

Information Technology, Securities and Exchange Commission, 450 5th Street, N.W., Washington, DC 20549.

Dated: January 27, 1999.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40998; File No. SR-CHX-98-27]

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Crossing Orders of 25,000 Shares or More

January 29, 1999.

I. Introduction

On November 5, 1998, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")¹ and Rule 19b-4 thereunder,² a proposed rule change relating to crossing orders of 25,000 shares or more.

The proposed rule change was published for comment in the **Federal Register** on December 15, 1998.³ No comments were received on the proposal. This order approves the proposal.

II. Description of the Proposal

The Exchange's general auction market procedures are codified in CHX Article XX, Rule 16, which provides for the manner in which bids and offers at the same price will be sequenced for execution. A member who makes the first bid or offer at a particular price has "priority" at that price, which means that the member is the first one in the market to be entitled to receive an execution at that price. If no member can claim priority, all members who are bidding or offering at a particular price are deemed to be on "parity" with each other, or equivalent in status.⁴ Unlike the rules of certain other exchanges,⁵

however, the CHX does not currently permit bids and offers that have parity to obtain precedence based on size (a so-called "size-out" rule).⁶ In addition, unlike some other exchanges,⁷ the CHX does not currently have a "clean cross" rule (as an exception to the normal priority rules) that would permit a member to cross a large block of stock, without the cross being broken up, by permitting the cross to obtain priority over all other existing bids and offers at the same price, regardless of the size of such bids or offers.⁸

The purpose of the proposed rule filing is to add new interpretation and policy .02 to Article XX, Rule 23, to allow a member or member organization that has an order to buy and an order to sell 25,000 shares or more of the same security to cross those orders at a price that is at or within the prevailing quotation, without the transaction being broken up at the cross price so long as (i) the size of the proposed cross transaction is of a size that is greater than the aggregate size of all interest communicated on the Exchange floor at that price at the time of the proposed cross, and (ii) neither side of the cross is for the account of the executing member or member organization.

As is the case for cross transactions that are permitted under existing CHX rules, prior to effecting the cross under the new proposal, the member will be required to make a public bid and offer on behalf of both sides of the cross.⁹ The offer must be made at a price which is

Boston Stock Exchange rules. The American Stock Exchange ("Amex") has a modified version of a "size out" rule for crosses of 25,000 shares or more. See Amex Rule 126(g), commentary .01 and .02.

⁶ Under a typical size-out rule, the priority of existing bids and offers are first removed by means of a sale so that all bids and offers are on parity. Then, a person desiring to execute a cross can usually do so by claiming precedence based on size, so long as the size of the cross is greater than any other single bid or offer at that price.

⁷ See, e.g., NYSE Rule 72(g) which gives priority to an agency cross transaction of 25,000 shares or more that is executed at or within the prevailing quotation, without regard to the size or price of existing bids or offers on the floor. Other members can typically interact with the cross only by bettering one side of the cross, and even then, can only do so after satisfying all other existing bids or offers at that price. The Pacific Exchange, Inc. ("PCX") and Amex have similar crossing rules.

⁸ While the CHX does have a crossing rule, Article XX, Rule 23, this rule only permits crosses *between* (and not *at*) the CHX disseminated market. Thus, under current rules, assuming a specialist has properly reflected all limit orders from his book in his quote, the crossing rule does not have any effect on the Exchange's general priority, parity and precedence rules because all crosses must be at a better price than the disseminated market. Therefore, they are entitled to priority because of price (and not because of a special priority rule giving certain crosses priority over other bids and offers).

⁹ See CHX Art. XX, Rule 23.

higher than the bid by the minimum trading variation permitted for the security. Under the Proposal, another member may trade with either the bid or offer side of the cross transaction only to provide a price which is better than the cross price as to all or part of the bid or offer. A member who is providing a better price to one side of the cross transaction must trade with all other market interest having priority at that price before trading with any part of the cross transaction.

Because the proposal provides that the bid or offer of the member desiring to execute the cross would be entitled to priority at such price (over pre-existing bids and offers at that price) only if the size of the cross is greater than the aggregate size of all interest communicated on the Exchange floor (which includes the specialist's bid or offer—including any limit order reflected in such quote—and any communicated interest of floor brokers or market makers standing in the crowd), the proposed rule is more akin to a size-out rule than a special priority rule.

The difference between the CHX proposal and the size-out rules contained on other exchanges is that the priority of earlier bids and offers will not have to be removed, by means of a sale, before effecting the cross. In addition, a cross transaction effected in accord with the CHX proposal does not affect the priority of existing orders in a specialist's book, and once the cross is executed, the priority (based on time rather than size) shall remain as it was before the execution of the cross transaction. In this sense, the proposal does have some attributes of a special priority rule. However, unlike the special priority afforded certain crosses on other exchanges, which are reported to the tape as "stopped stock," cross transactions effected under the proposed rule will be reported to the tape without a "tape designator."

The CHX proposal limits the types of orders eligible to be crossed. Specifically, as stated above, no part of the cross can include an order for the account of the executing member or member organization. Under the proposal, only customer orders of a floor broker (*i.e.*, orders in which the floor broker acts as agent) can be included in the cross. For purposes of this proposal, the term customer order includes professional orders not for the account of the executing member (*i.e.*, orders for the accounts of broker-dealers and other members or member organizations communicated from off the floor).

The proposal is intended to facilitate the execution of certain cross

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 40758 (December 8, 1998), 63 FR 69125.

⁴ Members are on parity with each other when two or more bids or offers are announced simultaneously, or after a trade takes place leaving several bids or offers unfilled at the same price as the executed trade. See CHX Art. XX, Rule 16 (b) and (c).

⁵ See New York Stock Exchange ("NYSE") Rule 72 and similar Philadelphia Stock Exchange and

transactions on the CHX. The Exchange asserts that confining the proposed size threshold to block size orders of 25,000 shares or more will limit the effects of the rule primarily to actively traded, liquid securities.

The CHX further believes that the proposal, as drafted, furthers the important auction market principle of price improvement by allowing another member, under certain conditions, to trade with either the bid or offer side of the cross transaction to provide a price that is better than the proposed cross price.

Finally, the Exchange believes that limiting the proposal to crosses not involving principal transactions of the executing broker (*i.e.*, limiting the proposal to orders in which the floor broker is acting as agent), is consistent with Section 11(a)(1)(G) of the Act¹⁰ as well as portions of other crossing rules at other exchanges. For example, in approving a crossing rule for the PCX, the Commission stated that it "believes that the [PCX] proposal would not grant priority, parity or precedence to the order of a member in a manner inconsistent with Section 11(a)(1)(G) of the Act or Rule 11a1-1(T)(a)(3) thereunder."¹¹ The PCX proposal defined customer to include any order that the broker represents in an agency capacity, including a professional order that is not for an account associated with the executing broker. The Commission concluded that because "this definition of customer order excludes, and thus does not grant priority to, an order for an account over which the broker or an associated person of the broker exercises investment discretion, the Commission is satisfied that the proposed rule change complies with Section 11(a)."¹²

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act¹³ and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of Sections 6(b) and 11A of the Act.¹⁴ Specifically, the Commission believes that the proposed rule change does not impose any burden

on competition not necessary or appropriate in furtherance of the Act and is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public interest.¹⁵ The Commission also believes that the proposed rule change is consistent with Section 11A of the Act,¹⁶ in that it will enable the CHX to better compete with the other exchanges markets.

The Commission believes that the proposed rule change should enhance CHX's ability to compete for block business and could enhance the depth and liquidity of CHX's market. That said, the Commission also believes that limiting the proposed size threshold to block-size orders of 25,000 shares or more should limit the effects of the rule primarily to actively traded, liquid securities.

The Commission believes that the proposed rule change should increase the opportunities for the efficient execution of block-sized agency cross transactions. Specifically, the proposed rule change should facilitate the ability of CHX members to execute block agency transactions on the CHX by giving such orders priority over orders at or within the prevailing quotation.

The Commission notes that the proposed rule change also preserves the auction market principle of price improvement by prohibiting the cross transaction from being broken up unless a member is willing to provide price improvement to the cross price (either all or part of such bid or offer). The proposal also preserves the principle of priority by requiring that a member who breaks up a cross by providing a better price must first satisfy all existing market interest having priority at that better price before trading with any part of the cross.

The Commission recognizes that approval of the clean cross proposal could disadvantage smaller orders with time priority which are on the book, or in the trading crowd, as the same price as the cross transaction. The Commission, however, believes that the proposal restricts sufficiently the circumstances in which members may execute clean cross transactions on the Exchange. In particular, the Commission believes that the share size threshold of 25,000 shares or more should help ensure that the clean cross proposal will apply primarily to large block-sized orders where the depth of the prevailing bid or offer may be less likely to satisfy either side of the clean cross. In

addition, the proposal is limited to agency orders only and, therefore, it should not give any special advantage to members, member organizations, and non-member broker-dealers in their proprietary trading.

The Commission notes that similar rules are in place at the Amex, NYSE, and PCX.¹⁷ The rules of the Amex, NYSE, and PCX, like the CHX proposal, give priority to agency cross transactions of 25,000 shares or more and permit such crosses to be broken up only if price improvement will result therefrom. The Commission notes, however, that the CHX's proposed rule is more restrictive than the rules of the Amex, NYSE, or PCX in that it allows for an agency block-sized cross transaction to occur without being broken up at the cross price as long as the size of the proposed cross transaction is of a size greater than the aggregate size of all interest communicated on the Exchange Floor at that price at the time of the cross.

Finally, the Commission believes that because the CHX proposal is limited to crosses not involving principal transactions of the executing broker (*i.e.*, limited to orders in which the floor broker acts as agent) it would not grant priority, parity or precedence to the order of a member inconsistent with Section 11(a)(1)(G) of the Act¹⁸ or Exchange Act Rule 11a1-1(T)(a)(3) thereunder.¹⁹ For purposes of the proposed rule change, the CHX has defined the term "customer order" as an order that a broker represents in an agency capacity, including a professional order that is not for an account associated with the executing broker. Because the definition of "customer order" excludes (and, thus does not grant priority to) an order for an account over which the broker or an associated person of the broker exercises investment discretion, the Commission is satisfied that the proposed rule change complies with Section 11(a) of the Act.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁰ that the proposed rule change (SR-CHX-98-27) is approved.

¹⁷ See Amex Rule 126(g), Commentary .02; NYSE Rule 72(b)(Priority of Agency Cross Transactions); PCX Rule 5.14(b), Commentary .05.

¹⁸ 15 U.S.C. 78k(a)(1)(G).

¹⁹ 17 C.F.R. 240.11a1-1(T)(a)(3).

²⁰ 15 U.S.C. 78s(b)(2).

¹⁰ 15 U.S.C. 78k(a)(1)(G).

¹¹ See Exchange Act Release No. 33391 (December 28, 1993), 59 FR 336 (January 4, 1994) (order approving SR-PSE-91-11). The PCX changed its name in 1997 from Pacific Stock Exchange to Pacific Exchange.

¹² *Id.*

¹³ In reviewing this proposal, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁴ 15 U.S.C. 78f(b) and 78k-1.

¹⁵ 15 U.S.C. 78f(b)(5).

¹⁶ 15 U.S.C. 78k-1(a)(1)(C)(ii).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²¹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41004; File No. SR-MBSCC-93-03]

Self-Regulatory Organizations; MBS Clearing Corporation; Order Granting Approval of a Proposed Rule Change Increasing the Number of Directors

January 29, 1999.

On November 5, 1998, MBS Clearing Corporation ("MBSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change (File No. SR-MBSCC-98-03) pursuant to Section 19(b)(1) of the Securities and Exchange Act of 1934 ("Act").¹ Notice of the proposal was published in the **Federal Register** on November 30, 1998.² For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

The rule change amends Article 3, Section 3.1 of MBSCC's By-laws to increase the number of directors on its board from thirteen to fifteen.³ Currently, MBSCC has thirteen directors divided into three classes. Classes I and II each consist of four directors, and Class III consists of five directors. Under the rule change, each class will now consist of five directors.

MBSCC's shareholders agreement provides that one director represents management, one director represents the National Securities Clearing Corporation, and the remaining directors represent MBSCC's participants. Under the rule change, the two additional directors will represent MBSCC's participants.

II. Discussion

Section 17A(b)(3)(C)⁴ provides that the rules of a clearing agency must provide for the fair representation of its shareholders or members and participants in the selection of directors. The Commission believes that the increase in the size of MBSCC's board

is consistent with the Act's fair representation requirements because the addition of two directors will increase the opportunity for participants to be represented on MBSCC's board and should allow the board to more accurately reflect its membership.

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with Section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. MBSCC-98-03) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40992; File No. SR-NASD-98-94]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Adjudication of Clearly Erroneous Transactions

January 28, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 18, 1998, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly-owned regulatory subsidiary, NASD Regulation, Inc. ("NASD Regulation"), 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 NASD Regulation. 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

NASD Regulation is proposing to amend NASD Rule 11890 ("Rule") to

conform the time frame for requesting a clearly erroneous adjudication for pre-opening transactions to the 30-minute time frame that applies to trades that occur after 10:00 a.m. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in *brackets*.

11890. Clearly Erroneous Transactions

- (a) No Change
- (b) Procedures for Reviewing Transactions

(1) Any member or person associated with a member that seeks to have a transaction reviewed pursuant to paragraph (a) hereof, shall submit a written complaint, via facsimile or otherwise, to Nasdaq Market Operations in accordance with the following time parameters:

(A) For transactions occurring *at or after 9:30 a.m., Eastern Time*, but prior to 10:00 a.m., Eastern Time, complaints must be submitted by 10:30 a.m., Eastern Time; and

(B) For transactions occurring [on] *prior to 9:30 a.m., Eastern Time and those occurring at or after 10:00 a.m., Eastern Time*, complaints must be submitted within thirty minutes.

* * * * *

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

In its filing with the Commission, NASD Regulation 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. NASD Regulation 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

The Rule sets forth the process through which The Nasdaq Stock Market, Inc. ("Nasdaq") may review certain transactions and declare them null and void or otherwise modify their terms. In early 1998, the Commission approved changes to the rule to make this process more efficient and fair ("Amendments").³ Among other things, the rule was amended to shorten the

²¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² Securities and Exchange Act Release No. 34-40702 (November 23, 1998) 63 FR 65831.

³ Article 3, Section 3.1 governs the number, election, and term of office of directors.

⁴ 15 U.S.C. 78q-1(b)(3)(C).

⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 39550 (January 14, 1998), 63 FR 4333 (January 28, 1998) (approving SR-NASD-96-51).