

profitability. In addition to any other information the Board may request, the Adviser will provide information concerning the Adviser's profitability for the preceding quarter with respect to the relevant Fund.

For the Commission, by the Division of Investment Management, under delegated authority.

Joanathan G. Katz,
Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40204; File No. 4-208]

RIN 3235-AH51

Proposed Rulemaking Pursuant to Section 11A of the Securities Exchange Act of 1934 to Amend the Intermarket Trading System ("ITS") Plan To Link the PCX Application of the OptiMark System to the ITS System

AGENCY: Securities and Exchange Commission.

ACTION: Proposed amendments to national market system plan.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing alternative amendments to the plan governing the operation of the Intermarket Trading System ("ITS Plan" or "Plan") that was approved pursuant to Rule 11Aa3-2 under the Securities Exchange Act of 1934, as amended ("Exchange Act" or "Act"). The proposed amendments provide for the linkage of the Pacific Exchange, Inc. ("PCX") Application of the OptiMark System to the ITS System.

DATES: Comments should be submitted by August 21, 1998.

ADDRESSES: All comments should be submitted in triplicate and addressed to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Mail Stop 6-9, 450 Fifth Street, NW., Washington, DC 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comments should refer to File No. 4-208; this file number should be included in the subject line if E-mail is used. Comment letters will be available for public inspection and copying at the Commission's Public Reference Room at the same address. Electronically submitted comment letters will be posted on the Commission's web site (<http://www.sec.gov>).

FOR FURTHER INFORMATION CONTACT: Katherine A. England, Assistant Director, at (202) 942-0154; Elizabeth

Prout Lefler, Special Counsel, at (202) 942-0170; Heather A. Seidel, Attorney, at (202) 942-4165; or Christine Richardson, Attorney, at (202) 942-0748, Office of Market Supervision, Division of Market Regulation, Securities and Exchange Commission, Mail Stop 10-1, 450 Fifth Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is proposing, on its own initiative pursuant to Rule 11Aa3-2 under the Exchange Act,¹ alternative amendments to the ITS Plan² to link the PCX Application of the OptiMark System ("PCX Application") to the ITS System. Facilitation of this linkage is intended to further the statutory goals of efficient execution of securities transactions, opportunities for best execution of customer orders, as well opportunities for investors' order to be executed without the participation of a dealer. The Commission is proposing these alternative amendments only after the ITS Operating Committee ("ITSOC") was unsuccessful in reaching agreement on Plan amendments to implement the linkage with the PCX Application.³ The

¹ Rule 11Aa3-2 (17 CFR 240.11Aa3-2) establishes procedures for initiating or approving amendments to national market system plans such as the ITS Plan. Paragraph (b)(2) of Rule 11Aa3-2 states that the Commission may propose amendments to an effective national market system plan by publishing the text thereof together with a statement of purpose of the amendments. Paragraph (c)(2) requires the Commission to publish notice of any amendments initiated by the Commission and provide interested parties an opportunity to submit written comments. Further, Paragraph (c)(2) of Rule 11Aa3-2 requires that promulgation of an amendment to an effective national market system plan initiated by the Commission be by rule.

² ITS is a communications and order routing network linking eight national securities exchanges and electronic over-the-counter ("OTC") market operated by the National Association of Securities Dealers, Inc. ("NASD"). ITS was designed to facilitate intermarket trading in exchange-listed equity securities based on current quotation information emanating from the linked markets. The ITS Plan governs the use of ITS. Signatories to the ITS Plan are the American Stock Exchange, Inc. ("Amex"), the Boston Stock Exchange, Inc. ("BSE"), the Chicago Board Options Exchange, Inc. ("CBOE"), the Chicago Stock Exchange, Inc. ("CHX"), the Cincinnati Stock Exchange, Inc. ("CSE"), the NASD, the New York Stock Exchange, Inc. ("NYSE"), the Pacific Exchange, Inc. ("PCX"), and the Philadelphia Stock Exchange, Inc. ("Phlx") (collectively, "Participants").

³ Section 4(c) of the ITS Plan requires a unanimous vote of approval in order to amend the Plan. The full ITSOC met on June 3, 1998, to vote on amendments proposed by the PCX that are substantially similar to one alternative being proposed today by the Commission. The PCX proposed a "Description Amendment" and a "Formula Amendment." The NYSE provided alternative proposed language but did not formally propose the language amendments or seek a vote on its language. The ITSOC members were divided on the PCX's amendments. The amendments were not approved.

Commission is publishing this proposal for comment from interested persons.

I. Background

A. The ITS System

Section 11A(a)(2) of the Exchange Act, adopted by the Securities Acts Amendments of 1975 ("1975 Amendments"),⁴ directs the Commission, having due regard for the public interest, the protection of investors and the maintenance of fair and orderly markets, to use its authority under the Act to facilitate the establishment of a national market system ("NMS") for securities in accordance with the Congressional findings and objects set forth in Section 11A(a)(1) of the Act. Among these findings and objectives is the "linking of all markets for qualified securities through communication and data processing facilities."⁵

On January 26, 1978, the Commission issued a statement on the national market system calling for, among other things, the prompt development of comprehensive market linkage and order routing systems to permit the efficient transmission of orders among the various markets for qualified securities, whether on an exchange or over-the-counter.⁶ In particular, the Commission stated that an intermarket order routing system was necessary to "permit orders for the purchase and sale of multiply-traded securities to be sent directly from any qualified market to another such market promptly and efficiently."⁷ The Commission further stated that "[t]he need to develop and implement a new intermarket order routing system to link all qualified markets could be obviated if participation in the ITS market linkage currently under development were made available on a reasonable basis to all qualified markets and if all qualified markets joined that linkage."⁸

As requested by the Commission, in March 1978, various exchanges⁹ filed jointly with the Commission a "Plan for

⁴ Pub. L. No. 94-29 (June 4, 1975).

⁵ Section 11A(a)(1)(D) of the Act, 15 U.S.C. 78k-1(a)(1)(D).

⁶ Exchange Act Release No. 14416 (January 26, 1978) ("1978 Statement"), at 26, 43 FR 4354, 4358. Previously, on June 23, 1977, the Commission had indicated that a national market system would include those "regulatory and technological steps [necessary] to achieve a nationwide interactive market system." See Exchange Act Release No. 13662 (June 23, 1977), at 20, 42 FR 33510, 33512.

⁷ 1978 Statement, *supra*, note 6, at 4358.

⁸ In this connection, the Commission specifically indicated that "qualified markets" would include not only exchanges but OTC market makers as well. *Id.*

⁹ The exchanges involved were Amex, BSE, NYSE, PSE (now the PCX), and Phlx.

the Purpose of Creating and Operating an Intermarket Communications Linkage," now known as the ITS Plan.¹⁰ On April 14, 1978, the Commission, noting that ITS might provide the basis for an appropriate market linkage facility in a national market system, issued a provisional order, pursuant to Section 11A(a)(3)(B) of the Act,¹¹ authorizing the filing exchanges (and any other self-regulatory organization ("SRO") that agreed to become a participant in the ITS Plan) to act jointly in planning, developing, operating and regulating the ITS in accordance with the terms of the ITS Plan for a period of 120 days.¹²

The ITS Plan was approved on a permanent, indefinite basis on January 27, 1983.¹³ It contains a number of market integrity provisions to provide for continuity of transaction prices among the various market centers. For example, the Plan includes a trade-through rule.¹⁴ It also contains a block trade policy, that provides special rights to any market displaying the best national bid or offer when block-size transactions are occurring in another market.¹⁵

Furthermore, since its permanent approval, the NASD and CSE have been added as Participants to the Plan.¹⁶

¹⁰ The ITS Plan is contained in File No. 4-208.

¹¹ 15 U.S.C. 78k-1(a)(3)(B).

¹² See Exchange Act Release No. 14661 (April 14, 1978), 43 FR 17419. In authorizing the implementation of ITS, the Commission urged those SROs not yet ITS participants to participate in ITS. *Id.* at 7 n.15, 43 FR 17421. On August 11, 1978, the Commission extended ITS authority for an additional period of one year. See Exchange Act Release No. 15058 (August 11, 1978), 43 FR 36732. In the interim the ITS Plan had been amended to include the Midwest Stock Exchange ("MSE") as a participant. The MSE is now the CHX.

¹³ See Exchange Act Release No. 19456 (January 27, 1983), 48 FR 4938 (February 3, 1983).

¹⁴ A trade-through occurs when a transaction is effected at a price below the best prevailing bid, or above the best prevailing offer. The ITS Plan requires price continuity among the various markets by ensuring that the best national bids and offers are provided opportunities to trade with other markets affecting trades outside the best national quote.

¹⁵ See ITS Plan, Section 8(d)(iii).

¹⁶ On April 28, 1981, due to a reluctance of the ITS Participants, the Commission issued an order requiring the ITS Participants to implement an automated interface between CAES and ITS by March 1, 1982, limited to Rule 19c-3 securities, and to submit proposed amendments to the ITS Plan reflecting the inclusion of the NASD as an ITS Participant. See Exchange Act Release No. 17744 (April 21, 1981), 46 FR 23856 (April 28, 1981). On March 11, 1982 the Commission delayed the implementation date of the interface until May 1, 1982 and published its own proposed amendments to the ITS Plan. See Exchange Act Release No. 18536 (March 11, 1982), 47 FR 10658. Consequently, due to the inability of the ITS Participants to submit an amendment, on May 12, 1982, the Commission adopted its own amendments to the ITS Plan, providing for the

B. Description of the PCX Application

The PCX application¹⁷ is the computerized facility of the PCX that receives orders generated by the "OptiMark System",¹⁸ a patented electronic matching system based on an optimization algorithm that, on a periodic "call" basis, processes certain qualifying expressions of trading interest called satisfaction profiles ("Profiles"), including Profiles created from the published quotations disseminated by the other participants at commencement of the OptiMark System call reflecting the best bid and offer prices and associated sizes ("CQS Profiles").¹⁹ OptiMark is a screen-based trading service intended for use by PCX members and their customers. The OptiMark System will provide automatic order formulation, matching, and execution capabilities in the equity securities listed or traded on the PCX ("PCX Securities"). The OptiMark system will be used by PCX members, in addition to PCX's traditional floor facilities, to buy and sell PCX Securities.

The PCX Application will allow PCX members and their customers to submit anonymously from their computer terminals Profiles to the OptiMark System. At specified times during the trading day, the OptiMark System will conduct certain calculations against the Profiles to identify specific orders capable of execution (a "cycle").²⁰ All

inclusion of the NASD in ITS. See Exchange Act Release No. 18713 (May 12, 1982), 47 FR 20413.

Rule 19c-3 under the Act, as adopted, precludes exchange off-board trading restrictions from applying to securities listed after April 26, 1979. See Exchange Act Release No. 16888 (June 11, 1980), 45 FR 41125.

In April 1981, the ITS Plan was amended to provide for participation of the CSE in ITS via a manual interface between ITS and CSE's automated National Securities Trading System ("NSTS"). See Exchange Act Release No. 17702 (April 9, 1981). The Plan was later amended again to provide for automated interface between ITS and the CSE's NSTS. See Exchange Act Release No. 23365 (June 23, 1986), 51 FR 23865 (July 1, 1986).

¹⁷ For a more detailed description of the OptiMark System, see Exchange Act Release No. 39086 (September 17, 1997), 62 FR 50036 (September 24, 1997).

¹⁸ The OptiMark System was developed by OptiMark Technologies, Inc. ("OTI"), a computer technology firm located in Durango, Colorado.

¹⁹ CQS Profiles are profiles created from the published quotations disseminated by the other Participants at commencement of the OptiMark System call reflecting the public best bid and offer prices and associated sizes. See Proposed ITS Plan Section 1(33A).

²⁰ Cycles would be based on a computer algorithm that is designed to measure and rank all relevant mutual satisfaction outcomes by matching individual coordinates from intersecting Buy Profiles and Sell Profiles. The matching algorithm of the OptiMark System is intended to compute optimal trade results from Users based on their different willingness to trade across a wide range of price and size.

orders formulated by the OptiMark System will be executed automatically on the PCX, except to the extent that they are executed on other market centers through ITS.

II. Discussion

The Commission is proposing, on its own initiative as requested by PCX,²¹ to amend the ITS Plan, pursuant to Rule 11Aa3-2(b)(2) and (c)(1) and the Commission's authority under Section 11A(a)(3)(B) of the Act,²² to link the PCX Application of the OptiMark System to the ITS System. Specifically, the Commission is proposing two alternative ITS Plan amendments, each of which would incorporate definitions of basic terms and a description of ITS transactions resulting from the PCX Application ("PCX Description Amendment" and "NYSE Description Amendment"). In addition, the Commission is proposing two alternative amendments, each of which would establish a formula limiting the percentage of outgoing commitments to trade that can be sent from the PCX Application to ITS ("PCX Formula Amendment" and "NYSE Formula Amendment"). The proposed alternative amendments substantially reflect amendments presented by the PCX to the ITSOC on June 6, 1998, as well as amendments submitted to the ITSOC by the NYSE in response to PCX's proposed amendments.²³ The Commission has determined to take this action only after the ITS Participants, despite extended negotiations, have proven unable to come to agreement regarding the linkage of the PCX Application to the ITS System. The PCX Application will be ready to begin operations in September 1998. The Commission believes that this linkage will further the purposes of Section 11A of the Act²⁴ and the development of a NMS by promoting economically efficient execution of securities transactions, fair competition among markets, the best execution of customer orders, and an opportunity for orders to be executed without the participation of a dealer.

The Commission believes that linkage of the PCX Application to the ITS System will provide a new and potentially more efficient way to match and execute trading interest. The PCX Application appears principally

²¹ See Petition for Rulemaking to Amend the ITS Plan, from PCX and OptiMark, dated June 9, 1998 ("PCX Rulemaking Petition").

²² 5 U.S.C. 78k-1(a)(3)(B).

²³ The alternative amendments being proposed by the Commission substantively reflect those amendments proposed by the PCX and the NYSE.

²⁴ 15 U.S.C. 78k-1.

designed to meet the demands of sophisticated portfolio managers and other market professionals implementing complex trading strategies. These market participants often require instantaneous access to the market, and desire to minimize the market impact of their transactions through the expression of varied trading interests on a confidential basis. At the same time, the PCX Application is designed to allow retail customers, through PCX members Users, to interact with institutional trading interests.

The Commission believes that PCX is entitled to modify its market place, subject to Commission approval, to provide a new, innovative trading system for listed securities. The PCX Application is likely to promote competition among market centers because it has the potential to attract new market participants and to increase order flow to the PCX. By attracting order flow, the PCX Application may provide a new and enhanced source of liquidity for investors that may lessen order flow to other less-automated exchanges. The linkage of the PCX Application to the ITS System should increase the ability of investor orders to interact directly with other investor orders. Moreover, the Commission believes that the linking of the PCX Application to the ITS System should benefit both institutional and retail investors insofar as their expressions of trading interest will be represented in the OptiMark System and should be more likely to result in executions.

The Commission has historically encouraged exchanges to integrate new data communications and trade execution mechanisms into their markets in furtherance of the development of the NMS.²⁵ The

Commission, for example, approved the fully computerized NSTS of the Cincinnati Stock Exchange, the MAX and SuperMAX Systems of the CHX, the CAES operated by Nasdaq.²⁶ In fact, the PCX Application shares many of the characteristics of the CHX's Chicago Match System, which was approved by the Commission in 1994.²⁷ The Commission notes that both the NSTS and CAES are linked with the ITS System.

The PCX represented in its rule filing for the PCX Application that the PCX Application would be operated in a manner consistent with the PCX's intermarket price protection obligations under the ITS Plan.²⁸ The PCX Application would incorporate existing market interest from each of the ITS Participant markets in the form of CQS Profiles. All orders generated from a cycle priced inferior to the quotations of another ITS Participant market would be executed on the PCX only upon submission of appropriate ITS commitments seeking to reach such better-priced interest. For orders representing matched coordinates from CQS Profiles and other Profiles, the PCX would send an ITS commitment reflecting each such order for execution on other market centers to which the OptiMark System is not directly linked. Under the PCX Description Amendment, an ITS commitment would be sent immediately following the matching of the Profiles. Under the NYSE Description Amendment, before an ITS commitment could be sent, the PCX Application would first be required to provide the PCX specialist with an opportunity to trade in place of the pending ITS commitment. Every ITS commitment would then be sent under

the "give-up" (an identifying symbol) of the member User or the Designated Broker, by way of the traditional PCX linkage to the ITS, in the sequence in which orders are generated from the cycle. Thus, the Commission preliminarily believes that the linkage of the PCX Application to the ITS System may be accomplished in a manner fully consistent with the ITS Plan.

The Commission understands that certain ITS Participants believe that adoption of an amendment establishing a percentage formula is necessary in order to prevent the possibility that ITS, as used by the PCX members and their customers through the PCX Application, will be used as an automated order delivery device to obtain cost-free, non-member access to other market centers. The Participants considered two formulas, the PCX Formula and the NYSE Formula, in an attempt to provide a form of "back-end" protection that would serve as a prophylactic measure to address potential access concerns. The Commission is proposing these as alternative amendments. Although they differ in specifics, both the PCX Formula Amendment and the NYSE Formula Amendment would prevent, by establishing a numerical limit, the PCX Application's linkage to ITS from becoming an automated order delivery system to other market centers. The proposed percentage ceilings of each formula amendment vary depending on what types of trades are included in the formula.

A. Background to the PCX Application Amendment

The Commission approved the PCX's new facility called the PCX Application of the OptiMark System in September 1997.²⁹ With regard to ITS, the Commission notes that the PCX has consistently taken the position that no ITS Plan amendments are necessary before the PCX Application of the OptiMark System is implemented, but that after such implementation, the PCX Application would be monitored to ensure that no Plan violations occurred. This position was affirmed by six of the eight other ITS Participants when the issue was presented to the entire ITSOC for deliberation on December 11, 1997. Two Participants, the NYSE and Amex, abstained from voting. Despite the results of the ITSOC vote, the NYSE continued to express its belief that the PCX Application requires a Plan amendment that includes certain specific protections to ensure that the PCX Application will not be used in an improper manner. The NYSE also

²⁵ In 1982, when recognizing the Cincinnati Stock Exchange's NSTS as a permanent program, the Commission stated:

In mandating the development of a NMS, Congress expressly stated that "[n]ew data processing and communications techniques create the opportunity for more efficient market operations." . . . In carrying out Congress' mandate, the Commission has taken an evolutionary approach by encouraging the securities industry to take the primary initiative in fashioning trading mechanisms which are consistent with the goals of a NMS. The Commission believes that, as a general matter, the industry has responded well to changing economic and technological demands by attempting to integrate state of the art data processing and communications technology to develop many new trading systems which have advanced the objectives of a NMS. In this respect, the Commission believes that ITS, the NASD's [National Association of Securities Dealers'] Computer Assisted Execution System ("CAES") and the NSTS represent constructive approaches to integrating trading in physically dispersed locations. (citations omitted)

Exchange Act Release No. 19315 (December 9, 1982), 47 FR 56236 (December 15, 1982).

²⁶ See, e.g., Exchange Act Release No. 19315 (Dec. 9, 1982), 47 FR 56236 (Dec. 15, 1982) (Commission approval to terminate the NSTS as an experimental program and extend its duration for an indefinite period of time); Exchange Act Release No. 12451 (May 14, 1976), 41 FR 20932 (May 21, 1976) (Commission approval of the MAX system to operate on a permanent basis); Exchange Act Release No. 32631 (July 14, 1993), 58 FR 39069 (July 21, 1993) (Commission approval to operate the SuperMAX system on a permanent basis); Exchange Act Release No. 17601 (March 4, 1981), 46 FR 16171 (March 11, 1981) (Commission notice of the NASD filing of proposed rule change for the establishment of CAES); Exchange Act Release No. 17744 (April 21, 1981), 46 FR 23856 (April 28, 1981) (Commission order to implement an automated interface between the ITS and the CAES); and Exchange Act Release No. 18713 (May 6, 1982), 47 FR 20413 (May 12, 1982) (implementing ITS/CAES interface and operations).

²⁷ Exchange Act Release No. 35030 (November 30, 1994), 59 FR 63141 (December 7, 1994). The PCX Application differs from Chicago Match in that it is a periodic, rather than a unitary, call market.

²⁸ See Exchange Act Release No. 39086 (September 17, 1997), 62 FR 50036 (September 24, 1997).

²⁹ *Id.*

disagreed with the implication that the ITSOC has the policy-making authority to interpret provisions of the ITS Plan.

Notwithstanding the NYSE's position, the PCX continued to believe that an amendment to the ITS Plan prior to the implementation of the PCX Application was not necessary, however, the PCX indicated that, to the extent that certain prophylactic protections were deemed necessary by the ITSOC, the PCX would submit for ITSOC consideration a description amendment, as well as a formula amendment. On June 3, 1998, the ITSOC met to consider PCX's proposed amendments to the ITS Plan regarding the PCX Application of the OptiMark System. The first amendment, the PCX Description Amendment, contained a definition of basic terms and a description of ITS transactions resulting from the PCX Application. The second amendment, the PCX Formula Amendment, contained a prophylactic protection in the form of a percentage formula to prevent any potential misuse of the PCX Application. Neither amendment was approved. The NYSE also submitted its own version of an NYSE Description Amendment and as NYSE Formula Amendment; however, these amendments were not presented for a vote to the ITSOC. As a result of the ITSOC vote, the Commission, on its own initiative, is proposing in substantially similar form, both the PCX and NYSE Description Amendments, as well as the PCX and NYSE Formula Amendments, in order to link the PCX Application to the ITS System.

B. Description of the ITS Amendments

The Commission proposes to add two new terms to Section 1, the "PCX Application" and the "PCX Application Module," in subsections 33(a) and 33(b) respectively. Both the PCX and NYSE Description Amendments propose to add the term, "PCX Application," which refers to the computerized facility of the PCX (as defined in PCX Rule 15.1) that will receive orders generated by the OptiMark System. Specifically, Section 1(33A) provides that the PCX would process orders received by the PCX Application to permit: (1) Execution on PCX of orders that reflect a match between contra-side non-CQS Profiles; and (2) transmission to ITS of those orders reflecting a match between a non-CQS Profile and a CQS Profile. The two proposed definitions of "PCX Application" are similar except for the method by which orders reflecting a match between a non-CQS Profile and a CQS Profile would be transmitted to ITS. The PCX Application would not become an ITS

Participant under either proposed definition.

Both the PCX and NYSE Description Amendment provide for identical definitions of "PCX Application Module" to be added to the Plan. "PCX Application Module" refers to the computerized subsystem of the PCX Application that will permit automatic formatting of orders received from the OptiMark System to ITS commitments. Certain technical amendments to the existing definitions are also being proposed to specifically incorporate the proposed operation of the PCX Application.³⁰

The Commission is proposing both the PCX's and the NYSE's Description Amendment to Section 6(a)(ii) of the Plan. In proposing these alternative amendments, the Commission takes no position with respect to the need for any Plan amendment. The amendments being proposed provide a detailed description of four generic scenarios in which ITS commitments will be automatically generated and sent by means of the PCX Application Module.³¹ As proposed, the NYSE's Description Amendment to Section 6(a)(ii) differs from the PCX's version in that the fourth scenario refers to commitments generated via a transaction involving one or more commitments to trade at the inferior block trade price for all of the size associated with the CQS Profile as "block policy" commitments originating from the PCX Application Module. In contrast, the PCX Description Amendment refers to such commitments as "trade-through" commitment. The substantive result is

³⁰ Both the PCX and NYSE Description Amendments proposed identical changes with respect to the following: (a) section 1(11) is being amended to reflect that, in addition to meaning the floor(s) of an Exchange Participant, the term "Exchange (Participant's) Market" also means the PCX Application of the PCX; (b) section 1(23) is being amended to provide that "member," member in the market center," "member on the floor" and "member in the Participant" (and any derivative) are defined to include one or more PCX members in their use of the PCX Application; (c) section 1(34A) is being amended to state that, in the case of PCX, members will be able to participate with the regional computer interface by means of the PCX Application Module; and (d) section 1(34B) to state that on PCX the entry of commitments to trade and receipt of reports of executions or cancellations of such commitments will be by means of the PCX Application Module.

³¹ The NYSE proposed amendment to Section 6(a)(ii) contained language that, if adopted, would have required a Plan amendment for any proposal that was developed by a Participant for communicating with the ITS System in a manner different than described in Section 6(a)(ii) for that Participant. The Commission, however, is not including this language in the amendments currently being proposed.

that these trades would be counted differently in the formula calculation.

Both the PCX and NYSE Description Amendments distinguish between (1) "trade-at" commitments and (2) "trade-through" commitments. For the specific purposes of the PCX Application, "trade-at" commitments refer to those commitments sent to obtain access to the quotes of other ITS Participants upon exhausting all available PCX trading interest at a price superior or equal to the quoted interest. "Trade-through" commitments refer to those commitments sent when trades otherwise would be executed on the PCX at inferior prices—that is, these commitments are sent to satisfy the away market superior quotes to avoid a potential violation of the ITS trade-through rule and block trade policy.

The NYSE Description Amendment to Section 6(a)(ii) also would require, prior to the PCX Application Module generating a commitment to trade representing an OptiMark System order, that the PCX process the order in accordance with proposed Section 8(a)(v) (requiring a probe of the PCX market—that is, a second exposure of the order to the PCX floor specialists before an ITS commitment is sent to another market), and, if possible, execution of the order on the PCX. The PCX Description Amendment does not contain this requirement. The PCX believes that, since PCX specialists will be required to enter their displayed bids and offers into the OptiMark System, a secondary probe is unnecessary after an order is generated by OptiMark and sent to the PCX Application.

Finally, the Commission realizes that certain ITS Participants believe that adoption of an amendment establishing a percentage formula is necessary in order to prevent the possibility that ITS, as used by the PCX members and their customers through the PCX Application, will be used as an order-delivery device to obtain cost-free, non-member access to other market centers. Therefore, the Commission is proposing both the PCX Formula Amendment and the NYSE Formula amendment. Generally, both Amendments add Section 8(h) to describe the operational parameters of the automated linkage between the PCX Application and ITS.

The PCX Formula Amendment establishes a percentage formula that would operate as a ceiling on the volume of "trade-at" commitments generated by the PCX on an automated basis, relative to the total volume of transactions resulting from the PCX Application (inclusive of ITS commitments). The percentage would be calculated on a share volume basis

for each "Rolling Calendar Quarter."³² This calculation would look at the "trade-at" commitments sent to and executed by certain Participants that appropriately notify PCX in advance.³³ Under the PCX Formula Amendment, the generation of "trade-through" commitments would be outside the scope of the formula because the PCX does not believe that it should be penalized for, or prevented from, sending any "trade-through" commitments that it is obligated to send in order to fulfill what it characterizes as its "best execution obligations as a national market system participant."³⁴ The ceiling applicable to the PCX Application is determined in reference to the PCX's historical use of ITS, but will be higher for the first two phase-in stages. In this regard, the base percentage ceiling is set at 20%, with the phase-in ceilings set at 25% and 22.5%, subject to an adjustment in the ceilings to account for sudden periods of market volatility.

The PCS Formula Amendment also provides that, in the event that the Percentage of PCX Application ITS Volume exceeds the PCX Application ceiling for three consecutive rolling calendar quarters, PCX would be required to stop sending "trade-at" commitments that originate from the PCX Application Module on the first business day of the second month following the end of the third of such consecutive rolling calendar quarters. The restrictions would end on the first business day of the third month following the restriction date.³⁵ The PCX Formula Amendment further provides for a twenty-four-month implementation period during which the PCX may notify the ITSOC that it will undertake system adjustments to

the PCX Application to ensure future compliance with the PCX Application ceiling. The PCX would have a minimum of nine calendar months from the date of notice to implement the proposed system adjustments. During this implementation period, the restrictions on sending ITS "trade-at" commitments originating from the PCX Application Module would not apply. Furthermore, the PCX Formula Amendment would require the PCX to provide the ITSOC with a report each month, indicating the number of shares for each of the components of the PCX Application Formula for the previous month, as well as the data necessary to determine the number of "trade-through" commitments originating from the PCX Application Module. Any Participant may call for an audit of these reports by a certified public accountant.

The NYSE Formula Amendment would calculate the percentage ceiling by dividing (a) ITS executed share volume resulting from PCX Application-generated automated commitments sent to other Participant markets by (b) total OptiMark share volume (that is, ITS outgoing executed share volume plus internal PCX Application executed volume). The NYSE Formula Amendment also provides for application of the formula on a rolling calendar quarter basis. Furthermore, the NYSE Formula Amendment initially would cover only "trade-at" commitments. It would not include "block trade" commitments. The formula also would not initially cover "trade-through" commitments, but such commitments would be included on a prospective basis if the ITS executed share volume resulting from a cycle evidences that the exclusion of trade-throughs creates a loophole in the formula. Specifically, the NYSE Formula Amendment provides that share volume from "trade-through" commitments would not be included in the formula unless, for a rolling calendar quarter, the PCX fails to execute internally at least 75 percent of the volume in those OptiMark calls producing trade-through commitments. Under the NYSE Formula Amendment, the base percentage ceiling applicable to the PCX Application would be set at 5%, with the phase-in ceilings set at 15% and 10%.³⁶ The NYSE Formula Amendment does not provide for adjustments to the ceiling limits to account for market volatility.

³⁶ The NYSE Formula Amendment bases these ceiling levels on the PCX's historical use of ITS for agency business (that is, excluding activity for the accounts of PCX specialists).

The NYSE Formula Amendment provides that, in the event that the Percentage of PCX Application ITS Volume exceeds the PCX Application ceiling for three consecutive rolling calendar quarters, PCX would be required to stop sending "trade-at" commitments, as well as "non-block-trade-through" commitments that originate from the PCX Application Module on the first business day of the second month following the end of the third of such consecutive rolling calendar quarters. The restrictions would end on the first business day of the third month following the restriction date. The restrictions would not apply to block trade commitments. The NYSE Formula Amendment also provides for a twenty-four-month implementation period during which the PCX may notify the ITSOC that it will undertake system adjustments to the PCX Application to ensure future compliance with the PCX Application ceiling. The NYSE Formula Amendment also grants the PCX a minimum of nine calendar months from the date of notice to implement the proposed system adjustments. During this implementation period, the restrictions on sending ITS "trade-at" commitments originating from the PCX Application Module would not apply; however, the NYSE Formula Amendment provides for a "fail-safe" mechanism: if the formula produces a number greater than 30 percent for a rolling calendar quarter, the restrictions would take effect notwithstanding any grace periods or other delay. The NYSE Formula Amendment also would require the PCX to provide the ITSOC with a report each month, indicating the number of shares for each of the components of the PCX Application Formula for the previous month, as well as the data necessary to determine the number of "trade-through" commitments originating from the PCX Application Module. Any Participant may call for an audit of these reports by a certified public account.

III. Request for Comment

The Commission is soliciting comment on the proposed amendments to the ITS Plan to link the PCX Application to the ITS System as discussed above, and also requests comment on specific issues presented by the proposed linkage. Interested persons are invited to submit written presentations of views, data and arguments concerning the proposed amendments to the ITS Plan, including the feasibility of implementing the proposed changes. The Commission further solicits comments on any other alternative amendments that

³² "Rolling Calendar Quarter" means any three consecutive calendar months, with the first Rolling Calendar Quarter ending on the last business day of the first three full calendar months following the month in which the PCX Application commences operation.

³³ Any Participant may notify the PCX, in writing, that it chooses to have included in the formula the ITS share volume (for "trade-at")

³⁴ See PCX Rulemaking Petition, *supra* note 21.

³⁵ For example, assume that the percentage of PCX Application ITS volume exceeded the PCX Application ceiling for the Rolling Calendar Quarters ending January, February and March of a given year. The restriction date would be the first business day of May of that year, which is the first business day of the second month following March. The restrictions would apply as of that date and would continue through the end of July (ceasing as of the first business day of August, which is the first business day of the third month following May). Nothing would prohibit PCX from sending "trade-at" commitments through an acceptable alternative means, in lieu of utilizing the PCX Application, such as by electing to participate manually, as permitted under the ITS Plan outside the scope of Section 8(a)(v) of the Plan.

commenters may feel would better achieve the goals of the federal securities laws with respect to linking the PCX Application to the ITS.

The NYSE does not believe that the PCX Application complies with the probing requirement contained in Section 8(a)(v) of the Plan, which states, in part, that "[r]easonable efforts to probe the market to achieve a satisfactory execution there are expected to be taken before an order is reformatted as a commitment to trade and rerouted to another market through the System." The PCX believes that a requirement (which it plans to implement) that all specialists on its floor enter their quotes into the OptiMark System prior to a matching session satisfies the probing requirement. The Commission is requesting comment on whether the PCX Application, in light of PCX's requirement, complies with the "reasonable" probing aspect of Section 8(a)(v) of the Plan. The Commission also seeks comment on whether the PCX's or NYSE's version of the Description Amendment better meets the objectives of Section 11A of the Exchange Act, or whether an alternative that combines features of each version should be adopted.

According to the ITS Plan, ITS is not to be used as "an order delivery system whereby all or a substantial portion of orders to buy and sell System securities which are sent to a particular market are not executed within that market, but are rerouted to another market through the System for execution," as described in Section 8(a)(v) of the Plan. The Commission requests comment on the alternative formula amendments. The Commission may, after considering the comments, adopt some or all of the components of these formula amendments. The Commission also is requesting comment on whether it is necessary to amend the Plan to include a percentage formula in order to satisfy the requirements of Section 8(a)(v), or whether it would be sufficient for PCX to integrate OptiMark without a limitation on the amount of outgoing ITS commitments that are sent from the PCX Application to another marketplace for execution. If a percentage formula is not adopted in the Plan at this time, the Commission would expect the PCX to monitor the amount of outgoing commitments sent to ITS through the PCX Application in order to ensure that the PCX Application was not being used as this type of default order delivery system. If the Commission found that the PCX Application was being used in a manner inconsistent with this provision, the Commission would then

require that the Plan be amended or that the operation of the PCX Application be altered in order to resolve the problem.

IV. Costs and Benefits of the Proposed Amendments and Their Effects on Competition, Efficiency and Capital Formation

Section 23(a)(2) of the Exchange Act requires the Commission, when promulgating rules under the Exchange Act, to consider the anti-competitive effects of such rules, if any, and to not adopt any rule that would impose a burden on competition that is not necessary or appropriate to further the purposes of the Exchange Act.³⁷ The Commission preliminarily has considered the proposed amendments to the ITS Plan in light of the standards cited Section 23(a)(2) of the Act and believes that they would not likely impose any significant burden on competition not necessary or appropriate in furtherance of the Exchange Act. The Commission believes that the PCX Application likely will promote competition among market centers because it has the potential to attract new market participants and to increase order flow to the PCX. By attracting order flow, the PCX Application may provide a new and enhanced source of liquidity for investors.

Commenters should consider the proposed rule's effect on competition, efficiency and capital formation.

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission is also requesting information regarding the potential impact of the proposed rule on the economy on an annual basis. If possible, commenters should provide empirical data to support their views.

The assist the Commission in its evaluation of the costs and benefits that may result from the proposed amendments, commenters are requested to provide analysis and data, if possible, relating to costs and benefits associated with the proposal herein. The Commission preliminarily believes that the proposed amendments to the ITS Plan to include the PCX Application of the OptiMark System in the ITS System will provide a new and potentially more efficient way for the PCX to match and execute trading interest on behalf of investors. The Commission is requesting comment on the costs and benefits of the proposed amendments, and a comparison of the two alternative sets of amendments, as well as any possible anti-competitive impact of the proposed amendments. Specifically, the

Commission requests commenters to address whether the proposed amendment would generate the anticipated benefits or impose any cost on U.S. investors or others.

Comments should be submitted by August 21, 1998.

V. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis ("IRFA") has been prepared in accordance with Section 3 of the Regulatory Flexibility Act ("RFA").³⁸ It relates to proposed amendments to the ITS Plan to allow the linkage of the PCX Application of the OptiMark System to ITS.

A. Reasons for and Objectives of the Proposed

The Commission preliminarily believes that the Plan should be amended to add the PCX Application as an approved interface with ITS. The Commission is proposing the amendments on its own initiative because, despite prolonged negotiations, the ITS Participants have been unable to agree on how or whether to amend the Plan to link the PCX Application to ITS.

The Commission preliminarily believes that this linkage will further the purposes of Section 11A of the Act³⁹ and the development of a national market system by promoting economically efficient executions of securities transactions, fair competition among markets, best execution of customer order, and an opportunity for orders to be executed without the participation of a dealer.

B. Legal Basis

Section 11A(a)(3)(B) of the Exchange Act authorizes the Commission, by rule or order, to authorize or require SROs to act jointly with respect to matters as to which they share authority under the Exchange Act in planning, developing, operating or regulating a national market system (or a subsystem thereof) or one or more facilities thereof. It states explicitly that the Commission not only may approve national market system facilities in response to an application by SROs, but also may require SROs to implement such facilities on their own initiative. Rule 11Aa3-2,⁴⁰ adopted by the Commission under Section 11A, establishes procedures for proposing amendments to national market system plans such as the ITS Plan. Paragraph (b)(2) states that the Commission may propose amendments to an effective

³⁸ 5 U.S.C. 603(a).

³⁹ 15 U.S.C. 78k-1.

⁴⁰ 17 CFR 240.11Aa3-2.

³⁷ See 15 U.S.C. 78w(a)(2).

national market system plan by publishing the text of the amendment together with a statement of purpose of the amendment.

C. Small Entities Affected by the Proposed Amendments

The proposal would directly affect the nine Participants of ITS, none of which are small entities. However, specialists on the exchange floors who trade ITS securities, floor brokers on exchange floors placing orders into ITS, and registered ITS/CAES market makers who trade ITS securities in the third market could be indirectly affected.

Paragraph (c)(1) of Rule 0-10⁴¹ states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that: (1) Had total capital (net worth plus subordinated liabilities) of less than \$500,000 in its prior fiscal year audited financial statements or, if not required to file such statements, on the last business day of the preceding fiscal year; and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization. The Commission currently does not have any data on the number of small entities that could be affected.⁴²

1. ITS Participants

The ITS Participants must comply with the proposed amendments once the amendments are adopted. The amendments would affect the eight Participants (other than PCX) in that they would be obliged to accept all properly transmitted ITS commitments reflecting a match between an expression of interest from OptiMark and a quote from another Participant market sent to their markets from the PCX Application by virtue of PCX being allowed to link the PCX Application to ITS.

2. Specialists, Floor Brokers, and Market Makers

Specialists who trade ITS securities on exchange floors, and floor brokers who enter orders into ITS, would be

indirectly affected by the proposed amendments. Specialists would be required to accept commitments originating from the PCX Application reflecting a match between their quote or a floor broker order. Specifically, when a specialist entered its quote into ITS (or a floor broker entered an order into ITS) that constituted the best bid or offer for that security (ITS/BBO), the OptiMark System would match that quote (a "CQS Profile") with any appropriately priced OptiMark expression of interest (a "non-CQS profile"), resulting in an ITS commitment being sent from the PCX Application to the specialist. ITS/CAES market makers would be similarly affected.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposal would not impose any new reporting, recordkeeping, or other compliance requirements on broker-dealers indirectly affected by the proposal.

E. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap or conflict with, the proposed rules.

F. Significant Alternatives

The RFA directs the Commission to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant economic impact on small entities. In connection with the proposal, the Commission considered the following alternatives: (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the Rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the Rule, or any part thereof, for small entities.

The Commission believes that none of the above alternatives is applicable to the proposed amendments. The ITS Participants are the only parties that are subject to the requirements of the ITS Plan. The ITS Participants are all national SROs and, as such, are not "small entities." The additional recordkeeping and reporting burden is solely on PCX, which is subject to Exchange Act Rule 11Aa3-1 reporting requirements, and is not a small entity for purposes of the RFA. Therefore, having considered the foregoing alternatives in the context of the

proposed amendments, the Commission does not believe they are applicable to the instant proposal.

G. Solicitation of Comments

The Commission encourages the submission of comments with respect to any aspect of this IRFA. The Commission requests comment as well as empirical data on the impact the proposal will have on small broker-dealers, specialists or market makers that utilize ITS. Comment is specifically requested on whether broker-dealers that access ITS meet the revised definition of "small business" and on the number of small entities that would be affected by the proposed amendments and whether they would be considered small entities for purposes of the RFA. Also, the Commission is seeking comment on the perceived nature of the impact of the proposed amendments on these entities. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments to the ITS Plan are adopted, and will be placed in the same public file as comments on the proposed amendments themselves. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. 4-208; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Electronically submitted comment letters also will be posted on the Commission's Internet web site (<http://www.sec.gov>).

VI. Commission Authority

Pursuant to Section 11A(a)(3)(B) of the Exchange Act,⁴³ the Commission is proposing changes to the ITS Plan as set forth below.

VII. Description of Proposed Amendments to the ITS Plan

The Commission hereby proposes, on its own initiative, two alternative sets of amendments to the ITS Plan to provide for the linking of the PCX Application to the ITS System, pursuant to Rule 11Aa3-2(b)(2) and (c)(1) and the Commission's authority under Section

⁴¹ 17 CFR 240.0-10(c)(1).

⁴² The Commission recently adopted revised definitions of "small entity." See Definitions of "Small Business" or "Small Organization" Under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Exchange Act of 1934, and the Securities Act of 1933, Exchange Act Release No. 40122 (June 24, 1998). The revision, among other things, expanded the affiliation standard applicable to broker-dealers, to exclude from the definition of a small entity many introducing broker-dealers that clear customer transactions through large firms. Currently, approximately 1079 of all registered broker-dealers will be characterized as "small." See revised Rule 0-10(i). [The Commission estimates there are 8,300 registered broker-dealers.]

⁴³ 15 U.S.C. 78k-1(a)(3)(B).

11A(a)(3)(B) of the Act.⁴⁴ Below is the text of the amended ITS Plan.⁴⁵ The first version presented reflects the PCX Description and Formula Amendments. The second version presented substantially reflects the NYSE Description and Formula Amendments. Deleted text is [bracketed] and new language is italicized.

* * * * *

PCX Version of the Description and Formula Amendments

Section 1 Definitions

* * * * *

(11) "Exchange (Participant's) Market" means the floor(s) of an Exchange Participant, except that, in the case of (a) the CSE, "Exchange (Participant's) Market" means in addition to the premises on which NSTS terminals are located, NSTS and ITS stations located in the NSTS Supervisory Center [.] and (b) the PCX, "Exchange (Participant's) Market" also means the "PCX Application."

* * * * *

(23) "Member," "members in the market center," "member on the floor" and "member in the Participant" (and any derivative and comparable phrases) as applied to (a) the CSE each mean one or more NSTS Users in their use of NSTS well as more as one or more members physically on the CSE floor, and (b) the PCX in addition to the PCX members on the PCX floors, each also mean one or more PCX members in their use of the PCX Application.

* * * * *

(33A) "PCX Application" means the computerized facility of the PCX, as defined in PCX Rule 15.1, that receives orders generated by the OptiMark System, a patented electronic matching system based on an optimization algorithm that, on a periodic "call" basis, processes certain qualifying expressions of trading interest called satisfaction profiles ("profiles"), including profiles created from the published quotations disseminated by the other Participants at commencement of the OptiMark System call reflecting the best bid and offer prices and

associated sizes ("CQS profiles") and other PCX member profiles reflecting the bids or offers disseminated by the PCX specialists at commencement of the OptiMark System call. The orders received by the PCX Application will be processed by the PCX to permit: (a) in the case of those orders reflecting a match between contra-side non-CQS profiles, appropriate execution on the PCX and reporting thereafter in accordance with applicable PCX rules; and (b) in the case of those orders reflecting a match between a non-CQS profile and a CQS profile, appropriate transmission to the System by means of the PCX Application Module or any other authorized method. The PCX Application is not a part of the System.

(33B) "PCX Application Module" means the computerized subsystem of the PCX Application that permits automatic formatting of the orders received from the OptiMark System reflecting a match between a non-CQS profile and a CQS profile as commitments to trade for transmission thereafter to the System via the PCX Regional Switch.

(34A) "RCI" means the "Regional Computer Interface," the automated linkage between the System and collectively, the Regional Switches and the AMEX DBM that, when implemented, will enable members located on the floors of the AMEX, the BSE, the CHX, the PCX and the PHLX to participate in the Applications, and, in the case of (a) the CSE, will enable members to participate by means of the NSTS Switch and (b) the PCX, will also enable members to participate by means of the PCX Application Module.

(34B) "Regional Switch" means the computerized system of each of the BSE, the CHX, the PCX and the PHLX that, when implemented, will replace the original ITS stations on its floor. Each Regional Switch is not a part of the System, but permits the entry and receipt of System communications by means of CRT or other terminals, card readers and, in some instances, associated printers on the floor or the BSE, the CHX, the PCX or the PHLX, as appropriate (collective "ITS/Regional stations"), and, also in the case of the PCX, the entry of commitments to trade and receipt of reports of executions or cancellations of such commitments by means of the PCX Application Module.

* * * * *

Section 6 ITS

(a)(ii)

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The PCX would then report the trade to the CTA Plan Processor for

dissemination under the CTA Plan at 40 $\frac{1}{8}$ (or at the better price) with the identifier assigned to the PCX.

If a trade involves the PCX Application, the commitment to trade originating from the PCX may enter the System from the PCX Application Module through the RCI. In this case, a trade involving the PCX Application would take place as follows: In the original example, assume that the stock in question is traded on the NYSE as well as on the PCX. From time to time, on a periodic call basis, the OptiMark System matches available profiles (including CQS profiles and other PCX member profiles reflecting the bids or offers disseminated by the PCX specialists) in the stock and generates orders capable of immediate execution. For purposes of this example, assume that at the time an OptiMark System call commences, the continuously updated quotation display shows that the NYSE has a displayed best bid of 20 for 10,000 shares and a displayed best offer of 20 $\frac{1}{4}$ for 12,000 shares (i.e., 20-20 $\frac{1}{4}$, 100x120), representing the ITS BBO, and that all other Participant Markets' published quotations are disseminated at inferior prices and that none are greater in size than 100 shares.

The OptiMark System automatically creates the corresponding "buy" and "sell" CQS profiles reflecting the displayed interest from the NYSE and includes such profiles in ensuing call. As all profiles at hand are matched sequentially based on the satisfaction values assigned to different prices and sizes, a series of orders will be generated and delivered to the PCX. The PCX Application Module automatically will format any order reflecting a match with another Participant's displayed interest (in whole or in part) as a commitment to trade with such market, and acting on behalf of the responsible PCX member, will cause such commitment to enter the System (which, in turn, will route such commitment to the Participant Market). There are four possible scenarios that illustrate the different types of commitments to trade originating from the PCX Application Module.

Scenario 1

Upon exhausting all available matches among the non-CQS profiles, the OptiMark System call finds a match (in whole or in part) between the remainder of any such profile with the contra-side bid or offer as reflected in a CQS profile. In Scenario 1, the implementation of the PCX Application would result in (a) one or more trades reported by the PCX at a price better than or equal to the CQS profile and (b) one or more commitments to trade at

⁴⁴ 5 U.S.C. 78k-1(a)(3)(B). Section 11A(a)(3)(B) authorizes the Commission, in furtherance of its statutory directive to facilitate the development of a national market system, by rule or order, to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under the Act in planning, developing, operating, or regulating a national market system (or subsystem thereof) or one or more of the facilities thereof.

⁴⁵ The text reflects the latest unofficial compilation of the ITS Plan supplied by the ITSOC, including all previously incorporated amendments up to May 30, 1997.

the associated CQS profile price (the commitments generated in this context referred to as "trade-at" commitments originating from the PCX Application Module).

For example, an OptiMark System call may include a buy member profile for 20,000 shares at 20¼, a sell member profile for 16,000 shares at 20¼, and the NYSE's CQS sell profile for 12,000 shares at 20¼. The call may result in the generation of (a) orders reflecting the match between the contra member profiles to buy and sell 16,000 shares at 20¼ for immediate delivery to and execution on the PCX and (b) an order reflecting the match between the remaining portion of the member profile to buy 4,000 shares and the NYSE's stated offer at the price of 20¼ for immediate acceptance by the PCX Application Module and issuance thereafter of a commitment to buy. If the 20¼ offer is still available when the "trade-at" commitment originating from the PCX Application Module reaches the NYSE, or if a better offer is available and if the rules of the NYSE permit an execution at that price, then the NYSE offer would accept the commitment, and an execution at 20¼ (or at the better price) would take place. The NYSE would then report the trade to the CTA Processor dissemination under the CTA Plan at 20¼ (or at the better price) with the identifier assigned to the NYSE.

Scenario 2

Upon finding no matching potential among the non-CQS profiles, the OptiMark System call finds a match (in whole or in part) between a PCX member profile and the contra-side bid or offer as reflected in a CQS profile. In Scenario 2, the implementation of the PCX Application would result in (a) no trade reported by the PCX and (b) one or more commitments to trade at the associated CQS profile price (the commitments generated in this context also referred to as "trade-at" commitments originating from the PCX Application Module).

For example, an OptiMark System call may include a buy member profile for 20,000 shares at 20¼ with no contra sell profile at 20¼ or lower, except for the NYSE's CQS sell profile for 12,000 shares at 20¼. The call may result in the generation of an order reflecting the match between the buy member profile and the NYSE's stated offer of 12,000 shares at 20¼ for immediate acceptance by the PCX Application Module and issuance thereafter of a commitment to buy. If the 20¼ offer is still available when the "trade-at" commitment originating from the PCX Application Module reaches the NYSE,

or if a better offer is available and if the rules of the NYSE permit an execution at that price, then the NYSE offer would accept the commitment, and an execution at 20¼ (or at the better price) would take place. The NYSE would then report the trade to the CTA Processor for dissemination under the CTA Plan at 20¼ (or at the better price) with the identifier assigned to the NYSE.

Scenario 3

Prior to initiating any match among the non-CQS profiles at a price inferior to any CQS profile that otherwise may result in a potential "trade-through" as that term is defined in Exhibit B (Trade-Through Rule), the OptiMark System call finds a separate match (in whole or in part) with the contra-side bid or offer as reflected in the CQS profile. In Scenario 3, the implementation of the PCX Application would result in (a) one or more trades reported by the PCX at a price inferior to the CQS profile and (b) one or more commitments to trade at the superior price of the CQS profile for all of its associated size (the commitments generated in this context referred to as "trade-through" commitments originating from the PCX Application Module).

For example, an OptiMark System call may include a buy member profile for 20,000 shares at 20¾, a sell member profile for 1,000 shares at 20¼, another sell member profile for 10,000 shares at 20¾, and the NYSE's CQS sell profile for 12,000 shares at 20¼. The call may result in the generation of (a) orders reflecting the matches between the contra member profiles to buy and sell 1,000 shares at 20¾ and 7,000 shares also at 20¾ for immediate delivery to an execution on the PCX and (b) an order reflecting the match between the relevant portion of the member profile to buy 12,000 shares and the NYSE's stated offer of 12,000 shares at the price of 20¼ for immediate acceptance by the PCX Application Module and issuance thereafter a commitment to buy in accordance with Exhibit B (Trade-Through Rule).

Scenario 4

In connection with any matching potential found among the non-CQS profiles at a price inferior to any outstanding CQS profile and in a size that may result in a potential "block trade" as that term is defined in Exhibit C (Block Trade Policy), the OptiMark System call finds a separate match (in whole or in part) with the contra-side bid or offer as reflected in the CQS profile at the inferior price associated with the potential block trade. In Scenario 4, the implementation of the

PCX Application would result in (a) one or more block trades by the PCX at a price inferior to the CQS profile and (b) one or more commitments to trade at the inferior block trade price for all of the size associated with the CQS profile (the commitments generated in this context also referred to as "trade-through" commitments originating from the PCX Application Module).

For example, an OptiMark System call may include a buy member profile for 22,000 shares at 20¾, a sell member profile for 10,000 shares at 20¾, and the NYSE's CQS sell profile for 12,000 shares at 20¼. The call may result in the generation of (a) orders reflecting the match between the contra member profiles to buy and sell 10,000 shares at 20¾ for immediate delivery to and execution on the PCX and (b) an order reflecting the match between the relevant portion of the member profile to buy 12,000 shares and the NYSE's stated offer of 12,000 shares at the block trade price of 20¾ for immediate acceptance by the PCX Application Module and issuance thereafter of a commitment to buy in accordant with Exhibit C (Block Trade Policy).

* * * * *

Section 8 Participants' Implementation Obligations.

* * * * *

(h) Operational Parameters for the PCX Application Automated Linkage. (i) In order to ensure the proper use of the PCX Application in a manner consistent with the requirements set forth in Section 8(a)(v) of this Plan, the PCX may send "trade-at" commitments originating from the PCX Application Module (as such "trade-at" commitments are described more fully in section 6(a)(ii) in Scenarios 1 and 2) to other Participant Markets only in compliance with the requirements of this section 8(h).

(ii) For the purpose of this section 8(h):

(A) "Rolling Calendar Quarter" means any three consecutive calendar months, with the first Rolling Calendar Quarter ending on the last business day of the first three full calendar months following the month in which the PCX Application commences operation.

(B) "Percentage of PCX Application ITS Volume" for a Rolling Calendar Quarter is defined pursuant to the following formula (the "PCX Application Formula"), expressed as a percentage:

$$\frac{X}{X + Y}$$

X = Executed ITS share volume reported pursuant to the CTA Plan by the Notifying Participants resulting from the acceptance and execution of "trade-at" commitments originating from the PCX Application Module (as such "trade-at" commitments are described more fully in section 6(a)(ii) in Scenarios 1 and 2).

Y = Executed share volume reported pursuant to the CTA Plan by the PCX resulting from the execution of orders through the PCX Application.

(C) The "notifying Participant" means any Participant that notifies the PCX, in writing, that "X" of the PCX Application Formula should include the ITS share volume reported to the CTA Plan by such Participant resulting from the acceptance and execution of "trade-at" commitments originating from the PCX Application Module. Initial notice is due prior to the end of the first Rolling Calendar Quarter and will remain in effect until such notice is withdrawn.

(D) the "PCX Application Ceiling" for a Rolling Calendar Quarter is:

* For the first five consecutive Rolling Calendar Quarters: 25 percent;

* For the second five consecutive Rolling Calendar Quarters: 22.5 percent; and

* For each subsequent Rolling Calendar Quarters: 20 percent; provided, however, that each of the above-listed percentages shall be adjusted upward with respect to any given Rolling Calendar Quarter to include the difference, if any, by which the average Percentage of PCX Application ITS Volume for the immediately preceding three Rolling Calendar Quarters fell short of the average PCX Application Ceiling for the corresponding period of time.

For example, assume that the PCX Application is in the 11th Rolling Calendar Quarter of its operation. Further assume that the average Percentage of PCX Application ITS Volume for the 8th, 9th, and 10th Rolling Calendar Quarter was 18%. The applicable PCX Application Ceiling for the 11th Rolling Calendar Quarter would be calculated by adding the difference by which 18% fell short of the average PCX Application Ceiling over the same period of time—that is, the difference between 22.5% and 18%—to the initial percentage of 20%. In this case, the applicable PCX Application Ceiling for the 11th Rolling Calendar Quarter would be 24.5%, after adjusting the initial percentage of 20% to add the difference of 4.5%.

(iii) In the event that the Percentage of PCX Application ITS Volume exceeds the PCX Application Ceiling for three consecutive Rolling Calendar Quarters,

the PCX shall cease sending "trade-at" commitments originating from the PCX Application Module (the prohibition on sending such commitments hereinafter referred to as the "Restrictions") on the first business day of the second month following the end of the third of such consecutive Rolling Calendar Quarters (the "Restriction Date"). The Restrictions will end on the first business day of the third month following the Restriction Date.

For example, assume that the Percentage of PCX Application ITS Volume exceeds the PCX Application Ceiling for the Rolling Calendar Quarter ending in January, February and March of a given year. The Restriction Date would be the first business day of May of that year, which is the first business day of the second month following March. The Restrictions would apply as of that date and would continue through the end of July (ceasing as of the first business day of August, which is the first business day of the third month following May).

The Restrictions set forth in this subsection 8(h)(iii) shall, under no circumstances, be construed to apply to the "trade-through" commitments originating from PCX Application Module (as such "trade-through" commitments are described more fully in section 6(a)(ii) in Scenarios 3 and 4). Nothing herein prohibits the PCX from sending any "trade-at" commitments through an acceptable alternative means, in lieu of utilizing the PCX Application Module, such as by electing to participate manually as permitted under the ITS Plan outside the scope of section 8(a)(v).

(iv) Notwithstanding subsection 8(h)(iii) above, during the first 24 calendar months following implementation of the PCX Application, the PCX retains the right to notify the Operating Committee in writing, on or prior to the Restriction Date, that it will undertake, or cause to be undertaken, system adjustments to the operation of the PCX Application in an effort to ensure future compliance with the PCX Application Ceiling. In the event of such notification, the PCX shall have, at a minimum, nine calendar months from the date of such notice (or such longer period as may be approved by the Operating Committee upon showing of reasonable cause) to implement its proposed system adjustments (the "Implementation Period"). During the Implementation Period, the Restrictions shall not apply. During the next 12 calendar months following the end of the Implementation Period, if the Percentage of PCX Application ITS Volume exceeds the PCX Application

Ceiling for any Rolling Calendar Quarter, the Restrictions shall apply on the first business day of the second month following the end of such Rolling Calendar Quarter (the "Subsequent Restriction Date"). In that event, the Restrictions will end on the first business day of the third month following the Subsequent Restriction Date.

For example, assume that the Percentage of PCX Application ITS Volume exceeds the PCX Application Ceiling for the Rolling Calendar Quarters ending in January, February and March of Year 1 (which fall within the first 24 calendar months of the operation of the PCX Application). As in the example above, the Restriction Date would be the first business day of May of that year, which is the first business day of the second month following March. The Restrictions would apply as of that date, unless the PCX notified the Operating Committee, on or prior to the first business day in May, that it planned to effect system adjustments in an attempt to ensure future compliance with the PCX Application Ceiling. Assuming that the PCX provides such notification on the Restriction Date, the Restrictions would not apply during the Implementation Period, which would last for, at a minimum, nine months from the Restriction Date (that is, assuming the minimum duration, the nine calendar months of May through January of Year 2). Following the end of the Implementation Period, assume that the Percentage of PCX Application ITS Volume exceeded the PCX Application Ceiling for the next Rolling Calendar Quarter (the quarter beginning in February and ending April or Year 2). In that event, the Subsequent Restriction Date would be the first business day of June of Year 2, which is the first business day of the second month following April. The Restrictions would apply beginning on the day and would continue through the end of August of Year 2 (ceasing as of the first business day of September of Year 2, which is the first business day of the third month following June).

The Restrictions set forth in this subsection 8(h)(iv) shall, under no circumstances, be construed to apply to the "trade-through" commitments originating from the PCX Application Module (as such "trade-through" commitments are described more fully in section 6(a)(ii) in Scenarios 3 and 4). Nothing herein prohibits the PCX from sending any "trade-at" commitments through an acceptable alternative means, in lieu of utilizing the PCX Application Module, such as by electing to participate manually as permitted

under the ITS Plan outside the scope of section 8(a)(v).

(v) *Reporting and Audits.* Each month the PCX shall furnish the Operating Committee with a report showing the number of shares for each of the components of the PCX Application Formula for the previous month, as well as the date necessary to determine the number of "trade-through" commitments originating from the PCX Application Module (as such "trade-through" commitments are described more fully in section 6(a)(ii) in Scenarios 3 and 4). Any one or more Participants may cause a certified public accountant to audit any one or more such reports. The requesting Participant(s) shall pay for such audits.

* * * * *

NYSE Version of the Description and Formula Amendments

Section 1 Definitions

* * * * *

(11) "Exchange (Participant's) Market" means the floor(s) of an Exchange Participant, except that, in the case of (a) the CSE, "Exchange (Participant's) Market" means in addition to the premises on which NSTS terminals are located, NSTS and ITS stations located in the NSTS Supervisory Center[,], and (b) the PCX "Exchange (Participant's) Market" also means the "PCX Application."

* * * * *

(23) "Member," "member in the market center," "member on the floor" and "member in the Participant" (and any derivative and comparable phrases) as applied to (a) the CSE each mean one or more NSTS Users in their use of NSTS as well as one or more members physically on the CSE floor, and (b) the PCX, in addition to the PCX members on the PCX floors, each also mean one or more PCX members in their use of the PCX Application.

* * * * *

(33A) "PCX Application" means the computerized facility of the PCX, as defined in PCX Rule 15.1, that receives orders generated by the OptiMark System, a patented electronic matching system based on an optimization algorithm that, on a periodic "call" basis processes certain qualifying expressions of trading interest called satisfaction profiles ("profiles"), including profiles created from the published quotations disseminated by the other Participants at the commencement of the OptiMark System call reflecting the best bid and offer prices and associated sizes ("CQS profiles"). The orders received by the PCX Application will be processed by

the PCX to permit: (a) in the case of those orders reflecting a match between contra-side non-CQS profiles, appropriate execution on the PCX and reporting thereafter in accordance with the applicable PCX rules; and (b) in the case of those orders reflecting a match between a non-CQS profile and a CQS profile (i) processing pursuant to Section 6(a)(ii)(A); or (ii) transmission to the System pursuant to Section 6(a)(ii)(B). The PCX Application is not part of the System.

(33B) "PCX Application Module" means the computerized subsystem of the PCX Application that permits automatic formatting of the orders received from the OptiMark System reflecting a match between a non-CQS profile and a CQS profile as commitments to trade for transmission thereafter to the System via the PCX Regional Switch.

(34A) "RCI" means the "Regional Computer Interface," the automated linkage between the System and, and collectively, the Regional Switches and the AMEX DBM that, when implemented, will enable members located on the floors of the AMEX, the BSE, the CHX, the PCX and the PHLX to participate in the Applications, and, in the case of (a) the CSE, will enable members to participate by means of the NSTS Switch and (b) the PCX, also will enable members to participate by means of the PCX Application Module.

(34B) "Regional Switch" means the computerized system of each of the BSE, the CHX, the PCX and the PHLX that, when implemented, will replace the original ITS stations on its floor. Each Regional Switch is not a part of the System, but permits the entry and receipt of System communications by means of CRT or other terminals, card readers, and, in some instances, associated printers on the floor or the BSE, the CHX, the PCX or the PHLX, as appropriate (collectively "ITS/Regional stations"), and, also in the case of the PCX, the entry of commitments to trade and receipt of reports of executions or cancellations of such commitments by means of the PCX Applications Module.

* * * * *

Section 6 ITS.

* * * * *

(a)(ii) *Description of ITS Transactions.* Through ITS, a member located in one Participant Market who wishes to buy (or sell), for example, 100 shares of a particular common stock that is also traded through the System by members in one or more other Participant Markets is able to buy the stock from (or sell stock to) such member(s).

(A) *Description Applicable to the AMEX, BSE, CBOE, CHX, NYSE, PHLX and PCX.*

With respect to an ITS transaction involving the AMEX, BSE, CBOE, CHX, NYSE, PHLX and PCX (other than with respect to transactions involving the PCX Application Module), for example, assume that a member firm of the NYSE receives from a customer an order to purchase 100 shares of a given NYSE listed stock that is also traded on the PCX and the PHLX and sends that order to the NYSE floor for execution.

* * * * *

The PCX would then report the trade to the CTA Processor for dissemination under the CTA Plan at 40-40 $\frac{1}{8}$ (or at the better price) with the identifier assigned to the PCX.

(B) *Description Applicable to the PCX Application*

(1) Generation of ITS Commitments

If a trade involves the PCX Application, the commitment to trade originating from the PCX may enter the System from the PCX Application Module through the RCI. In this case, a trade involving the PCX Application would take place as follows: In the original example, assume that the stock in question is traded on the NYSE as well as on the PCX. From time to time, on a periodic call basis, the OptiMark System matches available profiles (including CQS profiles) in the stock and generates orders capable of immediate execution. For the purposes of this example, assume that at the time an OptiMark System call commences, the continuously updated quotation display shows that the NYSE has a displayed best bid of 20 for 10,000 shares and a displayed best offer of 20 $\frac{1}{4}$ for 12,000 shares (i.e., 20-20 $\frac{1}{4}$, 100 \times 120), representing the ITS BBO, and that all other Participant Markets' published quotations are disseminated at inferior prices and that none are greater in size than 100 shares.

The OptiMark System automatically creates the corresponding "buy" and "sell" CQS profiles reflecting the displayed interest from the NYSE and includes such profiles in the ensuing call. As all profiles at hand are matched sequentially based on the satisfaction values assigned to different prices and sizes, a series of orders will be generated and delivered to the PCX. Thereafter, the PCX Application Module automatically will format any order reflecting a match with another Participant Market's displayed interest (in whole or in part) as a commitment to trade with such market, and acting on behalf of the responsible PCX member,

will cause such commitment to enter the System (which, in turn, will route such commitment to the Participant Market). There are four possible scenarios that illustrate the different types of commitments to trade originating from the PCX Application Module.

Scenario 1

Upon exhausting all available matches among the non-CQS profiles, the OptiMark System call finds a match (in whole or in part) between the remainder of any such profile with the contra-side bid or offer as reflected in CQS profile. In Scenario 1, the implementation of the PCX Application would result in (a) one or more trades reported by the PCX at a price better than or equal to the CQS profile and (b) one or more commitments to trade at the associated CQS profile price (the commitments generated in this context referred to as "trade-at" commitments originating from the PCX Application Module).

For example, an OptiMark System call may include a buy member profile for 20,000 shares at 20 $\frac{1}{4}$, a PCX sell member profile for 16,000 shares at 20 $\frac{1}{4}$, and the NYSE's CQS sell profile for 12,000 shares at 20 $\frac{1}{4}$. The call will result in the generation of (a) orders reflecting the match between the contra member profiles to buy and sell 16,000 shares at 20 $\frac{1}{4}$ for immediate delivery to an execution on the PCX and (b) an order reflecting the match between the remaining portion of the member profile to buy 4,000 shares and the NYSE's stated offer at the price of 20 $\frac{1}{4}$ for immediate acceptance by the PCX Application Module and issuance thereafter of a commitment to buy. If the 20 $\frac{1}{4}$ offer is still available when the "trade-at" commitment originating from the PCX Application Module reaches the NYSE, or if a better offer is available and if the rules of the NYSE permit an execution at that price, then the NYSE offer would accept the commitment, and an execution at 20 $\frac{1}{4}$ (or at the better price) would take place. The NYSE would then report the trade to the CTA Processor for dissemination under the CTA Plan at 20 $\frac{1}{4}$ (or at the better price) with the identifier assigned to the NYSE.

Scenario 2

Upon finding no matching potential among the non-CQS profiles, the OptiMark System call finds a match (in whole or in part) between a PCX member profile and the contra-side bid or offer as reflected in a CQS profile. In Scenario 2, the implementation of the PCX Application would result in (a) no trade reported by the PCX and (b) one or more commitments to trade at the

associated CQS profile price (the commitments generated in this context also referred to as "trade-at" commitments originating from the PCX Application Module).

For example, an OptiMark System call may include buy member profile for 20,000 shares at 20 $\frac{1}{4}$ with no contra sell profile at 20 $\frac{1}{4}$ or lower, except for the NYSE's CQS profile to sell 12,000 shares at 20 $\frac{1}{4}$. The call will result in the generation of an order reflecting the match between the buy member profile and the NYSE's stated offer of 12,000 shares at 20 $\frac{1}{4}$ for immediate acceptance by the PCX Application Module and issuance thereafter of a commitment to buy. If the 20 $\frac{1}{4}$ offer is still available when the "trade-at" commitment originating from the PCX Application Module reaches the NYSE, or if a better offer is available and if the rules of the NYSE permit an execution at that price, then the NYSE offer would accept the commitment, and an execution at 20 $\frac{1}{4}$ (or at the better price) would take place. The NYSE would then report the trade to the CTA Processor for dissemination under the CTA Plan at 20 $\frac{1}{4}$ (or at the better price) with the identifier assigned to the NYSE.

Scenario 3

Prior to initiating any potential match among the non-CQS profiles at a price inferior to any outstanding CQS profile that may result in a potential "trade-through" as that term is defined in Exhibit B (Trade-Through Rule), the OptiMark System call finds a separate match (in whole or in part) with the contra-side bid or offer as reflected in the CQS profile. In Scenario 3, the implementation of the PCX Application would result in (a) one or more trades reported by the PCX at a price inferior to the CQS profile and (b) one or more commitments to trade at the superior price of the CQS profile for all of its associated size (the commitments generated in this context referred to as "trade-through" commitments originating from the PCX Application Module).

For example, an OptiMark System call may include a buy member profile for 20,000 shares at 20 $\frac{3}{8}$, a sell member profile for 1,000 shares at 20 $\frac{1}{4}$, another sell member profile for 10,000 shares at 20 $\frac{3}{8}$, and the NYSE's CQS profile to sell 12,000 shares at 20 $\frac{1}{4}$. The call will result in the generation of (a) orders reflecting the matches between the contra member profiles to buy and sell 1,000 shares at 20 $\frac{3}{8}$ and 7,000 shares also at 20 $\frac{3}{8}$ for immediate delivery to and execution on the PCX and (b) an order reflecting the match between the relevant portion of the member profile

to buy 12,000 shares and the NYSE's stated offer 12,000 shares at the price of 20 $\frac{1}{4}$ for immediate acceptance by the PCX Application Module and issuance thereafter of a commitment to buy in accordance with Exhibit B (Trade-Through Rule).

Scenario 4

In connection with any matching potential found among the non-CQS profiles at a price inferior to any outstanding CQS profile and in any size that may result in a potential "block trade" as that term is defined in Exhibit C (Block Trade Policy), the OptiMark System call finds a separate match (in whole or in part) with the contra-side bid or offers as reflected in the CQS profile at the inferior price associated with the potential block trade. In Scenario 4, the implementation of the PCX Application would result in (a) one or more block trades reported by the PCX at a price inferior to the CQS profile and (b) one or more commitments to trade at the inferior block trade price for all of the size associated with the CQS profile (the commitments generated in this context referred to as "block policy" commitments originating from the PCX Application Module).

For example, an OptiMark system call may include a PCX buy member profile for 22,000 shares at 20 $\frac{3}{8}$, a sell member profile for 10,000 shares at 20 $\frac{3}{8}$, and the NYSE's CQS profile to sell 12,000 shares at 20 $\frac{1}{4}$. The call will result in the generation of (a) orders reflecting the match between the contra member profiles to buy and sell 10,000 shares at 20 $\frac{3}{8}$ for immediate delivery to and execution on the PCX and (b) an order reflecting the match between the relevant portion of the member profile to buy 12,000 shares and the NYSE's stated offer of 12,000 shares at the block trade price of 20 $\frac{3}{8}$ for immediate acceptance by the PCX Application Module and issuance thereafter of a commitment to buy in accordance with Exhibit C (Block Trade Policy).

(2) PCX Application Processing/Pricing

Prior to the PCX Application Module generating a commitment to trade representing an OptiMark system order, the PCX shall process such order as required by Section 8(a)(v) of the Plan and PCX Rule 15.X, and, if possible, execute the order on the PCX. If after processing in accordance with the foregoing Plan provision and PCX rule, any portion of such order remains, the PCX Application Module will format the balance of the order into a commitment to trade and, acting on behalf of the PCX member who represented the

customer interest in the OptiMark System, send the commitment to the Participant Market with whose quotation the order had been matched. Such commitment shall be priced at the published contra-side bid or offer price disseminated by the Participant Market with which the order is matched, except that in the case of a "block policy" commitment, the price of the commitment shall be the price of the block trade on the PCX.

(C) *Description Applicable to the CSE*

With respect to an ITS transaction that [if a trade] involves the CSE, the commitment to trade or a response thereto destined for or originating from the CSE will leave and enter the System through a NSTS Switch. In the [foregoing] example in Section 6(a)(ii)(A) above, a trade involving the CSE would occur as follows:

* * * * *

The CSE would then report the trade to the CTA Plan Processor for dissemination under the CTA Plan at the response price with the identifier assigned to the CSE.

(D) *Description Applicable to the NASD*

With respect to an ITS transaction that [if a trade] involves the ITS/CAES Third Market, the commitment to trade or response thereto destined for or originating with an ITS/CAES Market Maker will leave and enter the System at the CAES Switch. A trade involving the ITS/CAES Third Market would take place as follows. In the [original] example in Section 6(a)(ii)(a) above, assume that the stock in question is also an ITS/CAES security and that the order is for 300 shares.

* * * * *

Section 8 Participant's Implementation Obligations

(a)(v) *Automated Generation of Commitments.* Section 6(a)(ii) describes the approved methods by which each of the Participants is authorized to send commitments to trade via the System. In addition to that section, and with respect to the general use of the System (and when considering possible amendments to the Plan), [T]he Participants agree that: ITS is not designed to be, and should not be used as, an order delivery system whereby all or a substantial portion of orders to buy and sell System securities which are sent to a particular market are not executed within that market, but are routinely rerouted to another market through the System for execution. In the normal course, most orders received within the market of an Exchange Participant are expected to be executed

within the market. Reasonable efforts to probe the market to achieve a satisfactory execution there are expected to be taken before the order is reformed as a commitment to trade and rerouted to another market through the System; provided, however, that PCX, with respect to an order received from the OptiMark System, shall not be required to probe the PCX market for an execution therein prior to the PCX Application Module automatically reformatting a commitment to trade with respect to such order if the share volume of the commitment, if executed, would not be included in the "X variable," as that term is used in subsection 8(h)(ii)(B).

* * * * *

(h) *Operational Parameters for the PCX Application Automated Linkage.* (i) The PCX may send computer-generated commitments to trade to other Participant Markets through the PCX Application Module only in compliance with the requirements of this Section.

(ii) For the purposes of this Section:

(A) "Rolling Calendar Quarter" means any three consecutive calendar months, with the first Rolling Calendar Quarter ending in the last business day of the first three full calendar months following the month in which the PCX Application commences operation.

(B) "Percentage of PCX Application ITS Volume" for a Rolling Calendar Quarter is defined pursuant to the following formula (the "PCX Application Formula") expressed as a percentage:

$X = \text{Executed share volume reported pursuant to the CTA Plan by all Participant Markets (other than the PCX) (the "Executed ITS Share Volume") resulting from the acceptance and execution of "trade-at" commitments originating from the PCX Application Module; provided however, that if in any Rolling Calendar Quarter the PCX does not execute in its own market more than 75 percent of the aggregate number of shares in those calls that produce "trade-through" commitments, then, beginning in the month following such Rolling Calendar Quarter, this X variable will include the Executed ITS Share Volume resulting from the acceptance and execution of "trade-through" commitments originating from the PCX Application Module. In that event, the Executed Share Volume resulting from the acceptance and execution of "trade-through" commitments shall continue to be included in this X variable until, for a Rolling Calendar Quarter, the PCX executes in its own market at least 75 percent of the aggregate number of}$

shares in those calls that produce "trade-through" commitments ("Trade-at" and "trade-through" commitments are described more fully in Section 6(a)(ii)(B).)

$Y = \text{Executed share volume reported pursuant to the CTA Plan by the PCX resulting from the execution of orders through the PCX Application.}$

(C) The "PCX Application Ceiling" for a Rolling Calendar Quarter is:

*For the first five consecutive Rolling Calendar Quarters: 15 percent.

*For the second five consecutive Rolling Calendar Quarters: 10 percent.

*For each subsequent Rolling Calendar Quarter: 5 percent.

(iii) In the event that the Percentage of PCX Application ITS Volume exceeds the PCX Application Ceiling for three consecutive Rolling Calendar Quarters, the PCX shall cease sending (i) "trade-at" commitments and (ii) trade-through commitments, if, at the end of each third consecutive Rolling Calendar Quarter, the share volume of such trade-through commitments were included in the "X variable" (as that term is used in subsection 8(h)(ii)(B)) originated from the PCX Application Module (the prohibition on sending such commitments hereinafter referred to as the "Restrictions") on the first business day of the second month following the end of the third of such consecutive Rolling Calendar Quarters (the "Restriction Date"). The Restrictions will end on the first business day of the third month following the Restriction Date.

For example, assume that the Percentage of PCX Application Volume exceeds the PCX Application Ceiling for the Rolling Calendar Quarters ending in January, February and March of a given year. The Restriction Date would be the first business day of May of that year, which is the first business day of the second month following March. The Restrictions would apply as of that date and would continue through the end of July (ceasing as of the first business day of August, which is the first business day of the third month following May). The restrictions set forth in this subsection 8(h)(iii) shall not be construed to apply to the "trade-through" commitments except as provided in the preceding paragraph) or "block policy" commitments originating from the PCX Application Module (as such commitments are described more fully in Section 6(a)(ii)(B) in Scenarios 3 and 4). Nothing herein prohibits the PCX from sending any commitments resulting from orders generated by the OptiMark System pursuant to Section

6(a)(ii) above in lieu of utilizing the PCX Application Module.

(iv) Notwithstanding subsection 8(h)(iii) above, during the first 24 calendar months following implementation of the PCX Application, the PCX retains the right to notify the Operating Committee in writing, on or prior to the Restriction Date, that it will undertake, or cause to be undertaken, system adjustments to the operation of the PCX Application in an effort to ensure future compliance with the PCX Application Ceiling. In the event of such notification, the PCX shall have, at a minimum, nine calendar months from the date of such notice (or such longer period as may be approved by all members of the Operating Committee upon showing of reasonable cause), to implement its proposed system adjustments (the "Implementation Period"). During the Implementation Period, the Restrictions shall not apply. During the next 12 calendar months following the end of the Implementation Period, if the Percentage of PCX Application ITS Volume exceeds the PCX Application Ceiling for any Rolling Calendar Quarter, the Restrictions shall apply on the first business day of the second month following the end of such Rolling Calendar Quarter (the "Subsequent Restriction Date"). In that event, the Restrictions will end on the first business day of the third month following the Subsequent Restriction Date.

For example, assume that the Percentage of PCX Application ITS Volume exceeds the PCX Application Ceiling for the Rolling Calendar Quarters ending in January, February and March of Year 1 (which fall within the first 24 calendar months of the operation of the PCX Application). As in the above example, the Restriction Date would be the first business day of May of that year, which is the first business day of the second month following March. The Restrictions would apply as of that date, unless the PCX notified the Operating Committee, on or prior to the first business day in May, that it planned to effect system adjustments in an attempt to ensure future compliance with the PCX Application Ceiling. Assuming that the PCX provides such notification on the Restriction Date, the Restrictions would not apply during the Implementation Period, which would last for at least nine months from the Restriction Date (that is, assuming the minimum duration, the nine calendar months of May through January of Year 2). Following the end of the Implementation Period, assume that the Percentage of PCX Application ITS Volume exceeded the PCX Application

Ceiling for the next Rolling Calendar (the quarter beginning in February and ending April of Year 2). In that event, the Subsequent Restriction Date would be the first business day of June of Year 2, which is the first business day of the second month following April. The Restrictions would apply beginning on that day and would continue through the end of August of Year 2 (ceasing as of the first business day of September of Year 2, which is the first business day of the third month following June).

(v) Notwithstanding subsections 8(h)(iii) and (iv) above, if for any Rolling Calendar Quarter the Percentage of PCX Application ITS Volume exceeds 30 percent, the Restrictions shall apply as of the first business day of the second month following the end of such rolling Calendar Quarter. In that event, the Restrictions shall apply for three calendar months.

(vi) Each month the PCX shall furnish the Operating Committee with a report showing the number of shares for each of the components of the PCX Application Formula for the previous month, as well as the data necessary to determine if the shares in those calls that produce "trade-through" commitments (as such commitments are described more fully in Section 6(a)(ii)(B) in Scenario 3) originating from the PCX Application Module are or are not included in the "X variable" of the PCX Application Formula. Any one or more Participants may cause a certified public accountant to audit any one or more of such reports. The requesting Participant(s) shall pay for all such audits.

* * * * *

Dated: July 15, 1998.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98-19435 Filed 7-21-98; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40202; File No. SR-CHX-98-15]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Inc. Relating to Specialists' Payment of Listing Fees

July 14, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,²

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

notice is hereby given that on June 16, 1998, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change, as described in Items I, II, and III below, which Items have been prepared by the CHX. 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 add Article XXX, Rule 20A in order to establish that Specialists, Co-Specialists and Relief Specialists may not pay listing fees for any issuing corporation for which they act in such capacity. The text of the proposed rule change is available at the Office of the Secretary, the CHX, 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 CHX 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 CHX 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 Exchange proposes to adopt new Rule 20A to Article XXX to establish that Specialists, Co-Specialists and Relief Specialists may not pay listing fees, including initial and maintenance fees, for any issuing corporation for which they act in such capacity.

The purpose of the proposed rule change is to avoid situations in which either an actual or apparent conflict of interest may arise. A Specialist has an obligation to maintain a free and open market in an issue. In order to maintain the integrity of the market, Specialists must remain independent of issuers. The Exchange has already established rules that seek to ensure that independence. For example, Article XXX, Rule 23 prohibits Specialists from engaging in any business transactions with the issuer of exclusive issues. Also, Interpretation .01 to Article XXXVIII,