

## 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 purpose of the proposed rule change is to amend several of the Exchange's fee schedules in order to capitalize on the competitive niches it currently enjoys and to improve the Exchange's competitive position in the overall marketplace. (1) The existing Value Charge and Trade Recording rates on single-sided BSE executions from 2,001 to 5,000 shares will be replaced with a \$.20 per 100 shares Value Charge rate. No Trade Recording fees will be charged on these trades. These new rates are consistent with the fee structure currently in place for BSE executions up to 2,000 shares. These changes will reduce members' costs of executing mid-sized trades on the BSE. (2) Specialist Trading Account fees will be reduced from \$5.00 per trade to \$1.50 per order. (3) Specialist Trade Processing (round lot/odd lot/trading account) fees will be levied on a per order rather than a per trade basis. (4) Maximum total Specialist Trade Processing fees for round lot/odd lot trades will be capped at \$250.00 per month per issue for both the competing and primary specialists in Competing Specialist Initiative ("CSI") issues. If, however, the competing specialist does not generate \$250.00 per month in round lot/odd lot fees in his or her competing issue, the primary specialist will not be eligible for the cap and, therefore, will be charged regular total trade processing (round lot/odd lot) fees. In addition, each primary specialist will receive a \$.50 per trade credit based on the total trading volume of the competing specialist. The total of the assessed fees for round lot/odd lot trades and trade credits in competitive issues will not be less than zero on a per issue basis. Due to the temporary nature of the CSI pilot program, the Exchange

proposes that this fee apply concurrently with the CSI pilot program, which is scheduled to expire on October 2, 1995.

#### 2. Statutory Basis

The proposed rule change is consistent with Section 6(b)(4) of the Securities Exchange Act of 1934 because it provides for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

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

The Exchange believes the fee change will impose no burden on competition.

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

Comments were neither solicited nor received with respect to the fee change.

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

The foregoing rule change establishes or changes a due, fee, or other charge imposed by the Exchange and, therefore, has become effective pursuant to Section 19(b)(3)(A) of the Act and subparagraph (e) of Rule 19b-4 thereunder. 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 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.<sup>2</sup>

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 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

<sup>2</sup> For the purposes of the foregoing, the Commission considers this proposed rule change to have been filed on July 7, 1995, the date that Amendment No. 1 was made.

available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Boston Stock Exchange. All submissions should refer to File No. SR-BSE-95-11 and should be submitted by August 9, 1995.

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

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

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[Release No. 34-35962; File No. SR-CHX-95-11]

## Self-Regulatory Organizations; Chicago Stock Exchange, Incorporated; Order Granting Approval to Proposed Rule Change Relating to the Automatic Execution of Limit Orders

July 12, 1995.

### I. Introduction

On March 31, 1995, the Chicago Stock Exchange, Incorporated ("CHX" 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 establish a one-year pilot program<sup>3</sup> for the automatic execution of non-marketable limit orders.<sup>4</sup> The proposed rule change was published for comment in Securities Exchange Act Release No. 35722 (May 16, 1995), 60 FR 27358 (May 23, 1995). No comments were received on the proposal.

### II. Proposal

The Exchange proposes to re-implement for a one-year pilot period a system enhancement that would facilitate the automatic execution of non-marketable limit orders in a specialist book. In 1993, the Commission first approved this system enhancement as a one-year pilot

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> 17 CFR 240.19b-4 (1994).

<sup>3</sup> See letter from Craig Long, Foley & Lardner, to Glen Barrentine, Senior Counsel, Division of Market Regulation, SEC, dated May 4, 1995 (requesting that the rule filing be approved on a one-year pilot basis).

<sup>4</sup> A limit order is an order to buy or sell a stated amount of a security at a specified price or at a better price.

program.<sup>5</sup> The original one-year pilot lapsed in April 1994 without the Exchange filing for an extension or permanent approval.

The proposed system enhancement ("Auto-Ex") is a feature of the Exchange's automated execution system ("MAX") that CHX specialists may voluntarily choose to activate to automatically execute non-marketable limit orders on a specialist's book. Auto-Ex will operate by comparing the size of the CHX-entered limit order against the amount of stock ahead of that order in the primary market when the issue is trading in the primary market at the limit price.<sup>6</sup> The Auto-Ex system will begin comparing CHX-entered limit orders when the limit price equals the bid or offer quoted in the primary market (as the case may be) for the first time.<sup>7</sup> Thereafter, the Auto-Ex system will keep track of all prints in the primary market and will automatically execute the limit order once sufficient size prints in the primary market.<sup>8</sup> The Auto-Ex feature will not permit a limit order to be filled out of sequence; the Auto-Ex will execute additional limit orders at the same price by comparing those orders with shares ahead in the primary market and on CHX.

The Auto-Ex feature will execute limit orders in accordance with existing CHX rules.<sup>9</sup> All dually traded issues are

<sup>5</sup> See Securities Exchange Act Release No. 32124 (Apr. 13, 1993), 58 FR 21325 (approving File No. SR-MSE-92-03).

<sup>6</sup> In the original pilot program, the Auto-Ex was to operate by comparing the size of CHX-entered limit order against the amount of stock ahead of that order in the "consolidated market" rather than in the primary market. This change is the one modification made by the Exchange to the original pilot program. Telephone conversation with Craig Long, Foley & Lardner, and Jennifer Choi, Attorney, Division of Market Regulation, SEC, on April 17, 1995.

<sup>7</sup> For example, if the primary market quotation is 1/4 bid, 1/2 offered, 4,000 shares bid and 4,000 shares offered, and a CHX specialist receives a limit order to buy 2,000 shares for 1/8, that limit order will not be compared against the amount of stock ahead of the order in the primary market until such time as the 1/4 bid is exhausted and the 1/8 bid becomes the best bid. At that time, the size that is disseminated in the primary market with the 1/8 bid is the size against which the limit order is compared for Auto-Ex purposes.

<sup>8</sup> For example, assume a CHX specialist receives an agency limit order to buy 2,000 shares of ABC at 1/2. The primary market quotation is 1/2 bid, 3/4 offered, 5,000 shares bid and 5,000 shares offered, meaning there are 5,000 shares ahead of the CHX order. The Auto-Ex system will automatically execute the entire CHX limit order after 7,000 shares print at 1/2 in the primary market. However, when more than 5,000 but less than 7,000 shares print at 1/2 in the primary market, the order will be flagged with a flashing prompt to alert the specialist that the order may be due at least a partial fill. See CHX Article XX, Rule 37(a) governing primary market protection of certain limit orders.

<sup>9</sup> The CHX specialist will be the contra-side of all Auto-Ex trades. See Securities Exchange Act

eligible for inclusion in Auto-Ex, but specialists will be permitted to choose the securities for Auto-Ex on an issue by issue basis. Once Auto-Ex is activated for a certain security, the feature must remain activated for a minimum of five trading days and can be deactivated only on a certain day each month, which is determined from time to time by the Exchange. Generally, the Exchange believes that specialists will choose to use Auto-Ex for issues that, based on experience, have demonstrated reliable and accurate quotes in the primary market.<sup>10</sup> Limit orders not subject to Auto-Ex will be "flagged" with a prompt to alert the specialist that a fill may be due. The proposed Auto-Ex feature will apply only to nonmarketable limit orders<sup>11</sup> and not to marketable limit orders or to market orders.<sup>12</sup>

The Exchange states that the purpose of the proposed rule change is to further automate the CHX's trading floor functions and to improve the CHX's performance in filling limit orders. By providing for automatic execution of limit orders in accordance with existing Exchange rules, the Exchange states that it is eliminating the need for the manual operation required of specialists in determining when and to what extent limit orders are due fills based on primary market prints. The Exchange notes that the manual effort expended by specialists in filling limit orders that are entitled to primary market protection is often time-consuming and can result in errors, particularly when there is heavy trading volume. The Exchange believes that the present proposal will, therefore, directly benefit customers because it will result in more timely fills while eliminating errors resulting from manual execution.

The Exchange also states that the Auto-Ex feature will not change or amend any CHX trading rules, nor will it cause or allow limit orders to be filled

Release No. 32124 (Apr. 13, 1993), 58 FR 21325 (approving File No. SR-MSE-92-03).

<sup>10</sup> Telephone conversation between Craig Long, Foley & Lardner, and Glen Barrentine and Jennifer Choi, Division of Market Regulation, SEC, on May 3, 1995.

<sup>11</sup> Under CHX Rule 37(b)(7), specialists generally are required to automatically execute nonmarketable agency limit orders at the limit price when there is a price penetration of the limit price in the primary market.

<sup>12</sup> A limit order is called "marketable" when the prevailing best offer (bid) is equal to or less (greater) than the limit buy (sell) order price. CHX Rule 37(b)(7) provides for the automatic execution at the best bid or best offer disseminated pursuant to Rule 11Ac1-2 ("BBO") or better of all limit orders that are marketable when entered into the MAX system provided that such orders are of a certain size and otherwise are eligible for execution under CHX Rule 37(a).

under different parameters than under existing rules. Auto-Ex will only automate the manner in which limit orders are filled. The Exchanged states that it will continue to monitor specialist execution of limit orders through the Market Regulation/Surveillance Department. In addition, CHX specialists will continue to be responsible for their books to the same degree as they are now under the manual execution system for limit orders.

### III. Discussion and Conclusion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of section 6(b) of the Act.<sup>13</sup> Specifically, the Commission believes the proposal is consistent with the section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change to provide for the automatic execution of non-marketable limit orders should result in prompt execution of such orders on the Exchange and reduce errors caused by manual execution of limit orders that are entitled to primary market protection, especially during periods of heavy trading volume.

As discussed above, the CHX proposal will allow specialists to choose which issues will be included in Auto-Ex. Although the Exchange has limited the specialist's discretion in deactivating the Auto-Ex feature once the system is activated for a particular security, the specialist does retain the ultimate decision of which stocks will be executed automatically. The Commission remains concerned with this aspect of the proposal even though all non-marketable limit orders should receive the same treatment, whether executed manually or through the Auto-Ex system.

The Commission believes that it would be appropriate to allow the Exchange to re-implement Auto-Ex for a one-year period to afford the Exchange and the Commission an opportunity to monitor the operation of the pilot and determine its effectiveness.<sup>14</sup> The

<sup>13</sup> 15 U.S.C. 78f(b) (1988 & Supp. v 1993).

<sup>14</sup> The Exchange has indicated that the Auto-Ex system can become operational immediately upon the approval of the proposal. Telephone conversation between Craig Long, Foley & Lardner,

Exchange should monitor the use of the system during the one-year pilot period and assure the Commission that manually-executed orders and Auto-Ex orders do not receive differential treatment. Moreover, the Exchange should examine the program during the pilot period to determine whether specialists are choosing the stocks to include in Auto-Ex on a discriminatory basis.

The Commission, therefore, requests that the Exchange submit a report to the Commission by May 31, 1996, describing its experience with the pilot program. At a minimum, this report should contain the following data gathered during the first 10-month period after the start-up date for Auto-Ex: (1) The total number of issues and specialists using Auto-Ex including their percentages in comparison to the Exchange's market as a whole; (2) a break down of each issue subject to Auto-Ex during the pilot period, including each date the issue was placed on Auto-Ex and removed; (3) the types of securities being chosen for Auto-Ex (if a pattern is discernable); and (4) whether any distinguishable market condition existed when an issue was placed on or taken off Auto-Ex. The Commission is also interested in the length of time between a print in the primary market and the resulting fill on CHX for both the issues on Auto-Ex and those issues not on Auto-Ex. Any requests to modify this pilot program, to extend its effectiveness, or to seek permanent approval for the pilot program also should be submitted to the Commission by May 31, 1996, as a proposed rule change pursuant to section 19(b) of the Act.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>15</sup> that the proposed rule change (SR-CHX-95-11) is approved for a one-year period ending on July 31, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

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

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and Jennifer s. Choi, Attorney, Division of Market Regulation, SEC, on July 5, 1995.

<sup>15</sup> U.S.C. 78s(b)(2) (1988).

<sup>16</sup> 17 CFR 200.30-3(a)(12) (1994).

[Release No. 34-35961; File No. SR-NASD-95-29]

**Self-Regulatory Organizations; Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. to the Corporate Financing Rule at Article III, Section 44 of the Rules of Fair Practice Regarding Rights of First Refusal**

July 12, 1995.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on June 1, 1995, the National Association of Securities Dealers, Inc. ("NASD" or "Association") 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 NASD. 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 NASD is proposing to amend Article III, section 44 of the Rules of Fair Practice regarding rights of first refusal. Proposed new language is in italics; proposed deletions are bracketed.

Rules of Fair Practice, Article III, The Corporate Financing Rule, Underwriting Terms and Arrangements

Section 44

\* \* \* \* \*

(c) Underwriting Compensation and Arrangements

\* \* \* \* \*

(3) Items of Compensation

(A) For purposes of determining the amount of underwriting compensation received or to be received by the underwriter and related persons pursuant to paragraph (c)(2) above, the following items and all other items of value received or to be received by the underwriter and related persons in connection with or related to the distribution of the offering, as determined pursuant to paragraph (c)(4) below shall be included:

\* \* \* \* \*

(ix) any right of first refusal provided to the underwriter and related persons to underwrite or participate in future *public offerings, private placements or other financings* [by the issuer], which will have a compensation value of 1% of the offering proceeds or that dollar amount contractually agreed to by the issuer and underwriter to waive *or terminate* the right of first refusal;

\* \* \* \* \*

(6) Unreasonable Terms and Arrangements

\* \* \* \* \*

(B) Without limiting the foregoing, the following terms and arrangements, when

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

proposed in connection with the distribution of a public offering of securities, shall be unfair and unreasonable:

\* \* \* \* \*

(v) any right of first refusal *provided to the underwriter and related persons* [regarding] *to underwrite or participate in* future public offerings, private placements or other financings which:

(1) has a duration of more than [five (5)] *three (3)* years from the effective date of the offering; or

(2) *has more than one opportunity to waive or terminate the right of first refusal in consideration of any payment or fee;*

(vi) *any payment or fee to waive or terminate a right of first refusal regarding future public offerings, private placements or other financings provided to the underwriter and related persons which:*

(1) *has a value in excess of the greater of one percent (1%) of the offering proceeds in the public offering where the right of first refusal was granted (or an amount in excess of one percent if additional compensation is available under the compensation guideline of the original offering) or five percent (5%) of the underwriting discount or commission paid in connection with the future financing (including any overallocation option that may be exercised), regardless of whether the payment or fee is negotiated at the time of or subsequent to the original public offering;* or

(2) *is not paid in cash.*

Subsection (vi)-(xii) are renumbered (vii)-(xiii).

**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 NASD 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 NASD 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*

**Background**

The NASD developed its policy on the valuation of rights of first refusal in the early 1970s. Rights of first refusal are typically negotiated in connection with an issuer's initial public offering and grant the underwriter a right to underwrite or participate in any future public offerings, private placements, or other financings by the issuer for a certain period of years. The NASD values rights of first refusal as a non-cash item of compensation at one