

the originally quoted prices were tied to the delta of the options.

The following example illustrates how proposed CBOE Rule 24.20 would operate: Assume that the S&P 500 Index September futures contract is trading at 1495 and an SPX trader requests quotes for the SPX September 1495 call and September 1495 put, for the purpose of pricing an SPX combo that will reproduce the S&P 500 future at 1495. Assume the September 1495 call and September 1495 put are each quoted at 12 bid, 12 $\frac{1}{8}$ asked. Assume that the trader then requests quotes for the 30 delta SPX September 1480 puts, based on the underlying futures value of 1495, and receives a quote of 6 bid, 6 $\frac{1}{8}$ asked. The trader agrees to buy 100 of the 1480 puts at 6 $\frac{1}{8}$ and to hedge these agrees to buy 30 September 1495 calls at 12 and to sell 30 September 1495 puts at 12 (30 "long" combos). Now assume that the market rallies five points, to a new underlying futures level of 1500, before these orders can be executed. The September 1495 call is now trading at 15, the September 1495 put at 10 and the September 1480 puts at 4 $\frac{5}{8}$. Under current Exchange rules, the trader could purchase the 1480 puts at 6 $\frac{1}{8}$, but could not execute the legs of the SPX combo at 12 because they would trade out-of-range of the current displayed market. Proposed CBOE Rule 24.20 would allow the parties to the trade to print and execute the orders at the original quotes, 12 and 6 $\frac{1}{8}$, because the options would not have traded outside the displayed bids or offers in the crowd or in the book (12 bid, 12 $\frac{1}{8}$ asked; 6 bid, 6 $\frac{1}{8}$ asked), and because the transaction as agreed to at a futures level of 1495 had market neutrality and would not have been affected by the five point market rally (the gain on the SPX combo of 5 points \times 30 contracts \times 500 multiplier = \$75,000, is offset by the loss on the 1480 puts of 1.5 \times 100 contracts \times 500 = \$75,000).

When an SPX combo transaction is effected out-of-range pursuant to proposed CBOE Rule 24.20, that fact will be denoted in the Exchange's disseminated quote by an "indicator."

The Exchange believes the proposed CBOE Rule 24.20 will give both customers and traders of SPX options an efficient means of hedging positions in SPX options, benefiting the marketplace. The Exchange believes that as a result of proposed CBOE Rule 24.20, SPX combo trading will become more consistent with current pricing practices in the futures markets⁶ and

the over-the-counter market, enabling the Exchange to compete more effectively with these markets and offering Exchange members and their customers greater flexibility.

The CBOE believes that the proposed rule will allow for the efficient conduct of SPX combo orders and will be beneficial to both customers and traders. Accordingly, the CBOE believes that the proposed rule change is consistent with and furthers the objectives of Section 6(b) of the Act, in general, and Section 6(b)(5), in particular, in that is designed to facilitate transactions in securities, to perfect the mechanisms of a free and open market and to protect investors and the public interest.

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

The CBOE does not believe that the proposed rule change will 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 Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

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

Within 35 days of the date of 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 by order approve such proposed rule change, or 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, including whether the proposed rule change 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

requirement that at least one leg must be within the price range established during the trading session whenever the spread or combination involves one or more contract months which have an established price range.

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 in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submission should refer to File No. SR-CBOE-00-40 and should be submitted by November 14, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43443; File No. SR-CHX-00-20]

Self-Regulatory Organizations Chicago Stock Exchange, Inc.; Order Granting Approval of Proposed Rule Change and Amendment No. 1 by the Chicago Stock Exchange, Incorporated Relating to Automatic Execution of Orders for Nasdaq/NM Securities

October 13, 2000.

I. Introduction

On June 9, 2000, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") submitted to the Securities and Exchange Commission "SEC" or "Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change relating to the automatic execution of orders for Nasdaq/NM Securities. On August 18, 2000, the Exchange filed Amendment No. 1, to the proposed rule change.³

⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Paul O'Kelly, Executive Vice President, CHX, to Katherine England, Assistant Director, Division of Market Regulation, Commission, dated August 15, 2000. ("Amendment No. 1"). In Amendment No. 1, the Exchange clarified how specialists would utilize the proposed enhanced liquidity function, and deleted a portion of the proposed rule text that would have permitted a specialist to switch to manual execution mode in unusual trading situations after, among other things, seeking relief from a member of the

⁶ See Chicago Mercantile Exchange Rule 542, which provides that spread and combination transactions involving options need not satisfy the

The proposed rule change, including Amendment No. 1, was published for comment in the **Federal Register** on August 30, 2000.⁴ No comments were received on the proposal. This order approves the proposal.

II. Description of Proposal

In its proposed rule change, the Exchange seeks to amend the CHX rules governing automatic execution sequences and algorithms relating to the trading of Nasdaq/NM Securities on the Exchange.⁵ The Exchange has represented that the proposed changes are intended to bring the CHX rules in line with the practices that currently exist in the Nasdaq market with respect to the trading of Nasdaq/NM Securities.⁶

CHX Article XX, Rule 37, describes among other things, the circumstances under which orders must be accepted and guaranteed an execution at the national best bid or offer (the "BEST Rule"). CHX Rule 37 also describes a specialist's ability to set a parameter (the auto-execution threshold) that identifies (by size) which orders guaranteed a fill under the BEST Rule will be automatically executed.

The proposed rule change would allow specialists to reduce the minimum auto-execution threshold from 1,000 shares to 300 shares for each security in which the specialist makes a market. It would not change specialists' obligations under the BEST Rule.⁷ In other words, specialists could choose to obligate themselves to *automatically* execute only those orders for 300 shares or less. Under these circumstances, specialists would still be required, however, to guarantee execution at the national best bid or offer ("NBBO") for orders up to the size associated with the NBBO.

Further, under the proposed rule, if a specialist at the NBBO chooses to set the auto-execution threshold at 300 shares, and an order for 1,000 shares is entered, the specialist must automatically execute 300 shares (the size of his bid or offer). The portion of the order that exceeds 300 shares (in this example, 700

shares) shall be treated as an open order, and must be manually executed at the NBBO.

The proposed rule also would permit specialists to choose to provide an enhanced execution guarantee for orders by setting a new parameter called an "enhanced liquidity quantity." The enhanced liquidity quantity, as the name implies, would permit a specialist to raise its automatic execution threshold to a size greater than 300 shares. If a specialist chooses to utilize this parameter, orders would be automatically executed up to the enhanced liquidity quantity designated by the specialist.⁸ The specialist can designate an enhanced liquidity quantity on a stock by stock basis.

Lastly, the proposed rule provides new guidelines for Nasdaq/NM specialists that want to switch from automatic execution mode to a manual execution mode when unusual trading conditions exist. The proposed rule would define the term "unusual trading conditions" to include the existence of large order imbalances and/or significant price volatility. The rule would require that upon switching to manual execution mode based on the existence of unusual trading conditions, a specialist must: (1) Document the basis for election of manual execution mode; (2) disclose to its customers the differences in procedures from normal market conditions and the circumstances under which the specialist generally may activate manual execution mode; and (3) seek permission to switch to manual execution mode for two floor officials.⁹

III. Discussion

After careful review, the Commission finds that the proposed rule is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁰ In particular, the Commission believes that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act¹¹ in that it is designed to promote just and equitable principles of trade, to facilitate transactions in securities, to remove impediments to and to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that it is appropriate for the Exchange to allow specialist flexibility in determining the size of orders that they will guarantee receive automatic executions. Automatic execution systems help specialists meet the demands of high trade volume in the Nasdaq market, and competitive pressures to provide fast, efficient executions. The Commission recognizes that there are conditions under which specialists are not willing to provide automatic executions. During extreme market conditions, where there are large order imbalances or significant private volatility, guarantees of automatic executions for large orders subject specialists to a high degree of risk. The proposed rule change offered by the CHX is designed to mitigate that risk.

By giving specialists the option of lowering the size of orders that they must guarantee an automatic execution from 1,000 shares to 300 shares, the Commission believes the Exchange is providing specialists with an acceptable way to limit their exposure. The CHX has represented that reduction of the minimum auto-execution threshold is intended to limit the exposure of Nasdaq/NM specialists in the case of highly-volatile Nasdaq/NM Securities. The Exchange has stated that it anticipates that for the majority of Nasdaq/NM Securities, specialists will voluntarily remain at the 1,000-share auto-execution threshold.

In reviewing this proposal, the Commission considered it important that while a specialist may lower the size of orders that are guaranteed *automatic* execution to 300 shares, under the proposed rule change a specialist must still provide an execution at the NBBO for all orders of 1,000 shares or less pursuant to the Exchange's Best Rule. Further, the proposed rule provides that in the case of orders larger than a specialist's automatic execution threshold, the specialist must provide an automatic execution up to the specialist's threshold, with the remainder of the order sent for manual execution. In this way, the Exchange is providing investors with some opportunity for a guaranteed automatic execution, while at the same time, protecting the specialist from unreasonable risk.

The Commission also finds that the Exchange's proposal to allow specialists to designate an "enhanced liquidity quantity" will give specialists an appropriate level of flexibility in determining what size orders they want to guarantee automatic executions. If a specialist chooses to offer automatic executions to orders greater than his or

Exchange. Under the amended version of the rule, a specialist must seek relief from two floor officials.

⁴ Securities Exchange Release No. 43199 August 23, 2000, 65 FR 52802.

⁵ See CHX Article XX, rules 37 and 43.

⁶ See NASD Notices to Members 99-11 and 99-12 (February, 1999) (discussing NASD member firm order execution practices, particularly during periods of significant market volatility).

⁷ The CHX has represented that reduction of the minimum auto-execution threshold is intended to limit the exposure of Nasdaq/NM specialists in the case of highly-volatile Nasdaq/NM Securities. The Exchange anticipates, however, that for the majority of Nasdaq/NM Securities, specialists will voluntarily remain at the 1000-share auto-execution threshold.

⁸ See Amendment No. 1, *supra* note 3.

⁹ See Amendment No. 1, *supra* note 3.

¹⁰ In approving this rule proposal, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹¹ 15 U.S.C. 78s(b)(5).

her automatic execution threshold, he or she may do so using this function.

Next, the Commission believes that the Exchange's proposal to allow Nasdaq/NM specialists to switch from automatic execution mode to a manual execution mode in the event of unusual trading situations if they comply with certain requirements will also provide specialists with adequate protection in the event of large order imbalances and/or significant price volatility, or other unusual trading situations.¹² The proposed rule requires that upon switching to manual execution mode based on the existence of unusual trading conditions, a specialist must: (1) document the basis for election of manual execution mode; (2) disclose to its customers the differences in procedures from normal market conditions and the circumstances under which the specialist generally may activate manual execution mode; and (3) seek permission to switch to manual execution mode from two floor officials. The Commission believes the proposed rule adequately balances the concern that specialists not be required to offer automatic executions under truly unusual circumstances with the concern that investors who reasonably expect to receive an automatic execution pursuant to Exchange rules and policies actually receive an automatic execution. The Commission believes that with the aforementioned requirements prior to switching from automatic to manual executions, both specialists and investors will be protected in the event of unusual market conditions.

IV. Conclusion

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-CHX-00-20) is approved.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43457; File No. SR-NSCC-00-12]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change Relating the Submission of Extended Corrections in Fund/Serv

October 17, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on August 28, 2000, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") and on October 16, 2000, amended the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change will modify NSCC's rules to allow Fund Members and Mutual Fund Processors to submit extended (post settlement) corrections in NSCC's Fund/Serv.

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

In its filing with the Commission, NSCC 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. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.²

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

Pursuant to NSCC's Rule 52A, Section 12, only a Settling Member or TPA Member may currently submit extended (post settlement) correction instructions. These types of instructions are submitted when a Settling Member or TPA Member determines that data

previously transmitted to a Fund Member or Mutual Fund Processor with respect to a settled order is in need of correction.³

Under the proposed rule change, Section 12 will be amended to also permit Fund Members and Mutual Fund Processors to submit extended (post settlement) corrections to Settling Members or TPA Members. No action will be required by a Settling Member or TPA Member if it determines to accept the extended correction of a Fund Member or Mutual Fund Processor. A Settling Member or TPA Member will be able to reject the extended correction instruction within the time frame established by NSCC.⁴ In addition, Section 12 will be revised to permit extended corrections for exchange orders.

The rule change also proposes to make two additional changes to Rule 52A. Sections 4 and 8 of Rule 52A will be amended to allow NSCC to delete certain orders, corrections, and extended corrections that have not been confirmed or rejected, respectively, within a time frame established by NSCC. Section 21 will permit NSCC to reduce the maximum time frame within which a Delivering Fund Member must confirm the value of Fund/Serv eligible mutual fund shares, investment funds, or UIT units from sixty days to ten days.⁵

NSCC intends to implement these changes, subject to SEC approval, on November 20, 2000.

NSCC believes the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act and the rules thereunder because it will facilitate the prompt and accurate clearance and settlement of securities transactions.

³ Securities Exchange Act Release No. 31937 (March 1, 1993), 58 FR 12609 [SR-NSCC-92-14] (order approving post settlement correction initiated by Settling Members and TPA Members).

⁴ NSCC will issue an "Important Notice" at least 30 days prior to implementing changes in the time frames required for rejections of extended corrections. Telephone conversation with Richard J. Paley, Associate Counsel, NSCC (October 16, 2000).

⁵ Pursuant to Section 21 of Rule 52A, a Fund Member or Mutual Fund Processor ("Receiving Fund Member") may initiate a request for the transfer of a customer's mutual fund shares, investment fund, or UIT units from another Fund Member or Mutual Fund Processor ("Delivering Fund Member"). The Delivering Fund Member must acknowledge or reject the transfer request within two business days. Once the transfer is acknowledged, the Delivering Fund Member must also confirm the value of the shares to be transferred within the time frame specified under Section 21. Under the proposed rule change, a Delivering Fund Member must submit the confirmation no earlier than one business day and no later than ten business days after acknowledging the transfer.

¹² The Commission expects the Exchange to keep records of instances when specialists are permitted to switch to a manual execution mode so that the Exchange and the Commission can monitor the use of this option.

¹³ 15 U.S.C. 78f(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).

¹⁵ 15 U.S.C. 78s(b)(1).

² The Commission has modified the text of the summaries prepared by NSCC.