

## SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-46280; File Nos. SR-Amex-2002-02, SR-BSE-2002-02, SR-CBOE-2002-02, SR-CHX-2002-06, SR-CSE-2002-02, SR-ISE-2002-06, SR-NASD-2002-08, SR-NYSE-2002-12, SR-PCX-2002-04, SR-Phlx-2002-05)

**Self-Regulatory Organizations; American Stock Exchange LLC, Boston Stock Exchange, Inc., Chicago Board Options Exchange, Inc., Chicago Stock Exchange, Inc., Cincinnati Stock Exchange, Inc., International Securities Exchange LLC, National Association of Securities Dealers, Inc., New York Stock Exchange, Inc., Pacific Exchange, Inc., and the Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Changes and Amendments Thereto Relating to Decimal Pricing**

July 29, 2002.

### I. Introduction

On June 8, 2000, the Securities and Exchange Commission ("Commission"), pursuant to Section 11A(a)(3)(B) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> ordered the American Stock Exchange LLC ("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 International Securities Exchange, LLC ("ISE"), the National Association of Securities Dealers, Inc. ("NASD"), the New York Stock Exchange, Inc. ("NYSE"), the Pacific Exchange, Inc. ("PCX") and the Philadelphia Stock Exchange, Inc. ("Phlx") ("Participant" or "Participants") to act jointly in planning, discussing, developing, and submitting to the Commission a plan that would begin phasing in the implementation of decimal pricing in equity securities and options on or before September 5, 2000, and to fully implement the conversion to decimal pricing by April 9, 2001.<sup>2</sup> In its June 2000 Order, the Commission also suggested that the Participants discuss the development and implementation of a phase-in plan with interested market

participants, including, but not limited to, the Securities Industry Association ("SIA") and its members, the National Securities Clearing Corporation, the Depository Trust and Clearing Corporation ("DTCC"), the Options Clearing Corporation ("OCC"), the Securities Industry Automation Corporation, the Intermarket Trading System Operating Committee, the Options Price Reporting Authority, the Consolidated Tape Association, and the Consolidated Quote Operating Committee (collectively the "Interested Parties"). In its June 2000 Order, the Commission indicated that the Participants' phase-in plan could establish a minimum price variation ("MPV") for quoting equity securities during the conversion, provided that the MPV was set no greater than \$0.05 and no less than \$0.01. The Commission directed the Participants to submit studies to the Commission two months after full implementation of decimal pricing, analyzing the impact of decimal pricing on systems capacity, liquidity, and trading behavior, including an analysis of whether there should be a uniform minimum increment for a security ("Study" or "Studies"). The June 2000 Order also directed each Participant, within 30 days after submitting its Study, to file for notice, comment, and Commission consideration, proposed rule changes to permanently establish its choice of the MPVs by which equities and options are quoted on their respective markets. By its terms, the June 2000 Order would remain in effect until the Commission acts on the proposed rule changes filed by the individual Participants pursuant to Section 19(b)(2) of the Act<sup>3</sup> permanently establishing the MPVs by which equities and options are quoted on their respective markets or until otherwise ordered by the Commission.

The NYSE, on behalf of the Participants, submitted to the Commission the Decimals Implementation Plan for the Equities and Options Markets on July 26, 2000 (the "Plan").<sup>4</sup> The Plan indicated that the phase-in of decimal pricing for equities would begin on August 28, 2000, and that decimal pricing would be fully implemented for all equities and options by April 9, 2001. In the Plan, the Participants adopted on a pilot basis a uniform MPV of \$0.01 for quoting equity securities.<sup>5</sup> Due to capacity

limitations in quoting and trading options, however, the Plan selected uniform MPVs for quoting options that were closer to existing fractional MPVs: \$0.05 for quoting equity options quoted under \$3.00 and \$0.10 for quoting equity options at \$3.00 or greater.

As a result of the careful planning, preparation, and coordination among the markets, clearing agencies, vendors, and the securities industry, the phase-in of decimal pricing was completed on schedule and without significant operational problems or trading disruptions. Moreover, preliminary reviews by the Commission's Office of Economic Analysis ("OEA") and Nasdaq indicated that some of the anticipated benefits of decimalization, such as the significant narrowing of quoted spreads, were evident almost immediately. For example, OEA estimated that, from December 2000 to March 2001, quoted spreads in securities listed on the NYSE narrowed an average of 37%. An even more dramatic reduction in quoted spreads was observed in Nasdaq securities, with spreads narrowing an average of 50% following decimalization. The overall narrowing of spreads was consistent with the view that decimalization had the potential to reduce trading costs for investors entering small orders that are executed at or within the quotes.

Nevertheless, the Commission has long recognized that the shift from fractional to decimal prices had the potential to influence market dynamics and trading behavior in ways that could affect the transparency, liquidity, and fairness of the markets. In view of the complexities of some of the issues that were raised during the decimal conversion process, therefore, the Commission extended the deadline for submission of the Studies to September 10, 2001.<sup>6</sup>

In general, the Studies addressed the issues the Commission directed the Participants to analyze.<sup>7</sup> For example,

Plan did not address the limited amount of stock trading at smaller price increments that had developed over recent years. For example, the last sale tape operated by Nasdaq records trade prices in increments of less than \$0.01.

<sup>6</sup> See Securities Exchange Act Release No. 44336 (May 22, 2001), 66 FR 29368 (May 30, 2001). The Commission also extended the deadline for the Participants' MPV rule filings to November 5, 2001, and again to January 14, 2002. See Securities Exchange Act Release Nos. 44336 (May 22, 2001), 66 FR 29368 (May 30, 2001); and 44846 (September 25, 2001), 66 FR 49983 (October 1, 2001).

<sup>7</sup> See *The Impact of Decimalization on the Nasdaq Stock Market, Final Report to the SEC*, submitted by the Nasdaq Stock Market ("Nasdaq") on behalf of the NASD, dated June 11, 2001 ("Nasdaq Study"); *Decimalization Impact Report*, submitted by the CHX on September 7, 2001 ("CHX Study"); *Decimalization of Trading on the New York Stock Exchange, A Report to the Securities*

<sup>1</sup> Section 11A(a)(3)(B) of the Act authorizes the Commission, in furtherance of its statutory directive to facilitate the establishment 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 a subsystem thereof) or one or more facilities thereof." 15 U.S.C. 78k-1(a)(3)(B).

<sup>2</sup> See Securities Exchange Act Release No. 42914 (June 8, 2000), 65 FR 38010 (June 19, 2000) ("June 2000 Order").

<sup>3</sup> 15 U.S.C. 78s(b)(2).

<sup>4</sup> See letter from Dennis L. Covelli, Vice President, NYSE, to Annette Nazareth, Director, Division of Market Regulation ("Division"), Commission, dated July 25, 2000.

<sup>5</sup> While the Plan set an MPV of \$0.01 for consolidated quotations in equity securities, the

the Studies submitted by the NYSE and Nasdaq confirmed preliminary estimates on the reduction of quoted spreads following decimalization. The NYSE Study found that bid-ask spreads in NYSE-listed stocks fell to less than half their pre-decimalization average size and effective spreads<sup>8</sup> averaged 43% lower.<sup>9</sup> Nasdaq also found that quoted and effective spreads declined for most Nasdaq stocks by an average of about 50%.<sup>10</sup>

Despite the liquidity improvements implied by smaller effective spreads, the Studies offered more mixed conclusions regarding liquidity and transparency. For example, the NYSE Study found that the amounts of buying or selling interest displayed at the quoted prices fell by an average of two-thirds for NYSE-listed securities, and that the cumulative amount of displayed liquidity on the overall limit order book also fell by two-thirds.<sup>11</sup> While the Nasdaq Study also found that the quoted size posted at the best bid or offer in Nasdaq securities also fell by about two-thirds, the cumulative displayed depth (measured by a specific distance from the bid-ask mid-point) fell by a much smaller percentage.<sup>12</sup> Moreover, Nasdaq found that there was no evidence to indicate that liquidity for large institutional investors had diminished, although there was evidence that large institutional orders may take longer to be "worked."§<sup>13</sup>

and Exchange Commission, submitted by the NYSE on September 7, 2001 ("NYSE Study"); *Decimal Pricing Impact Study for Equities and Options*, submitted by the Phlx on September 7, 2001 ("Phlx Study"); *Report on the Impact of Decimal Pricing*, submitted by the CBOE on September 10, 2001 ("CBOE Study"); letter from Jeffrey T. Brown, CSE, Vice President Regulation and General Counsel, to Jonathan G. Katz, Secretary for the Commission, dated September 10, 2001 ("CSE Study"); letter from David Krell, ISE, President & Chief Executive Officer, to Jonathan G. Katz, Secretary for the Commission, dated September 10, 2001 ("ISE Study"); *Report on Decimal Pricing*, submitted by the PCX on September 10, 2001 ("PCX Study"); *The Impact of Decimalization at the Boston Stock Exchange*, submitted by the BSE on September 26, 2001; and *The Impact of Decimalization, Final Report to the SEC*, dated September 10, 2001, but submitted on October 25, 2001, due to the effects on the Amex from the events of September 11, 2001 ("Amex Study").

<sup>8</sup> The quote spread is the difference between the national best ask price and the national best bid price. The effective spread is twice the difference between the midpoint of the bid-ask spread and the price paid (or received) by investors, and accounts for trading that occurs at prices other than the quoted prices. Effective spreads are generally viewed as giving a more accurate view of trading costs and liquidity than do quoted spreads.

<sup>9</sup> See NYSE Study at 1.

<sup>10</sup> See Nasdaq Study at i.

<sup>11</sup> See NYSE Study at 2.

<sup>12</sup> See Nasdaq Study at i.

<sup>13</sup> See Nasdaq Study at 2.

The Studies also discussed a number of other issues related to the decimal conversion experience. For example, the NYSE and Nasdaq Studies indicated that, while decimalization had increased quote traffic in their stocks, these increases were not of a magnitude to strain systems capacity.<sup>14</sup> In addition, while some of the Studies also discussed some of the reported negative effects of decimalization, such as complaints by some institutional traders that professional traders were using penny increments to trade ahead of large orders (so-called "penny jumping"),<sup>15</sup> none of the Studies offered compelling empirical evidence to suggest that the \$0.01 MPV for stocks<sup>16</sup> or the \$0.05 and \$0.10 MPVs for options<sup>17</sup> should be changed.

The Participants individually filed proposed rule changes to implement the Plan, and individually submitted Studies as required by the Commission's June 2000 Order. As set forth below, the Participants submitted proposed rule changes necessary to make permanent the pilot rule changes previously adopted to implement decimal pricing.

<sup>14</sup> See NYSE Study at 1, 24, and 25, and Nasdaq Study at 1. While the NYSE Study found a very large rise in the number of transactions with a reduction in the size of limit orders and an increase in order cancellations, the Nasdaq Study found little change in the number of trades or share volume in Nasdaq stocks. See NYSE Study at 2, and Nasdaq Study at i, respectively.

<sup>15</sup> See, e.g., NYSE Study at 2.

<sup>16</sup> Some of the Studies that cited apparent negative effects from decimalization in terms of market liquidity, transparency, and trading behavior (such as penny jumping) suggested that these effects would be exacerbated if the MPV for quoting stocks was reduced to less than \$0.01. Moreover, these Studies opined that the use of "sub-penny" quotes across markets would likely lead to a large increase in the number of trades, cancellations, and quotes that would imply a need for substantially higher communications capacity and infrastructure. See, e.g., *id.*, at 3. The Commission has separately solicited public comments on the market structure and investor protection issues that could be raised if the current limited extent of sub-penny quoting and trading in stocks were significantly expanded. See Securities Exchange Act Release No. 44568 (July 18, 2001), 66 FR 38390 (July 24, 2001); as extended by Securities Exchange Act Release No. 44845 (September 25, 2001), 66 FR 49877 (October 1, 2001). The Commission received a total of 29 comment letters on this subject.

<sup>17</sup> Because the \$0.05 and \$0.10 MPVs selected by the Participants for options during the conversion process were not significantly different from the fractional MPVs used prior to the conversion, the studies submitted by the options exchanges could cite little or no evidence based on post-decimalization trading to argue for retaining or changing the decimal MPVs for options. See generally Amex Study, CBOE Study, ISE Study, PCX Study, and Phlx Study. The Amex Study, however, provided findings from a penny pilot simulation (based on a theoretical \$0.01 MPV for options) that the Amex believed counseled against penny increments in options at this time. See Amex Study at 18.

## II. Description of the Proposed Rule Changes

### SR-Amex-2002-02

On January 14, 2002, the Amex filed SR-Amex-2002-02 to amend its equities and options rules to make permanent the pilot rules adopted in SR-Amex-2000-41.<sup>18</sup> On March 18, 2002, the Amex amended the proposed rule change.<sup>19</sup> The Amex again amended the proposal on April 18, 2002.<sup>20</sup> On May 8, 2002, notice of the proposed rule change, as amended, was published in the **Federal Register**.<sup>21</sup> The Commission received no comments on the proposal.

The Amex proposes to make permanent the MPVs for equities and options established on a pilot basis in SR-Amex-2000-41<sup>22</sup> of: \$0.01 MPV for equities, exchange traded funds, and trust issued receipts; \$0.05 MPV for option issues quoted under \$3 a contract; and \$0.10 MPV for option issues quoted at \$3 a contract or greater. The proposal also deletes any remaining references to quoting in fractions.

### SR-BSE-2002-02

On February 15, 2002, the BSE filed SR-BSE-2002-02 to amend its rules to delete all references to fractional pricing and to permanently the pilot rules established in SR-BSE-2000-11.<sup>23</sup> On March 1, 2002, the BSE amended the proposed rule change.<sup>24</sup> On March 18, 2002, notice of the proposed rule change, as amended, was published in

<sup>18</sup> See Securities Exchange Act Release No. 43231 (August 30, 2000), 65 FR 54574 (September 8, 2000) (SR-Amex-2000-41).

<sup>19</sup> See letter from Geraldine Brindisi, Vice President and Corporate Secretary, Amex, to Alton S. Harvey, Assistant Director, Division, Commission, dated March 14, 2002 ("Amendment No. 1"). In Amendment No. 1, the Amex made technical corrections to the proposed rule text.

<sup>20</sup> See letter from Claire P. McGrath, Senior Vice President and Deputy General Counsel, Amex, to Alton S. Harvey, Assistant Director, Division, Commission, dated April 17, 2002 ("Amendment No. 2"). In Amendment No. 2, the Amex: (1) deleted the term "Trading Increment" from Amex Rule 1000, Commentary .03(e) and Amex Rule 1000A, Commentary .02(e); and (2) amended Amex Rule 952(a) to replace the term "trading increments" with "quoting increments."

<sup>21</sup> See Securities Exchange Act Release No. 45858 (May 1, 2002), 67 FR 30984.

<sup>22</sup> See *supra* note 15.

<sup>23</sup> See Securities Exchange Act Release No. 43255 (September 6, 2000), 65 FR 54574 (September 14, 2000) (SR-BSE-2000-11).

<sup>24</sup> See letter from John A. Boese, Assistant Vice President, Legal and Regulatory, BSE, to Alton S. Harvey, Chief, Office of Market Watch, Division, Commission, dated February 28, 2002 ("Amendment No. 1"). In Amendment No. 1, the BSE asked that the proposed rule change be considered pursuant to Section 19(b)(2) of the Act. 15 U.S.C. 78s(b)(2).

the **Federal Register**.<sup>25</sup> The Commission received no comments on the proposal.

#### SR-CBOE-2002-02

On January 14, 2002, the CBOE filed SR-CBOE-2002-02 to permanently adopt the pilot MPV rules currently in place on the CBOE established in SR-CBOE-2000-07.<sup>26</sup> On March 20, 2002, notice of the proposed rule change was published in the **Federal Register**.<sup>27</sup> The Commission received no comments on the proposal.

The CBOE's MPVs established in CBOE-2000-07 are: \$0.05 MPV for option issues quoted under \$3 a contract; \$0.10 MPV for option issues quoted at \$3 a contract or greater; and a \$0.01 MPV for the quoting of CBOE's equity products. The proposed rule change would also provide that future changes to the CBOE's MPVs would be handled as they were handled before the conversion to decimal pricing, namely that the CBOE Board of Directors may determine to change the minimum increments and that the CBOE will designate any such change as a stated policy, practice, or interpretation with respect to the administration of the CBOE minimum increment rule for bids and offers (CBOE Rule 6.42) within the meaning of Section 19(b)(3)(A) of the Exchange Act<sup>28</sup> and will file a rule change for effectiveness upon filing with the Commission. Lastly, the CBOE also seeks to formally eliminate CBOE Rule 15.11 (Mandatory Year 2000 Testing) and CBOE Rule 15.22 (Mandatory Decimal Pricing Testing), both of which have expired.

#### SR-CHX-2002-06

On March 1, 2002, the CHX filed SR-CHX-2002-06 to make permanent the pilot rule changes established in SR-CHX-2000-25<sup>29</sup> during the securities industry transition to a decimal pricing environment. On March 22, 2002, notice of the proposed rule change was published in the **Federal Register**.<sup>30</sup> The Commission received no comments on the proposal.

The CHX proposal would: (1) Make permanent the CHX's MPV of \$0.01; (2) delete references to the procedures and conventions that were used during the

conversion from quoting in fractions to quoting in decimals; and (3) remove all references to fractional price increments.<sup>31</sup>

#### SR-CSE-2002-02

On March 4, 2002, the CSE filed SR-CSE-2002-02 to make permanent the pilot rule changes established in SR-CSE-2000-01<sup>32</sup> and eliminate references to fractional price variations in stocks traded on the CSE. On March 18, 2002, notice of the proposed rule change was published in the **Federal Register**.<sup>33</sup> The Commission received no comments on the proposal.

The CSE proposes to activate the provisions of CSE Rules 11.3(a) and (c) to eliminate Rules 11.3(a) and (c). With regard to all equity securities, CSE Rule 11.3 will reflect only decimal pricing upon approval of this proposed rule change.

#### SR-ISE-2002-06

On February 12, 2002, the ISE filed SR-ISE-2002-06 to make permanent the pilot rule changes established in SR-ISE-2001-14<sup>34</sup> setting forth its current minimum pricing increments for quotations as \$0.05 for options trading at less than \$3.00 and \$0.10 for options trading at \$3.00 or more. On March 18, 2002, notice of the proposed rule change was published in the **Federal Register**.<sup>35</sup> The Commission received no comments on the proposal.

#### SR-NASD-2002-08

On January 15, 2002, the NASD, through its subsidiary Nasdaq, filed SR-NASD-2002-08 to make permanent the pilot rule changes established in SR-NASD-2001-07.<sup>36</sup> On March 28, 2002, Nasdaq amended the proposed rule change.<sup>37</sup> On April 22, 2002, notice of the proposed rule change, as amended,

was published in the **Federal Register**.<sup>38</sup> The Commission received no comments on the proposal.

The proposed rule change would amend NASD Rule 4613 to permanently adopt a \$0.01 minimum quotation increment for Nasdaq securities. The proposed rule change would also permit Nasdaq to continue to display and disseminate quotations in Nasdaq securities in decimal-based increments to two places beyond the decimal point (*i.e.*, to the penny). This proposed rule change again reminds market participants that decimal quotations submitted to Nasdaq that do not comport with the penny minimum quotation increment standard will be rejected by Nasdaq systems.

#### SR-NYSE-2002-13

On March 5, 2002, the NYSE filed SR-NYSE-2002-13 to make permanent the pilot rules established in (SR-NYSE-2000-22),<sup>39</sup> and to amend its rules to eliminate references to fractional pricing increments and to make such rules compatible with quoting in decimals. On March 20, 2002, notice of the proposed rule change was published in the **Federal Register**.<sup>40</sup> The Commission received no comments on the proposal.

In SR-NYSE-2000-22,<sup>41</sup> the NYSE established an MPV of \$0.01 for equities. In SR-NYSE-2002-13, the NYSE proposes to continue the MPV for equities of \$0.01. The NYSE proposes to delete references to quoting in fractions that were retained in NYSE rules to accommodate securities that continued quoting in fractions during the phase in of full decimalization.

#### SR-PCX-2002-04

On January 15, 2002, the PCX filed SR-PCX-2002-04 to permanently adopt the pilot rule changes the PCX made in SR-PCX-2000-23<sup>42</sup> and SR-PCX-2001-39.<sup>43</sup> On March 18, 2002, notice of the proposed rule change was published in the **Federal Register**.<sup>44</sup> The Commission received no comments on the proposal. The PCX is not making

<sup>31</sup> See *supra* note 17. SR-CHX-2000-25 contained language that sought to remove fractional references automatically once the transition to decimal trading had been completed. SR-CHX-2002-06 recognizes that that automatic removal was not an available alternative and formally removes the fractional references from the Exchange's rules.

<sup>32</sup> See Securities Exchange Act Release No. 43408 (October 3, 2000), 65 FR 60708 (October 12, 2000) (SR-CSE-2000-01).

<sup>33</sup> See Securities Exchange Act Release No. 45538 (March 12, 2002), 67 FR 12069.

<sup>34</sup> See Securities Exchange Act Release No. 44349 (May 24, 2001), 66 FR 9617 (May 31, 2001) (SR-ISE-2001-14).

<sup>35</sup> See Securities Exchange Act Release No. 45541 (March 12, 2002), 67 FR 12071.

<sup>36</sup> See Securities Exchange Act Release No. 43876 (January 23, 2001), 66 FR 8251 (January 30, 2001) (SR-NASD-2001-07).

<sup>37</sup> See letter from Thomas P. Moran, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated March 28, 2002 ("Amendment No. 1"). In Amendment No. 1, Nasdaq made technical corrections to the proposed rule text.

<sup>38</sup> See Securities Exchange Act Release No. 45763 (April 16, 2002), 67 FR 19608.

<sup>39</sup> See Securities Exchange Act Release No. 43230 (August 30, 2000), 65 FR 54589 (September 8, 2000) (SR-NYSE-2000-22).

<sup>40</sup> See Securities Exchange Act Release No. 45547 (March 12, 2002), 67 FR 13031.

<sup>41</sup> See *supra* note 36.

<sup>42</sup> See Securities Exchange Act Release No. 43369 (September 27, 2000), 65 FR 59485 (October 5, 2000) (SR-PCX-2000-23).

<sup>43</sup> See Securities Exchange Act Release No. 45077 (November 19, 2001), 66 FR 59280 (November 27, 2001) (SR-PCX-2001-39) (eliminating all references to fractional pricing from its rules).

<sup>44</sup> See Securities Exchange Act Release No. 45544 (March 12, 2002), 67 FR 12074.

<sup>25</sup> See Securities Exchange Act Release No. 45537 (March 12, 2002), 67 FR 12067.

<sup>26</sup> See Securities Exchange Act Release No. 43238 (August 31, 2000), 65 FR 54582 (September 8, 2000) (SR-CBOE-2000-07).

<sup>27</sup> See Securities Exchange Act Release No. 45543 (March 12, 2002), 67 FR 13029.

<sup>28</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>29</sup> See Securities Exchange Act Release No. 43256 (September 6, 2000), 65 FR 55659 (September 14, 2000) (SR-CHX-2000-25).

<sup>30</sup> See Securities Exchange Act Release No. 45585 (March 18, 2002), 67 FR 13385.

any changes to its rules; rather, the PCX is permanently adopting the rule changes that were initially implemented on a pilot basis.

#### SR-Phlx-2002-05

On January 14, 2002, the Phlx filed SR-Phlx-2002-05 with the Commission make permanent the pilot rule changes established in SR-Phlx-2000-05<sup>45</sup> that amended certain Phlx rules and Phlx Options Floor Procedure Advices and Order and Decorum Regulations ("Options Advices"), and to remove references to fractional pricing and references dual pricing in fractions and in decimals. On March 8, 2002, the Phlx amended the proposed rule change.<sup>46</sup> On March 22, 2002, notice of the proposed rule change, as amended, was published in the **Federal Register**.<sup>47</sup> The Commission received no comments on the proposal.

The Phlx proposes to continue the \$0.01 MPV for equities, and the \$0.05 and \$0.10 MPVs for options and Exchange-Traded Fund Shares. The Phlx proposes to delete references to fractions and dual pricing from its options rules and Options Advices. According to the Phlx, the proposed amendments are non-substantive, technical changes for the purpose of conforming Phlx rules to the development of full decimalization in the securities industry.

This order approves all the proposed rule changes, as amended.

### III. Discussion

The Commission has reviewed carefully the proposed rule changes, as amended, and the Studies, and finds, for the reasons set forth below, that the proposals are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and a registered national securities association, and, in particular, with the requirements of Sections 6(b)(5)<sup>48</sup> and 15A(b)(6)<sup>49</sup> of the Act. Section 6(b)(5) of the Act<sup>50</sup> requires the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with

persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Section 15A(b)(6) of the Act<sup>51</sup> imposes the same requirements on a registered national securities association.

The Commission finds that the proposed rule changes are consistent with these Sections of the Act.<sup>52</sup> The Commission also finds that the proposed rule changes accurately and reasonably implement the requirements of the June 2000 Order.

Specifically, the Commission finds that the Participants complied with the June 2000 Order by jointly developing a phase-in plan for the implementation of decimal pricing, by submitting the Studies evaluating the impact of decimalization on the marketplace, and by filing proposed rule changes to permanently adopt pilot rules that were established during the initial phase-in of decimal pricing. After careful review of the Studies, discussions with the Participants and the with the Interested Parties, and complete review of the proposed rule changes, as amended, the Commission finds that the proposed rule changes to make permanent the pilot rules established during the phase-in of decimal pricing by the Participants, and to remove any remaining references to fractional pricing, are consistent with the Act.

The Commission notes that the Participants selected the MPVs, and agreed to abide by the MPV schedule set forth in the Plan while the Plan remained in effect. Specifically, the Participants chose an MPV of \$0.01 MPV for equity issues, a \$0.05 MPV for option issues quoted under \$3.00 a contract, and a \$0.10 MPV for option issues quoted at \$3.00 a contract or greater. Notably, the Studies did not provide any compelling empirical evidence to suggest that the Commission should require the Participants to alter the MPVs they selected and used during implementation. Further, the Commission notes that the proposed rule changes described herein represent each Participant's individual choice permanently establishing the MPVs by which equities and/or options are quoted on its market.

Moreover, the Commission notes that, since the full implementation of

decimal pricing, there have been no significant systems or capacity problems as a result of the conversion from quoting in fractions to decimals. The Commission received no comment letters on any of the proposed rule changes to make permanent the pilot proposed rule changes that the Participants established during the conversion to decimal pricing.

The Commission believes that the full implementation of decimal pricing, as represented by the proposed rule changes set forth herein, is consistent with the Act, because decimal pricing promotes just and equitable principles of trade, fosters cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities, removes impediments to and perfects the mechanism of a free and open market and a national market system, is designed to prevent fraudulent and manipulative acts and practices, and, in general, protects investors and the public interest.<sup>53</sup> The Commission acknowledges that, as the marketplace continues to evolve, and unforeseen issues arise, additional rule changes may be necessary to ensure the operation of a free and open market and a national market system in a decimals pricing environment. The Commission fully expects that the Participants will continue to review their rules and will make any changes necessary to further the public interest.

Moreover, the Commission notes that, while some Participants have rules that would permit changes to their MPVs by filing proposed rule changes under Section 19(b)(3)(A) of the Act,<sup>54</sup> the Commission believes if a proposed change raised significant capacity concerns or other issues that had the potential to disrupt the orderly operation of the national market system, it would not be appropriately filed under Section 19(b)(3)(A) of the Act.<sup>55</sup> Accordingly, any proposed change to a Participant's MPV that has the potential to raise such concerns should be implemented only after notice, comment, and Commission

<sup>53</sup> 15 U.S.C. 78f(b)(5); 15 U.S.C. 78o-3(b)(6).

<sup>54</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>55</sup> *Id.* Section 19(b)(3)(C) of the Act provides that "the Commission summarily may abrogate the change in the rules of the self-regulatory organization made thereby and require that the proposed rule change be refiled in accordance with the provisions of paragraph (1) of this subsection and reviewed in accordance with the provisions of Section (2) of this subsection, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title." 15 U.S.C. 78s(b)(3)(C).

<sup>45</sup> See Securities Exchange Act Release No. 43421 (October 6, 2000), 65 FR 61207 (October 16, 2000) (SR-Phlx-2000-05).

<sup>46</sup> The Phlx submitted a new Form 19b-4, which replaced and superseded the original filing in its entirety.

<sup>47</sup> See Securities Exchange Act Release No. 45581 (March 18, 2002), 67 FR 12067.

<sup>48</sup> 15 U.S.C. 78f(b)(5).

<sup>49</sup> 15 U.S.C. 78o-3(b)(6).

<sup>50</sup> 15 U.S.C. 78f(b)(5).

<sup>51</sup> 15 U.S.C. 78o-3(b)(6).

<sup>52</sup> In approving these rules, the Commission has considered their impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

consideration pursuant to Section 19(b)(2) of the Act.<sup>56</sup>

Finally, the Commission notes that this approval order marks the official end of the decimalization phase-in plan, established in the June 2000 Order. Any antitrust immunity conferred upon the Participants by the June 2000 Order is terminated as of the effective date of this order.<sup>57</sup>

#### IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>58</sup> that the proposals SR-Amex-2002-02, SR-BSE-2002-02, SR-CBOE-2002-02, SR-CHX-2002-06, SR-CSE-2002-02, SR-ISE-2002-06, SR-NASD-2002-08, SR-NYSE-2002-12, SR-PCX-2002-04, and SR-Phlx-2002-05 be and hereby are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>59</sup>

Margaret H. McFarland,

Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46274; File No. SR-CSE-2001-06]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Cincinnati Stock Exchange, Inc. Amending CSE Rule 12.6, Customer Priority, to Require Designated Dealers to Better Customer Orders at the National Best Bid or Offer by Whole Penny Increments

July 29, 2002.

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 November 30, 2001, the Cincinnati Stock Exchange, Inc. ("CSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the

proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On April 22, 2002, the CSE filed Amendment No. 1 to the proposal.<sup>3</sup> On April 26, 2002, the CSE filed Amendment No. 2 to the proposal.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval of the proposed rule change for a pilot period until September 30, 2002.

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

The Exchange proposes to amend CSE Rule 12.6, Customer Priority, by adding new Interpretation .02, which will require a CSE Designated Dealer ("Specialist") to better the price of a customer limit order that is held by that Specialist if that Specialist determines to trade with an incoming market or marketable limit order. Under the rule, the Specialist will be required to better a customer limit order at the NBBO by at least one penny and at a price outside the current NBBO by at least the nearest penny increment. The Exchange is requesting approval of the proposed rule change on a pilot basis, through September 30, 2002. The text of the proposed rule change is set forth below. Proposed new language is in italics; proposed deletions are in brackets.

\* \* \* \* \*

#### Chapter XII

##### Rule 12.6 Customer Priority

(a)-(c) No change.

Interpretations and Policies:

.01—No change.

.02(a)—*A Designated Dealer shall be deemed to have violated Rule 12.6 if, while holding a customer limit order (as rounded to a penny increment) representing the NBBO, the Designated Dealer, for his own account, trades with an incoming market or marketable limit order at a price which is less than one penny better than the price of such customer limit order (not the quoted price) held by such Designated Dealer.*

<sup>3</sup> In Amendment No. 1, the CSE requested that the proposal be converted to pilot status and that the pilot expire on September 30, 2002. See Letter from Jeffrey T. Brown, Senior Vice President and General Counsel, CSE, to Katherine England, Assistant Director, Division of Market Regulation ("Division"), SEC (April 19, 2002).

<sup>4</sup> In Amendment No. 2, the CSE requested that additional proposed rule language be added to the proposal so that the rule would apply in instances when the customer limit order is not at the national best bid or offer ("NBBO"), rather than just instances when the customer limit order is at the NBBO. See Letter from Jeffrey T. Brown, Senior Vice President and General Counsel, CSE, to Katherine England, Assistant Director, Division, SEC (April 25, 2002).

.02(b)—*A Designated Dealer shall be deemed to have violated Rule 12.6 if, while holding a customer limit order (as rounded to a penny increment) at a price outside the current NBBO, the Designated Dealer, for his own account, trades with an incoming market or marketable limit order at a price which is less than the nearest penny increment to the actual price of the customer limit order (not the quoted price) held by such Designated Dealer.*

#### 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 III 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

The Exchange proposes to amend Exchange Rule 12.6<sup>5</sup> by adding an interpretation to the rule covering the trading of Nasdaq National Market ("NNM") and SmallCap securities in subpenny increments.<sup>6</sup> New Interpretation .02 to the Rule will require a Specialist to better the price of a customer limit order held by the Specialist by at least one penny (for those customer limit orders at the

<sup>5</sup> CSE Rule 12.6 provides, in pertinent part, that no member shall (i) personally buy or initiate the purchase of any security traded on the Exchange for its own account or for any account in which it or any associated person of the member is directly or indirectly interested while such a member holds or has knowledge that any person associated with it holds an unexecuted market or limit price order to buy such security in the unit of trading for a customer, or (ii) sell or initiate the sale of any such security for any such account while it personally holds or has knowledge that any person associated with it holds an unexecuted market or limit price order to sell such security in the unit of trading for a customer.

<sup>6</sup> In conjunction with this proposed rule change, the CSE is requesting that the Commission grant exemptive relief pursuant to Rules 11Ac1-1(e)(17 CFR 240.11Ac1-1(e)), 11Ac1-2(g) (17 CFR 240.11Ac1-2(g)) and 11Ac1-4(d) (17 CFR 240.11Ac1-4(d)) to allow subpenny quotations to be rounded down (buy orders) and rounded up (sell orders) to the nearest penny for quote dissemination ("Exemptive Request"). See Letter to Annette Nazareth, Director, Division of Market Regulation ("Division"), Commission, from Jeffrey T. Brown, General Counsel, CSE (November 27, 2001).

<sup>56</sup> 15 U.S.C. 78s(b)(2).

<sup>57</sup> In issuing the June 2000 Order, the Commission instructed the Participants to act jointly in planning, discussing, developing, and submitting to the Commission the Plan, as discussed herein. See *supra* note 1. The June 2000 Order did not address: (a) any joint or other conduct that occurred prior to the issuance of the June 2000 Order or prior orders; and (b) any joint or other conduct occurring after June 8, 2000, that was not ordered or requested by the June 2000 Order.

<sup>58</sup> 15 U.S.C. 78s(b)(2).

<sup>59</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.