

expected to promote stability and investor confidence during a period of significant stress by providing market participants with a reasonable opportunity to become aware of and respond to significant price movements, thereby facilitating, in an orderly manner, the maintenance of an equilibrium between buying and selling 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.

*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:

(A) By order approve the proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interest persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal

office of the CBOE. All submissions should refer to File No. SR-CBOE-96-78 and should be submitted by January 21, 1997.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

Margaret H. McFarland,

*Deputy Secretary.*

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[Release No. 34-38082; File No. SR-CHX-96-27]

**Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Stock Exchange, Incorporated Relating to Permanent Approval of Its Pilot Program for Automatic Execution of Limit Orders**

December 24, 1996.

**I. Introduction**

On October 15, 1996, 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")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change seeking permanent approval of its system enhancement relating to the automatic execution of non-marketable limit orders.

Notice of the proposed rule change, together with the substance of the proposal, was provided by issuance of a release,<sup>3</sup> and by publication in the Federal Register.<sup>4</sup> No comments were received. This order approves the proposed rule change.

**II. Description of the Proposal**

The rule change approved today provides permanent approval of the Exchange's system enhancement relating to the automatic execution of non-marketable limit orders. On July 12, 1995, the Commission approved this system enhancement on a pilot basis, with an expiration date of July 31, 1996.<sup>5</sup> The pilot program was extended in a subsequent Commission approval order and is currently scheduled to

expire on December 31, 1996.<sup>6</sup> In the Pilot Approval Order, as amended by the Pilot Extension Order, the Commission requested that the CHX provide a report to the Commission, by August 31, 1996, describing its experience with the pilot program. This report has been submitted to the Commission.

The proposed system enhancement ("Auto-Ex") is a feature of the Exchange's automated execution system ("MAX") that CHX specialists may voluntarily choose to activate to execute automatically non-marketable limit orders<sup>7</sup> on the specialist's book. Auto-Ex operates by comparing the size of the CHX-entered limit order against the amount of stock ahead of that order in the primary market when the issue is trading in the primary market at the limit price. The Auto-Ex System begins comparing CHX-entered limit orders when the order's limit price equals the bid (for a limit order to buy) or offer (for a limit order to sell) quoted in the primary market.<sup>8</sup> Thereafter, the Auto-Ex system keeps track of all prints in the primary market and automatically executes the limit order once the required size prints in the primary market.<sup>9</sup> As additional limit orders at the same price are received by the specialist, comparisons are made and entered based upon the shares ahead of those limit orders at the time of receipt, including shares ahead on the CHX. The Auto-Ex feature does not permit a limit order to be filled out of sequence.

The Auto-Ex feature executes limit orders in accordance with existing CHX

<sup>6</sup> See Securities Exchange Act Release No. 37442 (July 16, 1996), 61 FR 38491 (July 24, 1996) (File No. SR-CHX-96-18) ("Pilot Extension Order").

<sup>7</sup> A limit order is an order to buy or sell a stated amount of a security at a specified price or at a better price. A limit order is called "marketable" when the prevailing best offer (bid) is equal to or less (greater) than the limit buy (sell) order price.

<sup>8</sup> For example, if the primary market quotation is 1/4 bid, 1/2 offered, 4,000 shares bid and 4,000 shares offered, and a CHX specialist receives a limit order to buy 2,000 shares for 1/8, that limit order will not be compared against the amount of stock ahead of the order in the primary market until such time as the 1/4 bid is exhausted and the 1/8 bid becomes the best bid. At that time, the size which is disseminated with the 1/8 bid is the size against which the limit order is compared for Auto-Ex purposes.

<sup>9</sup> For example, assume a CHX specialist receives an agency limit order to buy 2,000 shares of ABC at 1/2. The primary market quotation is 1/2 bid, 3/4 offered, 5,000 shares bid and CHX order. The Auto-Ex will automatically execute the entire CHX limit 5,000 shares offered, meaning there are 5,000 shares ahead of the order after 7,000 shares print at 1/2 or better in the primary market. However, when more than 5,000 but less than 7,000 shares print at 1/2 in the primary market, the order will be flagged with a flashing prompt to alert the specialist that the order may be due at least a partial fill. See CHX Article XX, Rule 37(a) governing primary market protection of certain limit orders.

<sup>6</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> See Securities Exchange Act Release No. 37946, November 13, 1996.

<sup>4</sup> See 61 FR 59263, November 21, 1996.

<sup>5</sup> See Securities Exchange Act Release No. 35962 (July 12, 1995), 60 FR 37115 (July 19, 1995) (File No. SR-CHX-95-11) ("Pilot Approval Order").

rules.<sup>10</sup> Auto-Ex is available for all dually traded issues; however, specialists are permitted to choose Auto-Ex on an issue by issue basis.<sup>11</sup> Generally, however, Auto-Ex has been used by specialists for issues which, based on experience, have demonstrated reliable and accurate quotes in the primary market. Limit orders not subject to Auto-Ex will be "flagged" with a prompt to alert the specialist that a fill may be due. The proposal to establish an Auto-Ex feature applies only to non-marketable limit orders. It is not applicable to marketable limit orders or to market orders.

The Exchange states that the purpose of the proposed rule change is to further automate the CHX's trading floor functions, and to improve the CHX's performance in filling limit orders. By providing for automatic execution of limit orders in accordance with existing Exchange rules, the Exchange states that it is eliminating the need for the manual operation required of specialists in determining when and to what extent limit orders are due fills based on primary market prints. The Exchange notes that the manual effort expended by specialists in filling limit orders that are entitled to primary market protection is often time-consuming and can result in errors, particularly when there is heavy trading volume. The Exchange believes that the present proposal will, therefore, directly benefit customers because it will result in more timely fills while eliminating errors resulting from manual execution.

The Exchange also states that the Auto-Ex feature will not change or amend any CHX trading rules, nor will it cause or allow limit orders to be filled under different parameters than under existing rules. Auto-Ex only automates the manner in which limit orders are filled. The Exchange states that it will continue to monitor specialist execution of limit orders through the Market Regulation/Surveillance Department. In addition CHX specialists will continue to be responsible for their books to the same degree as they are now under the manual execution system for limit orders.

### III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.<sup>12</sup> Specifically, the Commission believes the proposal is consistent with the Section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change to provide for the automatic execution of non-marketable limit orders should result in prompt execution of such orders on the Exchange and reduce errors caused by manual execution of limit orders that are entitled to primary market protection, especially during periods of heavy trading volume.

In the Pilot Approval Order, the Commission noted several items to be addressed prior to implementation of the pilot on a permanent basis. The Commission sought clarification regarding the basis upon which issues would be added and removed from Auto-Ex. The Commission also requested clarification that manually-executed limit orders and Auto-Ex limit orders receive an identical quality of execution. Finally, the Commission expressed an interest regarding the length of time between a print in the primary market and the resulting fill on CHX for both issues included in Auto-Ex and those issues not included in Auto-Ex.

In order to address the items noted by the Commission, the Exchange submitted a report summarizing data gathered during the pilot period.<sup>13</sup> The Exchange stated that during the reporting period, five of the 348 issues participating in the pilot were removed. Of those issues removed, three had been added to the pilot in error<sup>14</sup> and two

were removed at the specialist's request due to a high volume of activity on the primary market. According to the report submitted by the Exchange, specialists seem to be biased against including issues in Auto-Ex which generate large size orders. The Exchange stated that it believes this bias is due to the fact that the maximum quote size that CQS can disseminate is 99,900. For example, if a specialist on the primary market has a limit order on the book for 400,000, only 99,900 appears on the CHX system. Therefore, once the CHX system registered the execution of 99,900 shares on the primary market, executions would occur on Auto-Ex while more than 300,000 in limit orders still remained in the primary market limit order book. Further, these executions would occur when CHX rules did not yet require the order to be filled.<sup>15</sup> Therefore, to avoid automatic executions when an order fill was not yet required, some specialists for issues which generated larger size orders requested that those issues be removed from Auto-Ex.

The Exchange reported that the length of time between a print in the primary market and an Auto-Ex was less than one second. Further, according to the Exchange report, the length of time between a print in the primary market and a manual CHX order fill averaged 11.623 minutes. The Exchange stated in the report that fifty percent of the manually filled orders are executed in 1½ minutes or less. Although the submitted data appears to suggest that the execution of some manually-executed limit orders was delayed for several hours, the Exchange has confirmed that these orders were not executed late; rather, the prompt to execute was actually premature due to the fact that an order of more than 99,900 shares (in the primary market) was ahead of the CHX order.<sup>16</sup>

The Commission believes that the Exchange reports adequately addresses the potential issues identified by the Commission in the Pilot Approval Order. Specifically, the Commission finds that the report indicates that issues participating in Auto-Ex during the pilot period were added and removed in a fair and non-discriminatory manner. Further the Commission finds that it does not appear that the method of selection of issues for participation in Auto-Ex raised concerns regarding manipulation.

AutoEx was no longer a market maker in the erroneously added stock. Phone conversation between David Rusoff, Foley & Lardner and Janice Mitnick, SEC on December 16, 1996.

<sup>15</sup> See CHX Article XX, Rule 37(a)(3)(c).

<sup>16</sup> See *Id.*

<sup>10</sup> Further, the Exchange has stated that the recent adoption of the Order Execution Obligations (Securities Exchange Act Release No. 37619 (August 29, 1996), 61 FR 48290 (September 12, 1996)) will have no impact or effect on the proposed rule change. See Letter from J. Craig Long, Foley & Lardner to Janice Mitnick, Division of Market Regulation, SEC, dated November 8, 1996.

<sup>11</sup> The CHX will limit a specialist's ability to activate and deactivate Auto-Ex by: (1) only permitting a specialist to deactivate Auto-Ex on a certain day each month, which is determined from time to time by the Exchange; and (2) requiring that issues remain on Auto-Ex for a minimum of five trading days.

<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> The report includes data gathered from April 7, 1996 through July 25, 1996. Phone conversation between David Rusoff, Foley & Lardner and Janice Mitnick, SEC on December 16, 1996.

<sup>14</sup> In one case, a stock ticker symbol was incorrectly entered. The other two errors resulted from outdated information. Generally, firms participating in the pilot requested that the Exchange include all of their specialists in the pilot. One error resulted from the addition of an issue marketed by a specialist who had was no longer with the firm requesting participation in AutoEx. Additionally, if a specialist chose to participate in AutoEx, the specialist usually placed all of his or her stocks in the pilot. One error resulted from the fact that the specialist who chose to participate

The only factor noted in the report which created a bias regarding the issues selected for inclusion in Auto-Ex appears to be the result of the size limitations of the CQS. As discussed above in detail, the size limitation of CQS, combined with issues which generate large orders, could result in fills being generated on Auto-Ex before the CHX rules require a fill to occur. Finally, the Commission finds that the report data indicates that executions on Auto-Ex are timely, occurring in 1½ minutes or less, and, in most cases, faster than manual executions for issues not included on Auto-Ex. As discussed above, the Commission believes that the proposed rule change should result in prompt execution of non-marketable limit orders and reduce errors caused by manual execution of limit orders that are entitled to primary market protection, especially during periods of heavy trading volume.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>17</sup> that the proposed rule change (SR-CHX-96-27) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

Margaret H. McFarland,  
Deputy Secretary.

[FR Doc. 96-33270 Filed 12-30-96; 8:45 am]

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[Release No. 34-38078; File No. SR-NYSE-96-37]

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of a Proposal by the New York Exchange, Inc. Regarding the Limitation of Liability for Use of Facilities**

December 23, 1996.

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 10, 1996, the New York Stock Exchange, Incorporated ("NYSE" 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. 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 Exchange proposes to clarify that transactions in baskets that include American Stock Exchange, Inc. ("Amex") listed securities effected through NYSE Crossing Session II are deemed to constitute use of Exchange facilities, as described in Article II, Section 6 of the NYSE Constitution. The text of the proposed rule change is available at the Office of the Secretary, 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 Exchange included statements concerning the purpose of and basis for 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 Section (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**

NYSE Crossing Session II permits members and member organizations to cross multi-stock baskets between 4:00 p.m. and 5:15 p.m. New York time. Baskets must include at least 15 NYSE-listed stocks with an aggregate value of \$1 million or more.

The Amex has filed with the Commission a proposed rule change to extend its trading hours to permit the execution of "aggregate-price orders" for Amex-listed securities which are part of a basket being done in large part through the exchange's Crossing Session II.<sup>3</sup> Once approved, the Amex rule change will allow dual NYSE/Amex members and member organizations contemporaneously to execute on the NYSE, the NYSE-listed portion of a basket and on the Amex, the Amex-listed portion of the basket.

To facilitate contemporaneous execution, the NYSE will accept the entire basket order and forward to the Amex the Amex-listed portion of the basket order, provided that the member or member organizations submitting the order is a member of both the NYSE and the Amex. The Amex will execute the Amex portion, report it to the "Tape" and back to the member or member

organization, and facilitate any regulatory reports that may be required of the member or member organization with respect to the Amex portion.

The Exchange proposes to clarify that Article II, Section 6 of the NYSE Constitution shall, in addition to all other applications, also apply to any transaction, notice or communication effected through or arising in connection with NYSE Crossing Session II. This includes, but is not limited to, transactions, notices or communications involving a basket consisting of both Exchange-listed securities and securities listed on the Amex. This shall not preclude the applicability of any other provision of the Constitution or Rules that would serve to limit the liability of the Exchange for use by its members and member organizations of Exchange facilities.

The Exchange believes that the proposal is consistent with Section 6(b) of the Act in general and furthers the objectives of Section 6(b)(5) in particular in that it is designed to promote just and equitable principles of change, to remove impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

**(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**

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**

Because the foregoing rule change constitutes a stated interpretation with respect to the meaning, administration, or enforcement of an existing rule, it has become effective pursuant to section 19(b)(3)(A), and Rule 19b-4 thereunder. At any time within 60 days of the filing of the 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.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and

<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>18</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> See Securities Exchange Act Release No. 37965 (November 19, 1996), 61 FR 60135 (November 26, 1996) (File No. SR-Amex-96-43).