

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

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*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42565; File No. SR-CHX-99-24]

### Self-Regulatory Organizations; Order Granting Accelerated Approval and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to Proposed Rule Change by the Chicago Stock Exchange, Inc. Relating to Price Improvement for Securities that Trade in Minimum Variations of $\frac{1}{64}$ th of \$1.00

March 22, 2000.

#### I. Background

On October 20, 1999, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Article XX, Rule 37, of the Exchange's rules relating to price improvement. The proposed rule change was published for comment in the *Federal Register* on February 28, 2000.<sup>3</sup> On March 21, 2000, the Exchange filed Amendment No. 1 to the proposal.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposal, as amended on an accelerated basis.

#### II. Description of the Proposal

The Exchange proposes to amend Article XX, Rule 37, of the Exchange's rules, governing price improvement, to

add section 37(g) to provide for an algorithm for price improvement for issues trading in minimum variations of  $\frac{1}{64}$ th of \$1.00. The primary purpose of the proposed rule change is to afford specialists a viable means of offering customers price improvement for securities that trade in minimum variations of  $\frac{1}{64}$ th.

Presently, three existing CHX programs within the MAX system, SuperMAX, Enhanced SuperMAX and SuperMAX Plus, use computerized algorithms to provide automated price improvement. These programs were created for securities that trade in minimum variations of  $\frac{1}{16}$ th to provide for price improvement of  $\frac{1}{16}$ th of a point when the spread is  $\frac{1}{8}$ th or greater. Specialist participation in all three of these programs is voluntary. Each of these price improvement programs were approved by the Commission on a permanent basis.<sup>5</sup> Under this proposal, the CHX would add a fourth voluntary program, Derivative SuperMAX, within the MAX system to provide for price improvement for securities trading in minimum variation of  $\frac{1}{64}$ th.<sup>6</sup> The addition of the proposed price improvement algorithm for Derivative SuperMAX should enhance the ability of CHX specialists to offer customers price improvement for all securities at the minimum increment, even those securities that trade in  $\frac{1}{64}$ th increments.

Under Derivative Super MAX, which would be available only for those securities trading in minimum variation of  $\frac{1}{64}$ th of \$1.00, small agency market order (*i.e.* orders from 100 shares up to and including 500 shares (or such greater amount designated by the specialist and approved by the Exchange)) would be eligible for price improvement if the market for the security is quoted with a spread of  $\frac{1}{16}$ th of a point or greater. The new algorithm would provide  $\frac{1}{64}$ th of a point price improvement from the ITS BBO. Specialist participation in the Derivative SuperMAX would be on a security-by-

security basis and would be limited to securities that trade in minimum variations of  $\frac{1}{64}$ th of \$1.00.

The addition of Derivative SuperMAX would become operative shortly after Commission approval of this proposed rule change, on a date to be determined by the Exchange.<sup>7</sup>

#### III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments conceding Amendment No. 1, including whether Amendment No. 1 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All submissions should refer to File No. SR-CHX-99-24 and should be submitted by April 18, 2000.

#### IV. Commission findings and Order Granting Accelerated Approval of the Proposed Rule Change

After careful review, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange.<sup>8</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act<sup>9</sup> which requires that the rules of an exchange be designed, among other things, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediment and to perfect the mechanism of a free and open market and a national market

<sup>16</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 789s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 42442 (February 18, 2000), 65 FR 10575.

<sup>4</sup> See letter from Paul B. O'Kelly, Executive Vice President, Market Regulation and Legal, CHX to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated March 21, 2000. ("Amendment No. 1"). In Amendment No. 1, the CHX confirmed its readiness and intention to activate the price improvement algorithm described in this proposal within one day following the Commission's approval of this proposed rule change. The CHX also indicated that it intended to implement the proposal as soon as practicable in order to remain competitive with other market centers that trade the securities that trade at the CHX in minimum increments of  $\frac{1}{64}$ th. Finally, the CHX noted that approximately 88% of the trades in such securities are for 599 shares or less.

<sup>5</sup> See Securities Exchange Act Release Nos. 40017 (May 20, 1998), 63 FR 29277 (May 28, 1998) and 40235 (July 17, 1998), 63 FR 40147 (July 27, 1998) (File No. SR-CHX-98-9) (orders approving revised SuperMAX and Enhanced SuperMAX algorithms); 41480 (June 4, 1999), 64 FR 32570 (June 17, 1999) (order approving revised SuperMAX Plus algorithm).

<sup>6</sup> Presently, only securities derivative equity products trade in a minimum increment of  $\frac{1}{64}$ th on the Exchange. However, the Derivative SuperMAX algorithm is not limited to derivative products, thus non-derivative securities traded in  $\frac{1}{64}$ th increments on the Exchange in the future would be eligible for price improvement under this proposal. Telephone conversation between Paul B. O'Kelly, Executive Vice President, Market Regulation and Legal, CHX, and Marc McKayle, Attorney, Division, Commission on March 20, 2000.

<sup>7</sup> See Amendment No. 1, note 4, *above*.

<sup>8</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation.

<sup>9</sup> 15 U.S.C. 78f(b)(5).

system, and, in general, to protect investors and the public interest.

The Commission believes that the Derivative SuperMAX price improvement algorithm should provide investors a meaningful opportunity for price improvement when securities trading in  $\frac{1}{64}$ th increments have a spread of  $\frac{1}{16}$ th point or greater. The Commission believes that, because the opportunity for price improvement is automatic and without any specialist intervention, Derivative SuperMAX could facilitate order interaction and enhance customer orders consistent with section 6(b)(5) of the Act.<sup>10</sup> The Commission notes that while Derivative Super MAX is a voluntary program that specialists may choose to participate in for Dual Trading System issues,<sup>11</sup> providing a greater number of investors an opportunity to achieve price improvement is compatible with the views on best execution expressed in the Order Handling release.<sup>12</sup>

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of the proposal in the **Federal Register** because in Amendment No. 1 to the proposal the Exchange has asserted that is able to activate the price improvement algorithm within one day of Commission approval. Further the, Commission believes that the proposal's price improvement algorithm should enhance the CHX's ability to compete with other market centers that trade the same securities that trade at the Exchange in minimum increments of  $\frac{1}{64}$ th, which in turn should benefit customers. Finally, the Commission notes that it expects the Exchange to submit proposed rule changes for all four MAX price improvement algorithms, pursuant to Section 19(b)(3)(A) of the Act,<sup>13</sup> to clarify the interpretation and operation of the pricing algorithms once securities are quoted and traded in decimals.

#### IV. CONCLUSION

It is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (File No. SR-CHX-24), as amended, be approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Margaret H. McFarland**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42561; File No. SR-CHX-00-06]

#### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Stock Exchange, Incorporated, Amending Its Membership Dues and Fees Schedule

March 22, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice hereby is given that on March 3, 2000, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange"), 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 the CHX. The CHX has designated this proposal as one establishing or changing a due, fee, or other charge imposed by the CHX under Section 19(b)(3)(A)(ii) of the Act,<sup>2</sup> which renders the proposal effective upon filing with the Commission. 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 CHX proposes to amend its membership dues and fees schedule ("Schedule") in several ways. These changes increase the membership dues paid by all members; revise the fixed fees and credits for all securities; revise the application and assignment fee structure for all securities; and reflect charges relating to the processing of applications. The text of the proposed rule change is available upon request from the CHX or the Commission.

#### 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 Exchange included statements

concerning the purpose of and basis for the proposed rule change and discussed any comments it received regarding the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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 proposed rule change amends the Schedule in several ways. These changes are designed to allow the Exchange to continue its rapid growth while providing a strong market for its members and for investors.

First, the proposal increases the annual membership dues for all members by \$1,800 (from \$3,200 to \$5,000 per year). These dues are paid in equal monthly installments throughout the year. The proposal would increase the payments beginning April 1, 2000.<sup>3</sup>

Second, the proposal revises the specialist fixed fees and credits for all securities by increasing the specialist fixed fees and credits for Dual Trading System Securities and by imposing a specialist fixed fee and a credit for Nasdaq/NM Securities. The specialist fixed fee is paid by the specialist in a particular security; the amount of the fee is based either on the trading volume in that security (for Dual Trading System Securities) or on a market share calculation in that security (for Nasdaq/NM Securities).<sup>4</sup> Specialist credits are designed to reduce the total monthly fees paid by each specialist and to reduce the costs of trading on the

<sup>3</sup> Because the increase takes effect during the year, a member will not pay the full \$5,000 in 2000; instead, a member will pay approximately \$4,550 (three months at \$266.66/month plus nine months at \$416.66/month equals \$4,549.92).

<sup>4</sup> According to the proposed schedule, the fixed fee for Dual Trading System Securities would increase on April 1, 2000, and again on October 1, 2000; the new fixed fee for Nasdaq/NM Securities would begin on April 1, 2000. The Exchange has charged its members a fixed fee on Dual Trading System Securities for many years; this proposed revision to the Schedule represents the first time that the Exchange would charge a fixed fee on its nascent Nasdaq/NM Securities product line. These new Nasdaq/NM-related fixed fees allow the Exchange to defray, at least partially, the costs associated with the continued development and anticipated growth of this program. The Exchange believes it is appropriate, at least initially, to begin assessing this new Nasdaq/NM Securities fixed fee at a somewhat lower level than the fee that has been in place for Dual Trading System Securities for a number of years in order to allow members time to adjust their business models to this new requirement.

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> Dual Trading issues are issues traded on the CHX, either through listing on the CHX or pursuant to unlisted trading privileges, and are also listed on either the New York Stock Exchange or the American Stock Exchange.

<sup>12</sup> See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996).

<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 15 U.S.C. 78s(b)(3)(A)(ii).