

member not offer or continue to offer or use the tool, written-report template or sales material until all changes specified by the Department have been made by the member.

A member that offers an investment analysis tool exclusively to "institutional investors," as defined in Rule 2211(a)(3), is not subject to the post-use access and filing requirement in this paragraph if the communications relating to or produced by the tool meet the criteria for "institutional sales material," as defined in Rule 2211(a)(2). A member that intends to make the tool available to, or that intends to use the tool with, any person other than an institutional investor (such as an employee benefit plan participant or a retail broker-dealer customer) will be subject to the filing and access requirements, however.

As in all cases, a member's compliance with this Interpretive Material does not mean that the member is acting in conformity with other applicable laws and rules. A member that offers an investment analysis tool under this Interpretive Material (whether customers use the member's tool independently or with assistance from the member) is responsible for ensuring that use of the investment analysis tool and all recommendations based on the investment analysis tool (whether made via the automated tool or a written report) comply, as applicable, with NASD's suitability rule (Rule 2310), the other provisions of Rule 2210 (including, but not limited to, the principles of fair dealing and good faith, the prohibition on exaggerated, unwarranted or misleading statements or claims, and any other applicable filing requirements for advertisements and sales literature), the federal securities laws (including, but not limited to, the antifraud provisions), the Securities and Exchange Commission rules (including, but not limited to, SEC Rule 156 under the Securities Act of 1933) and other NASD rules.

#### (b) Definition

For purposes of this Interpretive Material and any interpretation thereof, an "investment analysis tool" is an interactive technological tool that produces simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices.

#### (c) Use of Investment Analysis Tools and Related Written Reports and Sales Material

A member may provide an investment analysis tool (whether customers use the member's tool independently or with assistance from the member), written reports indicating the results generated by such tool and related sales material<sup>3</sup> only if:

(1) The member describes the criteria and methodology used, including the investment analysis tool's limitations and key assumptions;

(2) the member explains that results may vary with each use and over time;

(3) if applicable, the member describes the universe of investments considered in the analysis, explains how the tool determines which securities to select, discloses if the tool favors certain securities and, if so, explains the reason for the selectivity,<sup>4</sup> and states that other investments not considered may have characteristics similar or superior to those being analyzed; and

(4) the member displays the following additional disclosure: "IMPORTANT: The projections or other information generated by [name of investment analysis tool] regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results."

#### (d) Disclosures

The disclosures and other required information discussed in paragraph (c) must be clear and prominent and must be in written or electronic narrative form.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50473; File No. SR-PCX-2003-64]

### Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Granting Approval of Proposed Rule Change and Amendments No. 1 and 2 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendments No. 3, 4, and 5 Thereto Regarding Facilitation Crossing Procedures

September 29, 2004.

#### I. Introduction

On November 20, 2003, the Pacific Exchange, Inc. ("PCX" 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 modify the Exchange's facilitation crossing procedures in several respects. On July 7, 2004, and July 15, 2004, respectively, the Exchange filed Amendments No. 1 and 2 to the proposed rule change.<sup>3</sup> The proposed rule change as amended by Amendments No. 1 and 2 was published for comment in the **Federal Register** on July 29, 2004.<sup>4</sup> The Commission received no comments on the proposal, as amended. On September 24, 2004, the Exchange submitted Amendment No. 3 to the proposal.<sup>5</sup> On September 29, 2004, the Exchange submitted Amendment No. 4 and Amendment No. 5 to the proposed rule change.<sup>6</sup> This order approves the proposed rule change and Amendments No. 1 and 2, grants accelerated approval of Amendments No. 3, 4, and 5, and solicits comments on Amendments No. 3 and 5.

#### II. Discussion of the Proposed Rule Change

Current PCX Rule 6.47(b), concerning the crossing of facilitation orders, permits a Floor Broker who holds an order for a customer and an order for the proprietary account of an OTP (Options Trading Permit) Holder or OTP Firm

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

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

<sup>3</sup> See letters from Mai S. Shiver, Acting Director/Senior Counsel, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated July 6, 2004, and July 14, 2004.

<sup>4</sup> See Securities Exchange Act Release No. 50064 (July 22, 2004), 69 FR 45360 ("Notice").

<sup>5</sup> See letter from Mai S. Shiver, Director/Senior Counsel, PCX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated September 23, 2004 ("Amendment No. 3"). In Amendment No. 3, the Exchange expanded the types of orders eligible for crossing with a Customer Order to include orders for the proprietary account of an organization under common control with a Market Maker that is representing the customer. The version of this provision published in the Notice applied only to orders for the proprietary account of an organization under common control with a Lead Market Maker ("LMM") that is representing the customer. Amendment No. 3 also clarified the rule with respect to allocation of the portion of the Customer Order remaining after the Floor Broker executes its guarantee in certain situations, and made technical and stylistic changes to the rule text.

<sup>6</sup> See letters from Mai S. Shiver, Director/Senior Counsel, PCX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated September 28, 2004 ("Amendment No. 4") and September 29, 2004 ("Amendment No. 5"). Amendment No. 4 was a technical amendment correcting typographical errors in the proposed rule text, and is not required to be noticed for comment. In Amendment No. 5, the Exchange proposed to make the effective date of the proposal October 29, 2004 in order to allow the Exchange to provide proper notice and education to the Exchange OTP Holders and OTP Firms that are affected by the rule change.

<sup>3</sup> Sales material that contains an incidental reference to an investment analysis tool (e.g., a brochure that merely mentions a member's tool as one of the services offered by the member) need not include the disclosures required by this Interpretive Material and would not need to be filed with the Department, unless otherwise required by the other provisions of Rule 2210.

<sup>4</sup> This disclosure must indicate, among other things, whether the investment analysis tool searches, analyzes or in any way favors certain securities within the universe of securities considered based on revenue received by the member in connection with the sale of those securities or based on relationships or understandings between the member and the entity that created the investment analysis tool. The disclosure also must indicate whether the investment analysis tool is limited to searching, analyzing or in any way favoring securities in which the member makes a market or has any other direct or indirect interest. Members are not required to provide a "negative" disclosure (i.e., a disclosure indicating that the tool does not favor certain securities).

that is representing that customer ("Facilitation Order") to cross those orders, provided that specified procedures and requirements are met. Among other things, before executing the cross, the Floor Broker must request from the trading crowd bids and offers for all components of the customer order and clearly disclose his or her intention to execute a facilitation cross transaction. With respect to customer orders of 50 contracts or more, the current rule further provides that once a market has been established and all public customer orders represented in the trading crowd have been satisfied, the Floor Broker may cross either (i) 40% of any remaining contracts at a price between the trading crowd's quoted market, or (ii) 25% of the contracts at the trading crowd's best bid or offer.

The proposed rule change would amend Rule 6.47(b), to be newly entitled "Facilitation Procedure," in several ways. Whereas the current rule defines a "customer order" subject to facilitation to include orders of broker-dealers, under the proposal, the facilitation procedure would apply only to orders of public customers.<sup>7</sup> The proposed rule change would add a requirement that in calling for the crowd's market, the Floor Broker must include the size of the order, but would eliminate the requirement that the Floor Broker disclose his intention to execute a facilitation cross. The proposal would also permit the Floor Broker to immediately consummate the facilitation cross in response to the trading crowd's quoted market if he or she immediately bids or offers a price on the customer order that is on or inside the quoted market ("Facilitation Price") provided by the trading crowd. As revised by Amendment No. 3, the proposal would also expand the rule to allow a Floor Broker to cross a Customer Order with an order for the proprietary account of an organization under common control with a Market Maker that is representing that customer.<sup>8</sup>

Further, the proposal would (a) increase to 40% the guaranteed percentage of a Customer Order that a Floor Broker is entitled to cross at the quoted market, and (b) obligate the Floor Broker to fill any portion of the customer order that remains unexecuted after the Floor Broker has provided the trading crowd an opportunity to execute the remainder of the order. Specifically, after first satisfying any orders for the

account of persons who are not OTP Holders or OTP Firms pending at the Facilitation Price, the Floor Broker would be permitted to facilitate up to 40% of the remaining contracts in the Customer Order against the Facilitation Order at the Facilitation Price. The Floor Broker would be required to allow any other member of the trading crowd interested in trading at the Facilitation Price to execute the remaining 60% or more of the Customer Order.

The remaining 60% would be allocated among the members interested in trading at the Facilitation Price on a size pro-rata basis or, in the case of identical offers or bids (where the Floor Broker's offer or bid improved the crowd's price in response to the request for a market), on an equal basis. If any portion of the Customer Order remains after providing the crowd reasonable time to execute the remaining 60%, the Floor Broker would be required to fill the remainder of the Customer Order by executing it against the Facilitation Order at the Facilitation Price.

The Exchange also proposes to add new PCX Rule 6.47(b)(5), which states that if the trading crowd does not provide a bid and offer for all components of the Customer Order in response to the Floor Broker's request within a reasonable period of time, the "market quote" for the purpose of this rule will be either (i) the quoted market disseminated by the Exchange prior to the commencement of the Facilitation Procedure, or (ii) for orders for which there is no disseminated market, a quote that is determined by the disseminated quote for each leg of the transaction prior to the commencement of the Facilitation Procedure. As clarified in Amendment No. 3, the 60% of the Customer Order remaining after the Floor Broker executes the 40% guarantee in such a situation would be allocated on an equal basis among any members of the crowd interested in trading at the Facilitation Price.

The proposal would renumber former PCX Rule 6.47(b)(5) as PCX Rule 6.47(b)(6) and amend it to provide that if the facilitation trade occurs at the LMM's quoted bid or offer in its allocated issue and the Floor Broker takes less than 40% of the trade, then the LMM may elect either (i) to accept a guaranteed participation level of 40% minus the Floor Broker's allocation percentage, or (ii) to participate in the pro-rata allocation without a guaranteed participation level. If the trade occurs at a price other than the LMM's quoted bid or offer, the LMM would not be entitled to a guaranteed participation. A Floor Broker or LMM would not be prohibited from trading more than their guaranteed

participation levels if the members of the trading crowd do not choose to trade the remaining portion of the order.

The proposed rule change would revise Commentary .06 to PCX Rule 6.47 to provide that it will be a violation of a Floor Broker's duty to use due diligence in representing its Customer Order if the Floor Broker does not employ the Facilitation Procedure on the PCX immediately upon receipt on the PCX of the order that the OTP Holder or OTP Firm wishes to have executed as a facilitation cross. The Exchange also proposes to add Commentary .07, which provides that it will be a violation of an OTP Holder's or OTP Firm's duty of best execution to its customer if it cancels a facilitation order for the purpose of avoiding execution of the order at a better price.

Finally, the proposed rule change would clarify facilitation crossing procedures for orders of less than 50 contracts, which are not subject to the guarantees set forth in the rule. The proposal would establish that, when facilitating such orders, the Floor Broker must satisfy all orders in the book and all orders represented in the trading crowd (affording the trading crowd a reasonable period of time to respond to the Customer Order) before the Floor Broker may cross the Customer Order.

### III. Commission Findings and Order Granting Approval

After careful consideration, the Commission has determined to approve the proposed rule change, as amended.<sup>9</sup> For the reasons discussed below, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of Section 6(b)(5) of the Act,<sup>10</sup> which requires, among other things, that an exchange's rules be designed to promote just and equitable principles of trade, to remove impediments to and 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 proposed rule change sets forth a number of amendments to the procedures for the execution of facilitation crossing transactions on the Exchange, and would also increase the

<sup>7</sup> See Notice at note 5 and accompanying text. Such orders would be defined in the rule as "Customer Orders."

<sup>8</sup> See *supra* note 5.

<sup>9</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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

guaranteed percentage to which a Floor Broker is entitled when facilitating a Customer Order at the quoted market. The Commission believes that these changes are generally consistent with rules in place variously at other exchanges or otherwise constitute reasonable modifications to the Exchange's procedures. In particular, the Commission notes that the increase in the percentage that the Floor Broker is entitled to facilitate at the quoted market would not exceed 40% of an order. The Commission has previously found that participation guarantees of as much as 40% of an order in options trading are not inconsistent with statutory standards of competition and free and open markets.<sup>11</sup>

The Commission further notes that the proposed rule change also would require a Floor Broker to fill the remainder of the Customer Order that is not filled by the trading crowd by executing it against the Facilitation Order, thus ensuring that the Customer Order will be executed at or between quoted markets.<sup>12</sup> The proposed rule change also clarifies the Exchange's facilitation procedures by setting forth explicit provisions regarding the method for allocating the contracts remaining after the Floor Broker executes his or her guaranteed percentage. Finally, the new commentaries regarding Floor Brokers' duties of best execution and due diligence contribute to the clarity of the facilitation rules by expressly defining violative conduct.

The Commission finds good cause for approving Amendments No. 3 and 5 to the proposed rule change prior to the thirtieth day after the amendment is published in the **Federal Register**, pursuant to Section 19(b)(2) of the Act.<sup>13</sup> With respect to the types of orders that may be Facilitation Orders, Amendment No. 3 eliminated a distinction between orders for the proprietary accounts of organizations under common control with LMMs and orders for the proprietary accounts of organizations under common control with Market Makers, and thus enhanced the proposed rule change. Amendment No. 3 also strengthened the proposal by

clarifying the method of allocation of the remaining 60% of a Customer Order in a situation where the crowd had not provided a response to Floor Broker's request for a market. Finally, Amendment No. 3 made a few minor technical and stylistic changes to the proposed rule text. In Amendment No. 5, the Exchange proposed to make the effective date of the proposal October 29, 2004 in order to allow the Exchange to provide proper notice and education to the Exchange OTP Holders and OTP Firms that are affected by the rule change. Acceleration of Amendments No. 3 and 5 will permit the Exchange to implement the proposal in an expeditious manner. The Commission, therefore, believes that good cause exists, consistent with Section 6(b)(5)<sup>14</sup> and Section 19(b)<sup>15</sup> of the Act, to accelerate approval of Amendment No. 3.

#### IV. Solicitation of Comments Concerning Amendment No. 3

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether it is consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's Internet comment form <http://www.sec.gov/rules/sro.shtml>; or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-PCX-2003-64 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-PCX-2003-64. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-PCX-2003-64 and should be submitted on or before October 28, 2004.

#### V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (File No. SR-PCX-2003-64) and Amendments No. 1 and 2 thereto are approved, and that Amendments No. 3, 4 and 5 thereto are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Margaret H. McFarland,  
Deputy Secretary.

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## SMALL BUSINESS ADMINISTRATION

### Small Business Size Standards: Waiver of the Nonmanufacturer Rule

**AGENCY:** Small Business Administration.

**ACTION:** Notice of termination of waiver of the Nonmanufacturer Rule for Paint and Paint Manufacturing.

**SUMMARY:** The U. S. Small Business Administration (SBA) is terminating the waiver of the Nonmanufacturer Rule for Paint and Paint Manufacturing based on our recent discovery of a small business manufacturer for this class of products. Terminating this waiver will require recipients of contracts set aside for small or 8(a) businesses to provide the products of small business manufacturers or process on such contracts.

**DATES:** This termination of waiver is effective on October 22, 2004.

**FOR FURTHER INFORMATION CONTACT:** Edith Butler, Program Analyst, by telephone at (202) 619-0422; by Fax at (202) 205-7280; or by e-mail at [edith.butler@sba.gov](mailto:edith.butler@sba.gov).

<sup>11</sup> See, e.g., Securities Exchange Act Releases No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) at 11398; and No. 43100 (July 31, 2000), 65 FR 48778 (August 9, 2000) at notes 96-99 and accompanying text.

<sup>12</sup> The Exchange represents that any portion of a Customer Order executed pursuant to this rule would not be executed at a price inferior to the national best bid or offer. Telephone conversation between Mai S. Shiver, Director/Senior Counsel, PCX, and Ira L. Brandriss, Assistant Director, Division, Commission, September 29, 2004.

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

<sup>14</sup> 15 U.S.C. 78f(b)(5).

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

<sup>16</sup> 15 U.S.C. 78s(b)(2).

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