

(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, N.W., Washington, D.C. 20549-0609. 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 Board's principal offices. All submissions should refer to File No. SR-MSRB-99-7 and should be submitted by September 20, 1999.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 99-22429 Filed 8-27-99; 8:45 am]

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41774; File No. SR-PCX-99-24]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Automated Opening Rotations

August 20, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 13, 1999, the Pacific Exchange Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On August 4,

1999, the Exchange filed with the Commission Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to adopt a new procedure for handling customer orders and executing option transactions during the opening rotation. This rule change is intended to automate the current procedures for opening rotations, except for those situations in which the opening rotation will continue to be conducted manually. The test of the proposed rule change follows. New text is italicized.

#### ¶15073—Trading Rotations

Rule 6.64(a)—No additional change.

(b) *Automated Opening Rotation. The Exchange may employ automated opening rotations in designated series of options. All option series that are eligible for participation in the Automatic Opening Rotation will be opened automatically. Conversely, if an option series is not opened automatically pursuant to this Rule, then that series must be opened manually pursuant to applicable Exchange Rules. Automated Opening Rotations, when held, will be based upon the following procedures.*

(1) *Establishing a Market for the Opening Rotation: Prior to the opening rotation in a particular option series, the Order Book Official will determine whether there are any manual orders being represented in the trading crowd to be executed during the opening rotation. In doing so, the Order Book Official will call for bids and offers from the trading crowd once the underlying security has opened. The trading crowd may determine that the bids and offers then being displayed on the overhead screens are accurate, or alternatively, may modify those bids and offers by public outcry.*

(2) *Designating Series that are Not Eligible for the Automated Opening Rotation. The Order Book Official must identify, prior to the opening, all option series that are not eligible for the automated opening rotation. These series include:*

(A) *Series for which there are no market or marketable limit orders in the POETS system.*

(B) *Series for which there are one or more manual orders being represented in the trading crowd that are likely to be executed during the opening rotation, as determined by an Order Book Official.*

(C) *Series for which one or more members of the trading crowd has reasonably requested that a manual opening rotation be conducted. Two Floor Officials may deny member requests for manual opening rotations in the absence of reasonable justification for doing so. Prior to the opening, the OBO, in conjunction with the members of the trading crowd, will set for each option issue a number of contracts that constitutes an imbalance threshold, i.e., a specific number of option contracts to buy in excess of the number of contracts to sell or a specific number of contracts to sell in excess of the number of contracts to buy. The POETS system will not automatically open any series with an imbalance exceeding the threshold for that issue.*

(3) *Automated Opening Rotations. Series Eligible for the Automated Opening Rotation will be opened automatically based on the following principles and procedures:*

(A) *The POETS system will determine a single price at which a particular option series will be opened, as provided in Commentary .03, below.*

(B) *Orders in the system will maintain priority over Market Maker bids and offers. Orders in the system will be matched up with one another, if possible, before they are executed against the accounts of Market Makers participating on the Automatic Execution System.*

(C) *If there is an imbalance in the number of contracts to buy or sell at the opening, then the imbalance will be cleaned up by the Market Makers who are participating on the Automatic Execution System. Accordingly, each Market Maker will be assigned a number of option contracts for execution until the imbalance has been exhausted. The maximum number of option contracts that may be assigned to a Market Maker is established pursuant to Rule 6.87. When the Auto-Ex System assigns the imbalance of contracts to Market Makers, the assignments will be made in the same manner in which option contracts are allocated to Market Makers who are participating on the Auto-Ex System pursuant to Rule 6.87. The maximum number of contracts assigned will be the same as the number assigned under the Auto-Ex procedures established pursuant to Rule 6.87.*

<sup>5</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> In Amendment No. 1, the Exchange further clarifies the operation of automated openings, provides rule text related to the new procedures, and justifies its request for accelerated approval. See letter from Michael D. Pierson, Director, Regulatory Policy, PCX, to Michael A. Walinskias, Associate Director, Commission, dated August 3, 1999 ("Amendment No. 1").

## Commentary:

.01-.02—No Change.

.03—*Determining the Opening Price of a Single Price Opening.* The appropriate price to be used in a single price opening on the Exchange is determined in the following manner: Once the trading crowd has established the bid and offering prices in a particular series, the Order Book Official will identify the number of contracts available to sell at the previously-established bid price and the number of contracts available to buy at the previously-established offering price.

(a) If the number of contracts available to sell at the bid price is greater than the number available to buy at the offering price, then the opening price will be the bid price.

(b) If the number of contracts available to buy at the offering price is greater than the number available to sell at the bid price, then the opening price will be the offering price.

(c) If eligible market and marketable limit orders can be completely satisfied by trading against other orders in the Limit Order Book, then the market may open between the established bid and ask prices, with no Market Maker participation. For example, if the market is  $2\frac{1}{4}$ , with an order in the Limit Order Book to sell 20 contracts at  $2\frac{1}{8}$ , and there is a market order to buy 5 contracts, the single price open, will occur with 5 contracts trading at  $2\frac{1}{8}$ . The opening price will always be on or between the established bid and offer.

(d) If there is no trading increment available at the half-way point between the bid and offering prices e.g., as in the case of a market of bid,  $2\frac{1}{16}$  asked), then the opening price will be established at the price closest to the last sale price of option contracts in that series.

## II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules 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 place specified in Item IV below. The Exchange 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

*Introduction.* The Exchange is proposing to adopt a new procedure to facilitate trading of option contracts during the opening rotation.<sup>4</sup> Opening rotations are held promptly following the opening of the underlying security on the principal market where it is traded.<sup>5</sup> Opening rotations are conducted by an Order Book Official ("OBO"), who is an Exchange employee.<sup>6</sup> The PCX rules on opening rotations apply to both index and equity option contracts.<sup>7</sup>

*Current Procedures for Opening Rotations.* Prior to the opening, firms and floor brokers may enter customer orders into the Limit Order Book ("Book") for handling by the OBO to facilitate a single price opening. It is the responsibility of the floor broker to make the OBO aware of orders that may be expected to trade on the opening.<sup>8</sup>

In conducting the opening rotation, the OBO first asks the trading crowd whether the quotes generated by Auto-Quote<sup>9</sup> are consistent with the trading crowd's markets. At that time, the market makers have an opportunity to adjust the Auto-Quote parameters, including the volatility settings. If one or more members of the trading crowd determines to improve a market, they may do so. Alternatively, the trading crowd or LMM may establish a market without the use of the Auto-Quote function, and in that case, the OBO will request bids and offers from members of the trading crowd and enter the quotes manually.

Once the best bid and ask prices have been established, each option series,<sup>10</sup> is

<sup>4</sup> The Exchange intends to continue to employ the current (manual) procedures for closing rotations.

<sup>5</sup> See PCX Rule 6.64, Comment. .01(a).

<sup>6</sup> See PCX Rules 6.51 and 6.64.

<sup>7</sup> See PCX Rule 7.10.

<sup>8</sup> See OFPA A-1.

<sup>9</sup> The Auto-Quote feature of POETS allows market quotes to be generated systematically, using programmed theoretical models and variable criteria that are entered through the Auto-Quote function by Book staff. See Securities Exchange Act Release No. 27633 (January 18, 1990), 55 FF 2466 (January 24, 1990).

<sup>10</sup> The term "series" means all option contracts of the same class (puts or calls) having the same expiration date and exercise price, and the same unit of trading. In general, when a new issue is first listed and traded on the Exchange, there will be 24 series available for trading. These include series that are in-, at- and out-of-the money, for both puts and calls, and for each of four expiration months. As the price of the underlying stock moves and new series are added, the number of series outstanding at any given time can be greater than 100. For example, on July 1, 1999, the number of series

opened as follows: First, if there are no orders in the Book and no orders being manually represented in the trading crowd of which the OBO is aware, the series is flagged "open," free trading is commenced in that series and the Auto-Ex System<sup>11</sup> is flagged on in that series. Second, if there are one or more market or marketable limit orders in the Book, or one or more orders being manually represented in the trading crowd and designed for trading at the opening rotation, the OBO will call for a market and attempt to determine from floor brokers the sizes and prices of those orders.<sup>12</sup> The OBO will then ask the floor brokers in the crowd what customers orders they are holding to be executed at the opening and, when possible, match all customers orders at the appropriate price.<sup>13</sup> If imbalances occur, the OBO asks the market makers if they can clean up the imbalance at the established price and, if not, establish

outstanding in options on America Online, Inc. was 104.

<sup>11</sup> The Auto-Ex system permits eligible market or marketable limit orders sent from member firms to be executed automatically at the displayed bid or offering price. Participating market makers are designated as the contra side to each Auto-Ex order. Participating market makers are assigned by Auto-Ex on a rotating basis, with the first market maker selected at random from the list of signed-on market makers. Auto-Ex preserves Book Priority in all options. Automatic executions through Auto-Ex are currently available for public customer orders of 20 contracts or less in most option issues traded on the Exchange (however, the maximum size of orders eligible for Auto-Ex is ten contracts in a small number of issues).

<sup>12</sup> See OFPA C-1. If the OBO believes that the response to the request for markets is insufficient either as to price or size, the OBO may request markets from each market maker who did not respond and/or may call for supplemental market makers. See OFPA C-1.

<sup>13</sup> See OFPA C-1. The appropriate price that is used in a single price opening is determined in the following manner: Once the bid and offering prices in a particular series have been determined, the OBO will identify the number of contracts available to sell at the bid price and the number of contracts available to buy at the offering price. If the number available to sell at the bid price is greater than the number available to buy at the offering price, then the opening price will be the bid price, and vice versa. If the number of contracts to sell is equal to the number to buy, then the opening price will be established halfway between the bid and offering price. However, if there is no trading increment available at the half-way point between the bid and offering prices (e.g., as in the case of a market 2 bid,  $2\frac{1}{16}$  asked), then the opening price will be established at the price closest to the last sale price of option contracts of that series.

If market and marketable limit orders can be completely satisfied by trading against other orders in the Book, then the market may open between the established bid and ask prices, with no market maker participation. For example, if the market is  $2\frac{1}{4}$ , with an order in the Book to sell 20 contracts at  $2\frac{1}{8}$ , and a market order to buy 5 contracts, the single price opening will occur with 5 contracts trading at  $2\frac{1}{8}$  (public customer to public customer). The market quote at the opening will then be  $2\frac{1}{8}$ .

where the orders can be filled.<sup>14</sup> Market makers who respond with bids or offers are entitled to participate based on existing rules on priority of bids and offers.<sup>15</sup>

While conducting the opening rotation, the OBO will attempt to match all public customer orders at a single price.<sup>16</sup> If there is an imbalance of public customer orders in the Book, the OBO will seek market maker and firm participation to establish the opening price.<sup>17</sup> The OBO may give market orders that are entitled to participate at the opening<sup>18</sup> priority over limit orders at the same opening price on the Book.

Generally, each option issue traded at a given trading post is to be opened in the same order in which opening transactions are reported in the underlying securities.<sup>19</sup> In opening a particular option issue, the OBO will ordinarily first open one or more series of a given class having the nearest expiration, and then proceed to series of options having the next most distant expiration, and so forth, until all series in that issue have been opened.<sup>20</sup> Unless the Options Floor Trading Committee ("OFTC") provides otherwise, the OBO will determine whether to open puts first or calls first, but may alternate the opening of put series and call series, or may open all series of one type (puts or calls) before opening series of the other type, depending upon market conditions.<sup>21</sup>

**New Automated Opening Rotation ("AOR") Process.** The Exchange is proposing to adopt a new procedure that will allow the OBO to establish electronically a single price opening for executing eligible market and marketable limit orders in the POETS system. In the event of an imbalance, any remaining orders in the system that are eligible to be executed will be assigned to market makers participating on the Auto-Ex System. The new process involves three basic steps: first, the markets are established; second, the opening rotation is automatically processed for the majority of series; and finally, any series was manual orders or

complication is opened manually *i.e.*, pursuant to the current procedures for opening rotations as described above.<sup>22</sup>

More specifically, under the new AOR process, opening rotations on the PCX will occur in the following manner: Prior to the opening, the OBO will determine whether there are any orders in the trading crowd to be executed at the opening.<sup>23</sup> Once the underlying security has opened, the OBO will request from the trading crowd bids and offers in the specific option issue. The trading crowd may determine that the posted bids and offers are accurate, or alternatively, may request by public outcry that certain quotes be modified.<sup>24</sup>

Once the bid and asking price in each series has been ascertained, the OBO and AOR system will identify all series that are eligible for the AOR and that can be opened immediately, and will also identify all series that are not eligible for the AOR. Those that are not eligible for the AOR must be opened manually. Procedures for automatic and manual opening are discussed below.

#### 1. Automatic Opening

The Exchange intends to use the AOR in all issues traded on the PCX. The Exchange also expects that particular series will only be designated for manual openings (*i.e.*, "de-selected" from the automated procedure) in unusual circumstances. The Exchange does not anticipate any situations where all series of a given issue will be opened manually when the AOR is operational. The Exchange also does not anticipate that any particular series will be de-selected and opened manually on a routine or regular basis.<sup>25</sup>

<sup>22</sup> See *Current Procedures for Opening Rotations*, *supra*.

<sup>23</sup> These may include, for example, orders that cannot be represented in POETS, such as contingency orders, broker/dealer orders, orders designated "not held," orders for spreads or straddlers, combination orders, all-or-none orders, as well as any order the floor broker determines to represent manually. As noted above, it is the floor brokers' obligation to notify the OBO of such orders prior to the opening. See note 8, *supra*.

<sup>24</sup> Prior to an automated opening, the members of the trading crowd must establish a bid and offer for each series in a given issue. This occurs basically as follows: The OBO will first display a bid price and an offering price for a particular series. (These prices will have been established either by the Auto-Quote feature of POETS or by manual process, *i.e.*, a member or members of the trading crowd will vocalize bids and offers that a Market Quote Terminal Operator will enter into the system and display on the overhead screen.) The OBO will then ask the crowd if the displayed prices are "all right" (or other words to that effect). There will then be a short window period when the displayed prices may be adjusted. While the trading crowd is establishing the market, any member may vocalize a bid or offer that improves the market, and the OBO will be required to update the market accordingly. See Amendment No. 1.

<sup>25</sup> See Amendment No. 1.

To prepare for an automated opening, the AOR will first exclude series for which there are no market or marketable limit orders in the system,<sup>26</sup> as well as all series deemed ineligible for AOR. The series eligible for AOR will be promptly opened in accordance with the following principles and procedures. First, the system will determine a single price at which the series will be opened.<sup>27</sup> Second, orders in the system will maintain priority over market maker bids and offers, so orders in the system will be matched up with one another, if possible, before executing against the accounts of market makers. Third, if there is an imbalance in the number of contracts to buy or sell at the opening,<sup>28</sup> then the imbalance will be "cleaned up" by the market makers who are participating on the Auto-Ex system, *i.e.*, the system will assign a set number of contracts (generally 20) to each participating market maker until the imbalance has been exhausted.

Currently, under the manual process, the imbalance will be cleaned up based on auction market principles: Any member can bid or offer for some (or all) of the imbalance at the established price. If there are no bids or offers for the imbalance, the OBO will allocate the imbalance to the members of the trading crowd. Under the proposal, however, the imbalance will be allocated to the members of the trading crowd using the Exchange's existing Auto-Ex system. When the Auto-Ex System assigns the imbalance of contracts to market makers, the assignments will be made in the same manner in which option contracts are allocated to market makers who are participating on the Auto-Ex System pursuant to PCX Rule 6.87. The maximum number of contracts assigned will be the same as the number assigned under the Auto-Ex procedures established pursuant to PCX Rule 6.87.<sup>29</sup>

The number of contracts allocated to each market will depend on the Auto-Ex size guarantee established for that particular issue. If that number is 20 (which currently applies to most issues currently traded on the PCX), then based on the example, two market

<sup>26</sup> There can be single price opening unless there are orders eligible for trading being represented.

<sup>27</sup> The formula that the Exchange intends to use for establishing a single price opening in automated openings is set forth above. See note 13, *supra*.

<sup>28</sup> For example, if there are market or marketable limit orders collectively representing interest to buy 500 contracts and to sell 100 contracts at a single price, the imbalance will be 400 contracts. As discussed below, an imbalance in an amount greater than a previously-established threshold level will render the series ineligible for the AOR.

<sup>29</sup> See Amendment No. 1.

<sup>14</sup> See OFPA C-1. During the opening rotation, OBOs are permitted to match market orders at the opening price, but floor brokers who present these orders to the OBO must remain on the trading floor during the rotation (or must designate another floor broker to represent those market orders in his or her place). See OFPA A-1.

<sup>15</sup> See PCX Rules 6.73 and 6.75.

<sup>16</sup> See PCX Rule 6.75(c)(2).

<sup>17</sup> See PCX Rule 6.75(c)(2).

<sup>18</sup> The OFTC is required to establish a cut-off-time for orders entitled to participate in the opening. See PCX Rule 6.75(c)(1).

<sup>19</sup> See PCX Rule 6.64, Comment. .01(a).

<sup>20</sup> See PCX Rule 6.64, Comment. .01(a).

<sup>21</sup> See PCX Rule 6.64, Comment. .01(a).

markers will each receive automatic executions of 20 contracts against their trading accounts at the opening price. Under the proposal, whatever the opening price, the system will guarantee that all contracts constituting an imbalance will be cleaned by the Auto-Ex System.<sup>30</sup>

Under the proposal, orders may participate in the automated opening rotation regardless of size. An order will not be prohibited from participating in the automated opening rotation on the ground that the order is ineligible from being executed over the Auto-Ex System due to its size.<sup>31</sup>

## 2. Manual Opening

As noted above, all series that are not eligible for AOR will have been identified before any series are opened automatically. The OBO can designate a series as ineligible for AOR by deliberately not entering a quote into the system for that series. Series not eligible for the AOR include series for which: (a) there are orders requiring special handling;<sup>32</sup> (b) there is an imbalance of contracts exceeding an established threshold; or (c) the trading crowd and OBO determine that the series should be opened manually.

### a. Manual Orders Requiring Special Handling

A series will be deemed ineligible for AOR if a broker in the crowd is holding an order that is likely to be executed during the opening. In general, manual orders to buy at relatively low prices or to sell at relatively high prices generally will not likely participate in the opening.<sup>33</sup>

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> The following types of orders are ineligible to participate in the automated opening rotation: (1) broker/dealer orders; (2) contingency orders; (3) spreads; (4) straddles; (5) not held orders; and (6) combination orders. These types of orders are defined in PCX Rule 6.62. If any of these types of orders are being represented in the trading crowd and are likely to participate in the opening based on price, a manual opening rotation will be held in that series. See Amendment No. 1.

Market orders and plain limit orders (*i.e.*, limit orders with no contingencies) are eligible to participate in the automated opening rotation. See PCX Rule 6.75(c)(1); OFPA A-1 (eligibility of market orders); and Amendment No. 1.

<sup>33</sup> If there is an order in the crowd that is ineligible to participate in the automated opening rotation due to its type, and, based on its price, that order is likely to participate in the opening (*e.g.*, there is a broker/dealer order to buy puts at  $5\frac{1}{4}$  and the established market is  $4\frac{7}{8}$ - $5$ ), the opening rotation will be conducted manually for that series. On the other hand, if the market were  $5\frac{1}{2}$ - $5\frac{7}{8}$ , the  $5\frac{1}{4}$  bid would not likely participate in the opening, so it will not be required that a manual process be held. (A manual opening is required under proposed PCX Rule 6.64(b)(2)(B) for a series if there are one or more manual orders in the trading crowd

### b. Imbalance of Contracts Exceeding Established Thresholds

The Exchange will establish, for each option issue, a number of contracts that constitutes an imbalance threshold. This number will attempt to reflect the relative liquidity in the trading crowd and size of the trading crowd.<sup>34</sup> The AOR will calculate imbalance on a series-by-series basis and flag those series for which the imbalance threshold has been exceeded. The threshold level will vary by issue and by trading crowd. For example, assume the established market is  $5-5\frac{1}{4}$  and there are orders for 100 contracts to buy at  $5\frac{1}{4}$  and orders for 500 contracts to sell at 5. Since the imbalance is 400 contracts, the threshold will be exceeded unless the established level is greater than 400. If the established level is greater than 400, the opening will occur under AOR. If the threshold is exceeded there will be a manual opening.

### c. Crowd's Request for Manual Opening

A member or members of a trading crowd may request a particular series to be opened manually, and the OBO will honor reasonable requests. These requests may typically be made in a series with a large amount of open interest or for other reasons.<sup>35</sup> Although

"that are likely to be executed during the opening rotation, as determined by the Order Book Official.") However, in the second example above, the broker/dealer order to buy puts at  $5\frac{1}{4}$  will be eligible to be executed in free trading immediately following the opening of that series. See Amendment No. 1.

<sup>34</sup> The Exchange anticipates that the number of contracts constituting an imbalance threshold will be established by the OBO in consultation with the trading crowd. The Options Floor Trading Committee will monitor and supervise the general process of designating imbalance thresholds on the trading floor. The Exchange believes that it is necessary to provide a reasonable amount of flexibility in the process of establishing particular thresholds, and further that there is little risk of abuse in providing flexibility because if low thresholds are established by a trading crowd, the result will merely be that certain series will have to be opened manually. Although the Exchange does not anticipate that there will be any problems in this area, the Exchange will study the process during the first six months of use of the new system, and if rule changes appear necessary, the Exchange will file a rule filing with the Commission to effect the changes necessary. See Amendment No. 1.

<sup>35</sup> The Exchange represents that it does not anticipate that this provision will be used with any regularity, but instead, should be used under extraordinary circumstances. For example, there may be a series that has a very large amount of open interest, and the underlying stock is involved in a takeover or merger. The crowd may prefer to have a particular series opened manually because the proposed takeover price is equal to the strike price of that series. In this exceptional case, the use of the open outcry system would be preferable to the use of the auto-ex system because the allocation of contracts would more likely be consistent with the trading strategies of the members of the trading crowd. See Amendment No. 1.

the Exchange does not anticipate problems resulting from such requests, in the event of a dispute the matter would be resolved by floor officials.<sup>36</sup>

**Obligations and Eligibility of Market Makers.** Market makers may participate in the AOR if they are otherwise eligible to participate on the Auto-Ex system during the trading day pursuant to PCX Rule 6.87. Generally, to participate on Auto-Ex, a market maker must be present in the trading crowd and that trading crowd must be included within that market maker's primary appointment zone. If there is inadequate participation in a particular option issue, two floor officials may require market makers who are members of the trading crowd, as defined in subsection (6) of PCX Rule 6.87, to log on to Auto-Ex, while present in the trading crowd, absent reasonable justification or excuse for non-participation. The Exchange proposes that these rules will apply to market maker participation in the AOR with respect to contracts allocated to market makers during the opening rotation process.

**Surveillance of Market Maker Procedures.** The market makers participating on AOR will be required to price the contracts fairly, in a manner consistent with their obligations under PCX Rule 6.37. In conjunction with the implementation of the AOR system, the Exchange will publish a regulatory bulletin to remind market makers of their obligation to set Auto-Quote fairly. The Exchange believes that a number of factors, including scrutiny by customers and firms representing customer orders, will ensure that market makers adjust the Auto-Quote values consistent with their obligation. Moreover, market makers are required to vocalize their changes to Auto-Quote, which allows OBO's to oversee the markets and alerts market makers who may want to improve the markets. In addition, if an OBO notices any unusual activity in the setting of Auto-Quote values, the OBO must fill out an OBO Unusual Activity Report which will be investigated by the Exchange. Finally, the Exchange's Auto-Quote has an audit trail log that details every quote change resulting from the use of Auto-Quote. This audit trail report can be studied in the event of any concerns with the way the Auto-Quote values were established for AOR.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section

<sup>36</sup> See PCX Constitution, art. IV, sec. 8. On the PCX, floor officials are members of the OFTC who are responsible for the general supervision of the dealings of members on the Options Floor.

6(b)<sup>37</sup> of the Act, in general, and furthers the objectives of Section 6(b)(5),<sup>38</sup> in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principles of trade, to protect investors and the public interest, to remove impediments to and to perfect the mechanism of a free and open market and a national market system. Specifically, the proposal is designed to facilitate the execution of orders at the opening by providing a means of establishing a single price opening. This will expedite the opening of option issues on the Exchange, which will serve all market participants. It will eliminate problems associated with later openings, including the elimination of backlogs of unexecuted orders that can result when opening rotations are conducted entirely manually.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others*

Written comments on the proposed rule change were neither solicited nor received.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (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 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-PCX-99-24 and should be submitted by [insert date 21 days from date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>39</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-41776; File No. SR-Phlx-99-07]

#### **Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Amendment Nos. 1 and 2 and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 3 to the Proposed Rule Change Requiring Off-Floor Traders for which the Phlx is the Designated Examining Authority to Successfully Complete the General Securities Representative Examination Series 7**

August 20, 1999.

On March 15, 1999, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> The proposed rule change would amend Phlx Rule 604, Registration and Termination of Registered Representatives, to require successful completion of the General

Securities Representative Examination Series 7 ("Series 7 Exam") by persons who are associated with members or participant organizations<sup>3</sup> for which the Exchange is the Designated Examining Authority ("DEA")<sup>4</sup> and who trade off the floor of the Exchange ("off-floor traders").<sup>5</sup>

On April 6, 1999, the Exchange filed Amendment No. 1 with the Commission, removing a description of professional traders from the filing.<sup>6</sup> On April 12, 1999, the Exchange filed Amendment No. 2 with the Commission, making technical changes to the proposed rule.<sup>7</sup> On August 18, 1999, the Exchange filed Amendment No. 3 with the Commission, which revised the rule language.<sup>8</sup> Notice of the proposed rule change, as amended, together with the substance of the proposal, was published in the **Federal Register**.<sup>9</sup> The Commission received 22 comment letters from 21 commenters on the filing.<sup>10</sup> This order approves the proposed rule change, as amended.

<sup>3</sup> The term "participant organizations" refers to foreign currency options participant organizations, which includes foreign currency options participants firms and foreign currency options participant corporations. Phlx Rules 13-16.

<sup>4</sup> Pursuant to Section 17(d) of the Exchange Act, 15 U.S.C. 78q(d), the Commission may "allocate among self-regulatory organizations the authority to adopt rules with respect to matters as to which, in the absence of such allocations, such self-regulatory organizations share authority under this title." The DEA is the self-regulatory organization ("SRO") that has the responsibility for examining a broker or dealer member for compliance with the federal securities laws and the rules of the SRO.

<sup>5</sup> Under the proposed rule change, Phlx Rule 604 would be retitled as Registration and Termination of Registered Persons.

<sup>6</sup> See Letter from Richard S. Rudolph, Legal Counsel, Phlx, to Karl Varner, Special Counsel, Division of Market Regulation ("Division"), SEC (April 6, 1999).

<sup>7</sup> See Letter from Richard S. Rudolph, Legal Counsel, Phlx, to Karl Varner, Special Counsel, Division, SEC (April 12, 1999).

<sup>8</sup> See Letter from Richard S. Rudolph, Legal Counsel, Phlx, to Karl Varner, Special Counsel, Division, SEC (Aug. 18, 1999). Amendment No. 3 revised the proposed rule language for paragraph (e) of Phlx Rule 604. (Amendment No. 3 was inadvertently designated as Amendment No. 2 by the Phlx).

<sup>9</sup> Securities Exchange Act Release No. 41306 (April 16, 1999), 64 FR 22665 (April 27, 1999).

<sup>10</sup> See Letter from Donald M. Nisonoff, Senior Counsel, Proskauer Rose LLP to Secretary, SEC (May 14, 1999) ("Nisonoff Letter"); E-mail from Chris Pheil to Rule-Comments at OSI (May 3, 1999); E-mail from Victor Shakerchi to Rule-Comments at OSI (May 3, 1999); Letter from H.R. Roger Menear III to Secretary, SEC (May 7, 1999); Letter from Brian Dalinsky to Secretary, SEC (May 7, 1999); Letter from Vladimir M. Slavinsky to Secretary, SEC (May 7, 1999); Letter from Joseph H. Phoenix to Secretary, SEC (May 7, 1999); Letter from Aleksandr E. Shapiro to Secretary, SEC (May 7, 1999); Letter from Dan Dimitrijevic to Secretary, SEC (May 7, 1999); Letter from Nelson R. Davis, Jr. to Secretary, SEC (May 10, 1999); E-mail from Sean von Tegen to Rule-Comments at OSI (May 12, 1999); E-mail from Dan Laycock to Rule-Comments at OSI (May

<sup>37</sup> 15 U.S.C. 78f(b).

<sup>38</sup> 15 U.S.C. 78f(b)(5).

<sup>39</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.