SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40990; File No. SR–CHX–98–24]

Self-Regulatory Organizations; Chicago Stock Exchange, Incorporated; Order Approving a Proposed Rule Change Relation to the Exchange's Decorum Rules, Short Sales and Minor Rule Violation Plan

January 28, 1999.

On September 29, 1998,[1] the Chicago Stock Exchange, Incorporated (''CHX'' or ''Exchange'') submitted to the Securities and Exchange Commission (''Commission'' or ''SEC''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[2] and Rule 19b–4 thereunder,[3] a proposed rule change to amend: (1) Interpretation and Policy .01 of Rule 3 of Article XII relating to the Exchange's Decorum Rules regarding repetitive administrative/executive messages; (2) Rule 17 of Article IX, to codify the existing requirement for members to comply with Rule 10a–1 under the Act (''Short Sale Rule''); and (3) Rule 9(h) of Article XII, to add certain rules and policies to the Exchange's Minor Rule Violation Plan. Notice of the proposed rule change appeared in the **Federal Register** on December 22, 1998.[4] The Commission received no comment letters concerning the proposed rule change. This order approves the proposed rule change.

First, the Exchange proposed to amend the list of Class B violations set forth under Rule 3, Article XII of the Exchange's Decorum Rules to include repetitive administrative execution messages sent over the Intermarket Trading System (''ITS'') or the Midwest Automated Execution System (''MAX'') that are inappropriate or unnecessary. Additionally, the Exchange proposed to include these violations as Class B violations for purposes of the Minor Rule Violation Plan and proposed to retain the existing recommended fines.

Second, the Exchange proposed to codify the requirement for members to comply with the Short Sale Rule. Codifying the Short Sale Rule within the Exchange rules will allow the Exchange to assess fines for violation of this rule under its Minor Rule Violation Plan in appropriate circumstances. If the violation is inadvertent or isolated, the Exchange may assess fines pursuant to the Minor Rule Violation Plan and not pursuant to the Exchange's formal disciplinary procedures.

Finally, the Exchange proposed to add certain rules and policies to its Minor Rule Violation Plan under Article XII, Rule 9. Specifically, the Exchange proposed to add violations of its rules relating to: (1) proprietry short sales by floor members (Article IX, Rule 17)(*e.g.,* failing to properly mark a short sale a short and executing a short sale at an inappropriate tick); (2) the issuance of pre-opening responses under the ITS Rules (Article XX, Rule 39) (*e.g.,* using DOT, Post Execution Reporting (''PER''), or any method other than ITS to send a pre-opening response); and (3) the failure of a specialist to adjust limit orders to the block price when MAX automatically executes limit orders at the limit price upon a price penetration in the primary market (Article XX, Rule 7.06 and related Rule 37(b)(6) of Article XX). The Exchange proposed that the recommended fines for the above violations be $100, $500 and $1,000 for the first, second, third, and subsequent violations, respectively, except for violations of the Short Sale Rule, where the recommended fines would be $500, $1,000, and $2,500 for the first, second, and third, and subsequent violations, respectively.[6]

The Commission believes the proposed rule change is consistent with the Act and the rules and regulations promulgated thereunder.[7] Specifically, the Commission believes that approval of the proposed rule change is consistent with Sections 6(b)(6)[8] and 6(b)(7)[9] of the Act. The proposal is consistent with the requirement of Sections 6(b)(6) and (b)(7) in that it provides fair procedures and guidelines that enable the Exchange to appropriately discipline its members and persons associated with members for violations of the rules of the exchange.

The Commission believes that amending the list of Class B violations set forth in the Exchange's Decorum Rules to include inappropriate messages will provide a fair procedure whereby member organizations can be properly sanctioned for these violations that are minor in nature. Moreover, the Commission believes that including the Short Sale Rule within the rules of the Exchange and imposing fines for violations of the Short Sale Rule under its Minor Rule Violation Plan provide a fair procedure for the disciplining of members and persons associated with members, which is consistent with the Act. The Commission suggests that only those violations of the Short Sale Rule which are inadvertent or isolated be handled pursuant to the Exchange's Minor Rule Violation Plan. In the event that a violation occurs involving circumstances where more severe sanctions would be warranted, the Commission believes the Exhange should address them by taking a formal disciplinary proceeding.[10]

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[1] The Exchange initially filed this proposal on September 29, 1998. However, on December 2, 1998, the Exchange filed Amendment No. 1 to provide an example of an ''inadvertent'' violation and to increase the recommended fines for short sale violations. *See* Letter from Patricia L. Levy, Senior Vice President and General Counsel, the Chicago Stock Exchange, Inc., to Mignon McLemore, Division of Market Regulation, SEC, dated December 1, 1998.

[2] 15 U.S.C. 78s(b)(1).

[3] 17 CFR 240.19b–4.

[4] *See* Securities Exchange Act Release No. 40793 (December 15, 1998), 63 FR 70820 (December 22, 1998).

[5] According to the CHX, an inadvertent violation of the Short Sale Rule might occur, for example, if a specialist that is long 1,000 shares of a security sends an order to sell 1,000 shares in that security to the New York Stock Exchange (''NYSE'') via an NYSE Designated Order Turnaround (''DOT'') machine. Because a specialist's inventory is not automatically updated to reflect executions over a DOT machine (unlike executions on the CHX or via ITS which are automatically reflected in a specialist's inventory on a real-time basis), it is possible that a specialist may either forget about the DOT order, or may be late in manually updating his inventory position to reflect the sale via DOT. In either event, the specialist's inventory at that time would not reflect that the specialist is now ''flat'' rather than ''long'' the security. If the specialist then marks his next sale as ''long'' rather than properly marking the order as ''short,'' it might be because the specialist merely looked at his inventory position and did not take the DOT order into account in determining whether he was long or short. While this would still be a violation of the Short Sale Rule, depending on the totality of the facts (*e.g.,* whether this is isolated or part of a larger fraud, or if other unusual circumstances existed, etc.) in certain circumstances, this violation might be considered an ''inadvertent'' violation that is appropriate for the minor rule violation plan. *See* Amendment No. 1, *supra* note 3.

[6] The Commission staff recommended that the Exhcange's fines for Short Sale Rule violations be commensurate with the fine schedules of other exchanges. Hence, the fines for violation of this rule were increased. *See* Amendment No. 1 *supra* note 1.

[7] The Commission has considered the proposed rule's impact on efficiency, competition and capital formation. By classifying certain messages as a violation of the Exchange's Decorum Rules, the proposal should enhance efficiency by eliminating unnecessary communications which could burden computer capacity. Codifying the Short Sale Rule in the Exchange's rules should enhance competition by preventing market manipulation in securities. 15 U.S.C. 78c(f).

[8] Section 6(b)(6) requires the Commission to determine that the rules of the exchange provide that its members and persons associated with members shall be appropriately disciplined for violating the federal securities laws or the rules of the exchange by fine or other fitting sanction. 15 U.S.C. 78f(b)(6).

[9] Section 6(b)(7) requires the Commission to determine that the rules of the exchange provide a fair procedure for disciplining its members and persons associated with members. 15 U.S.C. 78(b)(7).

[10] The Commission expects that the CHX would err on the side of caution in disposing of violations under the Minor Rule Violation Plan. For example, the Commission expects that the CHX would not

The Commission also finds that the additional rules and policies added to the Minor Rule Violation Plan are objective in nature and easily verifiable. Thus, these rules and policies qualify for the less labor intensive and costly disciplinary procedure. The Commission notes that inclusion of these additional rules and policies under the Minor Rule Violation Plan should make the Exchange's disciplinary system more efficient in prosecuting violations of these rules.

For the above reasons, the Commission believes that the proposed rule change is consistent with the provisions of the Act, and in particular with Sections 6(b)(6) and 6(b)(7).

It is therefore ordered, pursuant to Section 19(b)(2) [11] of the Act, that the proposed rule change (SR–CHX–98–24), is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[12]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–2606 Filed 2–3–99; 8:45 am]

BILLING CODE 8010–01–M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40991; File No. SR–Phlx–98–45]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto Proposing To Adopt New Rule 949 Respecting Purchase, Sale, Transfer, and Posting of Membership Transactions

January 28, 1999.

I. Introduction

On November 5, 1998, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') filed with 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 adopt new Rule 949 respecting the purchase, sale, transfer, and posting of membership transactions. On December 14, 1998, the Phlx submitted an amendment to the proposed rule change.[3] The proposed rule change was published for comment in the **Federal Register** on December 23, 1998.[4] The Commission did not receive any comments on the proposal. This order approves the proposal, as amended.

II. Description of the Proposal

The Exchange proposed to adopt a new rule which codifies Exchange procedures concerning the purchase, sale, transfer and posting of membership transactions. The proposal also provides for privately negotiated sales and requests for transfer under certain specified circumstances.

If the transaction is between unrelated parties, the proposed rule provides that transactions must be posted, published, and be for monetary consideration between the posted bid and offer. The proposed rule also permits sales between related entities, but requires publication in the Secretary's bulletin. Thus, both members and non-members will have access to information regarding transfers of membership. Additionally, the proposal ensures that the Exchange will be protected by requiring that the proceeds of all sales be deposited with the Exchange to satisfy any outstanding charges owed by the member.

The proposed rule provides that bids and offers must be in writing and submitted to the Office of the Secretary of the Exchange by an approved applicant, member organization, or lessor. Bids and offers may only be made in $500 increments. Additionally, the proposed rule codifies an existing Exchange practice of requiring payment for a membership by certified or cashier's check payable to the Exchange. Furthermore, the rule specifies that the sale of a membership shall be deemed negotiated and contracted when the filed bid and offer are matched in price and confirmed by the Office of the Secretary. The sale is consummated upon receipt of payment from the purchaser for the purchase price and other associated membership initiation, transfer, and prorated dues and other fees.

The procedures for privately negotiated sales and requests for transfer are found in Section D of the proposed rule. This section provides for the posting of a deposit with the Exchange to cover potential claims that could be asserted pursuant to By-Law Article XV.[5] Only those transfers that conform with Section D will be processed for transfer and all other private sales will be void.

III. Discussion

The Commission believes that the proposed rule is consistent with the requirements of the Act and the rules and regulations thereunder [6] applicable to a national securities exchange. In particular, the Commission finds that the proposed rule is consistent with Section 6(b)(5) [7] of the Act. Section 6(b)(5) of the Act requires, among other things, that the rules of the Exchange be designed to promote just and equitable principles of trade and protect investors and the public interest.

The proposed rule codifies procedures for the transfer of membership interests. By codifying these procedures, the Exchange should ensure the prompt and orderly transfer of membership interests. All bids and offers must be filed in writing with the Office of the Secretary which shall then match the bids and offers according to price and confirm the sale. In addition, all money exchanged must be filed with the Office of the Secretary to ensure that all outstanding debts and fees are paid. By implementing these procedures, the Exchange should protect the financial interests of both buyers and sellers of memberships and provide equity and openness to all who seek to purchase or sell a membership. Buyers should be confident that all outstanding liens are paid and sellers should be confident that the potential buyers have the means to pay their offering price.

Moreover, the new procedures should ensure fairness by providing a public market in which to transfer memberships. All persons interested in purchasing membership interests will have to follow the same procedures. These procedures, in general, protect investors and the public interest by providing a fair and open market for membership transactions. Therefore, the

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issue several cautionary letters before instituting the fines under the Minor Rule Violation Plan or aggregate multiple violations of the rules before instituting abbreviated disciplinary procedures, or, if necessary, a formal disciplinary proceeding.

[11] 15 U.S.C. 78s(b)(2).

[12] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19b–4.

[3] Letter from Murray L. Ross, Vice President and Secretary, Phlx, to Michael Walinskas, Deputy Associate Director, Division of Market Regulation, SEC, dated December 14, 1998 (''Amendment No. 1''). Amendment No. 1 corrected grammatical errors in the proposed rule language.

[4] Securities Exchange Act Release No. 40798 (December 16, 1998), 63 FR 71181.

[5] By-Law Article XV sets forth procedures for transferring memberships. Section 15–3 provides that proceeds are to be distributed according to a provided seniority list.

[6] In reviewing this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. The proposed rule change should improve efficiency because it provides an orderly process by which memberships can be transferred. In addition, the proposed rule change should improve competition because the procedures provide notice to all interested parties about the current market for memberships which should improve bids and offers. 15 U.S.C. 78f(b)(7).

[7] 15 U.S.C. 78f(b)(5).