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. 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 Section, 450 Fifth Street, N.W., Washington, D.C. 20549. 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–NYSE–99–6 and should be submitted by March 12, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[15]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–4116 Filed 2–18–99; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41041; File No. SR–NYSE–98–45]

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change by the New York Stock Exchange, Inc. Relating to Amendments to Rule 80A

February 11, 1999.

I. Introduction

On December 8, 1998, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend its Rule 80A relating to limitations on program trading.

The proposed rule change was published for comment in the **Federal Register** on December 23, 1998.[3] Three comment letters were received on the proposal.[4] This order approves the NYSE proposal.

II. Description of the Proposal

The NYSE proposes to eliminate the ''sidecar'' provisions contained in Rule 80A. As discussed below, current Rule 80A(a) provides that, under the sidecar, program trading orders in stocks in the Standard & Poor's (''S&P'') 500 Stock Price Index are temporarily diverted into separate electronic files for a five-minute period if the primary S&P 500 futures contract declines by 12 points form its previous close. If the sidecar is triggered, current Rule 80A(b) also imposes limitations on the entry of certain types of stop orders or stop limit orders. Both of these provisions would be eliminated under the Exchange's proposal.

The NYSE also proposes to revise the trigger levels for the ''collar'' provisions of Rule 80A. Currently, NYSE Rule 80A(c) provides for limitations on index arbitrage trading in any component of the S&P 500 Stock Price Index whenever the Dow Jones Industrial Average[5] (''DJIA'') moves up or down 50 points form its previous close. If the market advances by 50 points or more, all index arbitrage orders to buy must be stabilizing (buy minus); similarly, if the market declines, all index arbitrage orders to sell must be stabilizing (sell plus). The stabilizing requirements are removed if the DJIA moves back to or within 25 points of the previous day's close. The NYSE proposes to replace the current 50-point and 25-point triggers with thresholds set at a ''two-percent value'' and a ''one-percent value'' of the DJIA. These percent values would be translated into specific point levels at the beginning of each calendar quarter based on an average for the DJIA over the preceding month.

The NYSE is also proposing to delete the provisions, contained in current Rule 80A(d), relating to purchases and sales of a ''basket'' (as that term is defined in Rule 800(b)(iii)), because the basket product is no longer traded on the Exchange.

Finally, the Exchange is proposing to clarify its definition of index arbitrage in Supplementary Material .40 to Rule 80A to include some forms of ''basis trading.''[6]

III. Summary of Comments

As previously stated, the Commission received three comment letters on the Exchange's proposal. Two of the commenters, the CME and the Broker-Dealers, were generally supportive of the proposal, while one commenter, Neuberger, opposed parts of the proposal.

The CME ''applaud[ed] the efforts of the NYSE to liberalize the provisions of Rule [80A]'' because it ''has long regarded Rule 80A as an artificial constraint to the interplay of U.S. equity markets.''[7] The CME cited studies that it asserted would refute the efficacy of the rule.[8] While the CME stated that ''further expansion of the trigger or the elimination of the collar altogether is a worthy objective[,]'' it also ''understand[s] that progress is often realized in graduated steps rather than in leaps.''[9]

The Broker-Dealers also generally supported the NYSE's proposals to eliminate the sidecar procedures and to widen the thresholds for the restrictions on index arbitrage imposed by Rule 80A's collar provisions. Nevertheless, the Broker-Dealers stated that they agree with members of The President's Working Group on Financial Markets (''Working Group''),[10] that the index arbitrage collar provisions do not appear to be appropriate and may hamper legitimate intermarket trading activities and result in market inefficiencies. Like the CME, the Broker-Dealers believe that the Commission should approve the Exchange's current revisions to Rule

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[15] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 40797 (December 23, 1998), 63 FR 71176.

[4] The comment letters have been placed in Public File SR–NYSE–98–45, which is available for inspection in the Commission's Public Reference Room. *See* Letters from T. Eric Kilcolin, President and Chief Executive Officer, Chicago Mercantile Exchange (''CME''), dated January 11, 1999 (''CME Letter''); Pikku Thakkar, Senior Counsel, Neuberger Berman, LLC (''Neuberger'') dated January 15, 1999 (''Neuberger Letter''); and Paul A. Merolla, Vice President, Associate General Counsel, Goldman, Sachs & Co., Christine A. Sakach, Director and Senior Counsel, Merrill Lynch & Co., Robin Roger, Principal and Counsel, Morgan Stanley & Co. Incorporated, and Andrew Constan, Managing Director, Salomon Smith Barney Inc. (collectively, ''Broker-Dealers''), dated January 20, 1999 (''Broker-Dealer Letter'').

[5] ''Dow Jones Industrial Average'' is a service mark of Dow Jones & Company, Inc.

[6] A description of the types of basis trading included in Supplementary Material .40 is provided in infra note 24.

[7] CME Letter at 1, supra note 4.

[8] *See* Harris, L., Sofianos, G., and Shapiro J. 1994, ''Program Trading and Intraday Volatility'' *The Review of Financial Studies* Vol. 7, No. 4, Winter 1994; and Overdahl, J., and McMillan, H. 1998, ''Another Day, Another Collar: An Evaluation of the Effects of NYSE Rule 80A on Trading Costs and Intermarket Arbitrage,'' *Journal of Business* Vol. 71, No. 1, 1998.

[9] CME Letter at 2, supra note 4.

[10] The Working Group consists of the Under Secretary of Finance of the Department of the Treasury and the Chairmen of the Commission, the Commodity Futures Trading Commission, and the Board of Governors of the Federal Reserve System. The Working Group's concerns over NYSE Rule 80A are discussed below.

80A only as an interim step and that the Commission should urge the NYSE to move expeditiously toward ultimate rescission of Rule 80A.[11] In addition, the Broker-Dealers were critical of the Exchange's proposed revision to its definition of index arbitrage for purposes of Rule 80A. In particular, the Broker-Dealers were concerned that the reference to "basis trading" in the revised definition of index arbitrage could be interpreted to apply to activities that are not typically associated with index arbitrage and not reasonably implied by the language of Rule 80A.[12]

Neuberger, on the other hand, believes that, if adopted, the proposed expansion of the collar thresholds "is certain to substantially increase the daily volume of index arbitrage activity and will simultaneously translate into a substantially higher level of daily volatility upon the NYSE." [13] In addition, Neuberger "feel[s] that this proposal is not in the best interests of the investing public, particularly the small investor." [14]

IV. Discussion

After careful review of the Exchange's proposed amendment to Rule 80A and the comments, the Commission is approving the changes as proposed. The Commission believes that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of Section 6(b).[15] Specifically, the Commission believes that the proposals are consistent with Section 6(b)(5) requirements that the rules of an exchange be 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, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public interest.[16]

Elimination of Sidecar Provisions

As discussed above, the sidecar provisions of current NYSE Rule 80A(a) temporarily divert program trading orders and impose limitations on the entry of stop orders if the primary S&P 500 futures contract declines by 12 points from its previous close if this price decline occurs prior to 3:25 p.m. (Eastern). Specifically, when the 12-point trigger is reached in the S&P 500 futures, for the next five minutes, market orders involving program trading in each of the stocks underlying the S&P 500 futures entered into the Exchange's automated order-routing facilities are routed to a separate file for each such stock. Buy and sell orders are then paired in the file to determine the extent of the order imbalance, if any. After five minutes, the program trading order imbalances, if any, are reported to the stocks' specialists. The program orders then become eligible for execution. Trading in a stock will halt, however, if there appears that there is not sufficient trading interest on the Exchange to allow for an orderly execution of a transaction in the stock.

The sidecar provisions of current NYSE Rule 80A(b) also prohibit members or member organizations from entering certain types of stop orders or stop limit orders for the remainder of the trading day if the 12-point trigger in the S&P 500 futures is reached prior to 3:25 p.m. A member or member organization may, however, enter a stop order or stop limit order of 2,099 shares or less for the account of an individual investor pursuant to instructions received directly from that investor.

The Exchange proposes to eliminate these sidecar provisions in their entirety. The Exchange represents that experience has shown that program trading orders have not been entered in significant numbers while a sidecar is in effect and that these restrictions, therefore, do not appear to be necessary. The Exchange believes that the collars contained in NYSE Rule 80A, along with the Exchange's trading halt policy and circuit breakers contained in NYSE Rule 80B, obviate the need for a sidecar. The NYSE's proposal to eliminate the sidecar provisions was supported by the CME [17] and the Broker-Dealers,[18] and no objection to this aspect of the rule proposal was addressed by Neuberger.[19] In addition, the Commission staff's trading analysis of October 27, 1997 indicated that the triggering of the sidecar provisions had no discernible effect on that day's market decline.[20] Accordingly, the Commission believes that the Exchange's determinations regarding the elimination of the sidecar provisions are reasonable and appropriate in the public interest.

B. Widening of the Collar Trigger Levels

The Exchange also proposes to widen the trigger levels for the collar restrictions on index arbitrage program trading imposed by NYSE Rule 80A(c). Currently, the collar restrictions apply to index arbitrage trading in any component of the S&P 500 Stock Price Index whenever the DJIA is up or down 50 points from its previous close. If the market advances by 50 points or more, all index arbitrage orders to buy must be stabilizing (buy minus); similarly, if the market declines, all index arbitrage orders to sell must be stabilizing (sell plus). The stabilizing requirements are removed if the DJIA moves back to or within 25 points of the previous day's close.

In its proposal, the NYSE acknowledges that the stock market has risen dramatically since the 50-point and 25-point triggers for Rule 80A(c) were adopted in 1990. The Exchange, therefore, proposes to replace the current 50-point and 25-point triggers with thresholds set at a "two-percent value" and a "one-percent value" of the DJIA. These percent values would be translated into specific point levels at the beginning of each calendar quarter based on a average for the DJIA over the preceding month. Resetting the NYSE Rule 80A triggers on a quarterly basis to retain alignments with the 2% and 1% thresholds of the DJIA would be consistent with the procedures currently used by the securities markets to reset the point triggers for the 10%, 20%, and 30% cross-market circuit breaker trading halts.

The Commission believes that the Exchange's proposal to widen the current thresholds for NYSE Rule 80A is reasonable and appropriate in the public interest. The shift to 2% and 1% thresholds for the collars represents a significant improvement over the current 50-point and 25-point triggers. The new percentage thresholds for Rule 80A should result in a substantial reduction in the frequency of the application of the rule's restrictions on index arbitrage trading, which have been implemented on virtually a daily basis over the past few months. For example, the 50-point collar provisions were triggered a total of 366 times in 1998; if the proposed 2% threshold had been in place, the collar provisions would have been triggered only 42 times during the year.

The Commission is sensitive to the issue raised in the Neuberger comment letter that some small investors may be concerned that the NYSE's proposal to

[11] Broker-Dealer Letter at 1–3, supra note 4.

[12] *Id.* at 1–4.

[13] Neuberger Letter at 1, supra note 4.

[14] *Id.*

[15] 15 U.S.C. 78f(b).

[16] 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).

[17] CME Letter at 1, supra note 4.

[18] Broker-Dealer Letter at 1, supra note 4.

[19] Neuberger Letter, supra note 4.

[20] *See* Division of Market Regulation, *Trading Analysis of October 27 and 28, 1997* (September 1998), at 35 n. 102.

widen the collars to 2% and 1% could result in increased program trading that may contribute to higher levels of market volatility.[21] Nevertheless, the Commission questions whether Rule 80As current restrictions on certain types of intermarket program trading strategies are an appropriate means to address overall volatility. Indeed, the Commission notes that last year the Working Group suggested that Rule 80A had become outdated and recommended that the NYSE at least significantly increase Rule 80A's trigger levels.[22]

Although the Commission is approving the Exchange's current proposal, it continues to question whether the restrictions on index arbitrage that are retained in the revised Rule 80A are appropriate. The markets have changed significantly over the past decade. For example, the NYSE has substantially increased its system capacity so that it can handle five times the trading volumes experienced in October 1987. Moreover, the variety of derivative products has grown, as has the array of derivative-related equity trading strategies. It may make little sense to single out index arbitrage, which ensures that markets are aligned economically, from all other types of program trading. Indeed, the restrictions on index arbitrage may tend to disconnect the securities and futures markets and impose unnecessary costs on market participants.[23]

Accordingly, although the Commission believes that the Exchange's proposal meets the statutory standards for approval and that it represents an improvement over the previous set of trading restrictions contained in Rule 80A, the Commission recommends that the Exchange periodically evaluate the continuing need for Rule 80A's restrictions on index arbitrage.

C. The Rule's Definition of Index Arbitrage

In its proposal, the Exchange defines index arbitrage in Supplementary Material .40 to Rule 80A to include some forms of ''basis trading.'' [24] As discussed above, the Broker-Dealers were critical of the proposed revision to the definition of index arbitrage. In particular, the Broker-Dealers indicated that the inclusion of basis trading in the revised definition of index arbitrage would be inappropriate and could apply to activities that are not typically associated with index arbitrage and not reasonably implied by the language of Rule 80A.[25]

The Commission agrees with the Broker-Dealers that care needs to be exercised by the NYSE in its interpretation of the proposed definition of index arbitrage so that the collar restrictions are not applied to activities that are not typically associated with index arbitrage and not reasonably implied by the language of Rule 80A. The Commission also agrees with the Broker-Dealers that a basis trade would be subject to Rule 80A only if the trade otherwise satisfies all of the conditions of the definition of index arbitrage contained in Supplementary Material .40.[26]

The Commission understands that the NYSE regulatory staff has been diligent in working with program trading firms over the past few years to clarify which types of intermarket trading strategies are subject to the collar provisions of Rule 80A and the Commission urges the Exchange to continue these efforts. In the long term, the Commission believes that the best resolution of the definitional issues raised by the Broker-Dealer would be to have the Exchange reassess the overall rationale for Rule 80A's restrictions on selected intermarket trading stragies.

V. Conclusion

For the foregoing reasons, the Commission finds that the amendments to NYSE Rule 80A are consistent with the requirements of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR–NYSE–98–45) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[27]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–4117 Filed 2–18–99; 8:45 am]

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[21] Neuberger Letter at 1, supra note 4.

[22] This position was reflected in a joint letter issued by the Working Group to Richard Grasso, NYSE Chairman and Chief Executive Officer, dated May 7, 1998 (''Working Group Joint Letter''), as well as in the Working Group Staff Report on Circuit Breakers, issued on August 18, 1998 (''Working Group Staff Report''), at 21.

[23] *See* Working Group Staff Report at 21.

[24] The proposed Supplementary Material .40 states that, for purposes of Rule 80A, ''index arbitrage'' means a trading strategy in which pricing is based on discrepancies between a ''basket'' or group of stocks and the derivative index product (*i.e.*, a basis trade) involving the purchase or sale of a basket or group of stocks in conjunction with the purchase or sale, or intended purchase or sale, of one or more derivative index products in an attempt to profit by the price difference between the basket or group of stocks and the derivative index products. The inclusion of some forms of basis trading for the application of the index arbitrage limitations of Rule 80A was reflected in the NYSE Information Memorandum 92–23 (August 28, 1992) (''1992 Memo'').

[25] Broker-Dealer Letter at 1–2, supra note 4.

[26] *Id.* at 3.

[27] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41051; File No. SR–PCX–98–41]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. Relating to Its Remote Trading Access Program for Specialists

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on September 4, 1998, the Pacific Exchange, Inc. (''PCX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') a proposed rule change and file an amendment thereto on January 21, 1999,[3] 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 is proposing to adopt a Remote Trading Access Program for Specialists (''Program'') under which Registered PCX Specialists will be permitted to conduct their regular trading activities from off the Trading Floor, at a remote location. Below is the text of the proposed rule, which is entirely new.

* * * * *

Remote Trading Access Program

Rule 5.38(a). The Remote Trading Access Program allows Registered PCX Specialists to conduct their regular trading activities from off the Trading Floor, at remote locations, subject to the approval of the Equity Floor Trading Committee. Specialists participating

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letter, dated January 20, 1999, from Michael D. Pierson, Senior Attorney, Regulatory Policy, PCX to S. Kevin An, Special Counsel, Division of Market Regulation, Commission (''Amendment No. 1''). Among other things, Amendment No. 1 made several technical corrections and also explained how the Exchange will conduct surveillance of Remote Specialists. The substance of Amendment No. 1 is incorporated into this Notice.