

### V. Commission Findings and Order Granting Partial Accelerated Approval of the Proposed Rule Change for a Pilot Period

The Commission finds that the proposed rule change is consistent with the Act and the rules and regulations promulgated thereunder.<sup>9</sup> Specifically, the Commission finds that approval of the proposed rule change is consistent with Section 15A(b)(6) of the Act.<sup>10</sup>

The Commission believes the proposed amendment to the Manning Interpretation should provide protection to customer limit orders in a subpenny trading environment by ensuring that such orders will continue to have access to market liquidity ahead of market makers in appropriate circumstances.<sup>11</sup> However, we believe that the amendment should be reexamined once Nasdaq decimal trading behavior can be analyzed. As a result, the Commission is approving the amendment on a pilot basis through July 9, 2001. Nasdaq must submit to the Commission trade data related to the pilot on a monthly basis in order to allow the Commission to monitor the effect of the pilot on Nasdaq trading. Such information will include reported volume of orders received and executed in subpenny increments (in terms of both trades and shares), the execution price points, and the nature of the subpenny orders received and executed (*i.e.*, agency, proprietary, professional or otherwise). Requiring this data does not alleviate the NASD of its obligations to provide any other reports required to be submitted to the Commission as part of its conversion to decimal pricing.<sup>12</sup> The Commission will examine the data provided pursuant to this order, and other information provided by all self-regulatory organizations as required by the Implementation Plan. As a part of that examination, the Commission intends to

reconsider the amendment to the Interpretation provided in this order.

The Commission finds good cause for granting Nasdaq's request for approval of the proposed rule change on a pilot basis prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission notes that the completion of Nasdaq's decimal transition will occur on April 9, 2001, at which point market makers will be subject to accepting and executing orders in subpenny increments for all Nasdaq securities. The Commission believes that granting accelerated approval to the proposed rule change will allow Nasdaq to continue to provide protection to customer limit orders when trading in subpenny increments for all Nasdaq securities begins.

*It is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (File No. SR-NASD-2001-27) is approved on a pilot basis until July 9, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 01-9148 Filed 4-12-01; 8:45 am]

**BILLING CODE 8010-01-M**

### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44150; File No. SR-PCX-00-36]

#### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Solicited Options Transactions

April 4, 2001.

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> notice is hereby given that on January 26, 2001, the Pacific Exchange, Inc. ("PCX" 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 Exchange.<sup>3</sup> The

proposed rule change has been filed by the PCX as a "non-controversial" rule change under Rule 19b-4(f)(6)<sup>4</sup> under the Act. 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 PCX is proposing to add new PCX Rule 6.49 to allow members representing an options order to solicit a third party outside of the trading crowd. Below is the text of the proposed rule change. Proposed new language is in *italics*.

\* \* \* \* \*

#### ¶4995 Solicited Transactions

*Rule 6.49*

*(a) A member or member organization representing an order in options ("originating order") may solicit another member, member organization or non-member broker/dealer outside the trading crowd ("solicited party") to participate in the transaction on a proprietary basis provided the following criteria are met.*

*(1) The member or member organization, upon entering the trading crowd to execute the transaction must announce to the trading crowd the same terms and conditions of the originating order that have been disclosed to the solicited party;*

*(2) The member or member organization must bid at the price he is prepared to buy from the solicited party or offer at the price he is prepared to sell to the solicited party; and*

*(3) The member or member organization must give the trading crowd a reasonable opportunity to accept the bid or offer.*

*The members of the trading crowd will have priority over the solicited party order.*

*(b) It will be considered conduct inconsistent with just and equitable principles of trade for any member, member organization or person associated with a member or member organization, who has knowledge of all material terms and conditions of an originating order, a solicited order, or a facilitation order, the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option on the underlying securities of any option that is the subject of the order, or an order to buy or sell the security underlying any option that is the subject of the order, or any order to buy or sell any related instrument until either:*

*(1) All the terms and conditions of the originating order and any changes in the terms or conditions of the order of which the member, member organization or person associated with the member or member*

<sup>9</sup> In granting accelerated approval of the proposal, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

<sup>11</sup> As noted in the Interpretation, members accepting customer limit orders continue to owe those customers duties of "best execution," *i.e.*, a duty to use reasonable diligence to ascertain the best inter-dealer market for the security and buy or sell in such a market so that the price to the customer is as favorable as possible under prevailing market conditions.

<sup>12</sup> Specifically, NASD has agreed, pursuant to the Implementation Plan, to perform a detailed statistical analysis of quoting and trading activity that will be used to form the basis for a study or studies on systems capacity, liquidity, and trading behavior, including an analysis of whether there should be a uniform minimum trading increment. This report is required to be delivered to the Commission no later than 60 days after the full implementation of decimals. Securities Exchange Act Release No. 42914 (June 8, 2000), 65 FR 38010.

<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> The PCX filed its submission of January 26, 2001, in the form of an amendment to an earlier version of the proposed rule change filed with the Commission on October 24, 2000. See Letter from Hassan Abedi, attorney, PCX, to Nancy J. Sanow, assistant director, Division of Market Regulation,

the Commission, dated January 25, 2001. For purposes of Rule 19b4(f)(6) under the Act, the Commission deems the date of filing and effectiveness of the proposed rule change to be January 26, 2001.

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

organization has knowledge are disclosed to the trading crowd, or

(2) The trade can no longer reasonably be considered imminent in view of the passage of time since the order was received.

For the purposes of this rule, an order to buy or sell a "related instrument" means, in reference to an index option, an order to buy or sell securities comprising 10% or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index.

(c) "Solicited" shall be written in the "Optional Data" area on the order ticket of the Solicited order.

#### ¶4981 Responsibilities of Floor Brokers

Rule 6.46

(a)–(c)—No change.

Commentary:

.01–.04—No change.

.05 A Floor Broker's use of due diligence in handling an order shall include the immediate and continuous representation of market and marketable orders at the trading post where the option class represented by his order is designated for trading, *except that a Floor Broker who is acting pursuant to Rule 6.49 need not represent such orders immediately at the designated trading post.*

\* \* \* \* \*

## 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 PCX 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 PCX 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 purpose of the proposed rule change is to allow a member that is representing an options order on the trading floor to solicit a third party outside of the trading crowd to participate in the transaction on a proprietary basis before representing the order in the trading crowd.<sup>5</sup>

<sup>5</sup> The proposed rule differs from current PCX Rule 6.47(c), which also allows for solicitation of options orders in specified circumstances. Under Rule 6.47(c), a member first represents an order to the trading crowd, and if the member cannot fill the order, then an attempt to solicit the other side may be made outside the crowd. Rule 6.47(c) requires the member to continue to represent the order in the trading crowd while he attempts to solicit the other side. However, once the other side is obtained from outside the trading crowd, the member is

Currently, PCX Rule 6.46, Commentary .05, states that a Floor Broker's duty of due diligence in handling an order includes the immediate representation of market and marketable limit orders at the trading post where the options class represented by his order is designated for trading. The PCX has interpreted this to mean that a Floor Broker who receives an order must immediately represent it in the crowd before soliciting the other side of the trade.

Under the proposed rule change a Floor Broker will now have the ability to solicit third parties outside the trading crowd before representing the order in the crowd. The Floor Broker, however, will still have a due diligence obligation to his customer when executing the transaction. The proposed rule change will allow option transactions to be solicited provided that the member, upon entering the trading crowd to execute the transaction, (1) announces to the crowd the same terms and conditions that were disclosed to the solicited party; (2) bids (offers) at the price that he is prepared to bid (offer) to the solicited party; and (3) gives the trading crowd a reasonable opportunity to accept the bid (offer). If a member in the trading crowd decides to match or better the terms of the transaction, the proposed rule grants the member in the trading crowd priority over the solicited party.

Further, the proposed rule will prohibit the member who is representing the order to enter an order to buy or sell an option on the underlying securities of any option that is the subject of the order, or an order to buy or sell the security underlying any option that is the subject of the order, or any order to buy or sell any related instrument until the terms of the original order are disclosed or the trade can no longer be considered imminent in view of passage of time. This portion of the proposed rule change—which will also apply to orders facilitated under the provisions of PCX Rule 6.47—seek to prohibit anticipatory hedging that is based on inside information. The Commission has approved a similar rule change by the Chicago Board Options

permitted to cross the two sides, with the solicited order receiving priority over the trading crowd. Under proposed Rule 6.49, a member is permitted to solicit the other side of an order *before* taking the order to the trading crowd. However, as discussed below, once the member obtains the other side, he must then take the order to the trading crowd, disclose the terms of the order, and allow the crowd to step up and match the terms or better them. If the trading does decide to step up, it receives priority over the solicited order.

Exchange, Inc.<sup>6</sup> The Exchange recognizes the importance of fully disclosing the orders that comprise a solicited transaction to the trading crowd and believes that the current proposal allows customer orders to receive full consideration by the trading crowd.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b)<sup>7</sup> of the Act, in general, and furthers the objectives of section 6(b)(5),<sup>8</sup> in particular, in that it is designed to promote just and equitable principles of trade.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition.

#### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

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

The foregoing proposed rule change has become effective pursuant to section 19(b)(3)(A) of the Act<sup>9</sup> and Rule 19b–4(f)(6) thereunder<sup>10</sup> because the proposed rule change (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative until more than 30 days from the date on which it was filed, and the PCX provided the Commission with written notice of its intent to file the proposed rule change at least five days prior to the filing date. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

<sup>6</sup> See Securities Exchange Act Release No. 34959 (November 9, 1994), 59 FR 59446 (November 17, 1994). See also Securities Exchange Act Release No. 42894 (June 2, 2000), 65 FR 36850 (June 12, 2000) (concerning a similar rule change by the American Stock Exchange LLC).

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>10</sup> 17 CFR 240.19b–4(f)(6).

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether it 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 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 PCX. All submissions should refer to File No. SR-PCX-00-36, and should be submitted by May 4, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Jonathan G. Katz,**  
Secretary.

[FR Doc. 01-9113 Filed 4-12-01; 8:45 am]

BILLING CODE 8010-01-M

#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44149; File No. SR-PCX-00-47]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Adopting Formal Procedures for Members to Submit Proposals to List Option Classes on the Exchange

April 4, 2001.

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> notice is hereby given that on December 13, 2000, the Pacific Exchange, Inc. ("PCX" 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 PCX. The PCX submitted

Amendment Nos. 1<sup>3</sup> and 2<sup>4</sup> to the proposed rule change on February 13, 2001 and March 14, 2001, respectively. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The PCX is proposing procedures for member organizations to propose initial options listing. The text of the proposed rule change is set forth below. All language is being added.

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#### Listing Proposals

*3.8. A member organization seeking to propose an option listing in the Options Listing Committee ("OLC") must execute and deposit a Listing Request Form in the Options Allocation Box by 11:00 a.m. on a daily basis. Listing Request Forms placed in the Options Allocation Box after 11:00 a.m. will be considered on the following day. Once the request is made the PCX staff will:*

*(a) Confirm in writing the underlying issue of the options request meets all the requirements set forth in PCX Rule 3.6;*

*(b) Present the issue for listing consideration at the next scheduled OLC meeting. In making its determination the OLC will apply the qualitative and quantitative criteria set forth in Regulatory Bulletin Options 01-08; and*

*(c) Provide a written response to the requesting member organization within ten business days of the date of the request, (i) setting forth the basis on which any denial or placement of limitation or condition was made; or (ii) indicating that the denial or placement of limitation or condition is due to other bona-fide business reasons which are specifically documented and maintained in the OLC minutes.*

\* \* \* \* \*

<sup>3</sup> On February 13, 2001, the PCX submitted a new Form 19b-4, which replaces and supersedes the original filing in its entirety ("Amendment No. 1").

<sup>4</sup> See letter from Hassan Abedi, Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated March 13, 2001 ("Amendment No. 2"). Amendment No. 2 revises proposed PCX Rule 3.8(c) to require the Exchange to provide a written response within 10 days to the requesting member specifying that a denial or placement of limitations or conditions is due to other bona fide business considerations that are specifically documented and maintained in the minutes of the Exchange's Options Listings Committee.

#### 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 PCX 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 PCX 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 PCX proposes to adopt new PCX Rule 3.8 to provide procedures for member organizations to propose the listing of options on the Exchange.<sup>5</sup> The proposed rule would require a member organization proposing an option listing to the Options Listing Committee ("OLC") to execute and deposit a Listing Request Form in the Options Allocation Box by 11:00 a.m. on a daily basis.<sup>6</sup> Once the request is received, the PCX staff would: (i) Confirm that the underlying issue of the listing request meets all the requirements set forth in PCX Rule 3.6; (ii) present the issue for listing consideration at the next scheduled OLC meeting; and (iii) provide a written response, setting forth the basis for the denial or placement of limitations or conditions, to the requesting member organization within ten business days of the date of the request. Regulatory Bulletin Options 01-08 ("RBO 01-08") sets forth in detail the qualitative and quantitative procedures that the OLC would follow in making a listing determination.<sup>7</sup> As

<sup>5</sup> As part of a settlement of an enforcement action by the Commission, four of the options exchanges, including the PCX, are required to adopt rules to codify listing procedures to be carried out when a member or member organization requests the exchange to list options not currently trading on the exchange. See Order Instituting Public Administration Proceeding Pursuant to section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. Securities Exchange Act Release No. 43268 (September 11, 2000), and Administrative Proceeding File 3-10282.

<sup>6</sup> Proposals received after 11:00 a.m. will be considered on the following day.

<sup>7</sup> The quantitative factors to be considered by the OLC would include: (i) Six-month trading volume in the underlying issue; (ii) three-month average daily trading volume; (iii) total shares outstanding; and (iv) market capitalization. The qualitative factors would be: (i) operating and financial history; (ii) industry and competition; (iii) reputation of

Continued

<sup>11</sup> 17 CFR 200.30-3(a)(12).

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

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