

it is Nasdaq's position that the submission of trade details in PORTAL-designated securities to ACT will not subject these transactions to SEC fees pursuant to Section 31 of the Act,<sup>7</sup> as PORTAL-designated securities are not subject to "prompt last sale trade reporting" as that term is used for the purposes of Section 31 fee assessment.

## 2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>8</sup> which requires, among other things, that the Association's rules must 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. The NASD believes that the proposed rule change is wholly consistent with the purposes of the Act in that it will encourage members to submit trade details of transactions in PORTAL-designated securities to the Association through ACT for reconciliation, comparison, and clearance and settlement purposes and will, thereby, provide the Association with trade details regarding such transactions and facilitate clearance and settlement in such securities.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Nasdaq has neither solicited nor received comments on the proposed rule change.

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

The foregoing rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the

NASD and, therefore, has become effective pursuant to Section 19(b)(3)(A)(i) of the Act<sup>9</sup> and subparagraph (e)(1) of Rule 19b-4 thereunder.<sup>10</sup> At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

## 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.<sup>11</sup> Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to No. SR-NASD-98-68 and should be submitted by October 7, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40418; File No. SR-PCX-98-38]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Equity Trading Halts Due to Extraordinary Market Volatility

September 9, 1998.

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 August 4, 1998, as amended on August 31, 1998, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange.<sup>3</sup> 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 is proposing to codify its rules relating to trading halts in equity securities due to extraordinary market volatility.

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

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

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1982).

<sup>2</sup> 17 CFR 240.19b-4 (1991).

<sup>3</sup> On August 31, 1998, the PCX an amendment with the Commission, requesting that the Commission treat the filing as a "non-controversial" rule filing pursuant to Rule 19b-4(e)(6), 17 CFR 240.19b-4(e)(6). The amendment also clarified the background to the PCX's existing circuit breaker policy and proposed rule change, and made technical corrections to the filing. See Letter from Michael Pacileo, Staff Attorney, PCX to Joshua Kans, Attorney, Division of Market Regulation, Commission, dated August 31, 1998. The Commission deems the proposal filed upon receipt of the August 31, 1998 amendment.

<sup>7</sup> 15 U.S.C. 78ee.

<sup>8</sup> 15 U.S.C. 78o-3.

<sup>9</sup> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>10</sup> 17 CFR 240.19b-4(e)(1).

<sup>11</sup> In reviewing this proposed rule change, the Commission has considered its impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

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

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

(1) Purpose

The Exchange is proposing to codify its current policy of imposing trading halts as quickly as practicable whenever the New York Stock Exchange ("NYSE") and other equity markets have suspended trading due to extraordinary market volatility. The Exchange most recently restated its market closing policy in April 1998, in conjunction with the NYSE's and other exchanges' amendments to their circuit breaker rules.<sup>4</sup>

Circuit Breakers are coordinated cross-market trading halts that are intended to help avoid systematic breakdown when a severe one-day market drop of historic proportions prevents the financial markets from operating in an orderly manner. The securities and futures market introduced circuit breakers to offer investors an opportunity to assess information and positions when the markets experience a severe, rapid decline.

In 1988, in response to the October 19, 1987 market drop, the Commission approved various exchanges' circuit breaker proposals, along with the PCX's and National Association of Securities Dealers' ("NASD") circuit breaker policy statements. The circuit breaker proposals were intended to provide market participants with an opportunity during a severe market decline to reestablish an equilibrium between buying and selling interest in a more orderly fashion. In October 1997, the first circuit breakers were triggered due to a decline of 554 points on the Dow Jones Industrial Average ("Dow"). This triggering of the circuit breakers when the markets were operating smoothly prompted the markets to re-evaluate the operation and function of circuit breakers. In January 1998, as a result of the events of October 1997, several exchanges adopted interim changes to the circuit breaker rules.<sup>5</sup> Subsequently, the markets agreed to the current uniform circuit breaker rule, which the PCX proposes to codify.<sup>6</sup>

<sup>4</sup> See Securities Exchange Act Release No. 39846 (April 9, 1998), 63 FR 18477 (April 15, 1998).

<sup>5</sup> See Securities Exchange Act Release No. 39852 (January 26, 1998), 63 FR 5408 (February 2, 1998) (order granting accelerated approval of proposed rule changes by NYSE, American Stock Exchange ("AMEX"), Boston Stock Exchange ("BSE"), Chicago Stock Exchange ("CHX") and Philadelphia Stock Exchange ("PHLX")). The proposed rule changes became effective on February 2, 1998, and were approved on a pilot basis until April 30, 1998.

<sup>6</sup> See Securities Exchange Act Release No. 39846 (April 9, 1998), 63 FR 18477 (April 15, 1998).

The PCX proposes to codify its Circuit Breaker trigger levels for a one-day decline of 10 percent, 20 percent, and 30 percent of the Dow, to be calculated at the beginning of each calendar quarter, using the average closing value of the Dow for the previous month to establish specific point values for the quarter. Each trigger will be rounded to the nearest 50 points.<sup>7</sup>

Before 11:00 a.m.,<sup>8</sup> the halt for a 10 percent decline will be one hour. At or after 11:00 a.m. but before 11:30 a.m., the halt will be for one-half hour. If the 10 percent trigger value is reached at or after 11:30 a.m., the market will not halt at the 10 percent level and will continue trading.

The halt for a 20 percent decline will be two hours if triggered before 10:00 a.m. At or after 10:00 a.m. but before 11:00 a.m., the halt will be for one hour. If the 20 percent trigger value is reached at or after 11:00 a.m., trading will halt for the remainder of the day. If the market declines by 30 percent, at any time, trading will be halted for the remainder of the day.

(2) Basis

The Exchange believes that this proposal is consistent with Section 6(b) of the Act,<sup>9</sup> in general, and Section 6(b)(5),<sup>10</sup> in particular, in that it is designed 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, 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 burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

(approving proposed rule changes by NYSE, AMEX, BSE, CHX, PHLX and NASD).

<sup>7</sup> For example, if the average of the Dow closing values for the previous month is 7700, 10% of such average would be 770; this number would be rounded to the nearest 50 points to create a circuit breaker trigger level of 750 points. In addition, if a trigger level is midway between two points, it will be rounded down, e.g., 825 would be rounded to 800, and 875 would be rounded to 850.

<sup>8</sup> All time references are to Pacific Time.

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

<sup>10</sup> 15 U.S.C. 78f(b)(5).

*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**

Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from August 31, 1998, the date on which the filing was amended to reflect the noncontroversial status of this rule change,<sup>11</sup> it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>12</sup> and Rule 19b-4(e)(6) thereunder.

At any time within 60 days of the August 31, 1998 amendment of the proposed rule change, the Commission may summarily abrogate such rule change 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 the Act.

**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.<sup>13</sup> Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W.,

<sup>11</sup> The Commission waived the five-day pre-filing requirement for "noncontroversial" rule changes under Rule 19b-4(e)(6), 17 CFR 240.19b-4(e)(6), because the Commission had an opportunity to review the proposal when the Exchange originally submitted it on August 4, 1998.

<sup>12</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>13</sup> In reviewing the proposal, the Commission has considered its impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

Washington, D.C. 25049. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-98-38 and should be submitted by October 7, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40412; File No. SR-PCX-98-27]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Pacific Exchange, Inc. Relating to the Automatic Execution of Option Orders

September 8, 1998.

#### I. Introduction

On June 12, 1998, the Pacific Exchange, Inc. ("PCX" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend PCX Rule 6.87 governing the operations of the Exchange's Automatic Execution System. On July 14, 1998, the PCX filed with the Commission Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change, as amended, was published for comment in the **Federal Register** on August 3, 1998.<sup>4</sup> The Commission received no comments regarding the proposal. This order approves the proposal as amended.

#### II. Description of the Proposal

Presently, orders entered via the Exchange's Member Firm Interface ("MFI") are delivered to one of three

destinations: (a) to the Exchange's Automatic Execution System for options trading ("Auto-Ex"), where they are automatically executed at the disseminated bid or offering price; (b) to Auto-Book, which maintains non-marketable limit orders based on limit price and time receipt; or (c) to a Member Firm's default destination, a particular firm booth or remote entry site, if the order fails to meet the eligibility criteria necessary for using either Auto-Ex or Auto-Book or if the Member Firm requests such default for its orders.<sup>5</sup>

The Exchange now proposes to adopt new PCX Rule 6.87(d),<sup>6</sup> which would provide that the Exchange's Options Floor Trading Committee ("OFTC") may designate electronic orders in an option issue to receive automatic executions at prices reflecting the National Best Bid or Offer ("NBBO").

The proposal would allow the OFTC to designate, for an option issue, that an order will default for manual representation by a floor broker in the trading crowd if the order would be executed at a price that is more than one trading increment away from the PCX market price.<sup>7</sup> The proposal also would permit the OFTC to designate, for an option issue, that if the NBBO is crossed (e.g., 6 1/8 bid, 6 asked) or locked (e.g., 6 bid, 6 asked), then customer orders to buy or sell the series would default for manual representation in the trading crowd. Under the proposal, however, the Exchange would maintain the flexibility to require automatic executions on the Exchange when the

NBBO is locked or crossed. Such action may be appropriate, for example, when there is a large influx of electronic orders and a fair and orderly market would be better served by a reduction in the number of orders. In such situations, public customers would receive very favorable prices on their orders.

#### III. Discussion

After careful review, the Commission finds that the proposal rule change is consistent with the requirements of the Act. In particular, the Commission believes the proposal is consistent with Section 3(f)<sup>8</sup> and Section 6(b)(5)<sup>9</sup> of the Act. Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade and to protect investors and the public interest.

By automating the execution of eligible retail orders for equity options, the proposal should help to ensure that investors receive prompt, automatic execution of Auto-Ex options orders at the best available prices, even if those prices are being quoted in a market other than the Exchange. This proposal should minimize the delay inherent in manually handling orders in this circumstance, and thereby reduce the risk to investors that, as a result of an adverse move in the market while their orders are being manually handled, they may receive an inferior execution or none at all.

Moreover, the proposal is consistent with Section 3(f) of the Act because it should help to promote competition for dually listed options among options exchanges by helping to ensure that investors receive an automatic execution at the NBBO regardless of whether that quote originated on the PCX or on another exchange.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (SR-PCX-27), as amended, is hereby approved.

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

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<sup>8</sup>In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup>15 U.S.C. 78f(b)(5).

<sup>10</sup>15 U.S.C. 78s(b)(2).

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

<sup>5</sup> See Securities Exchange Act Release No. 27633 (January 18, 1990) 55 FR 2466 (January 24, 1990); Securities Exchange Act Release No. 39970 (May 7, 1998) 63 FR 26662 (May 13, 1998).

<sup>6</sup> PCX Rule 6.87 governs the operation of Auto-Ex. Currently, only non-broker/dealer customer orders for up to ten option contracts (or 20 option contracts, depending on the option issue) are eligible to be executed on Auto-Ex. See PCX Rule 6.87. Moreover, Auto-Ex is designed to prevent executions at prices inferior to prices being concurrently disseminated in other marketplaces in multiply-traded issues. When Auto-Ex prevents an automatic execution from occurring because it would trade through a better price on another market, the order will default either to a member firm booth or to a hand-held terminal in the trading crowd (depending on the member firm's instruction). See Letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, Exchange, to Kenneth Rosen, Attorney, Division, Commission, dated August 27, 1998. Thereafter, the order could be represented manually.

<sup>7</sup> The Commission recently approved a similar proposal by the Chicago Board Options Exchange. See Securities Exchange Act Release No. 40096 (June 16, 1998) 63 FR 34209 (June 23, 1998).

<sup>14</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 Michael D. Pierson, Senior Attorney, Regulatory Policy, Exchange, to Ken Rosen, Attorney, Division of Market Regulation, Commission, dated July 13, 1998 ("Amendment No. 1").

<sup>4</sup> Securities Exchange Act Release No. 40263 (July 24, 1998) 63 FR 41312.