above-mentioned proposed rule changes (File Nos. SR–MCC–95–01 and SR–MSTC–95–04) be, and hereby are, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[9]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 95–20154 Filed 8–14–95; 8:45 am]

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[Release No. 34–36077; File No. SR–NASD–95–28]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc., Regarding Trading in Anticipation of the Issuance of a Research Report

August 9, 1995.

On May 25, 1995, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') filed a proposed rule change with 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] The proposed rule change amends Article III, Section 1 of the NASD Rules of Fair Practice[3] by adding a new Interpretation prohibiting purposeful trading that affects a member firm's inventory position in a given security prior to the firm's issuance of a research report in that same security (''Interpretation'').

Notice of the proposed rule change, together with the substance of the proposal as initially filed, was provided by issuance of a Commission release (Securities Exchange Release No. 35877, June 21, 1995) and by publication in the **Federal Register** (60 FR 33444, June 28, 1995). Two comment letters were received.[4] This order approves the proposed rule change.

I. Introduction

Certain broker-dealers that have research departments may prepare research reports for customers with respect to certain identified securities. A research report may advise customers to buy or sell the security that is the subject of that report.

Certain of these broker-dealers may intentionally establish a proprietary position in the security that is to be the subject of a report in anticipation of meeting expected customer demand in response to the research report. A broker-dealer that intends to issue a positive research report may accumulate stock before issuing the research report. Once it issues the research report, it would then commence solicitation of orders, expecting to fill customers orders from the inventory position it has accumulated.

In 1991, the New York Stock Exchange (''NYSE''), in NYSE Information Memo 91–8, issued a policy statement regarding stock accumulations by a NYSE member organization in advance of that member's issuance of research reports. NYSE Information Memo 91–8 stated that an NYSE member organization would engage in conduct inconsistent with just and equitable principles of trade if it purposefully acquired a position in an NYSE-listed security in contemplation of its issuance of a favorable research report.

II. Description and Scope of the Proposed Rule Change

In 1994 the NASD solicited member comment on developing a formal policy deeming trading in anticipation of a research report to be a violation of Article III, Section 1 of the NASD Rules of Fair Practice. Purposeful inventory adjustments made in anticipation of customer trading activity as a result of the firm's research report could appear to, and at times would, conflict with the firm's fiduciary duties toward its customers. Therefore, the Interpretation approved today provides that an NASD member will violate just and equitable principles of trade if it purposefully adjusts its inventory position in a Nasdaq security, in an exchange listed security that is traded in the third market, or in a derivative product of any such security in anticipation of the issuance of a research report in that security. Such purposeful activity can create an appearance of impropriety that harms the perception of the marketplace and could cause a loss of investor confidence.

The Interpretation approved today is intended to enhance the overall perception of Nasdaq and the third market and encourage investors to participate in those markets, thereby promoting liquidity. The Interpretation also is intended to be consistent with the policy found in NYSE Information Memo 91–8, thereby promoting consistency among self-regulatory organizations and helping to alleviate compliance burdens for member firms that operate in multiple markets. However, unlike NYSE Information Memo 91–8, the Interpretation also provides that a member firm will violate just and equitable principles of trade if it purposefully decreases or liquidates its position in a security because it was about to issue a negative research report.

The Interpretation applies to third market trading in listed securities that are the subject of a firm's research report as well as to Nasdaq securities. The Interpretation covers third market trading because there could be a significant gap in customer protection rules on exchange-listed securities traded in the third market absent the inclusion of those securities.

Finally, the Interpretation prohibits a member firm from attempting to do indirectly what it is not permitted to do directly. For example, a member firm may trade in options on an underlying security that is to be the subject of a research report in order to do by means of an economically equivalent transaction that which it would otherwise be prohibited from doing.

Therefore, the Interpretation prohibits a member firm from purposefully establishing, increasing, decreasing or liquidating a derivative security position in anticipation of the firm's issuance of a research report on the security underlying the derivative position.

The Interpretation specifically notes that it is intended to apply to situations in which the member firm ''purposefully'' alters its inventory position in anticipation of the issuance of a favorable or unfavorable research report in anticipation of meeting expected customer demand in response to the research report. The Interpretation is not intended to halt all of a firm's trading activity in that security. Even if the trading desk knows of a forthcoming research report on a particular security, it may continue to trade with its retail customers or with other broker-dealers if such trading arises from unsolicited order flow. The Interpretation also does not apply to situations where the firm conducts research solely for in-house use and such research is not made available for external distribution.

In addition, the Interpretation encourages but does not require firms to establish information barriers (also known as Chinese Wall procedures or Chinese Walls) to control the flow of information between their research and trading departments. Information barriers are risk management controls

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[9] 17 CFR 200.30–3(a)(12) (1994).

[1] 15 U.S.C. § 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *NASD Manual*, Rules of Fair Practice, Art. III, Sec. 1 (CCH) ¶ 2151.

[4] *See* Letter from Brian C. Underwood, Vice President-Director of Compliance, A.G. Edwards & Sons, Inc. (''A.G. Edwards''), to Jonathan G. Katz, Secretary, SEC, dated July 18, 1995 (''A.G. Edwards Letter''); and Letter from Joseph McLaughlin Esq. , Brown & Wood, to Jonathan G. Katz, Secretary, SEC, dated July 21, 1995 (''Brown & Wood Letter'').

adopted by securities firms between different departments of firms to enhance the likelihood that knowledge of upcoming events will be isolated within a single group and not disclosed to other groups that might trade on or otherwise benefit from the information. Because many firms today already use information barriers between the research and trading departments of their firms, the Interpretation encourages the use of information barriers as the preferred method of complying with the Interpretation. If a member determines not to implement information barriers, it would carry the significantly greater burden of proving that stock accumulations or liquidations prior to the issuance of a research report had not been purposeful if an NASD investigation into the firm's buying or selling activity were initiated.

III. Summary of Comments

Two commenters objected to the Interpretation. A.G. Edwards stated that the Interpretation would adversely affect retail customers of a firm with an active research department. A.G. Edwards suggested that the Interpretation would prevent a firm from accumulating stock to satisfy expected customer demand once it issued a favorable research report. The A.G. Edwards Letter stated that a firm would need to use outside dealers in order to meet client demand for the security once the research report was issued. This, in turn, would cause the price of the security to rise, which would mean that retail orders would go unfilled or would be executed only at a price above the price at which the security was trading before the report was issued.

A.G. Edwards claimed that the Interpretation would discourage small issuers from issuing their securities because the Interpretation, if adopted, would discourage firms from initiating coverage of their securities. It also claimed that the Interpretation is flawed because it does not similarly prohibit firms from adjusting their inventory when conducting research not available for external distribution. A.G. Edwards suggested prohibiting firms from accumulating securities for a specified period in advance of the issuance of a favorable research report concerning the issuer of those securities, or requiring firms to sell accumulated securities to customers at a price based on the firm's average cost.

Brown & Wood also objected to the Interpretation. The Brown & Wood Letter stated that the Interpretation could not be intended to protect customers because it would apply not only to trading with a firm's own customers but to any trading with any person. The Brown & Wood Letter stated that the Interpretation would discourage firms from maintaining research staffs, would encourage firms not to distribute research to their customers, would encourage other firms not to maintain research staffs and would cause firms to transfer the value of their research without compensation.

The Commission does not believe that the objections raised by these commenters warrant disapproval of the Interpretation. The Commission notes that trading ahead of research reports raises questions about the motivation of the firm in issuing the research report and about the quality of information within the research report. In this regard, the Commission notes that a firm preparing a research report concerning a security solely for ''in-house'' use cannot expect the repot to affect public demand for the security; hence, such reports do not raise the same ''trading ahead'' concerns as do reports prepared for public investors.

Furthermore, the Commission does not believe that the prior accumulation of a security that is to be the subject of a favorable research report affects the level of investor demand for that security; therefore, the Commission does not believe that the Interpretation will cause firm customers to pay higher prices for the securities that are the subject of research reports than they would pay if firms could trade ahead of research reports.

The Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act in that the proposed rule change will increase investor confidence in the integrity of research reports, thereby protecting investors and the public interest.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR–NASD–95–28 be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30–3(a)(12).

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34–36070; International Series Release No. 837 File Nos. SR–Amex–94–55 and SR–CBOE–95–01]

Self-Regulatory Organizations; American Stock Exchange, Inc., and Chicago Board Options Exchange, Inc., Order Approving Proposed Rule Changes Relating to the Listing and Trading of Warrants on the Deutscher Aktienindex (''DAX Index'')

August 9, 1995.

I. Introduction

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] on December 5, 1994, the American Stock Exchange, Inc. (''Amex'') filed with the Securities and Exchange Commission (''Commission''), and on January 5, 1995, the Chicago Board Options Exchange, Inc. (''CBOE'') filed with the Commission, proposed rule changes to list and trade warrants on the Deutscher Aktienindex (''DAX Index'' or ''Index''). The Amex and the CBOE are collectively referred to herein as the ''Exchanges.'' Notices of the proposals appeared in the **Federal Register** on January 26, 1994.[3] The Commission received three comment letters concerning the proposed rule changes.[4] This order approves the Amex and the CBOE proposals.

II. Description of the Proposals

The Amex and the CBOE propose to list index warrants based on the DAX Index.

A. Composition and Maintenance of the Index

The DAX Index is a capitalization-weighted index of 30 German equity securities listed on the Frankfurt Stock Exchange (''FSE''). The capitalization of a particular stock in the Index is

[1] 15 U.S.C. § 78s(b)(1) (1988).

[2] 17 CFR 240.19b–4 (1994).

[3] *See* Securities Exchange Act Release Nos. 35249 (January 19, 1995), 60 FR 5236 (notice of File No. SR–Amex–94–55), and 35247 (January 16, 1995), 60 FR 5233 (notice of File No. SR–CBOE–95–01).

[4] All three letters were submitted on behalf of the Deutsche Börse AG, the Frankfurt Stock Exchange (''FSE''), and the Deutsche Terminbörse (''DTB''). The Deutsche Börse AG is a holding company formed in 1993 for the purpose of, among other things, assuming ownership and control of the FSE and the DTB. *See* Letter from Lawrence Hunt, Jr., Sidley & Austin, to Margaret McFarland, Deputy Security, Commission, dated March 21, 1995 (commenting on File No. SR–Amex–94–55), and letter from Lawrence Hunt, Jr., Sidley & Austin, to Margaret McFarland, Deputy Secretary, Commission, dated March 21, 1995, (collectively, ''Comment Letters''). The commenters subsequently submitted a follow-up statement to the Comment Letters. *See* Letter from Lawrence Hunt, Jr., Sidley & Austin, to Margaret McFarland, Deputy Secretary, Commission, dated July 19, 1995 (''July 19 Letter'').