

### III. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change

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, Section 6(b)(5).<sup>3</sup> Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, perfect the mechanism of a free and open national market, and in general, to further investor protection and the public interest.

The Commission believes that it is reasonable for the Exchange to amend its rules to close trading in equity and narrow-based index options at 4:02 p.m., versus the existing 4:10 p.m. close. Changing the closing time for these options to 4:02 p.m. preserves the Exchange's<sup>4</sup> stated need to continue trading options for some period of time after the close of trading in the underlying securities. The Exchange has stated that this two minute extension from the close of the stock markets will allow options traders to respond to late reports of closing prices over the consolidated tape, thereby bringing options quotes into line with the closing price of the underlying security. Due to improvements in the processing and reporting of transactions, the Exchange believes that two minutes of options trading after the underlying equities close is sufficient to bring options quotes into line with the closing prices of the underlying securities.

As discussed in similar rule filings submitted to the Commission, the CBOE and the American Stock Exchange, Inc. ("Amex") state that a number of issuers have adopted the practice of disseminating important corporate news after the close of trading on the primary equity exchange in order to minimize the short-term disruptive effect of the news on the market price of the stock by allowing investors the opportunity to digest the significance of the news after the markets have closed.<sup>5</sup> These announcements, if made while options markets are still trading, impact narrow-based index options, as well as equity

options, because a significant news announcement on one component of a narrow-based index may have substantial impact on that index. As a result, the exchanges are often deluged with option orders as a result of such significant news announcements after 4:00 p.m. The exchanges state that these orders may have a disruptive effect on the options market at a time when the exchanges are attempting to close in a fair and orderly fashion.

Accordingly, the Commission finds that a closing time of 4:02 p.m. for equity and narrow-based index options is a reasonable means to address the Exchange's desire to balance the need for some extended trading period with the need to prevent negative impact from issuers' major news announcements made while only the options markets remain open.

The Commission also finds that it is reasonable for the Exchange to amend its rules to remove the reference to the closing time and instead to specify that index stock group option exercise notices must be given five minutes after the close of trading.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that it is approving this proposal on the same date that it is approving nearly identical rule change proposals submitted by the Amex, CBOE, and Pacific Exchange, Inc. ("PCX"). These rule filings have been published in the **Federal Register**<sup>6</sup> and were subject to a full notice and comment period. No comments were received on the proposals. Accordingly, the Commission believes, consistent with Section 6(b)(5) of the Act, that good cause exists to approve the proposed rule change on an accelerated basis.

### IV. Solicitation of Comments

Interested 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-NYSE-97-02, and should be submitted by June 12, 1997.

### V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act, and, in particular, Section 6 of the Act.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>7</sup> that the proposed rule change (SR-NYSE-97-02) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Jonathan G. Katz,**

*Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38649; File No. SR-PSE-96-35]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 to the Proposed Rule Change by the Pacific Stock Exchange, Incorporated Relating to Its Rules on Executions of "Odd Lot" Equity Orders

May 16, 1997.

### I. Introduction

On September 25, 1996, the Pacific Stock Exchange, Incorporated ("PSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") 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 relating to its rules on executions of odd lot equity orders. On December 17, 1996, the PSE submitted an amendment ("Amendment No. 1") to

<sup>3</sup> 15 U.S.C. 78f(b)(5).

<sup>4</sup> The Commission notes that the NYSE has recently ceased all equity and index options trading on its floor, transferring its options business to the Chicago Board Options Exchange, Inc. ("CBOE"). Release No. 34-38542 (April 23, 1997) (Order approving NYSE-97-05). Nevertheless, the Commission believes it is appropriate to approve the current rule change, particularly since NYSE may reenter the options business at a later date.

<sup>5</sup> See SR-CBOE-96-71 and SR-AMEX-96-45.

<sup>6</sup> See SR-AMEX-96-45, Release No. 34-38123 (January 6, 1997); 62 FR 1786 (January 13, 1997); SR-CBOE-96-71, Release No. 34-37988 (November 26, 1996); 61 FR 64405 (December 4, 1996); and SR-PSE-96-41, Release No. 34-37920 (November 4, 1996); 61 FR 58434 (November 14, 1996).

<sup>7</sup> 15 U.S.C. 78s(b)(2).

<sup>8</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.

the proposed rule change.<sup>3</sup> The proposed rule change and Amendment No. 1 were published in the **Federal Register** on December 24, 1996.<sup>4</sup> No comments were received on the proposal. On May 15, 1997 the PSE submitted a second amendment ("Amendment No. 2") to the proposed rule change.<sup>5</sup> This order approves the proposal. Also, Amendment No. 2 is approved on an accelerated basis.

## II. Description of the Proposal

The Exchange proposed this rule change in order to provide better service to customers and to be competitive with other exchanges.<sup>6</sup> The Exchange proposed to modify Rule 5.34(b) ("Odd Lot Executions") to provide as follows:

First, with regard to market orders, the PSE proposed that an odd lot market order shall be filled at either (a) the price being disseminated on the Intermarket Trading System ("ITS") best bid or offer at the time the odd lot dealer receives the order, provided certain conditions are met;<sup>7</sup> or (b) the price of the next round lot sale on the primary market or a price deemed appropriate under prevailing market conditions if one or more of the conditions specified in (a) does not apply. The Exchange is making this change in order to assure that the application of the rule in unusual circumstances is fair, reasonable, and consistent with the rules relating to the ITS. The current rule states that such orders shall be filled at the price of the first round lot transaction which takes place on the

primary market, plus if a buy order, or minus if a sell order, an odd lot differential, if any.

Second, with regard to limit orders, the PSE proposed that an odd lot limit order shall be filled at, or better than, the price of the next<sup>8</sup> regular way round lot transaction that is at, or better than, the limit order's price printed on the consolidated tape from the security's primary market.<sup>9</sup> The PSE further proposed that such odd lot orders shall be allowed to establish precedence without regard to priority of existing round lot bids or offers at that price. The current rule states that such orders shall be filled at the price of the first round lot transaction which takes place on the primary market, which in the case of a buy order is below the specified limit by the amount of the trading differential, or by a greater amount; or which in the case of a sell order is above the specified limit by the amount of the trading differential, or by a greater amount; plus if a buy order, or minus if a sell order, an odd lot differential, if any.

Third, with regard to stop orders, the PSE proposed that an odd lot stop order to buy shall become a market order when a regular way round lot transaction takes place at or above the price of the stop order on the primary market.<sup>10</sup> The PSE further proposed that an odd lot stop order to sell shall become a market order when a regular way round lot transaction takes place at or below the price of the stop order on the primary market.<sup>11</sup> The current rule states that an odd lot stop order becomes a market order when a round lot transaction takes place on the primary market, which in the case of a buy order is at or above the stop price; or which in the case of a sell order is at or below the stop price; and it further states, that the order shall then be filled at the price of the next round lot transaction which takes place on the primary market, plus if a buy order, or minus if a sell order, an odd lot differential, if any.

Fourth, the PSE proposed that it shall be inconsistent with the purpose and intent of the Rule to engage in the following actions: (a) the unbundling of round lots for the purpose of entering odd lot limit orders in comparable amounts; (b) the failure to aggregate odd lot orders into round lots when such orders are for the same account or for various accounts in which there is a common monetary interest; and (c) the entry of both buy and sell odd lot limit

orders in the same stock before one of the orders is executed for the purpose of capturing the "spread" in the stock. The proposal also states that, in general, the Exchange views order entry practices that are intended to circumvent the round lot auction market as abuses of the intent and purpose of the odd lot system, and such practices shall be considered violations of these rules.

Finally, the PSE proposed to remove several provisions from the rules relating to odd lot executions that no longer apply. First, the Exchange proposed to eliminate all provisions in Rule 5.34(b) on odd lot differentials. Second, the proposal modified Rule 5.34(b) to eliminate the distinction between "PMP stocks" and "non-PMP stocks."<sup>12</sup>

The Exchange stated its belief that the proposal is consistent with Section 6(b) of the Act, in general, and Section 6(b)(5) of the Act, in particular, in that it is designed to facilitate transactions in securities and to promote just and equitable principles of trade.

## III. Discussion

After careful consideration, 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. In particular, the Commission believes the proposal is consistent with the requirements of Section 6(b)(5)<sup>13</sup> of the Act in that it is designed to facilitate transactions in securities and to promote just and equitable principles of trade.

The Commission believes that the Exchange's proposed pricing procedures for standard odd lot market orders should facilitate the execution and accurate reporting of odd lot transactions, and should also assist in the prompt and accurate clearance and settlement of such transactions. Because the orders, under most circumstances, will be priced off a current market quote instead of a subsequent transaction, investors should receive a timely execution of their orders. Moreover, the Commission believes that the revised procedures, which provide for the pricing of standard odd lot market orders at best bid or offer reflected in the consolidated quote system, rather

<sup>3</sup> Letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, PSE to Janet Russell-Hunter, Special Counsel, Office of Market Supervision, Division of Market Regulation, SEC, dated December 17, 1996. In Amendment No. 1, the PSE clarified the purpose of the rule change and made technical corrections to the text of the rule.

<sup>4</sup> Securities Exchange Act Release No. 38087 (December 24, 1997), 62 FR 782 (January 6, 1997).

<sup>5</sup> Letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, PSE to Janet Russell-Hunter, Special Counsel, Office of Market Supervision, Division of Market Regulation, SEC, dated May 14, 1997. In Amendment No. 2, the PSE modified the provision of the proposal on executions of odd-lot market orders (see discussion below) and made a minor technical correction to the proposal. The PSE also requested that the Commission approve Amendment No. 2 on an accelerated basis.

<sup>6</sup> See Amendment No. 1, *supra* note 3.

<sup>7</sup> The conditions are that: the stock is included in ITS in that market center; the size of the quote is greater than 100 shares; the bid or offer is no more than one-quarter dollar away from the bid or offer disseminated by the primary market; the quote conforms to PSE Rule 5.3(b) regarding trading differentials; the quote does not result in a locked market; the market center is not experiencing operational problems with respect to the dissemination of quotes; and that the bid or offer is firm. See PSE Rule 5.34(b)(1) (A)-(G). These conditions are essentially the same as those provided in New York Stock Exchange Rule 124, Odd Lot Orders, Supplementary Material .60.

<sup>8</sup> See Amendment No. 2, *supra* note 5.

<sup>9</sup> See Amendment No. 1, *supra* note 3.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> "PMP" stocks are those for which Exchange specialists provide primary market protection. Today, such protection applies to all stocks that may be executed on P/COAST, the Exchange's automatic execution system for equity securities.

<sup>13</sup> In approving the proposed rule change, the Commission has considered the proposed rule changes' impact on efficiency, competition, and capital formation. 15 U.S.C. § 78c(f).

than the price of the first round lot transaction in the primary market, will result in orders which should receive execution at prices which more accurately reflect market conditions than would otherwise be the case under the former procedures.

The PSE also has proposed an alternative method of pricing odd lot market orders in the event that the condition provided for in the proposed rule do not apply.<sup>14</sup> In such an event, an odd lot market order will be executed at the price of the next round lot sale on the primary market or will be executed by the odd lot dealer at a price deemed appropriate under prevailing market conditions. Using this method, the PSE can continue to provide procedures which will facilitate the execution of odd lot orders. The Commission recognizes that it is difficult to develop a method of pricing odd lot orders that under all market conditions would reflect appropriately the current market price. The Commission finds that it is reasonable for the PSE to have determined that use of the next sale price is appropriate under the several enumerated circumstances.

The Commission believes that the proposal with regard to odd lot limit orders also represents an improvement in the execution of such orders for investors. Allowing such limit orders to establish precedence without regard to priority of existing round lot bids or offers at that price will afford odd lot limit orders highly efficient and price superior execution services.

With respect to stop orders, the Commission finds that the proposal will provide improve execution for investors. Once a stop order becomes a market order under the terms of the amended rule, it will be treated in the same manner as a standard odd lot market order under the amended rule. Therefore, rather than receiving an execution at the price of the next round lot transaction which takes place on the primary market, as under the rule prior to amendment, investors will receive execution at the best bid or offer reflected in the consolidated quote system.

The Commission finds appropriate the proposal's explicit enumeration of those activities that shall be inconsistent with the intent of the rule, such as the unbundling of round lot orders for the purpose of entering odd lot limit orders in comparable amounts; the failure to aggregate odd lot orders into round lots when such orders are for the same account or for various accounts in which there is a common monetary

interest; and the entry of both buy and sell odd lot limit orders in the same stock before one of the orders is executed for the purpose of capturing the "spread" in the stock. The Commission finds reasonable the Exchange's statement that, in general, order entry practices that are intended to circumvent the round lot auction market will be viewed as abuses of the intent and purpose of the odd lot system and such practices shall be considered violations of these rules.

The Commission believes that the proposal's provision removing discussion of odd lot differentials is a technical correction that is consistent with the Exchange's previous elimination of odd-lot differentials.<sup>15</sup> The Commission also finds appropriate the elimination of the distinction between "PMP stocks" and "non-PMP stocks" in light of the fact that all stocks that may be executed on P/COAST, the exchange's automatic execution system, currently receive such primary market protection.

The Commission finds good cause to approve Amendment No. 2 to the proposed rule change prior to the thirtieth day after the publication of notice thereof in the **Federal Register**. Amendment No. 2 creates an alternate pricing mechanism that strengthens the proposal. Accordingly, the Commission believes there is good cause, consistent with Section 6(b)(5) and 19(b)(2) of the Act, to approve Amendment No. 2 to the proposal on an accelerated basis.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2. 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 Room, 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 PSE. All submissions

should refer to File No. SR-PSE-96-35 and should be submitted by June 12, 1997.

#### V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (SR-PSE-96-35), and amendments thereto, be and hereby are, approved.

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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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38642; File No. SR-PSE-96-41]

#### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Pacific Stock Exchange, Inc. Establishing a 1:02 p.m. Closing Time for Equity Options Trading

May 14, 1997.

#### I. Introduction

On October 25, 1996, the Pacific Stock Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change 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 of the substance of the proposed rule change 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 Exchange proposes to amend Rule 4.2, Commentary .01 to change the 1:10 p.m. closing time for equity options to 1:02 p.m.<sup>5</sup> Currently, the ten minute period for trading equity options after the close of the underlying securities allows options traders to respond to late reports of closing prices over the consolidated tape. The proposed change will result in the close of trading in

<sup>16</sup> 15 U.S.C. § 78s(b)(2).

<sup>17</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> Securities Exchange Act Release No. 37920 (November 4, 1996).

<sup>4</sup> 61 FR 58434 (November 14, 1996).

<sup>5</sup> All time references are in Pacific Time.

<sup>14</sup> *Supra* note 7.

<sup>15</sup> See PSE Rule 5.4.