representatives knowledgeable in the application of Rule 431. As a result of the efforts of the "Control Stock" and "Joint Back Office" subcommittees, and reviews by the Committee and Exchange staff, the Exchange Board approved amendments to Rule 431 as set forth below.

(a) JBO Arrangements

Regulation T, issued by the Board of Governors of the Federal Reserve System ("FRB"), permits a broker-dealer to "effect or finance transactions of any of its owners if the [broker-dealer] is a clearing and serving broker or dealer owned jointly or individually by other [broker-dealers]."² The proposed rule change would provide certain regulatory requirements for establishing and maintaining such JBO arrangements. Carrying/clearing broker-dealer forming a JBO would be required to: (i) provide

written notification to the Exchange prior to establishing a JBO, (ii) maintain minimum tentative net capital³ of \$25 million, or maintain minimum net capital of \$10 million if engaged in the primary business of clearing options market-maker accounts,⁴ (iii) maintain a written risk analysis methodology for assessing the amount of credit extended to participating broker-dealers, and (iv) deduct from net capital, the "haircut" requirements pursuant to the Commission's Net Capital Rule ("Rule 15c3-1")⁵ in excess of the equity maintained in the accounts of participating broker-dealers.

Furthermore, under the proposal JBO participants must be registered broker-dealers subject to Rule 15c3-1, and will be required to maintain an ownership interest in the JBO pursuant to Regulation T. Exclusive of their ownership interest in the JBO arrangement, JBO participants must maintain a minimum liquidating equity of \$1 million. If the liquidating equity falls below \$1 million, the JBO participant must eliminate the deficiency within five business days or become subject to the margin requirements under other provisions of Exchange Rule 431.⁶

(b) Margin Requirements for Broker-Dealer Accounts

Currently, the amount of any deficiency between the equity maintained in the proprietary account carried for another broker-dealer and the maintenance margin required by Exchange Rule 431(c)(1) (i.e., 25% of the current market value of securities "long" in the account) is deducted in computing the net capital of the carrying member organization. In order for introducing broker-dealers to receive the same treatment as proposed for JBO

³ As discussed in the Exchange's Interpretation Handbook, the term "tentative net capital" generally refers to net capital before the application of "haircuts" (*infra* note 5) and undue concentration charges on securities and options positions. See NYSE Interpretation Handbook, Section I(c)(2)(vi)(M)(04), "Tentative net Capital."

⁴ Under the proposed rule change, clearance of option market maker accounts would be deemed a broker-dealer's primary business if a minimum of 60% of the aggregate deductions in the ratio of gross options market maker deductions to net capital (including gross deductions for JBO participant accounts) are options market maker deductions.

⁵ 17 CFR 240.15c3-1 *et seq.*, "Net Capital Requirements for Brokers or Dealers." Rule 15c3-1 requires a broker-dealer to reduce its net worth by certain percentages, known as "haircuts," of the market value of its securities positions.

⁶ The Exchange believes that in order to establish an effective, industry-wide regulatory scheme for JBO arrangements, the other self-regulatory organizations should adopt the requirements in the proposed rule change that relate to JBO arrangements.

⁹ In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. The proposed rule change likely will enhance the efficiency and fairness of the process by which market makers update their quotes. It likely also will enhance the ability of investors to obtain updated market maker quotes quickly, thus increasing Nasdaq's transparency. The net effect of approving the proposed rule change will be positive. 15 U.S.C. 78c(f).

¹⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 12 CFR 220.11. Regulation T is titled "Credit By Brokers and Dealers" and was issued by the FRB pursuant to the Act.

participants, the amendments would compute the deduction to the carrying member organization's net capital based upon the haircut requirements of Rule 15c3-1 (i.e., 15% of the market value for long positions)⁷ rather than the currently required 25%.

(c) Margin Requirements for Specialists' and Market Makers' Accounts

Likewise, the amount of any deficiency between the equity in the account carried for an "approved specialist or market maker"⁸ and the 25% maintenance margin required by Exchange Rule 431(c)(1) is deducted in computing the net capital of the carrying member organization. Similar to the contemplated amendments relating to the margin requirements for broker-dealer accounts, the proposed rule change would compute the deduction to the carrying member organization's net capital based upon the haircut requirements of Rule 15c3-1 (i.e., 15%) rather than the presently mandated 25%.

The same modification would be made to the margin provision governing joint accounts carried by member organizations in which the member organizations participate. If the equity maintained in the account by the other participants is deficient, the proposal would require the carrying member organization to compute the deduction to its net capital based upon the haircut requirements of Rule 15c3-1 (i.e., 15%) rather than the margin requirements of Exchange Rule 431(c)(1).

(d) Control and Restricted Securities

Currently, Exchange Rule 431(e)(8)(C)(iv) sets forth a "Concentration Reduction" formula that establishes margin requirements for control and restricted securities based upon the percent of outstanding shares or the percent of average weekly volume. The Exchange believes the Concentration Reduction provision has the effect of imposing higher margin requirements on accounts that have greater collateral deposited. To eliminate what the Exchange views as an anomalous result, the proposed rule change would exclude "excess securities"⁹ from the calculations.

In addition, the proposed rule change would except from Exchange Rule 431(e)(8) all restricted securities saleable pursuant to Rule 144(k),¹⁰ Rule 145(d)(2),¹¹ or Rule 145(d)(3)¹² under the Securities Act of 1933. Currently, only those restricted securities saleable by non-affiliates of the issuer pursuant to Rule 144(k), Rule 145(d)(2), or Rule 145(d)(3) are excepted from Exchange Rule 431(e)(8). As a result, broker-dealers would be permitted to sell certain restricted securities in the event of a customer default pursuant to Rule 144(k) without being subject to the requirements of Exchange Rule 431. Accordingly, those customer-owned, restricted securities saleable under Rule 144(k) would be subject to the same maintenance margin requirements that presently apply to ordinary stock (25%).

Finally, the proposed rule change would alter the calculation of a member firm's net capital with regard to extending credit to customers on control and restricted securities. The proposal would amend Exchange Rule 431(e)(8)(C)(ii) to provide that the "greater of the aggregate credit agreed, in writing to be or actually extended to all customers on control and restricted securities of any one issue that exceeds 10% of the member organization's excess net capital shall be deducted from net capital for purposes of determining a member organization's status under Rule 326."

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act¹³ in that it is designed to promote just and equitable principles of trade, and to protect investors and the public interest. The Exchange further believes that the proposed rule change is consistent with the rules and regulations promulgated by the FRB for the purpose of preventing the excessive use of credit for the purchase or carrying of securities, pursuant to Section 7(a) of the Act.¹⁴

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

The Exchange does not believe that the proposed rule change will impose

any inappropriate burden on competition.

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

The Exchange did not solicit or receive written comments with respect to the proposed rule change.

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 Exchange consents, the Commission will:

(A) By order approve the 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. 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 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 persons, 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 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 Exchange. All submissions should refer to File No. SR-NYSE-97-28 and should be submitted by January 28, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,¹⁵

Margaret H. McFarland,
Deputy Secretary.

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¹⁵ 17 CFR 200.30-3(a)(12).

⁷ 17 CFR 240.15c3-1(c)(2)(vi)(I).

⁸ Exchange Rule 431(e)(5)(A) defines the term "approved specialist or market maker" as either: (1) a specialist or market maker, who is deemed a specialist for all purposes under the Securities Exchange Act of 1934 and who is registered pursuant to the rules of a national securities exchange; or (ii) an OTC market maker or third market maker, who meets the requirements of Section 220.12(d) of Regulation T.

⁹ The term "excess securities" would be defined as the amount of securities, if any, by which the

aggregate position in control and restricted securities of any one issue exceeds the aggregate amount of securities that would be required to support the aggregate credit extended on such control and restricted securities if the applicable margin requirement was 50%.

¹⁰ 17 CFR 230.144(k).

¹¹ 17 CFR 230.144(d)(2).

¹² 17 CFR 230.144(d)(3).

¹³ 15 U.S.C. 78f(b)(5).

¹⁴ 15 U.S.C. 78g(a).