

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

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. NYSE-98-35 and should be submitted by December 30, 1998.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40722; File No. SR-NYSE-97-09]

#### Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Relating to Specialists' Handling of Percentage Orders

November 30, 1998.

#### I. Introduction

On March 25, 1997, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act

of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend NYSE Rule 123A.30, relating to specialists' handling of percentage orders.

The proposed rule change was published for comment in the **Federal Register** on May 21, 1997.<sup>3</sup> No comments were received on the proposal. On June 15, 1998, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>4</sup> This order approves the proposed rule change and approves Amendment No. 1 to the proposed rule change on an accelerated basis.

#### II. Background and Description of the Proposal

##### A. Background

A percentage order is a limited price order to buy or sell 50% of the volume of a specified stock after its entry. A percentage order is essentially a memorandum entry left with a specialist which becomes a "live" order capable of execution in one of two ways: (i) all or part of the order can be "elected" as a limit order on the specialist's book based on trades in the market; or (ii) all or part of the order can be "converted" into a limit order to make a bid or offer or to participate directly in a trade.

##### 1. The Election Process

Under the election process, as trades occur at the percentage order's limit price or better, an equal number of shares of the percentage order are "elected" and become a limit order on the specialist's book. This limit order takes its place behind other limit orders on the specialist's book at the same price. The percentage order then is reduced by the number of elected shares until the entire order has been satisfied.

Currently, there are four types of percentage orders; last sale percentage orders, straight limit percentage orders,<sup>5</sup>

buy minus-sell percentage orders,<sup>6</sup> and immediate execution or cancel election percentage orders.<sup>7</sup> The Exchange has indicated that most percentage orders are entered as last sale percentage orders, meaning that they are elected to the book at the price of the electing sale and may be executed at that price, or at a better price.<sup>8</sup>

##### 2. The Conversion Process

The second way that a percentage order can be activated into a limit order is through the conversion process. Most percentage orders contain the additional instruction, "CAP-D." "CAP" is an acronym meaning "convert and parity," which instructs the specialist that he or she may convert all or a portion of the order into a limit order, and allows the specialist to be on parity with the converted percentage order, either to participate directly in a trade or to make a bid or offer ("bettering the market"). The "D" notation instructs the specialist that, under certain circumstances, the order may be converted to participate in destabilizing transactions, as well as stabilizing transactions.

The Exchange has stated that, as a practical matter, it views CAP-D orders as a necessary adjunct to the standard election procedures because they allow the specialist greater flexibility to match the order with other buying and selling interest in the market. CAP-D orders are subject to a number of restrictions intended to minimize the specialist's discretion in handling such orders.<sup>9</sup> Specifically, under the conversion process, the specialist may convert a percentage order into a "live" limit order on a destabilizing tick only where: (i) the transaction for which the order is being converted is for 10,000 shares or more; and (ii) the price at which the converted percentage order is to be

<sup>6</sup> A buy minus-sell plus percentage order operates in the same fashion as a straight limit percentage order, except that it places the additional requirement that elected portions of buy (sell) percentage orders be elected at a price on minus or zero-minus ticks (plus or zero plus ticks) from the previous sale.

<sup>7</sup> An immediate execution or cancel election percentage order instructs the specialist to execute the elected portion of the percentage order immediately in whole or in part at the price of the electing transactions. The remaining unexecuted elected portion of the percentage order, if any, reverts back to an unelected percentage order, subject to subsequent election or conversion. See Securities Exchange Act Release No. 39837 (April 8, 1998) 63 FR 18244 (April 14, 1998) (order approving File No. SR-NYSE-97-38).

<sup>8</sup> The various types of percentage orders differ only in terms of execution, and not the process by which they are elected. See notes 5-7 *supra*.

<sup>9</sup> See NYSE Rule 123A.30; Securities Exchange Act Release No. 24505 (May 22, 1987) 52 FR 20484 (June 1, 1987) (order approving File No. SR-NYSE-85-1 to permit conversion of percentage orders on destabilizing ticks under certain circumstances).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 38630 (May 13, 1997), 62 FR 27822.

<sup>4</sup> See Letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Michael Walinkas, Deputy Associate Director, Division of Market Regulation, Commission, dated June 12, 1998 ("Amendment No. 1"). In Amendment No. 1, the NYSE clarifies that its proposal to add the phrase "or converted" to the last paragraph of NYSE Rule 123A.30 would not change the existing rules governing the conversion of percentage orders. Instead, the Exchange believes that the issue of whether an executed percentage order was "elected" or "converted" to a limit order is irrelevant to its proposal to allow such execution to trigger the election of another percentage order on the opposite side of the market.

<sup>5</sup> A straight limit percentage order carries a limit price equal to the percentage order limit price.

<sup>8</sup> 17 CFR 200.30-3(a)(12).

executed is no more than 1/4 point away from the last sale price; provided, however, that this price parameter may be modified, in appropriate cases, with the prior approval of a Floor Official and the written consent of the broker who entered the order.<sup>10</sup>

### B. Description of the Proposal

Currently, NYSE Rule 123A.30 provides that percentage orders shall not be elected by any portion of volume which results from the execution of a previously elected portion of a percentage order. According to the Exchange, the intent of this restriction is to prevent "chain reaction" executions of percentage orders whereby executions of elected portions of percentage orders trigger additional elections. This result would be contrary to the objectives of most investors entering percentage orders, who generally want to "go along" with the overall trend of the market as reflected by other market interest, without necessarily leading that trend.

As currently interpreted, NYSE Rule 123A.30 does not distinguish between the election or conversion of percentage orders on the same side of the market and the election or conversion of percentage orders on opposite sides of the market. The Exchange believes that the restriction should be applied only to percentage orders on the same side of the market, as "same side" orders are the ones to be executed along with the market trend.<sup>11</sup>

The Exchange is proposing to amend NYSE Rule 123A.30 to provide that percentage orders held by a specialist may be elected by the execution of a previously elected or converted<sup>12</sup> portion of a percentage order that is on the opposite side of the market.<sup>13</sup>

<sup>10</sup> For a more detailed description of the procedures under which a percentage order may be converted on a destabilizing tick, see Securities Exchange Act Release No. 24505, *supra* note 9.

<sup>11</sup> For example, buy percentage orders would be elected and executed along with other buying interest, and sell percentage orders would be elected and executed along with other selling interest.

<sup>12</sup> See Amendment No. 1, *supra* note 4.

<sup>13</sup> For example, assume that the market is 20 to 20 1/4, 2,000 by 2,000, with the 2,000 share offer representing 2,000 "elected" or "converted" shares of a percentage order to sell 10,000 shares. The specialist then receives a last sale percentage order to buy 10,000 shares at a limit price of 20 3/8 after which he receives through SuperDOT an order to buy 1,000 shares at the market. After bidding 20 1/16 on behalf of the SuperDOT order, the specialist executes that order against the 2,000 share offer at 20 1/4. Under the current rule, no portion of the buy percentage order would be elected, and no additional portion of the sell percentage order would be elected. Under the proposed rule change, 1,000 shares of the buy percentage order would be elected at 20 1/4, and would then trade the remaining 1,000 share balance of the offer at 20 1/4. No portion

The Exchange also is proposing to amend NYSE Rule 123A.30 to permit the specialist to convert a percentage order on a destabilizing tick, as otherwise permitted by the rule, when the transaction is 10,000 shares or more or represents a quantity of stock having a market value of \$500,000 or more (whichever is less). The Exchange notes that this amendment will conform the size of permitted transactions to the definition of a "block" in NYSE Rule 97.

### III. Discussion

The Commission has considered carefully whether the NYSE's proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>14</sup> Specifically, the Commission has considered whether the proposal is consistent with the requirements set forth in Sections 6(b) and 11(b) of the Act.<sup>15</sup> In reviewing previous proposals involving percentage orders, the Commission has been concerned whether such orders provide the specialist with "discretion" in violation of Section 11(b) of the Act.<sup>16</sup> Section 11(b) was designed, in part, to address potential conflicts of interest that may arise as a result of a specialist's dual role as agent and principal in executing stock transactions. In particular, Congress intended to prevent specialists from unduly influencing market trends through their knowledge of market interest from the specialist book and their handling of discretionary agency orders.<sup>17</sup> The Commission has interpreted this section to mean that all orders other than market or limit orders are discretionary and therefore cannot be accepted by a specialist.<sup>18</sup>

The Commission previously has determined that it is appropriate to treat percentage orders as equivalent to limit orders.<sup>19</sup> With regard to the conversion process in particular, while acknowledging that it permits

of the sell percentage order would be elected since the execution of the remaining 1,000 share sell balance would result from the execution of a previously elected or converted percentage order on the same side of the market.

<sup>14</sup> In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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

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

<sup>17</sup> See H. Rep. No. 1383, 73d Cong., 2d Sess. 22; S. Rep. 792, 73d Cong., 2d Sess. 18 (1934).

<sup>18</sup> See, e.g., SEC, Special Study of the Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., Part 2, 72 (1963) ("Special Study") (noting that "Section 11(b) . . . prohibits, without exception, a specialist's effecting any transaction except upon a market or limit order").

<sup>19</sup> See Securities Exchange Act Release No. 24505, *supra* note 9.

specialists to employ their judgment to a certain extent, the Commission believed that the requirements imposed on the specialist when converting a percentage order for execution or quotation purposes provided sufficiently stringent guidelines to ensure that the specialist only will implement the conversion provisions in a manner consistent with his or her market making obligations and Section 11(b).<sup>20</sup>

Furthermore, the Commission previously has determined that the NYSE's percentage order rules are consistent with the standards set forth under Section 6(b)(5) of the Act.<sup>21</sup> This section requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices. The Commission determined that the NYSE's percentage order rules contain various limiting and protective provisions, to ensure that such rules will not increase the possibility of specialist abuse of the market.

As discussed in greater detail below, the Commission finds that the proposed rule change, in allowing a specialist to elect a percentage order based on the execution of a previously elected or converted percentage order on the opposite side of the market and modifying the restrictions pertaining to the conversion of a percentage order on a destabilizing tick, does not adversely impact the protective scheme that has been incorporated into the percentage order rules. Accordingly, the Commission finds that the proposed rule change is consistent with Sections 6(b)(5) and 11(b) of the Act<sup>22</sup> in that it neither greatly increases specialists' ability to engage in fraudulent and manipulative practices nor allots discretion to specialists in their handling of percentage orders.

### A. Proposed Modification to the Election Process

Currently, a percentage order may not be elected based on the execution of a previously elected or converted percentage order. For purposes of this prohibition, the current rules do not distinguish between percentage orders on the same side of the market and those on opposite sides of the market. The Exchange's proposal provides that percentage orders held by a specialist may be elected by the execution of a previously elected or converted portion of a percentage order that is on the opposite side of the market.

<sup>20</sup> 15 U.S.C. 78k(b).

<sup>21</sup> 15 U.S.C. 78f(b)(5).

<sup>22</sup> 15 U.S.C. 78f(b)(5) and 78k(b).

The Commission believes that it is consistent with the Act to allow the election of a percentage order based on the execution of a percentage order on the opposite side of the market. The Commission believes that the proposed rule change is consistent with the underlying rationale for the percentage order rule; namely, to allow larger-sized orders to trade along with the trend of the market, rather than lead that trend. For example, a percentage order cannot elect itself by its execution. Instead, independent interest on the same side of the market is needed to trigger an election. In addition, the Commission anticipates that by allowing the execution of percentage orders to trigger the election of percentage orders on the opposite side of the market, the proposal should increase the likelihood that percentage orders held by the specialist will be elected as limit orders and ultimately, executed.

Moreover, the Commission finds that permitting the election of a percentage order based on the execution of a previously elected or converted percentage order on the other side of the market is consistent with the Act in that it does not provide discretion to specialists in the handling of percentage orders. Instead, the Commission notes that previously executed percentage orders, regardless of whether initially elected or converted, will trigger the election of percentage orders on the other side of the market. The specialist is not provided any discretion over the process of electing percentage orders on the other side of the market, once a previously elected or converted percentage order has been executed, in accordance with the Exchange's rules.

Finally, the Commission notes that the Exchange's rules will continue to prohibit the election of percentage orders based on the execution of percentage orders on the same side of the market. The Commission believes that this continued prohibition, which will prevent same side percentage orders held by the specialist from being elected by the execution of percentage orders, is appropriate.

#### *B. Proposed Modification to the Conversion Process*

The Exchange's proposal also permits the specialist to convert a percentage order on a destabilizing tick, as otherwise permitted by the rule, when the transaction is 10,000 shares or more or represents a quantity of stock having a market value of \$500,000 or more (whichever is less). NYSE Rule 123A.30 currently provides that the specialist may convert a percentage order on a destabilizing tick only where: (i) the

transaction for which the order is being converted is for 10,000 shares or more; and (ii) the price at which the converted percentage order is to be executed is no more than  $\frac{1}{4}$  point away from the last sale price; provided, however, that this price parameter may be modified, in appropriate cases, with the prior approval of a Floor Official and the written consent of the broker who entered the order.

The Commission notes that by allowing a specialist to convert an order on a destabilizing tick when the transaction being converted is for 10,000 shares or more or represents a quantity of stock having a market value of \$500,000 or more, whichever is less, the proposed change will make the size of permitted transactions consistent with the definition of a "block" transaction in NYSE Rule 97. The Commission agrees that the proposed amendment, which will liberalize the requirements of NYSE Rule 123A.30, should facilitate conversion of percentage orders in stocks where the size of the trade has the appropriate market value to qualify as a block transaction, but may not have a share size of 10,000 or more. The Commission notes that the conversion procedures were intended to allow percentage orders to participate immediately with large-sized contra-side orders entering the market.<sup>23</sup> Previously, percentage orders were not eligible for execution until an electing transaction had occurred. As a result, all or part of a large percentage order was elected for execution in a large-size trade's "after-market," where execution of the elected portion could disrupt price continuity.<sup>24</sup> Therefore, the Commission believes that amending the conversion rules to parallel the definition of a block transaction in NYSE Rule 97 will align the rules more closely with the original intent of the conversion procedures.

While the proposal will afford specialists greater opportunity to convert percentage orders on a destabilizing tick, the Commission believes that existing requirements imposed on the specialist when converting percentage orders for execution or quotation purposes are sufficiently restrictive to ensure that the specialist will act in a manner consistent with his market making obligations and Section 11(b) of the

Act.<sup>25</sup> In addition, the Commission believes that the limiting and protective provisions incorporated into the Exchange's conversion procedures should ensure that the proposal will not increase the likelihood of fraudulent and manipulative activities by specialists. Therefore, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act.<sup>26</sup>

The Commission finds good cause for approving proposed Amendment No. 1 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. In Amendment No. 1, the NYSE attempts to clarify its proposal, with respect to the effect of the execution of percentage orders previously converted, in response to questions raised by Commission staff. As the NYSE's clarification does not in any way modify its original proposal, the Commission believes that Amendment No. 1 raises no novel issues of regulatory concern. Accordingly, the Commission believes that it is consistent with Section 6(b)(5) of the Act<sup>27</sup> to approve Amendment No. 1 to the proposed rule change on an accelerated basis.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of all such filings also will be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR-NYSE-97-09 and should be submitted by December 30, 1998.

<sup>23</sup> See Securities Exchange Act Release No. 21704 (February 1, 1985) 50 FR 5834 (February 12, 1985) (noticing File No. SR-NYSE-85-1).

<sup>24</sup> For example, if the sale of a block of stock results in a price decline, the subsequent execution of a large percentage buy order elected by the execution of that block transaction could drive the price up again. *Id.*

<sup>25</sup> 15 U.S.C. 78k(b).

<sup>26</sup> 15 U.S.C. 78f(b)(5).

<sup>27</sup> 15 U.S.C. 78f(b)(5).

## V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>28</sup> that the proposed rule change (SR-NYSE-97-09), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>29</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40720; File No. SR-NYSE-98-36]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the New York Stock Exchange, Inc. to Amend Rule 35 ("Floor Employees To Be Registered") and Adopt a New Interpretation to Rule 35

November 30, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,<sup>1</sup> ("Act") and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 22, 1998, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NYSE. 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 proposed rule change consists of an amendment to Exchange Rule 35 ("Floor Employees to be Registered") and a new interpretation with respect to the administration of proposed amended Rule 35. The text of the proposed rule is as follows. Additions are *italicized*; deletions are [bracketed].

#### Proposed Amendments to Rule 35

##### Floor Employees To Be Registered

Rule 35. No employee of a member or member organization shall be admitted to the Floor unless he is registered with, *qualified by* and approved by the Exchange, and upon compliance of both the employer and employee with such requirements as the Exchange may determine.

#### • • • Supplementary Material

.10-.50 No Change

*.60 Qualifications for Registration—Unless otherwise determined by the Exchange, each candidate for registration shall qualify by meeting the training requirements and by passing applicable qualification examination(s) as prescribed by the Exchange.*

[.60] .70 No Change in Text

#### Proposed New Interpretation to Rule 35

*Rule 35—Floor Employees to be Registered*

*.01 Unless otherwise determined by the Exchange, all Floor employees of members or member organizations (i.e., Trading Assistants) shall pass the Trading Assistant Qualification Examination ("Series 25").*

*New Trading Assistant candidates must complete three months of training, including on-the-job and classroom training, as prescribed by the Exchange, prior to taking the Series 25 Examination. During the three month training period, the Trading Assistant candidate may perform the functions and duties of a Trading Assistant provided that the candidate is properly supervised. However, a new Trading Assistant candidate must complete required training and pass the Series 25 Examination before functioning as an "unsupervised" Trading Assistant (i.e., functioning without the specialized supervision required during the training period).*

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change 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 and is set forth in sections A, B, and C below.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The purpose of the rule change is to revise Rule 35 to require Floor employees of members and member organizations to satisfy prescribed training and qualification examination requirements before being admitted to the Exchange Trading Floor. The proposed rule change will also adopt a new interpretation to Rule 35 to implement the qualification examination requirements for Floor Employees.

Exchange Rule 35 dictates the terms under which an employee of a member or member organization may be admitted to the Exchange Trading Floor. Currently, the registration process for

such Floor employees *i.e.*, Post Clerks and Booth Clerks, also known as Trading Assistants, consists of submission to the Exchange of a completed Form U-4 ("Uniform Application for Securities Industry Registration or Transfer") and the candidate's fingerprints. Under the proposed amendments to Rule 35, these Trading Assistants, will have to be qualified by taking and passing appropriate qualification examination(s) and by meeting prescribed training requirements.

In order to qualify Trading Assistants, the Exchange, in conjunction with a committee of Exchange Members and Trading Assistants, developed a new qualification examination, the Trading Assistant Qualification Examination ("Series 25 Examination"). The Series 25 Examination will ensue that Trading Assistants have the basic knowledge, skills and abilities necessary to perform the functions and carry out the responsibilities of a Trading Assistant. The Series 25 Examination itself is the subject of a separate filing.<sup>3</sup>

The requirement to take and pass the Series 25 examination in order to qualify as a Trading Assistant will apply to all current and prospective Trading Assistants. The proposed new interpretation to Rule 35 will establish that new Trading Assistants will be required to undergo three months of training (including on-the-job and prescribed classroom instruction provided by the Exchange) prior to taking the examination. New Trading Assistants will not be permitted to perform their functions without appropriate supervision until passing the examination. Current Trading Assistants would have one year from implementation of the qualification requirement to pass the examination and do not have to complete classroom training. If a current Trading Assistant fails the Series 25 examination twice, however, he or she must complete classroom training before retaking the examination. The NYSE intends to publish the new interpretation as an Interpretation Memorandum for inclusion in the Exchange's *Interpretation Handbook*.

###### 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the requirements of Section 6(c)(3)(B) of the Act.<sup>4</sup> Under that Section, it is the Exchange's responsibility to prescribe standards of training, experience and

<sup>28</sup> 15 U.S.C. 78s(b)(2).

<sup>29</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> Securities Exchange Act Release No. 40721 (November 30, 1998).

<sup>4</sup> 15 U.S.C. 78f(c)(3)(B).