

Exchange should monitor the use of the system during the one-year pilot period and assure the Commission that manually-executed orders and Auto-Ex orders do not receive differential treatment. Moreover, the Exchange should examine the program during the pilot period to determine whether specialists are choosing the stocks to include in Auto-Ex on a discriminatory basis.

The Commission, therefore, requests that the Exchange submit a report to the Commission by May 31, 1996, describing its experience with the pilot program. At a minimum, this report should contain the following data gathered during the first 10-month period after the start-up date for Auto-Ex: (1) The total number of issues and specialists using Auto-Ex including their percentages in comparison to the Exchange's market as a whole; (2) a break down of each issue subject to Auto-Ex during the pilot period, including each date the issue was placed on Auto-Ex and removed; (3) the types of securities being chosen for Auto-Ex (if a pattern is discernable); and (4) whether any distinguishable market condition existed when an issue was placed on or taken off Auto-Ex. The Commission is also interested in the length of time between a print in the primary market and the resulting fill on CHX for both the issues on Auto-Ex and those issues not on Auto-Ex. Any requests to modify this pilot program, to extend its effectiveness, or to seek permanent approval for the pilot program also should be submitted to the Commission by May 31, 1996, as a proposed rule change pursuant to section 19(b) of the Act.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-CHX-95-11) is approved for a one-year period ending on July 31, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,
Deputy Secretary.

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Self-Regulatory Organizations; Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. to the Corporate Financing Rule at Article III, Section 44 of the Rules of Fair Practice Regarding Rights of First Refusal

July 12, 1995.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on June 1, 1995, the National Association of Securities Dealers, Inc. ("NASD" or "Association") 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 NASD. 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 NASD is proposing to amend Article III, section 44 of the Rules of Fair Practice regarding rights of first refusal. Proposed new language is in *italics*; proposed deletions are bracketed.

Rules of Fair Practice, Article III, The Corporate Financing Rule, Underwriting Terms and Arrangements

Section 44

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(c) Underwriting Compensation and Arrangements

* * * * *

(3) Items of Compensation

(A) For purposes of determining the amount of underwriting compensation received or to be received by the underwriter and related persons pursuant to paragraph (c)(2) above, the following items and all other items of value received or to be received by the underwriter and related persons in connection with or related to the distribution of the offering, as determined pursuant to paragraph (c)(4) below shall be included:

* * * * *

(ix) any right of first refusal provided to the underwriter and related persons to underwrite or participate in future *public offerings, private placements or other financings* [by the issuer], which will have a compensation value of 1% of the offering proceeds or that dollar amount contractually agreed to by the issuer and underwriter to waive or terminate the right of first refusal;

* * * * *

(6) Unreasonable Terms and Arrangements

* * * * *

(B) Without limiting the foregoing, the following terms and arrangements, when

proposed in connection with the distribution of a public offering of securities, shall be unfair and unreasonable:

* * * * *

(v) any right of first refusal *provided to the underwriter and related persons* [regarding] *to underwrite or participate in* future public offerings, private placements or other financings which:

(1) has a duration of more than [five (5)] *three (3)* years from the effective date of the offering; or

(2) *has more than one opportunity to waive or terminate the right of first refusal in consideration of any payment or fee;*

(vi) *any payment or fee to waive or terminate a right of first refusal regarding future public offerings, private placements or other financings provided to the underwriter and related persons which:*

(1) *has a value in excess of the greater of one percent (1%) of the offering proceeds in the public offering where the right of first refusal was granted (or an amount in excess of one percent if additional compensation is available under the compensation guideline of the original offering) or five percent (5%) of the underwriting discount or commission paid in connection with the future financing (including any over-allotment option that may be exercised), regardless of whether the payment or fee is negotiated at the time of or subsequent to the original public offering;* or

(2) *is not paid in cash.*

Subsection (vi)-(xii) are renumbered (vii)-(xiii).

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 NASD 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 NASD 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

Background

The NASD developed its policy on the valuation of rights of first refusal in the early 1970s. Rights of first refusal are typically negotiated in connection with an issuer's initial public offering and grant the underwriter a right to underwrite or participate in any future public offerings, private placements, or other financings by the issuer for a certain period of years. The NASD values rights of first refusal as a non-cash item of compensation at one

and Jennifer S. Choi, Attorney, Division of Market Regulation, SEC, on July 5, 1995.

¹⁵ U.S.C. 78s(b)(2) (1988).

¹⁶ 17 CFR 200.30-3(a)(12) (1994).

¹ 15 U.S.C. 78s(b)(1) (1988).