

condition for review,¹⁶ were referred to the Performance Improvement Action Committee and/or the Market Performance Committee; and about the type of action taken with respect to each such deficient specialist.

In September 1993, and October 1994, the BSE submitted to the Commission monitoring reports regarding its amended Evaluation Program. The reports describe the BSE's experience with the pilot program during 1993 and the first two review periods of 1994. In terms of the overall scope of the Evaluation Program, the Commission continues to believe that objective measures, together with a floor broker questionnaire, should generate sufficiently detailed information to enable the Exchange to make accurate assessments of specialist performance. Based on results from several review periods, the BSE appears to have implemented its BEACON criteria and generated data to assess, in a quantitative way, how well specialists carry out certain aspects (*i.e.*, timeliness of execution, price improvement and market depth) of their responsibilities as specialists.

The Commission also has reviewed the BSE's experience with its minimum adequate performance thresholds. Based on the number of specialists who surpassed acceptable levels of performance for each measure (and on an informal comparison of the floor-wide average to the minimum threshold), it appears that these standards have been helpful in identifying some specialists with potential performance problems, as well as providing an incentive for improved market making performance.

Finally, based on the information provided in the BSE's monitoring reports, the Commission finds that the Exchange applied its conditions for review fairly and consistently. The Commission continues to believe that, taking the Evaluation Program as a whole, most potential performance problems should be brought to the attention of the appropriate committee. In terms of the BSE's response to the deficiencies it identified, the Commission notes that the monitoring reports only cover a limited time period; accordingly, it is too soon for the Commission to reach any definitive conclusion about the effectiveness of the performance improvement actions. Nevertheless, the BSE should examine its Evaluation Program to ensure that adequate corrective actions are taken with respect to each deficient specialist.

In conclusion, the Commission believes that the BSE has taken a good first step toward developing a more effective Specialist Performance Evaluation Program. Accordingly, the Commission believes that it is appropriate to extend the current pilot program for an additional twelve-month period, expiring December 31, 1995. This twelve-month period will allow the Exchange to respond to the Commission's concerns about the Evaluation Program, as set forth below. First, the Commission suggests that the BSE consider incorporating additional objective criteria, so that the Exchange can conduct an even more thorough analysis of specialist performance.¹⁷ At the same time, the BSE should assess whether each measure, as well as the questionnaire, is assigned an appropriate weight.¹⁸ Moreover, the Commission strongly encourages the Exchange to conduct an ongoing examination of its minimum adequate performance thresholds, in order to ensure that they continue to be set at appropriate levels. The Commission also continues to believe that relative performance rankings that subject the bottom ten percent of all specialists units to review by an Exchange committee are an important part of an effective Evaluation Program. Finally, the BSE should closely monitor the conditions for review and should take steps to ensure that all specialists whose performance is deficient and/or diverges widely from the best units will be subject to meaningful review. In the Commission's opinion, a meaningful review process would ensure that adequate corrective actions are taken with respect to each deficient specialist. The Commission would have difficulty granting permanent approval to an Evaluation Program that did not include a satisfactory response to the concerns described above.

The Commission therefore requests that the BSE submit a report to the Commission, by June 1, 1995, describing its experience with the pilot. At a minimum, this report should contain data, for the last review period of 1994

¹⁷ For example, the BSE could develop additional measures of market depth, such as how often the specialist's quote exceeds 500 shares or how often the BSE quote, in size, is larger than the BBO (excluding quotes for 100 shares). Another possible objective criteria could measure quote performance (*i.e.*, how often the BSE specialist's quote, in price, is alone at or tied with the BBO).

¹⁸ In this regard, because of the substantial overlap between Turnaround Time and Holding Orders Without Action, the Commission recommends that the BSE consider either having only one measure in this category (*i.e.*, timeliness of execution) or reducing the weights of the existing measures, which together account for the current Evaluation Program.

and the first review period of 1995, on (1) the number of specialists who fell below acceptable levels of performance for each objective measure,¹⁹ the questionnaire and the overall program, and the specific measures in which each such specialist was deficient; (2) the number of specialists who, as a result of the objective measures, appeared before the Performance Improvement Action Committee for informal counseling; (3) the number of such specialists then referred to the Market Performance Committee and the type of action taken; (4) the number of specialists who, as a result of the overall program, appeared before the Market Performance Committee and the type of action taken; (5) the number of specialists who, as a result of the questionnaire or falling in the bottom ten percent, were referred by the Exchange staff to the Performance Improvement Action Committee and the type of action taken (this should include the number of specialists then referred to the Market Performance Committee and the type of action taken by that Committee); and (6) a list of stocks reallocated due to substandard performance and the particular unit involved. Any requests to modify this pilot, to extend its effectiveness or to seek permanent approval for the Evaluation Program should be submitted to the Commission by July 31, 1995, as a proposed rule change pursuant to Section 19(b) of the Act.

IV. Conclusion

For the reasons discussed above, the Commission finds that the proposed rule change is consistent with the requirements of Sections 6 and 11 of the Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Commission believes the proposal is consistent with the Section 6(b)(5)²⁰ requirement that the rules of the Exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

Further, the Commission finds that the proposal is consistent with Section 11(b) of the Act,²¹ and Rule 11b-1 thereunder,²² which allow securities exchanges to promulgate rules relating to specialists in order to maintain fair and orderly markets and to remove

¹⁹ For each objective measure, the Commission also requests that the BSE provide the mean and median scores.

²⁰ 15 U.S.C. 78f(b)(5) (1988).

²¹ 15 U.S.C. 78k(b) (1988).

²² 17 CFR 240.11b-1 (1991).

¹⁶ See *supra*, notes 8-13 and accompanying text.