

SR-CBOE-2001-63 and should be submitted by March 6, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45410; File No. SR-CHX-2001-26]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Incorporated Relating to Automatic and Manual Execution Procedures

February 6, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on November 14, 2001, the Chicago Stock Exchange, Incorporated ("CHX" 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. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend Article XX, Rule 37 of the CHX Rules, which governs, among other things, automatic execution of market and marketable limit orders. Below is the text of the proposed rule change. Proposed new language is *italicized*; proposed deletions are [bracketed].

\* \* \* \* \*

#### Chicago Stock Exchange Rules, Article XX

##### Guaranteed Execution System and Midwest Automated Execution System

RULE 37. (a) Guaranteed Executions. The Exchange's Guaranteed Execution System (the BEST System) shall be available, during the Primary Trading Session and the Post Primary Trading Session, to Exchange member firms and, where applicable, to members of a participating exchange who send orders

to the Floor through a linkage pursuant to Rule 39 of this Article, in all issues in the specialist system which are traded in the Dual Trading System and NASDAQ/NM Securities. System orders shall be executed pursuant to the following requirements:

1-7. No change.

(b) Automated Executions. The Exchange's Midwest Automated Execution System (the MAX System) may be used to provide an automated delivery and execution facility for orders that are eligible for execution under the Exchange's BEST Rule (Article XX, Rule 37(a)) and certain other orders. In the event that an order that is subject to the BEST Rule is sent through MAX, it shall be executed in accordance with the parameters of the BEST Rule and the following. In the event that an order that is not subject to the BEST Rule is sent through MAX, it shall be executed in accordance with the parameters of the following:

(1) Size. The MAX System has two size parameters which must be designated by the specialist on a stock-by-stock basis. These parameters are the auto-execution threshold and the auto-acceptance threshold. For both Dual Trading System issues and NASDAQ/NM Securities, the auto-execution threshold must be set at 100 [300] shares or greater and the auto-acceptance threshold must be set at 1000 shares or greater. In no event may the auto-acceptance threshold be less than the auto-execution threshold. If the order sending firm sends an agency market order in a Dual Trading System issue through MAX, such order will be executed in accordance with paragraph (b)(6) of this Rule. If the order sending firm sends an agency market order in a Nasdaq/NM Security through MAX, such order shall be executed in accordance with paragraph (b)(7) of this Rule.

\* \* \* \* \*

#### Interpretations and Policies:

\* \* \* \* \*

04. Ability to Switch MAX to Manual Execution. Effective April 4, 1994. Specialists have the ability to switch their MAX terminals off automatic execution at their respective posts. This new functionality is being implemented to allow specialists to timely switch to a manual execution mode when a certain analyst/reporter's report is broadcast on cable T.V., if market conditions in a particular stock warrant it. Specialists should switch to manual mode only when absolutely necessary and are required to return to the automatic execution functionality immediately when the primary market

quotes accurately reflect market conditions. A specialist cannot remain in manual mode, under this paragraph, for more than *five* [10] minutes without securing the permission of two (2) floor officials.

In all other instances, when a specialist believes it is necessary to be in a manual execution mode, he or she must *secure the permission of his/her firm's floor supervisor (who, under normal circumstances should be located on the trading floor) before switching to manual, and the firm supervisor must immediately (but in no event more than three minutes after switching to manual mode) [always] notify and secure [seek] the permission of a [two (2)] floor official[s] to remain in manual mode [before switching to manual]*. This new functionality cannot be used merely because of a volatile market, but shall only be permitted when the primary market quotes are inaccurate due to market conditions. For example, this new functionality might be used if it became apparent that the NYSE invoked its unusual market conditions rule (pursuant to SEC Rule 11Ac1-1). *The [F]loor official[s] must be satisfied that the conditions which permit putting an issue on manual mode are present before granting a specialist's request to switch to the manual mode and such permission shall only be in effect for five minutes. A firm's floor supervisor shall monitor the conditions which formed the basis for the [ir] decision to ensure that specialists' return to the auto-execution feature when such conditions are no longer present. Both the firm's floor supervisor and the [S]pecialist[s] also have the responsibility, and are required, to immediately reinstate MAX's automatic execution functionality when the primary market quotes accurately reflect market conditions. If the specialist and the firm's floor supervisor believe it is necessary to continue in manual mode for longer than five minutes, then the firm supervisor must again secure the permission of the floor official who granted the initial permission, and if such floor official is not available, then from another floor official. Reasons for going to manual mode, the time spent in manual mode, the name of the firm supervisor who permitted the specialist to switch to manual mode and the name of the floor official who granted permission to go to manual mode must be documented and filed with the market regulation department before the next business day's opening.*

When operating in the manual mode. Specialists still have the responsibility to fill customer orders according to CHX Rules—including the BEST Rule. All

<sup>11</sup> 17 CFR 200.30-3(a)(12).

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

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

pricing executions will be reviewed for accuracy. This capability should only be utilized on an infrequent basis and only in unusual circumstances.

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

In its filing with the Commission, the CHX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received regarding the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The CHX has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

#### 1. Purpose

The Exchange proposes to amend Article XX, Rule 37 of the CHX Rules, which governs, among other things, automatic execution of market and marketable limit orders. The proposed rule change is intended to clarify a specialist's obligations relating to the automatic execution of orders and to provide CHX specialists and floor officials with additional guidance regarding the ability of a CHX specialist to switch to manual execution mode. The two rule changes are summarized below.

#### a. Reduction of Minimum Auto Execution Threshold

The proposed change to Article XX, Rule 37(b), which governs automatic execution of eligible orders, would reduce the minimum auto execution threshold from 300 shares to 100 shares. This change is intended to reconcile a specialist's automatic execution obligation with the post-decimalization trading environment. The Exchange represents that, given the scattering of liquidity over multiple price points and resulting reduction in Best Bid or Offer ("BBO") size,<sup>3</sup> many specialists desire to reduce their automatic execution exposure for certain issues to levels that are commensurate with reduced BBO

size. In order to preserve consistency and avoid customer confusion, the proposed rule change would apply to both Dual Trading System and Nasdaq/NM issues. Specialists would remain free to increase their auto execution thresholds to larger sizes if they believe that business/marketing considerations so demand; in fact, the Exchange represents that a number of CHX specialists have indicated that they would reduce their auto execution threshold to 100 shares only in very limited instances.

#### b. Procedures for Floor Official Approval of Manual Execution Mode

The Exchange also proposes to amend Article XX, Rule 37, Interpretation and Policy .04, which governs the procedures by which specialists are to obtain permission to switch from automatic execution mode to manual execution mode.

The proposed amendment to the interpretation/policy would give greater responsibility to the specialist firm seeking to shift to manual execution mode. Specifically, the specialist firm's floor supervisor would be required to seek floor official approval and would be responsible for the documentation that must be filed with the Market Regulation Department following a shift to manual execution mode. Additionally, the amended language makes clear that floor official permission to operate in manual execution mode expires after a limited time period; after five minutes, the specialist firm and its floor supervisor must again seek permission to remain in manual execution mode. Finally, the proposed rule change would reduce from ten minutes to five minutes the maximum period in which the specialist may remain in manual mode when a certain analyst/reporter's report is broadcast on cable television, pursuant to the terms and conditions of Interpretation .04.

The Exchange anticipates that this proposed rule change will promote greater accountability and preclude reliance on manual execution mode in a manner that is potentially violative of CHX rules. The Exchange also believes that the proposed rule change will assist the Market Regulation Department in determining whether violations of the Exchange's rules regarding manual execution mode have occurred.

#### 2. Statutory Basis

The CHX believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities

exchange, and, in particular, with the requirements of Section 6(b) of the Act. In particular, the Exchange believes that the proposed rule change is consistent with Section 6(b)(5) of the Act in that it is designed to promote just and equitable principles of trade, 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.

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or 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 Exchange consents, the Commission will:

- (A) by order approve the 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 at the Commission's Public Reference

<sup>3</sup> The Exchange represents that average size at BBO price points has declined significantly following the transition to decimal pricing, with approximate size reductions of 67% in the case of Tape A issues (securities listed on the NYSE), 37% for Tape B issues (securities listed on the AMEX) and 44% for Tape O issues (securities listed on Nasdaq).

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-CHX-2001-26 and should be submitted by March 6, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>4</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45411; File No. SR-NASD-2001-88]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Accelerated Approval to Proposed Rule Change and Amendment No. 1 Thereof Relating to Computer to Computer Interface Fees

February 6, 2001.

#### I. Introduction

On December 7, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with 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 increase the fees charged to non-members that continue to use the x.25 Computer to Computer Interface ("CTCI") to access Nasdaq services. On January 10, 2002, Nasdaq submitted Amendment No. 1 to the proposal.<sup>3</sup>

The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on January 18, 2002.<sup>4</sup> The comment period was for 15 days and expired on February 2, 2002. No comments were received on the proposal, as amended. In this order, the Commission is approving the proposed rule change, as amended, on an accelerated basis.

#### II. Description of the Proposal

Nasdaq's CTCI network is a point-to-point dedicated circuit connection from the premises of brokerages and service providers to Nasdaq's Trumbull, Connecticut processing facilities.

Through CTCI, firms are able to enter trade reports to Nasdaq's Automated Confirmation Transaction Service and orders to Nasdaq's Small Order Execution and SuperSOES systems. CTCI also processes SelectNet transaction confirmation reports.

In response to numerous requests from market participants that Nasdaq upgrade the speed and reliability of its CTCI data transmission environment, Nasdaq began the process last year of "sunsetting" its CTCI x.25/bisynch network in favor of a new network that provides greater capacity and a more efficient transmission protocol. The CTCI x.25/bisynch network can only transmit data up to 19.2 kilobits per second ("kb"). The new Transmission Control Protocol/Internet Protocol ("TCP/IP") CTCI network operates over the Enterprise Wide Network II and provides connectivity over more powerful 56kb and T1 data lines. In order to take advantage of the new CTCI network, users are required to upgrade their current x.25/19.2kb lines to either 56kb or T1 lines. Although the conversion process has been underway since January of 2001, as of late November, 295 x.25 CTCI circuits held by 60 firms remained active.

Nasdaq represents that as more and more users convert to TCP/IP, Nasdaq's per circuit cost of continuing to offer the x.25 CTCI connections increases. Since the x.25 CTCI network is provisioned to support over 600 circuits, Nasdaq believes that it is appropriate to pass through the expense of that network to those firms that have failed to transition. According to Nasdaq, the fee increase, together with continued transition support from Nasdaq staff, will allow Nasdaq to "sunset" the x.25 CTCI network on March 31, 2002 (or sooner, if all x.25 CTCI subscribers have transitioned prior to that date).<sup>5</sup>

NASD proposes to increase the fee assessed on NASD non-members that continue to use the x.25 CTCI to access Nasdaq services rather than transitioning to TCP/IP. Nasdaq plans to assess the new fee during the months of

February and March 2002 and to terminate remaining x.25 CTCI circuits at the end of March, although both the date for implementing the new fee and the date for terminating x.25 CTCI circuits are subject to adjustment.

#### III. Discussion

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.<sup>6</sup> In particular, the Commission believes that the proposal, as amended, is consistent with the requirements of section 15A(b)(5) of the Act<sup>7</sup> because it provides for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which the association operates or controls. The Commission notes that an identical proposed rule change for members became immediately effective upon filing on January 10, 2002.<sup>8</sup> Further, the Commission notes that Nasdaq has represented that as more and more users convert to TCP/IP, Nasdaq's per circuit cost of continuing to offer the x.25 CTCI connections increases. Nasdaq has stated that the proposed rule change, as amended, will permit it to pass through the expense of that network to those firms that have failed to transition.

Pursuant to section 19(b)(2) of the Act,<sup>9</sup> the Commission finds good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of the notice of filing thereof in the **Federal Register**. The Commission notes that Nasdaq plans to assess the new fee during the months of February and March 2002 and to terminate remaining x.25 CTCI circuits at the end of March. The Commission also notes that members also will be assessed an identical fee in February and March 2002 and therefore, the proposed fee will be consistent with the fee charged to members. Further, Nasdaq has represented to the Commission that the new fee is necessary due to a decrease in the number of subscribers of x.25 CTCI circuits and is comparable to the fee assessed to subscribers of the TCP/IP CTCI circuits. Accordingly, the Commission finds that there is good cause, consistent with section 15A of

<sup>4</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> See letter from John M. Yetter, Assistant General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated January 8, 2002 ("Amendment No. 1").

<sup>4</sup> See Securities Exchange Act Release No. 45266 (January 10, 2002), 67 FR 2714.

<sup>5</sup> Nasdaq has indicated that those members utilizing the remaining x.25 CTCI circuits will be unable to link to the CTCI system at the end of March. Nasdaq does not foresee any circumstances that would cause it to adjust the date of termination of the x.25 CTCI circuits at this time. January 3, 2002 telephone conversation between John M. Yetter, Assistant General Counsel, Nasdaq, and John Riedel, Staff Attorney, Division, Commission.

<sup>6</sup> In approving the proposed rule change, as amended, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78o-3.

<sup>8</sup> See Securities Exchange Act Release No. 45264 (January 10, 2002), 67 FR 2942 (January 22, 2002).

<sup>9</sup> 15 U.S.C. 78s(b)(2).