

or crossed until the locking or crossing market maker has notified the NASD, and the NASD, in turn, has notified the market maker that its quotation has been locked or crossed, would be highly inefficient and would be inconsistent with the NASD's statutory mandate that its rules remove impediments to and perfect the mechanism of a free and open market. The Commission also notes that each of the alternatives suggested by Morgan Stanley would inhibit the ability of investors to obtain executions at a market maker's displayed quotations if it were implemented. Thus, the Morgan Stanley alternatives do not give due recognition to the interests of investors or to the interest of the NASD in discouraging locked and crossed markets.

The 5-second interval between SOES executions during locked and crossed markets will apply to all SOES users and participants. Although the proposal will limit to a small extent the ability to investors to obtain executions in locked and crossed markets by providing a 5-second interval between executions, the Commission believes that the rule change appropriately balances the interests of investors and the need for market makers to have a very brief period to update their quotations expeditiously in locked or crossed markets. The rule change also is intended to enhance the production of fair and orderly quotations in NNM securities. This, in turn, should encourage market makers to enter more competitive quotations.

The Quote Rule requires that brokers and dealers execute orders to buy and sell securities at their published quotes unless communicating a revised bid or offer or unless updating their quotations in response to an execution. The 5-second interval is intended to provide market makers with an opportunity to update their quotations in response to an execution. Market makers who do not so will be required to execute further transactions at their published bid or offer.¹² The Commission notes that if the NASD adopted either alternative suggested by Morgan Stanley, Nasdaq market makers would not be required to execute orders to buy and sell securities at their published quotes even when they are not communicating a revised bid or offer or

updating their quotations in response to an execution.¹³

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR-NASD-95-54 be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

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[Release No. 38106; File No. SR-NYSE-96-27]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by New York Stock Exchange, Inc., Relating to an Interpretation of Rule 409 ("Statements of Accounts to Customers")

December 31, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on December 5, 1996,² the New York Stock Exchange, Inc. ("NYSE" or "Exchange") 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 the self-regulatory organization. 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 has filed with the Commission a proposed rule change which consists of an interpretation with respect to the meaning and administration of existing Exchange

¹³ Morgan Stanley argues that market makers whose quotes have been locked or crossed may not always have adequate notice that their quotation has been locked or crossed. It recommends that the NASD provide a market maker whose quotation has been locked or crossed with a warning window on its screen. While the suggestion has merit, the Commission does not believe that it is a necessary prerequisite for approving a rule change providing market makers with five additional seconds to update their quotations.

¹⁴ 17 CFR 200.30-3(a)(12) (1989).

¹⁵ 15 U.S.C. 78s(b)(1).

² On December 5, 1996, the NYSE filed Amendment No. 1 with the Commission. The proposed rule change was submitted on September 25, 1996. However, amendments to the rule language were improperly identified in contravention of Section 19(b); therefore, the filing is deemed to be filed on the later date. See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated December 5, 1996.

Rule 409 ("Statements of Accounts of Customers"). Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in brackets.

RULE 409: STATEMENTS OF ACCOUNTS TO CUSTOMERS

(a)

/01 Applicability

Compliance with Rule 409(a) and the accuracy of statements of accounts thereunder is the responsibility of the member organization carrying the customer account for which the statement is required, unless such responsibility has been allocated to a non-member carrying organization pursuant to an Exchange approved agreement under Rule 382.

/02 Information To Be Disclosed

Statements of accounts to customers must clearly and prominently disclose on the front of the statement:

- 1. the identity of the introducing and carrying organization and their respective phone numbers for service;¹*
- 2. where the customers' assets included on the statement are carried;*
- 3. that the carrying organization is a member of SIPC and whether any of the customers' assets included on the statement are not covered by SIPC;*
- 4. the opening and closing balances for the account.*

/03 Use of Third Party Agents

Prior to utilizing a "third party agent" to prepare and/or transmit statements of accounts to customers, a member organization shall represent/undertake in writing to the Exchange that:

- 1. the third party is acting as agent for the member organization;*
- 2. the member organization retains responsibility for compliance with Rule 409(a);*
- 3. the member organization has developed procedures/controls for reviewing and testing the accuracy of statements of accounts prepared and/or transmitted by the third party agent;*
- 4. the member organization will retain copies of statements of accounts prepared and/or transmitted by the third party agent in accordance with applicable books and records requirements.*

Allocation of responsibilities for preparation and/or transmission of statements to any person other than a carrying organization pursuant to an agreement approved by the Exchange in accordance with Rule 382 (Carrying

¹ If the phone number of the clearing organization appears on the back of the statement it must be in "bold" or "highlighted" letters.

¹² See Securities Exchange Act Release No. 29801 (October 10, 1991), 56 FR 52098 (approving 15-second interval following a market maker's receipt of a SOES execution report to update its quotation before being required to execute another order in that security through SOES).

Agreements) shall be deemed to be utilization of a "third party agent".

An introducing organization that is a provider of services included in a member organization's statements of accounts may not function as a "third party agent" and may not itself prepare and or transmit such statements.

/04 Assets Not In Possession/Control of Member Organization

Where a statement of account includes assets that are not within the possession or control of the member organization such assets must be clearly and distinguishably separated on the statement, and it must be clearly indicated on the statement that such externally held assets: are not within the possession or control of the member organization, are included on the statement solely as a service to the customer, information (including valuation) is derived from the customer or other external source for which the member organization is not responsible, and are not covered by SIPC.

/05 Use of Logos, Trademarks, etc.

Where the logo, trademark or other similar identification of a person (other than the carrying or introducing organization) appears on a customer account statement, the identify of such person(s) and the relationship to the introducing, carrying or other organization included on the statement must be provided and may not be utilized in a manner which is misleading or causes customer confusion.

/06 Combined Statements

Where a member organization carrying a customer's account and another person(s) who separately offers financial related products/services to the same customer (e.g. mutual fund sales/custodial services, banking products/services, insurance products/services, securities products/services, etc.) seek to jointly formulate and/or distribute their respective customer account statements together with a statement summarizing or combining assets held in different accounts, ("summary statement"), the Exchange will require:

1. That the summary statement:
 - a. indicate that the "summary statement" is provided for informational purposes and includes assets held at different entities;
 - b. identify each entity from which information is provided or assets being held are included, their relationship with each other (e.g., parent, subsidiary or affiliated organization), and their respective functions (introducing/

carrying brokerage firms, fund distributor, banking/insurance product providers, etc.);

c. clearly distinguish between assets held by each entity by way of use of columns, coloring or other distinct form of demarcation;

d. identify the customer's account number at each entity;²

e. provide a telephone number for customer service at each entity;²

f. disclose which entity carries each of the different assets or categories of assets included on the summary;

g. identify and distinguish between those accounts/assets covered and not covered by SIPC.

2. To the extent that the summary statement aggregates the values of the various accounts summarized or portions thereof, such aggregation shall be recognizable as having been arithmetically derived from the separately stated totals or their components.

3. That the beginning and end of each separate statement (e.g., summary, brokerage, mutual fund, banking, insurance, etc.) be clearly distinguishable by color, pagination or other distinct form of demarcation.

4. That there be a written agreement between the carrying organization and each other person jointly formulating and/or distributing its respective customer account statements attesting that each such person has developed procedures/controls for reviewing and testing the accuracy of its respective statements or any information included by it on a summary statement.

5. The summary statement shall comply with Rule 409 and all interpretations thereof.

* * * * *

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 self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

² Where the customer account number and telephone number for customer service at each entity are included on each entity's respective customer account statement, such account and telephone numbers need not be included on the summary statement.

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

1. Purpose

The purpose of the proposed rule change is to set forth an interpretation concerning the meaning and administration of Exchange Rule 409 with respect to the establishment of standards regarding the distribution of "summary statements" and the use of "third party agents" to prepare and/or distribute customer account statements. The proposed interpretation also codifies existing Exchange policy as to certain information that must be disclosed on account statement. Other items in the proposed interpretation address statements that include assets not in possession or control of a member organization and the use of logos and trademarks on statements.

Exchange Rule 409 addresses the responsibility of member organizations carrying customer accounts to send statements of these accounts to their customers. The Exchange has received requests from member organizations to allow them jointly, with other financial institutions (e.g., banks and investment companies), to formulate and distribute to common customers a "summary statement" together with their respective customer account statements. These requests generally involve entities that are part of a financial services "group" or "family" or where the Exchange member organization carries accounts for a broker-dealer that is part of such a group. The "summary statement" provides an overview of the customer's accounts at the separate entities and is supported by the detail on the separate respective statements.

The Exchange has worked with industry representatives to develop parameters so that this may be accomplished in a manner that will provide customers with accurate account statements that clearly identify the respective entities involved and distinguish brokerage from non-brokerage assets.

Specifically, the Exchange will require that the summary statement: indicate that the statement is informational and includes assets held at different entities; identify each entity, their relationship to each other and their respective functions; distinguish clearly between assets held by each entity³; identify the customer's account numbers at each entity and provide a

³ Columns, coloring or other distinct form of demarcation should be used to clearly distinguish assets.

customer service telephone number at each entity⁴; disclose which entity holds each of the different assets on the summary; and distinguish between accounts that are or are not covered by SIPC. Additionally, any aggregation of account values must be recognizable as having been derived from the separately stated totals; the beginning and end of each separate underlying statement must be clearly distinguishable; and there must be a written agreement between the parties jointly distributing the statements that each has developed procedures/controls for testing the accuracy of its own information on the customer statement.

The proposed interpretation will codify that carrying firms are responsible for sending statements to customers and for ensuring the accuracy of such statements. However, it is recognized that in many cases "third party agents" (e.g., service bureaus or other independent entities) prepare or transmit customer account statements. Therefore, the proposed interpretation to Rule 409 would also establish Exchange policy regarding use of "third party agents" to prepare and transmit statements of accounts and to set forth certain representations which must be made in writing by the member organization to the Exchange. Specifically, the member organization must represent that the third party is acting as agent for the member organization, that the member organization retains responsibility for compliance with Rule 409(a), that the member organization has developed procedures and implemented controls for reviewing and testing the accuracy of statements and that it will retain copies of all such statements. In addition, the interpretation states that an introducing organization that is a provider of services included in a member organization's statements of accounts may not function as a "third party agent" and may not itself prepare and or transmit such statements.

The proposed interpretation also clarifies that certain information must be disclosed on the front of account statements, i.e., the identity of the introducing and carrying organizations, where customer assets included on the statement are held, whether such customer assets are covered by SIPC,

and the opening and closing account balances.

The interpretation also requires that where the account statement includes assets not within the possession or control of the member organization, such assets must be clearly separated on the statement. In addition, the statement must clearly indicate that such externally held assets: are not within the possession or control of the member organization; are included on the statement solely as a service to the customer; and are not covered by SIPC. Moreover, the summary statement must indicate that the member organization is not responsible for any information derived from the customer or other external source relating to such assets.

As to the use of logos and trademarks, the proposed interpretation provides that where the logo, trademark or other identification of a person (other than that of the carrying or introducing organization) appears on an account statement, then the identity of such person and the relationship to the introducing, carrying or other organization included on the statement must be provided and may not be misleading or cause customer confusion.

The Exchange believes that this proposed interpretation will give member organizations the flexibility to distribute summary statements to customers or use third party agents to prepare and transmit customer account statements, while providing appropriate safeguards through detailed disclosure to customers and required undertakings to the Exchange.

2. Statutory Basis

The NYSE believes the proposed rule change is consistent with the requirements of Section 6(b)(5)⁵ of the Act which requires that the rules of the Exchange 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 interest. This proposal complies with the Act in that it establishes standards enabling members and member organizations to distribute summary statements and to use third party agents to prepare and distribute these statements, while providing customer protection through appropriate disclosures and implementation of specified procedures and controls.

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

The Exchange believes that the proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were neither solicited nor received.

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

Within 35 days of the 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 reasons for so finding or (ii) as to which the self-regulatory 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. 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 Commissions' Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal office of the New York Stock Exchange. All submissions should refer to the File No. SR-NYSE-96-27 and should be submitted by January 30, 1997.

Margaret H. McFarland,
Deputy Secretary.
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⁴ Where the customer account number and telephone number for customer service at each entity are included on each entity's respective customer account statement, such account and telephone numbers need not be included on the summary statement.

⁵ 15 U.S.C. 78f(b)(5).