

and (C) below, of the most significant aspects of such statements.²

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

The purpose of the proposed rule filing is to permit NSCC to keep McDonalds Corp., USX-Maraton GR., and Blackrock Inc., securities, which are subject to mini-tender offers, in the CNS system. Under normal circumstances because these mini-tender offers have no protect period, NSCC would exit these securities from CNS. However, because of the high trading volume in these securities and the operational impact exiting this security from CNS would have on NSCC's participants, NSCC has filed this rule change to allow NSCC to continue to process these securities in CNS. If NSCC receives a request from a long participant, NSCC will exit the relevant position and will issue a receive and deliver instruction naming short participants selected by an allocation procedure using the oldest short position first. Participants who wish to participate in any of the tender offers must contact NSCC Operations no later than 1:00 PM on Tuesday, May 30, 2000, so arrangements can be made to remove the relevant positions from CNS.

NSCC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder. In particular, the proposed rule change is consistent with section 17A(b)(3)(F) of the Act³ which requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NSCC does not believe that the proposed rule change will have an impact on or impose a 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 have been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

² The Commission has modified the text of the summaries prepared by NSCC.

³ 15 U.S.C. 78q-1(b)(3)(F).

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

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder and particularly with the requirements of section 17A(b)(3)(F).⁴ Section 17A(b)(3)(F) requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions. Allowing these securities which are subject to mini-tender offers to continue to be processed in the CNS system should help ensure the securities will be promptly and accurately cleared and settled.

NSCC has requested that the Commission approve the proposed rule change prior to the thirtieth day after publication of the notice of the filing. The Commission finds good cause for approving the rule change prior to the thirtieth day after publication because such approval will allow NSCC to continue to process these securities in the CNS system.

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 in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of NSCC. All submissions should refer to File No. SR-NSCC-00-07 and should be submitted by June 28, 2000.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,⁵ that the proposed rule change (File No. SR-

⁴ 15 U.S.C. 78q-1(b)(3)(F).

⁵ 15 U.S.C. 78s(b)(2).

NSCC-00-07) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42848; File No. SR-PCX-99-18]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to the Proposed Rule Change by the Pacific Exchange, Inc., Relating to Facilitation Crosses

May 26, 2000.

I. Introduction

On June 4, 1999, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("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 give member firms a participation right in trades proposed as facilitation crosses in certain circumstances; and to allow facilitation crosses for broker-dealer orders. Notice of the proposed rule change was published for comment in the **Federal Register** on September 21, 1999.³ On May 26, 2000, the PCX filed Amendment No. 1 to the proposal.⁴ No comments were received on the proposal. This order approves the proposed rule change, as amended, accelerates approval of Amendment No. 1, and solicits comments from interested persons on that amendment.

II. Description of the Proposal

PCX Rule 6.47(b) sets forth the procedures by which a floor broker representing the order of a member firm's public customer may cross it with a contra side order provided by the firm from its own proprietary account. In these circumstances, the firm is said to be "facilitating" the customer order, and

⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 41867 (September 13, 1999), 64 FR 51171.

⁴ The substantive modifications of Amendment No. 1 are incorporated in the description of the proposal in Section II below, and are further discussed in Section III below.

the transaction is called a "facilitation cross."

Under the current version of the rule, a floor broker seeking to execute a facilitation cross must first bring the transaction to the trading floor and request a market from the trading crowd. After receiving bids and offers from the crowd, the floor broker must propose a price at which to cross the order that improves upon the price provided by the crowd. However, before the floor broker can execute the cross, the market makers in the crowd are given the opportunity to take all or part of the transaction at the proposed price.

Under the current rule, if the crowd does not want to participate in the trade, the floor broker may proceed with the cross. If the crowd wants to take part of the order, however, the crowd has precedence and the floor broker may cross only that amount remaining after the crowd has taken its portion. If the crowd wants to take the entire order, the floor broker will not be able to cross any part of the order.

The proposed rule change, applicable to both equity options and index options,⁵ would entitle the floor broker, under certain conditions, to cross a specified percentage of the customer order on behalf of the member firm before market makers in the crowd can participate in the transaction. This provision would apply only to orders of 200 contracts or more. The percentage of the floor broker's guarantee would depend upon whether the price at which the order is ultimately traded is at the crowd's best bid or offer in response to the broker's initial request for a market, or at an improved price.

First, the floor broker would be granted a right under the proposal to execute a facilitation cross event at the price that does not improve upon the best bid or offer provided by the crowd in response to his initial request for a market. The proposed rule change provides that where the trade takes place at the market provided by the crowd, all public customer orders in the book⁶ and those represented in the crowd at the time the market was established would first need to be satisfied. Once these public customer orders are satisfied, the floor broker would be entitled to facilitate 25% of the contracts remaining in the customer order.

The proposed rule change further provides that if the floor broker

proposes the facilitation cross at a price between the best bid and offer provided by the crowd in response to his initial request for a market—and the crowd then wants to take part or all of the order at the improved price—the floor broker would be entitled to priority over the crowd to facilitate 40% of the contracts⁷ remaining after any public customer orders represented at that improved price have been satisfied.⁸

In the case of orders for less than 200 contracts, the proposed rule change makes clear that the floor broker would be permitted to facilitate a customer order by following PCX Rule 6.47(b) procedures, but would not receive any priority over the crowd.⁹

As under the current version of the PCX facilitation cross rule, the order tickets for both the customer order and the firm's facilitation order would be required under the proposal to display all the terms of the orders, including any contingencies involving, and all related transactions in, either options or the underlying security. Similarly, the floor broker would continue to be required to disclose all securities that are components of the customer order before requesting the crowd's market.¹⁰

The proposed rule change adds a stipulation that would require the floor broker to clearly disclose to the crowd that he is intending to execute a facilitation cross when he initially asks for its market. Once the trading crowd provides that market, it would remain in effect under the proposal until (a) a reasonable amount of time has passed; (b) a significant change has occurred in the price of the underlying security of the option; or (c) the market is improved. "Significant change" would be interpreted on a case-by-case basis by two Floor Officials, based upon the extent of recent trading in the option and the underlying security and any other relevant factors.

The proposed rule change also provides that if the trade takes place at the quoted bid or offer of the Lead Market Maker ("LMM") in the options

class being traded, the guaranteed participation to which the LMM is ordinarily entitled in such case¹¹ would apply only to the number of contracts remaining after all public customer orders have been filled and the facilitating firm's crossing rights have been exercised. Further, the total number of contracts allocated in the aggregate to the facilitating firm and the LMM as the result of their guaranteed participations could not exceed 40%.¹²

The proposed rule change makes clear, however, that it is not intended to prohibit either a floor broker or LMM from trading more than their percentage entitlements if the other members of the trading crowd do not choose to trade with the remainder of the order.¹³ The proposal further makes clear, in accordance with PCX Rule 6.82, that if the trade takes place at a price other than that of the LMM's quoted bid or offer, the LMM would not be entitled to a guaranteed participation.¹⁴

The proposed rule change also provides that the members of the crowd who establish the facilitation market in response to the floor broker's initial request would have priority over all other non-public customer orders¹⁵ that were not represented in the crowd at the time that market was established, except for orders that improve upon those quotes. Further, a floor broker holding a customer order and a facilitation order who calls for a facilitation market would be deemed to be representing both the customer order and the facilitation order, so that the customer order and the facilitation order would also have priority over all other non-public customer orders¹⁶ that were not being represented in the trading crowd at the time the market was established.

Finally, the proposed rule change would permit facilitation crosses for broker-dealer orders.¹⁷

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the provisions of the Act applicable to a national securities exchange, particularly those of section

⁷ See Amendment No. 1, which reduces the proposed percentage guarantee from 50% to 40%.

⁸ Such orders are included within the meaning of "all public customer orders represented in the trading crowd" in the proposed rule text. Telephone conversation with the PCX.

⁹ See Amendment No. 1, concerning proposed subsection 6.47(b)(1). In this case, the members of the trading crowd would have priority over the floor broker seeking to cross a transaction. Telephone conversation with the PCX.

¹⁰ As codified in PCX Rule 6.46, the floor broker must make all persons in the crowd aware of his request for a market, and must allow adequate time for a response. In its proposed amendments to Rule 6.47, the PCX has deleted current references to these procedural obligations to avoid redundancy. Telephone conversation with the PCX.

¹¹ See PCX Rule 6.82(d)(1).

¹² See Amendment No. 1, concerning proposed subsection 6.47(b)(5).

¹³ *Id.*, concerning proposed subsection 6.47(b)(6).

¹⁴ Thus the LMM participation right is not a concern where the facilitating firm receives a 40% crossing right, because that right is granted only when the trade occurs between the best bid and offer given by the crowd, which is by definition at a price other than the LMM's quoted bid or offer.

¹⁵ See Amendment No. 1, concerning proposed subsection 6.47(b)(6).

¹⁶ *Id.*

¹⁷ Current Rule 6.47(b) authorizes facilitation crosses only for public customer orders.

⁵ Telephone conversation between Robert P. Pacileo, Senior Attorney, Regulatory Policy, PCX, and Ira L. Brandriss, Attorney, Division of Market Regulation, the Commission, on May 23, 2000 ("Telephone conversation with the PCX").

⁶ Telephone conversation with the PCX.

6(b)(5)¹⁸ and section 6(b)(8)¹⁹ of the Act, and the rules and regulations thereunder.²⁰ The Commission believes that the proposal will enable the PCX to better compete with other options exchanges in attracting the order flow of broker-dealer firms seeking to facilitate customer orders, with adversely impacting the prices those orders receive.

The Commission finds that the PCX's proposal to grant participation rights, under certain conditions, to member firms seeking to execute facilitation crosses on the Exchange is reasonable. Currently, PCX market makers have priority rights for the full size of a customer order over the firm that brings a crossing transaction to the PCX floor, as long as the market makers are willing to trade at the proposed price.

While the proposal entitles the member firm to a specified percentage of a facilitation transaction when executed at the trading crowd's best bid or offer, it does not eliminate the crowd's ability to trade with a portion of the order proposed to be crossed, or even so substantially reduce that ability so as to raise serious concern that the proposal would reduce price competition by the crowd. Moreover, the Commission believes that the proposal may contribute to better prices for crossing transactions. Specifically, it provides an incentive for upstairs firms to improve on the prices quoted by the crowd by offering these firms a greater participation in the trade when they better the crowd's price. In addition, market makers will always have an opportunity to improve the market and compete for a greater portion of the trade.

In evaluating the proposed rule change, the Commission considered, among other matters, whether the PCX's proposal to guarantee that a member firm could cross up to 40% of an order would reduce the incentive of crowds to compete for orders, and thus impair the price discovery mechanism of the Exchange's market.

¹⁸ 15 U.S.C. 78f(b)(5). Section 6(b)(5) requires that the rules of a national securities exchange be designed to, among other things, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. It also requires that those rules not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

¹⁹ 15 U.S.C. 78f(b)(8). Section 6(b)(8) requires that the rules of the exchange do not impose any burden on competition not necessary to appropriate in furtherance of the purposes of the Act.

²⁰ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

In its recent approval of the application of the International Securities Exchange ("ISE") for registration as a national securities exchange, the Commission discussed the same concern with respect to the ISE's proposed "facilitation mechanism," a system designed to effect a type of facilitation guarantee in an electronic context. The Commission wrote:

It is difficult to assess the precise level at which guarantees may begin to erode competitive market maker participation and potential price competition within a given market. In the future, after the Commission has studied the impact of guarantees, the Commission may need to reassess the level of these guarantees. For the immediate term, the Commission believes that 40% is not clearly inconsistent with the statutory standards of competition and free and open markets.²¹

By the same token, the Commission believes that the PCX's proposed rule change, which allocates no more than 40% of an order to the firm seeking to facilitate an order, is not inconsistent with the statutory standard. The Commission notes, moreover, that for those crossing transactions in which an LMM is entitled to an allocation in addition to the proposed allocation for the facilitating firm, the PCX has included a provision to limit the combined allocations awarded to the firm and the LMM an aggregate of no more than 40% of the order.

Although facilitation cross rules have heretofore been limited to public customer orders, the Commission believes it is reasonable to permit the PCX to allow firms to facilitate orders of broker-dealers—to the degree permitted under the proposed rule change—in its belief that this will enable the PCX to better compete with other exchanges in attracting order flow to its market.

The Commission finds good cause, pursuant to section 19(b)(2)²² of the Act, for approving Amendment No. 1 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 1 includes the provisions described above that limit the total percentage of an order that may be guaranteed to no more than 40%, a percentage that the Commission has previously found consistent with the Act. It also clarifies the application of the facilitation cross rule, as amended by the proposal, for orders of less than 200 contracts. Amendment No. 1 further includes several changes to the

²¹ See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000).

²² 15 U.S.C. 78s(b)(2).

proposed new rule text that clarify its meaning and thus strengthen the proposal.²³ Accordingly, the Commission finds good cause, consistent with Sections 6(b)(5)²⁴ and 19(b)(2)²⁵ of the Act to accelerate approval of Amendment No. 1 to the proposed rule change.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether it 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 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 PCX. All submissions should refer to File No. SR-PCX-99-18 and should be submitted by June 28, 2000.

V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with 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-PCX-99-18), as amended, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁶

Margaret H. McFarland,

Deputy Secretary.

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²³ Among these is a textual revision that makes clear that members of the trading crowd who established the facilitation market will not maintain priority over any order that improves the market.

²⁴ 15 U.S.C. 78f(b)(5).

²⁵ 15 U.S.C. 78s(b)(2).

²⁶ 17 CFR 200.30-3(a)(12).