

For example, under current ISE Rule 716(d)(4)(i), assume that a Member proposes to facilitate an order to sell 500 contracts at the ISE's best bid price of \$4. During the exposure period, further assume that a non-customer order to buy 100 contracts at \$4¹/₈ and a public customer order to buy 20 contracts at \$4¹/₈ are entered. In this scenario, the facilitation order would have been executed at \$4 in its entirety (*i.e.*, both the customer and non-customer orders buy at \$4). Under the proposed rule change, the customer order at \$4¹/₈ would be executed at \$4, but the non-customer order would be executed at its stated price of \$4¹/₈. Accordingly, the order being facilitated would sell 100 contracts at \$4¹/₈ (an improved price) and 400 contracts at \$4.⁵

2. Statutory Basis

The ISE believes that the proposed rule change is consistent with the provisions of Section 6(b)(5) of the Act,⁶ which requires that an exchange have rules that are 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.

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

The ISE 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.

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

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

⁵ In this example, if public customer and/or non-customer orders totaling 500 contracts at \$4¹/₈ had been entered during the exposure time, the entire facilitation order would have been executed at \$4¹/₈.

⁶ 15 U.S.C. 78f(b)(5).

longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the ISE 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to File No. SR-ISE-00-03 and should be submitted by March 27, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00-5380 Filed 3-3-00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42472; File No. SR-ISE-00-01]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the International Securities Exchange LLC Relating to Market Maker Allocations

February 29, 2000.

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 February

⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

25, 2000 the International Securities Exchange LLC (the "Exchange" or the "ISE") 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 ISE. 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 ISE is proposing commentary to ISE Rule 713(e) regarding precedence of non-customer orders and market maker quotes to define its trading algorithm. Proposed new language is in italics.

* * * * *

Rule 713 Priority of Quotes and Orders

No change to text of Rule

Supplementary Material To Rule 713

.01 Rule 713(e) (Priority of Quotes and Orders) states that Public Customer Orders have priority on the Exchange. That rule further provides that the Exchange will determine a procedure for allocating executions among Non-Customer Orders and market maker quotes in cases where all Public Customer Orders have been executed and there are two or more Non-Customer Orders or market maker quotes at the best price. This procedure is as follows:

(a) Subject to the two limitations below, Non-Customer Orders and market maker quotes at the best price receive allocations based upon the percentage of the total number of contracts available at the best price that is represented by the size of the Non-Customer Order or quote;

(c) If the Primary market Maker is quoting at the best price, it has participation rights equal to the greater of (i) the proportion of the total size at the best price represented by the size of its quote, or (ii) sixty percent (60%) of the contracts to be allocated if there is only one (1) other Non-Customer Order or market market quotation at the best price, forty percent (40%) if there are two (2) other Non-Customer Orders and/or market maker quotes at the best price, and thirty percent (30%) if there are more than two (2) other Non-Customer Order and/or market maker quotes at the best price; and

(c) Orders for five (5) contracts or fewer will be executed first by the Primary Market Maker; provided however, that on a semi-annual basis the Exchange will evaluate what percentage of the volume executed on

the Exchange is comprised of orders for five (5) contracts or fewer executed by Primary Market Makers, and will reduce the size of the orders included in this provision if such percentage is over forty percent (40%).

This procedure only applies to the allocation of executions among Non-Customer Orders and market maker quotes existing in the Exchange's central order book at the time the order is received by the Exchange. No market participant is allocated any portion of an execution unless it has an existing interest at the execution price. Moreover, no market participant can execute a greater number of contracts than is associated with the price of its existing interest. Accordingly, the Primary Market Maker participation rights and the small order preference contained in this allocation procedure are not guarantees; the Primary Market Maker (i) must be quoting at the execution price to receive an allocation of any size, and (ii) cannot execute a greater number of contracts than the size that is associated with its quote.

* * * * *

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 ISE 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 ISE 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

ISE Rule 713(d) provides that customer orders at a given price have priority based on the time priority of such orders. ISE Rule 713(e) provides that, if there are two or more noncustomer orders or market maker quotations at the Exchange's inside market, after filling all customer orders at that price, executions will be allocated between the non-customer orders and market maker quotations "pursuant to an allocation procedure to be determined by the Exchange from time to time * * *." ISE Rule 713(e) also states that, if the Primary Market Maker ("PMM") is quoting at the Exchange's inside market, it will have

precedence over non-customer orders and Competitive Market Maker ("CMM") quotes for execution of orders that are up to a specified number of contracts. The purpose of the proposed rule change is to establish the ISE's allocation procedure for non-customer orders and market maker quotations, and to define the size of orders for which the PMM has priority.

The allocation procedure is a trading algorithm programmed in the ISE's electronic auction market system (the "System") that determines how to split the execution of incoming orders among professional trading interests at the same price. All public customer orders at a given price are always executed fully before the trading algorithm is applied. Moreover, because the algorithm is applied automatically by the System upon the receipt of an executable order, only those non-customer orders and market maker quotes that are in the System participate in the algorithm. Thus, there is no opportunity for a market participant to receive an allocation unless it had an order or quote in the System at the execution price at the time the System received the incoming order.

Subject to the PMM's participation rights discussed below, the allocation of executions to non-customer orders and market maker quotes is based on the size associated with the order or quote relative to the total size available at the execution price. For example, assume there is a public customer order for 10 contracts, a non-customer order for 60 contracts and a CMM quotation for 40 contracts in the System at the best bid price, so that there is a total of 110 contracts available at the best bid. If a market order to sell 30 contracts is received, the customer order to buy 10 contracts will be executed first. The trading algorithm is then applied to allocate the remaining 20 contracts to sell between the non-customer order and CMM quote. The non-customer order is 60 percent of the available size at the best bid (60 out of 100) and the CMM quote is 40 percent of the size available at the best bid (40 out of 100). Therefore, twelve contracts will be allocated to the non-customer order (60 percent of 20 is 12) and eight contracts will be allocated to the CMM (40 percent of 20 is 8). The size associated with the non-customer order and CMM quote are then reduced by twelve and eight respectively, so that there is a total of 80 contracts available at the best bid following the execution of the market order. This entire process will be completed by the System in a fraction of a second.

The Exchange believes that priority for non-customer orders and market maker quotes based on size at the execution price, rather than on strict time priority, is beneficial because size priority encourages market participants to provide deeper, more liquid markets.³ Participants with larger size receive a proportionately larger share of the execution, and participants that have small trading interests are not "sized-out" because all participants share in the executions. In contrast, the Exchange believes that time priority creates a race to enter trading interest first and does not give all participants an opportunity to trade. This is especially problematic in an electronic market, where entering an order or quote one micro-second (1/100 of a second) ahead of another order or quote is possible and would provide absolute priority for the first order that arrives. It also is problematic in a derivative market, where the price of a quote or order is based, in large part, on the price of the underlying instrument. In the Exchange's view, a time priority system would disadvantage less technologically advanced market participants and encourage competition based upon the speed of auto-quoting mechanisms. The Exchange does not believe that this type of competition would encourage participants to provide accessible and liquid markets.

Because PMMs have unique obligations to ISE's market,⁴ they are provided with certain participation rights. If the PMM is one of the participants with a quote at the best price, it has participation rights equal to the greater of (1) the proportion of the total size at the best price represented by the size of its quote, or (2) 60 percent of the contracts to be allocated if there is only one other non-customer order or market maker quotation at the best price, 40 percent if there are two other non-customer orders and/or market maker quotes at the best price, and 30 percent if there are more than two other non-customer orders and/or market maker quotes at the best price. In addition, the PMM has precedence to execute orders of five contracts or fewer. This means that such "odd-lot" orders will be executed first by the PMM if it is quoting at the best price.

These participation rights are programmed into the trading algorithm,

³ Orders at the same price with the same size receive allocations in time priority.

⁴ For example, PMMs are responsible for: ensuring that all ISE disseminated quotations are for at least 10 contracts; addressing customer orders that cannot be automatically executed when another market is disseminating a better quotation; and opening the market. See ISE Rule 803(c).

so that they are applied automatically by the System when splitting executions among non-customer orders and market maker quotes after public customer orders at the same price are fully executed as described above.

Consequently, like any other market participant, the PMM cannot receive any portion of an allocation, regardless of its participation rights, unless it is quoting at the best price at the time the System receives the executable order. Moreover, the size associated with the PMM's quote must be sufficient to fill the portion of the order that would be allocated to it according to the participation rights. For example, if a PMM would be allocated 30 contracts according to its participation rights, but the size of its quote is only 20 contracts, the PMM would receive an allocation of only 20 contracts. If the size associated with a PMM's quote is only three contracts when an executable order for five contracts is received (assuming there are no public customer orders), the PMM would execute only three contracts.

According to the participation rights, a PMM quoting at the inside market generally is allocated the plurality of an order. For example, if both a PMM and CMM are quoting at the inside market for 50 contracts each, an incoming order for 10 contracts will be allocated between the two for six and four contracts respectively (a 60% allocation to the PMM). If the PMM is quoting for 50 contracts and there are two CMMs each quoting for 50 contracts, the PMM is allocated four contracts and the two CMMs are allocated three each (40 percent for the PMM, and the remaining 60 percent split equally between the CMMs because they are quoting an equal size). At a minimum, a PMM will be allocated 30 percent of an order, regardless of the number of other quotes or orders at that price.⁵

PMMs quoting at the ISE's inside market will trade against all incoming orders of five contracts or less first. The size of an ISE "odd lot" is roughly equivalent to the similar concept in the equity markets. Specifically, the average options contract premium is approximately \$542.⁶ Thus, the premium for the average options five-lot is approximately \$2,710. This is equivalent to the purchase price of an odd-lot of 63 shares of stock traded on the New York Stock Exchange

("NYSE")⁷ or 49 shares of the 600 securities that likely will underlie options traded on the ISE.⁸ The Exchange believes that this participation right will not necessarily result in a significant portion of the Exchange's volume being executed by a PMM. As stated above, a PMM only will execute against such orders if it is quoting at the best price, and only for the number of contracts associated with its quotation. Nevertheless, on a semi-annual basis, the Exchange will evaluate what percentage of the volume executed on the Exchange is comprised of orders for five contracts or fewer executed by PMMs, and will reduce the size of the orders included in this provision if such percentage is over 40 percent.

The proposed participation rights for PMMs described above is part of the ISE's balancing of the rewards and obligations that pertain to each of the Exchange's classes of memberships. This balancing is part of the overall market structure that is designed to encourage vigorous price competition between market makers on the Exchange, as well as maximize the benefits of price competition resulting from the entry of customers and non-customer orders, while encouraging participants to provide market depth.⁹

The ISE is the first exchange in the United States to attempt to combine all of the elements of an auction market in an electronic environment. The Exchange believes the proposed trading algorithm, which includes participation rights for PMMs only when they are quoting at the best price, strikes the appropriate balance within its market and will maximize the benefits of an electronic auction market for all participants.

2. Statutory Basis

The ISE believes that the proposed rule change is consistent with the provisions of Section 6(b)(5) of the Act,¹⁰ which requires that an exchange have rules that are designated 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.

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

The ISE 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.

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

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 ISE 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to File No.

⁷ The average price of a share of stock traded on the NYSE in 1998 was \$43.10. NYSE 1998 Fact Book at 11.

⁸ The average price of a share of these 600 stocks was \$55.41 as of January 2000.

⁹ The other options exchanges also have participation rights for their specialists, designated primary market makers and lead market makers. See Amex Rule 950(d) and 126(e); CBOE Rule 8.80(c)(7); PCX Rule 6.82(d)(2); PHLX Rule 1014(g).

¹⁰ 15 U.S.C. 78f(b)(5).

⁵ The size associated with the PMM's quote, however, must be sufficient to fill the 30 percent allocation. Under no circumstances may the PMM execute more than the size associated with its displayed quote.

⁶ See Options News Network Internet web site (<http://onn.theocc.com>).

SR-ISE-00-01 and should be submitted by March 27, 2000,

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 00-5381 Filed 3-3-00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42464; File No. SR-Phlx-99-26]

Self-Regulatory Organizations; Notice of Filing of Proposed Amendment to the By-Laws and Corresponding Changes to the Rules of the Philadelphia Stock Exchange, Inc., Relating to Various Committees

February 28, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 30, 1999, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Phlx filed an amendment to the proposed by-law change on October 4, 1999.³ The Commission is publishing this notice to solicit comments on the proposed by-law change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed By-Law Change

The Phlx proposes to amend its By-laws as follows: (i) By-Law Article III, § 3-5, 3-6, 3-7, 3-8, 3-9, 3-12, Article IV, § 4-7, Article V, § 5-5, Article X, § 10-1, 10-4 and 10-11, combining the Nominating and Elections Committees; (ii) By-Law Article X, § 10-8 and 10-14 eliminating the Arbitration Committee and transferring its functions to the Executive Committee; and (iii) By-Law

Article XI, § 11-1, to create a single Quality of Markets Committee. The Phlx also proposes to make technical changes to certain of its rules to reflect the changes to the by-laws.⁴

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 self-regulatory organization 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 self-regulatory organization 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 proposed By-law amendments to provide for streamlining the committee process as follows: (i) Dissolving the Arbitration Committee, whose limited remaining functions would be transferred to the Executive Committee, who will oversee ongoing arbitrations filed before the transfer of arbitration responsibilities to the National Association of Securities Dealers, Inc. ("NASD") in October, 1998;⁵ (ii) dissolving the Elections Committee whose functions would be transferred to the Nominating Committee; and (iii) consolidating the three Quality of Markets Committees into a single Quality of Markets Committee with responsibilities for all three Phlx trading floors.

First, the Exchange proposes to dissolve the Arbitration Committee and transfer its duties to the Executive Committee. Specifically, the Exchange proposes to rescind By-Law Article X, § 10-8, entitled Arbitration Committee, and move its remaining powers to the Executive Committee by By-Law Article X, § 10-14(d). Additionally, the Exchange proposes to delete reference to the Arbitration Committee in By-Law Article XI, § 11-1(a). These changes are intended to eliminate a standing committee, while transferring its responsibilities to the Executive Committee whose powers are broadly

provided for in By-Law Article X, § 10-14.

By way of background, the Exchange ceased accepting arbitration cases on October 1, 1998. Jurisdiction for Phlx arbitration cases now resides with the NASD. Currently, the exchange is processing and closing the cases that were filed prior to October 1, 1998. Following the cessation of these cases, the arbitration function at the Exchange will cease, as will the need for any committee oversight of these matters. In addition, based on the experience since October 1, 1998 to the present, the Exchange believes that any remaining questions requiring committee oversight will be minimal.

Second, the Exchange proposes several changes to the Nominating Committee and the Elections Committee, essentially collapsing them into a single committee. The Exchange proposes to rescind By-Law Article X, § 10-13, entitled Elections Committee, and moves its powers to the Nominating Committee in By-Law Article III, § 3-5(e). The Exchange proposes changing the name of the Nominating Committee to the Nominating and Elections Committee in By-Law Article II, § 3-5, 3-6, 3-7, 3-8, 3-9 and 3-12, Article IV, § 4-7, Article VI § 5-5, Article X, § 10-1 and 10-4 and Article XI, § 11-1. These changes are intended to streamline the functions of these two committees, as described more fully below.

The Elections Committee performs the limited, yet important function of administering membership elections. The Nominating Committee submits nominations for industry Governors who stand for election by the members. It also submits nominations for non-industry Governors. Because these two Committees perform functions related to the election and appointment of Governors of the Exchange, the Exchange believes that the merging of the Elections Committee with the Nominating Committee will not impair the functioning of any of their tasks.⁶ In fact, merging these responsibilities should improve efficiency as well as coordination, as the same group of committee members will oversee the complete election-related process.

Finally, the Exchange proposes to reduce the number of Quality of Markets Committees from three to one, also to improve efficiency. Specifically, the

⁶ The Commission notes that the Exchange currently has a policy of engaging an independent auditing firm to administer elections. This practice will continue following the merger of the Nominations Committee and the Elections Committee. Phone call between John Dayton, Phlx, and Christine Richardson, Division of Market Regulation, Commission, February 23, 2000.

¹¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter to Michael Walinskas, Associate Director, Division of Market Regulation, Commission, from John Dayton, Counsel, Phlx, dated October 1, 1999 ("Amendment No. 1"). Amendment No. 1 proposes certain technical changes. Specifically, it amends Phlx Rule 930 to reflect the fact that the Arbitration Committee is being eliminated from the by-laws. Amendment No. 1 also proposes changes to Phlx Rule 950, §§ 1 and 2, to reflect the elimination of the Arbitration Committee.

⁴ See Amendment No. 1.

⁵ See Securities Exchange Act Release No. 40517 (October 1, 1998), 63 FR 54177 (October 8, 1998) (SR-Phlx-98-28).