

execution). Currently, execution quality data is not a factor for consideration during either the co-specialist assignment or evaluation processes. Instead such processes rely on the results of the co-specialist questionnaire, with substantial weight given to the questionnaire in the assignment process. Under the proposed rule change, the co-specialist questionnaire, while still a factor in the assignment process, would not be given substantial weight in the assignment process and would no longer be a factor in the evaluation process. Order execution quality data would be introduced as a factor in both the co-specialist assignment and evaluation processes and would be given substantial weight in the assignment process. The Commission believes that this change should help improve the quality of co-specialists serving on the CHX because it would require the CHX's Committee on Specialist Assignment and Evaluation ("CSAE") to make assignment and reallocation decisions based on objective, quantifiable performance criteria, rather than relying on the more subjective co-specialist questionnaire answers.

The proposed rule change also establishes a new process for evaluating co-specialists. Under this proposed evaluation process, on a quarterly basis, each co-specialist would be given an order execution quality score (derived from the execution quality data reported pursuant to Rule 11Ac1-5 under the Act⁷) and those co-specialists whose scores rank in the bottom 5% of all co-specialist scores would be required to participate in a special performance meeting with the CSAE. In the course of the special performance meeting, the CSAE would be permitted to take a variety of informal actions to encourage or assist the affected co-specialist. A special performance meeting could also be triggered by any of the factors considered in the assignment process (except the co-specialist questionnaire). If the informal actions from the special performance meeting do not result in improved co-specialist performance, the CSAE may conduct a formal hearing on the co-specialist's performance to determine whether to take action to reallocate the co-specialist's securities or suspend or terminate the co-specialist's registration in accordance with Rule 3, Article XVII of the CHX rules. In this regard, the Commission notes that a co-specialist may appeal the CSAE's decision by filing a request for review with the CHX's Executive

Committee under Rule 4, Article XVII of the CHX rules.

The Commission also notes that the proposed rule change strives to streamline the co-specialist questionnaire by reducing the range of rating scores and eliciting further responses for negative performance ratings. The Commission believes this change should make the questionnaires easier for brokers to complete and the responses to the questionnaires more useful to the CSAE. Therefore, the Commission finds that the proposed rule change is consistent with the Act.

It is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,⁸ that the proposed rule change (SR-CHX-2004-10), as amended by Amendment No. 1, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50025; File No. SR-DTC-2004-04]

Self-Regulatory Organizations; The Depository Trust Company; Order Granting Approval of a Proposed Rule Change To Establish a Valued Delivery Order Interface With the National Securities Clearing Corporation

July 15, 2004.

I. Introduction

On May 3, 2004, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") proposed rule change File No. SR-DTC-2004-04 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").¹ Notice of the proposed rule change was published in the **Federal Register** on June 2, 2004.² No comment letters were received. For the reasons discussed below, the Commission is now granting approval of the proposed rule change.

II. Description

The National Securities Clearing Corporation ("NSCC") currently creates receive and deliver instructions for "Balance Order Securities" and for

"Special Trades" which NSCC members then have to manually enter into DTC as "Valued Delivery Orders" ("VDOs").³ In connection with NSCC's project to update and revise its Continuous Net Settlement ("CNS") system ("CNS Rewrite"), NSCC requested DTC to establish an interface to automate and facilitate the processing and book-entry settlement of Balance Orders and Special Trades.⁴

DTC and NSCC currently have an automated VDO municipal bond interface known as the PDQ Automated Municipal Bond Settlement Facility ("PDQ Facility"). Pursuant to the PDQ Facility, NSCC members and NSCC municipal comparison only members ("MCOMs") that are also DTC participants ("common participants") or that clear through DTC participants may authorize NSCC to send to DTC their compared municipal bond transaction data in an automated file and may authorize DTC to accept and input such data as VDOs.

As a result of requests from common participants and based upon DTC's and NSCC's positive experience with the PDQ Facility, DTC and NSCC will expand the PDQ Facility to include all NSCC Balance Orders and Special Trades. The VDO Interface will automatically convey from NSCC to DTC VDO instructions for each common participant's Balance Orders and Special Trades pursuant to standing instructions given to NSCC by the common participant. For NSCC MCOMs that are not common participants, NSCC will create delivery versus payment VDO instructions for a MCOM's Special Trades if both the MCOM and its DTC clearing broker have each provided standing instructions to process such trades through the VDO Interface. The VDO Interface will incorporate the PDQ Facility's functionality and will replace the PDQ Facility.⁵ DTC intends to implement the proposed rule change in conjunction with the implementation of NSCC's CNS Rewrite on or about August 6, 2004.⁶

³ The terms Balance Order Securities and Special Trades are defined in Rule 1 of NSCC's Rules and Procedures. The term Valued Delivery Order refers to an order to deliver securities where delivery is to be made for payment as opposed to a Free Delivery which refers to an order to deliver securities free of any payment by the receiver.

⁴ The Commission recently approved NSCC's CNS Rewrite. Securities Exchange Act Release No. 50026 (July 15, 2004) [File No. SR-NSCC-2004-01].

⁵ Telephone conversation between Diane L. Brennan, Director of Risk Management, DTC, and staff of the Division of Market Regulation, Commission (May 21, 2004). Supplemented by letter from Diane L. Brennan, DTC (May 27, 2004).

⁶ The date for implementation in the Notice has been adjusted. E-mail from Diane L. Brennan, DTC (June 23, 2004).

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 34-49777 (May 26, 2004), 69 FR 31149.

⁷ 17 CFR 240.11Ac1-5.

III. Discussion

Section 17A(b)(3)(F) of the Act requires among other things that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.⁷ The Commission finds that DTC's proposed rule change is consistent with this requirement because VDO Interface being established will promote the prompt and accurate clearance and settlement of securities transactions by providing greater efficiency in the processing and book-entry settlement of Balance Orders and Special Trades by providing greater functionality and by allowing members to focus less attention on exception processing.

IV. 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 Section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁸ that the proposed rule change (File No. SR-DTC-2004-04) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50010; File No. SR-ISE-2004-25]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the International Securities Exchange, Inc., Relating to the Extension of the Linkage Fee Pilot Program

July 13, 2004.

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 July 1, 2004, the International Securities Exchange, Inc. (the "Exchange" or the "ISE") filed with the Securities and Exchange Commission ("Commission")

the proposed rule change as described in Items I and II below, which items have been substantially prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposed rule change on an accelerated basis.

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

The ISE is proposing to extend until July 31, 2005 the current pilot program regarding transaction fees charged for trades executed through the intermarket options linkage ("Linkage"). Currently pending before the Commission is a filing to make such fees permanent.³

The proposed fee schedule is available at the Exchange and at 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 ISE 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 III 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 purpose of this proposed rule change is to extend for one year the pilot program establishing ISE fees for Principal ("P") Orders and Principal Acting as Agent ("P/A") Orders executed through Linkage. The fees currently are effective for a pilot program scheduled to expire on July 31, 2004,⁴ and this filing would extend the fees through July 31, 2005. The three fees the ISE charges for P and P/A orders are: the basic execution fees for trading on the ISE, which range from \$.12 to \$.21 per contract/side depending on average daily trading volume on the Exchange; a \$.10 surcharge per contract/side for trading certain licensed products; and a \$.03 comparison fee

contract/side (collectively "Linkage fees"). The Exchange represents that these are the same fees that all ISE Members pay for non-customer transactions executed on the Exchange. The ISE does not charge for the execution of Satisfaction Orders sent through Linkage and is not proposing to charge for such orders.

In the Permanent Fee Filing, the ISE discusses in detail the reasoning why it believes it is appropriate to charge fees for P and P/A Orders executed through Linkage. In sum, the ISE argues that market makers on competing exchanges can match a better price on the ISE; they are never obligated to send orders to the ISE through Linkage. However, if such market makers do seek the ISE's liquidity, whether through conventional orders or through the use of P or P/A Orders, the Exchange believes it is appropriate to charge ISE Members the same fees levied on other non-customer orders. The ISE appreciates that there has been limited experience with Linkage and that the Commission is continuing to study Linkage in general and the effect of fees on trades executed through Linkage. Thus, this filing would extend the status quo for ISE's Linkage fees for one year while the Commission considers the Permanent Fee Filing.

2. Statutory Basis

The ISE believes that the basis for this proposed rule change is the requirement under Section 6(b)(4) of the Act⁵ that an exchange provide for the equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities. As discussed in more detail above, the ISE believes that this proposed rule change will equitably allocate fees by having all non-customer users of ISE transaction services pay the same fees. If the ISE were not to charge Linkage fees, the ISE believes that the Exchange's fee would not be equitable, in that ISE Members would be subsidizing the trading of their competitors, all of whom access the same trading services.

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

The Exchange does not believe that the proposed rule change imposes any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Moreover, the ISE believes that failing to adopt the proposed rule change would impose a burden on competition by requiring ISE Members to subsidize the trading of their competitors.

⁷ 15 U.S.C. 78q-1(b)(3)(F).

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See File No. SR-ISE-2003-30 (the "Permanent Fee Filing").

⁴ See Securities Exchange Act Release No. 49009 (December 30, 2003), 69 FR 714 (January 6, 2004) (SR-ISE-2003-39).

⁵ 15 U.S.C. 78f(b)(4).