

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. 34-41789; File No. SR-Phlx-98-43]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 by the Philadelphia Stock Exchange, Inc. Adopting Proposed Rule 134 Regarding Stop-Order Bans and Amendment Rule 229 To Require the Use of Account Identifiers for PACE Users

August 25, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 18, 1998, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On December 9, 1998, February 2, 1999, and July 14, 1999, respectively, the Exchange filed Amendment Nos. 1,<sup>3</sup> 2,<sup>4</sup> and 3<sup>5</sup> to the proposal with the

Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, including Amendments Nos. 1, 2, and 3, from interested persons.

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

The Phlx, pursuant to Rule 19b-4 of the Act, proposes to adopt Rule 134 to provide for stop order and stop limit order<sup>6</sup> bans whenever such orders are banned on the primary market. In addition, the Exchange proposes to amend Phlx Rule 229 to require account identifiers for orders submitted through the Phlx Automated Communication and Execution ("PACE")<sup>7</sup> System.

The text of the proposed rule change is available at the Phlx and at the Commission.

#### 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.

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

###### 1. Purpose

The Exchange has previously adopted circuit breaker rules, paralleling the rules of other exchanges.<sup>8</sup> At this time, the Exchange proposes, like other exchanges, to prohibit the entry of stop

a stop order ban in an individual stock. These factors include: (1) If the primary market cancels stop orders residing on their book; or (2) other unusual conditions or circumstances.

<sup>6</sup> A stop order to buy (sell) becomes a market order when a transaction in the security occurs at or above (below) the stop price after the order is represented at the specialist post. A stop limit order to buy (sell) becomes a limit order executable at the limit price or at a better price, if obtainable, when a transaction in the security occurs at or above (below) the stop price after the order is presented at the specialist post.

<sup>7</sup> PACE is an electronic order entry, delivery, and execution system which operates on the equity floor pursuant to Phlx Rule 229.

<sup>8</sup> See Securities Exchange Act Release No. 39846 (April 9, 1998), 63 FR 18477 (April 15, 1998) (Order approving SR-PHLX-98-15).

and stop limit orders during times of market stress.<sup>9</sup>

Proposed Rule 134 will establish a procedure prohibiting the entry of stop orders and stop limit orders in the following situations: (1) whenever the primary market for a stock admitted to dealings on the Exchange institutes a stop and stop limit order ban, the Exchange will also ban such orders in the stock until such time as the ban in the primary market is lifted; and (2) whenever the NYSE institutes a stop and stop limit order ban pursuant to NYSE Rule 80A, the Exchange will also ban stop and stop limit orders for the remainder of the day, except that a member or member organization may enter a stop or stop limit order of 2,099 shares or less for the account of an individual investor pursuant to instructions received directly from the individual investor.<sup>10</sup>

The first instance where a stop order ban can occur is when the primary market for the security issues a stop order ban. Following notice from the Consolidated Tape, the Exchange will announce to the floor and to PACE users that a stop order ban is in effect in the particular issue. The entry of stop and stop limit orders on the Phlx would be prohibited until the ban in the primary market is lifted and that information is disseminated on the Consolidated Tape. However, unlike the broad market ban described below, any stop or stop limit orders residing on the specialist's book when a ban goes into effect for an individual stock may<sup>11</sup> be canceled by the Exchange with the approval of two Floor Officials and a market regulation officer.<sup>12</sup> This provision is consistent with the rules of the Boston Stock Exchange.<sup>13</sup>

The Exchange believes that it is appropriate to ban stop orders and stop limit orders when the primary market institutes a ban because, in a volatile market, stop orders can accumulate at various prices and, if triggered, the stop orders may increase price fluctuations in a particular stock. Because other exchanges have adopted stop order ban

<sup>9</sup> See Boston Stock Exchange Rules Chapter II, Section 35(b); and Chicago Stock Exchange Chapter IX, Rule 10B, .01(ii).

<sup>10</sup> The Commission has approved a proposed rule change (SR-NYSE-98-45) to eliminate the stop and stop limit order ban under Rule 80A. See Securities Exchange Act Release No. 41041 (Feb. 11, 1999), 64 FR 8424 (Feb. 19, 1999).

<sup>11</sup> See Amendment No. 2, *supra* note 4. The Commission notes that, pursuant to Boston Stock Exchange Rules Chapter II, Section 35(b), any stop or stop limit orders residing on the specialist's book when a ban goes into effect for an individual stock will be canceled by the Exchange.

<sup>12</sup> See Amendment No. 2, *supra* note 5.

<sup>13</sup> See Boston Stock Exchange Rules Chapter II, Section 35(b).

<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 Nandita Yagnik, Counsel, Phlx, to Michael Walinskas, Deputy Associate Director, Division of Market Regulation ("Division"), Commission, dated December 8, 1998 ("Amendment No. 1"). In Amendment No. 1, the Exchange corrects the reference to the identifier "P" to refer to Principal orders not non-agency orders.

<sup>4</sup> See letter from Nandita Yagnik, Counsel, Phlx, to Michael Walinskas, Deputy Associate Director, Division, Commission, dated February 1, 1999 ("Amendment No. 2"). In Amendment No. 2, the Exchange proposes to adopt Rule 134, Commentary .01, *Stop order definition*. In addition, the Exchange has amended proposed Rule 134(c)(iii) to state that any stop orders or stop limit orders on the book may be canceled by the Exchange. The Exchange represents that, by changing "will" to "may," the Exchange retains flexibility to determine whether stop orders on the book should be canceled at the time the primary market institutes a stop order ban.

<sup>5</sup> See letter from Nandita Yagnik, Counsel, Phlx, to Michael Walinskas, Associate Director, Division, Commission, dated July 13, 1999 ("Amendment No. 3"). In Amendment No. 3, the Exchange clarified that outstanding stop and stop limit orders cannot be cancelled without the approval of two floor officials and a market regulation officer. The Exchange also amended Rule 134(c)(iii) to codify factors to be considered in determining whether stop and stop limit orders on the book would be cancelled in the event that the Exchange institutes

procedures, Phlx is concerned that a migration of stop and stop limit orders to the Phlx could occur, thus causing a burden on Phlx specialists.

The second situation automatically arises, pursuant to NYSE Rule 80A, when there is a 12 point decline in the Standard and Poor's 500<sup>14</sup> futures contract traded on the Chicago Mercantile Exchange. Once implemented, the ban remains in effect until the end of the trading day. Any stop and stop limit orders on the specialist's book at the time the ban goes into effect remain eligible for execution.

The proposed rule creates an exception for the entry of a stop or stop limit order of 2,099 shares or less for the account of an individual investor pursuant to instructions received from the individual investor. The Exchange defines the account of an individual investor as an account covered by Section 11(a)(1)(E) of the Act.<sup>15</sup>

The Exchange also proposes requiring PACE users to attach account identifiers on orders submitted through PACE. Among other things, this will allow the system to distinguish orders for the account of an individual investor from other orders. Specifically, Rule 229, Commentary .20 will require that all orders sent through PACE shall include the appropriate account designator. The following are acceptable account types: "P"—principal order;<sup>16</sup> "A"—agency; "I"—individual investor; "D"—program trade, non-index arbitrage for member/member organization; "J"—program trade, index arbitrage for individual customers; "K"—program trade, non-index arbitrage for individual customer; "U"—program trade, index arbitrage for other agency; and "Y"—program trade, non-index arbitrage for other agency. Orders for less than 2,099 shares with the account identifier of "I" would still be able to be entered during the duration of the ban. Other orders will be automatically rejected by the PACE System.

The Exchange believes that the account identifiers proposed in the filing will enhance efficiency and accuracy of audit trail information and will facilitate surveillance investigations by readily identifying a member's proprietary trades. More accurate audit trail information should also increase the effectiveness of the Exchange's

surveillance procedures.<sup>17</sup> Member firms will be given notice following the approval of the proposal to enable them to comply with new order identification requirements.

The purpose of the proposed rule is to reduce selling pressure by preventing market professionals from entering orders during a market sell-off as well as enhance market coordination of the circuit breaker rules; in turn, the Phlx believes that the proposal should help reduce market volatility. In addition, proposed Phlx Rule 134 should prevent the migration of stop orders from the primary markets to the Phlx in the case of extraordinary market volatility, which should prevent the transfer of market volatility to the Phlx. The exception, which allows individual investors to enter stop orders or stop limit orders for 2,099 shares or less, provides those investors who do not have the ability to continuously monitor market conditions some measure of downside protection in a rapidly moving market. Thus, the Exchange believes that the proposal represents a reasonable effort and coordinated means to address potential strain on the market that may develop should the Exchange become inundated with such orders.

## 2. Statutory Basis

For the reasons stated above, the Exchange believes that proposed Phlx Rule 134 and the amendment to Phlx Rule 229 are consistent with Section 6(b)(5) of the Act<sup>18</sup> in that they are designed to promote just and equitable principles of trade and remove impediments to and perfect the mechanism of a free and open market, by facilitating the maintenance of an orderly market and reducing market volatility.

### *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 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 appropriated and publishes its reasons for so finding or (ii) as to which the self-regulatory organization 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, N.W., Washington, D.C. 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-Phlx-98-43 and should be submitted by September 22, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

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

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<sup>14</sup> Standard & Poor's 500 Stock Index is a service mark of Standard & Poors Corporation.

<sup>15</sup> An account covered by Section 11(a)(1)(E) of the Act is an "account for a natural person, the estate of a natural person, or a trust created by a natural person for himself or another natural person." 15 U.S.C. 78k(a)(1)(E).

<sup>16</sup> See Amendment No. 1, *supra* note 3.

<sup>17</sup> Telephone conversation between Nandita Yagnik, Counsel, Phlx, and David Sieradzki, Special Counsel, Division, Commission, on July 21, 1999.

<sup>18</sup> 15 U.S.C. 78f(b)(5).

<sup>19</sup> 17 CFR 200.30-3(a)(12).