

on the Exchange or sent from the Exchange floor via ITS in determining a market maker's ability to use exempt credit.

In providing assistance in maintaining a fair and orderly market, a market maker may be required to decrease either a long or a short position in a particular security. Consequently, a market maker may, from time to time, engage in transactions that decrease its position. These transactions were not previously included in the calculation of transactions that qualify for exempt credit. The proposed rule change amends Interpretation .01 to Article XXXIV, Rule 16 to note that positions that decrease a position in a market maker account will be treated the same way as those that create or increase a position for purposes of determining whether a market maker has satisfied the 50% volume requirements needed to obtain exempt credit.

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with Sections 6(b) and 11(b) of the Act.⁵ In particular, the Commission believes the proposal is consistent with the Section 6(b)(5)⁶ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, 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. The Commission believes, moreover, that the proposed rule change is consistent with the requirements of Section 11(b) and Rule 11b-1 thereunder⁷ that specialist (*i.e.*, market maker)⁸ transactions contribute to the maintenance of fair and orderly markets.

The Commission believes that registered market makers on the Exchange serve an important function inasmuch as they add depth and liquidity to the market for CHX-traded securities. Pursuant to Article XXXIV of the CHX Rules, market makers are subject to both affirmative and negative obligations,⁹ and, in return, are accorded certain privileges, including

exempt credit financing.¹⁰ For this reason, it is critical that only those members who are engaged in bona fide market making activities qualify for favorable margin treatment under the Exchange's rules. To the extent that transactions that decrease a position in a market maker account contribute to the depth and liquidity in the market for CHX-traded securities, the Commission believes that it is appropriate for the Exchange to conclude that such transactions constitute bona fide market making activity.

By including in the Exchange's exempt credit 50% minimum quarterly share volume requirements a greater number of transactions that contribute to the maintenance of fair and orderly markets, registered market makers are facilitated in their ability to finance transactions that provide market continuity and stability. Enhancements in the quality of the market CHX-traded securities in turn foster investor confidence and participation in the market. Accordingly, the Commission believes 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) and 11(b).¹¹

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹² that the proposed rule change SR-CHX-98-05 be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40017; File No. SR-CHX-98-09]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Partial Temporary Approval of Proposed Rule Change by the Chicago Stock Exchange, Incorporated Amending the SuperMAX and Enhanced SuperMAX Algorithms

May 20, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on April 20, 1998, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval, on a temporary basis, for a portion of the proposed rule change relating to a new SuperMAX algorithm.

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

The Exchange proposes to amend its SuperMAX and Enhanced SuperMAX programs, located in subsections (c) and (e) of Rule 37 of Article XX.

Specifically, the Exchange is proposing new algorithms to provide price improvement under SuperMAX and Enhanced SuperMAX in 1/16th point markets. Below is the text of the proposed rule change, additions are italicized; deletions are bracketed.

(c) SuperMAX.

[The Exchange's SuperMAX program shall be an automatic execution program within MAX in which a Specialist may voluntarily choose to participate on a stock-by-stock basis. A Specialist shall decide if his or her stock will be eligible for SuperMAX treatment. In the event that a Specialist determines that his stock is eligible for SuperMAX and voluntarily chooses to participate in SuperMAX, small agency market orders in that stock will automatically be executed in MAX, through the SuperMAX program, without any Specialist intervention based on the following criteria (for purposes of this Rule, small market orders shall mean orders up to and including 599 shares, except for the 500 stocks listed in the

⁵ 15 U.S.C. 78f(b) and 78k(b).

⁶ 15 U.S.C. 78f(b)(5).

⁷ 17 CFR 240.11b-1.

⁸ Under Article XXXIV, Rule 16, registered market makers are registered as specialists for purposes of the Act.

⁹ For example, under Article XXXIV, a registered market maker on the Exchange has the duty to maintain fair and orderly markets in assigned issues (Rule 1); the duty to execute at least 50% of quarterly share volume in assigned issues (Rule 3); and the duty to register separately for each security to be traded as a market maker (Rule 4).

¹⁰ Under the federal securities laws and the Exchange's Rules as set forth in Article XXXIV, market makers are also granted special treatment and exemptions from requirements regarding net capital, position financing, and short sales for transaction effected during the course of bona fide market making.

¹¹ In approving the rule change, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78s(b).

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

S&P 500™ Index, in which case, small market orders shall mean orders up to and including 1099 shares):

(1) Pricing.

(i) Both buy and sell orders in markets quoted with less than 1/4 point spread or orders which do not meet the criteria in (ii) or (iii) below will be executed based on the ITS BBO.

(ii) Buy orders in markets quoted with a 1/4 point spread or wider will be executed at a price 1/8th point better than the ITS Best Offer if (i) an execution at the ITS Best Offer would create a double up tick based upon the last sale in the primary market or (2) an execution at the ITS Best Offer would result in a greater than a 1/8th point price change from the last sale in the primary market.

(iii) Sell orders in markets quoted with a 1/4 point spread or wider will be executed at a price 1/8th point better than the ITS Best Bid if (i) an execution at the ITS Best Bid would create a double down tick based upon the last sale in the primary market or (2) an execution at the ITS Best Bid would result in a greater than a 1/8th point price change from the last sale in the primary market.

For example, the execution price for a market buy order in a 1/4-1/2 quoted market is as follows:

| Tick/last sale | Execution price |
|----------------|-------------------|
| +1/2 | 1/2 |
| +3/8 | 3/8 |
| - 3/8 | 1/2 |
| - 1/4 | 3/8 |
| +1/4 | 3/8 (if in range) |

The execution price for a market buy order in a 1/4-5/8 quoted market is as follows:

| Tick/last sale | Execution price |
|----------------|-----------------|
| +5/8 | 5/8 |
| +1/2 | 1/2 |
| 3/8 | 1/2 |
| - 1/2 | 5/8 |
| - 3/8 | 1/2 |
| - 1/4 | 1/2 |
| +1/4 | 1/2 |

(2) Operating Time. SuperMAX will operate each day that the Exchange is open for trading from 8:45 a.m. (C.T.) until the close. During volatile periods, individual stocks or all stocks may be removed from SuperMAX with the approval of two members of the Committee on Floor Procedure.

(3) Timing. Orders entered into SuperMAX shall be immediately executed without any delay (i.e. 0 seconds).

(4) Applicability to Odd-Lots. Although an order generated by the

Odd-Lot Execution Service ("OLES") is a professional order (because it is deemed to be for the account of a broker-dealer), it is nonetheless eligible for SuperMAX execution if: (i) the issue is on SuperMAX, (ii) it is an order for 200 shares or less, and (iii) it is an OLES passively driven, system-generated market order (and not an actively managed order).

(5) Other. Any eligible order in a stock included in SuperMAX which is manually presented at the Specialist post by a floor broker must also be guaranteed an execution by the Specialist pursuant to the criteria set forth in (1) above. In the event that a contra side order which would better a SuperMAX execution is presented at the post, the incoming order which is executed pursuant to the SuperMAX criteria must be adjusted to the better price.]

SuperMAX shall be a voluntary automatic execution program within the MAX System. SuperMAX shall be available for Dual Trading System securities. Dual Trading System securities are securities that are traded on both the Exchange and either the New York Stock Exchange or the American Stock Exchange. A specialist may choose to enable this voluntary program within the MAX System on a security-by-security basis. In the event that the security is eligible for SuperMAX and the specialist in such security has chosen to engage SuperMAX for such security, small agency market orders in that security will automatically be executed in accordance with the SuperMAX algorithm, as set forth below. For purposes of this subsection (c), the term "small agency market order" shall mean an agency order from 100 shares up to and including 499 shares (or such greater amount specified by the specialist and approved by the Exchange).

(1) Pricing.

(i) In the event that a small agency market order to buy or sell is received in a security in which SuperMAX has been enabled, such order shall be executed at the ITS Best Offer (for a buy order) or ITS Best Bid (for a sell order) if (A) the spread between the ITS Best Bid and the ITS Best Offer in such security at the time the order is received is less than 1/8th of a point, or (B) the order does not meet the criteria in (ii) below.

(ii) In the event that a small agency market order to buy or sell is received in a security in which SuperMAX has been enabled, and the last primary market sale is at least 1/8th of a point lower than (for a buy order) or higher

than (for a sell order) the ITS Best Offer (for a buy order) or the ITS Best Bid (for a sell order), such order shall be executed a 1/16th of a point lower than the ITS Best Offer (for a buy order) or 1/16th of a point higher than the ITS Best Bid (for a sell order).

(2) Operating Time.

SuperMAX will operate each day that the Exchange is open for trading from 8:45 a.m. (C.T.) until the close of the Primary trading Session. A specialist may enable or remove SuperMAX for a particular security only on one given day each month, as determined by the Exchange from time to time.

Notwithstanding the previous sentence, during unusual market conditions, individual securities or all securities may be removed from SuperMAX with approval of two members of the Committee on Floor Procedure.

(3) Timing.

Orders entered into SuperMAX shall be immediately executed upon completion of the algorithm without any delay (i.e., 0 seconds).

(4) Applicability to Odd-Lots.

Although an order generated by the Odd-Lot Execution Service ("OLES") is a professional order (because it is deemed to be for the account of a broker-dealer), it is nonetheless eligible for SuperMAX execution if: (i) the issue is on SuperMAX, (ii) it is an order for 200 shares or less, and (iii) it is an OLES passively driven, system-generated market order (and not an actively managed order).

(5) Out of Range.

Notwithstanding anything herein to the contrary, SuperMAX will not automatically execute an order if such execution would result in an out of range execution.

(6) Other.

Any eligible order in a security included in SuperMAX, which is manually presented at the Specialist post by a floor broker must also be guaranteed an execution by the Specialist pursuant to the criteria set forth in (1) above. In the event that a contra side order which would better a SuperMAX execution is presented at the post, the incoming order which is executed pursuant to the SuperMAX criteria must be adjusted to the better price.

(d) No change in text.

(e) Enhanced SuperMAX

[The Exchange's Enhanced SuperMAX program shall be an automatic execution program within MAX in which a specialist may voluntarily choose to participate on a stock-by-stock basis. A specialist shall decide if his or her stock will be eligible for Enhanced SuperMAX treatment. In

the event that a stock is eligible for Enhanced SuperMAX treatment (pursuant to paragraph (e) of this Rule) and SuperMAX treatment (pursuant to paragraph (c) of this Rule) at the same time, the size of the order and the inclusion of the security in the S&P 500™ Index will determine which program will be followed for execution. If a stock is not included in the S&P 500™ Index, an order of 299 shares or less will execute according to the SuperMAX program and an order from 300 shares up to and including 1099 shares (or such greater size specified by the specialist and approved by the Exchange) will execute according to the Enhanced SuperMAX program. If a stock is included in the S&P 500™ Index, or if a specialist in a non-S&P 500™ Index issue so chooses, an order of 599 shares or less will execute according to the SuperMAX program and an order from 600 shares up to and including 1099 shares (or such greater size specified by the specialist and approved by the Exchange) will execute according to the Enhanced SuperMAX program. In the event that a specialist determines that his stock is eligible for Enhanced SuperMAX only and voluntarily chooses to participate in Enhanced SuperMAX, agency market orders up to and including 1099 shares (or such greater size specified by a specialist and approved by the Exchange) in that stock may automatically be stopped and executed in MAX, through the Enhanced SuperMAX program, without any specialist intervention based on the following criteria:

(1) Stopping. If an agency market order eligible for Enhanced SuperMAX would create either a double up tick (buy order) or double down tick (sell order) if the order was executed at the ITS BBO, the Enhanced SuperMAX program will "stop" the order. Once stopped, the order will not receive an execution that is worse than the stopped price. Notwithstanding anything in the previous sentence to the contrary, agency market orders in markets quoted in less than a 1/4 point market will not be stopped. Orders not stopped will be immediately executed based upon the ITS BBO as the case may be.

(2) Pricing. Buy orders stopped under (1) above will be executed as follows:

(i) If the next primary market sale is equal to or less than the last sale then the stopped order will be executed at such last sale price (subject, however, to the Exchange's block protection policy as set forth in interpretation and policy .06 of Rule 7 of this Article).

(ii) If the next primary market sale is greater than the last sale then the

stopped order will be executed at such next primary market sale price. However, if the next primary market sale is greater than the stopped price then the stopped order will be filled at the stopped price.

Sell orders stopped under (1) above will be executed as follows:

(iii) If the next primary market sale is equal to or greater than the last sale then the stopped order will be executed at such last sale price (subject, however, to the Exchange's block protection policy as set forth in interpretation and policy .06 of Rule 7 of this Article).

(iv) If the next primary market sale is less than the last sale then the stopped order will be executed at such primary market sale price. However, if the next primary market sale is less than the stopped price then the stopped order will be filled at the stopped price.

Notwithstanding anything in this paragraph (2) to the contrary, orders stopped under this paragraph that are subject to a Time Out Period (as defined below) shall be executed at the stopped price if there are no executions in the primary market at the end of the applicable Time Out Period. The Time Out Period shall be the time specified by the specialist on a stock-by-stock basis based on the size of the order. Such Time Out Period may be changed by a specialist no more frequently than once a month and may be no less than 30 seconds. A specialist shall not be required to specify a Time Out Period. If no Time Out Period is specified, no Time Out Period shall apply.

(3) Operating Time. Enhanced SuperMAX will operate each day that the Exchange is open for trading from 8:45 a.m. (C.T.) until the close. A specialist may make a particular stock eligible for Enhanced SuperMAX and may remove a particular stock from Enhanced SuperMAX only on one given day each month, as determined from time to time by the Exchange. Notwithstanding anything in the previous sentence to the contrary, in unusual trading situations, individual stocks or all stocks may be removed from Enhanced SuperMAX with the approval of two members of the Committee on Floor Procedure.

(4) Timing. Orders entered into Enhanced SuperMAX shall, when due a fill under the Enhanced SuperMAX program, be immediately executed without any delay (i.e. 0 seconds).

(5) Applicability to Odd-Lots. Although an order generated by the Odd-Lot Execution Service ("OLES") is a professional order (because it is deemed to be for the account of a broker-dealer), it is nonetheless eligible for Enhanced SuperMAX execution if:

(i) the issue is on Enhanced SuperMAX, (ii) it is an order for 200 shares or less, and (iii) it is an OLES passively drive, system-generated market order (and not an actively managed order).

(6) Out of Range. Notwithstanding anything in this paragraph (e) to the contrary, Enhanced SuperMAX will not execute an order at the ITS BBO if such execution would result in an out of range execution.

(7) Other. Any eligible order in a stock included in Enhanced SuperMAX which is manually presented at the Specialist post by a floor broker must also be guaranteed an execution by the Specialist pursuant to the criteria set forth in this paragraph (e). In the event that a contra side order which would better an Enhanced SuperMAX execution is presented at the post, the incoming order which is executed pursuant to the Enhanced SuperMAX criteria must be adjusted to the better price.]

Enhanced SuperMAX shall be a voluntary automatic execution program within the MAX System. Enhanced SuperMAX shall be available for any Dual Trading System security in which SuperMAX has been enabled. A specialist may choose to enable this voluntary program within the MAX System on a security-by-security basis. In the event that the security is eligible for Enhanced SuperMAX and the specialist in such security has chosen to engage Enhanced SuperMAX for such security, small agency market orders in that security will automatically be executed in accordance with the Enhanced SuperMAX algorithm, as set forth below. For purposes of this subsection (e), the term "small agency market order" shall mean an agency order for at least 500 shares, up to and including 2099 shares (or such greater amount chosen by the specialist and approved by the Exchange). Notwithstanding the previous sentence, the smallest size order in a particular security that is eligible for Enhanced SuperMAX shall always be of a size that is at least one share greater than the largest size order in such security that is eligible for SuperMAX.

(1) Stopping.

(i) In the event that a small agency market order to buy or sell is received in a security in which Enhanced SuperMAX has been enabled, and both (A) the spread between the ITS Best Bid and the ITS Best Offer in such security at the time the order is received is equal to or greater than 3/16th of a point, and (B) the last primary market sale is at least 1/8th of a point lower than (for a buy order) or higher than (for a sell order) the ITS Best Offer (for a buy

order) or the ITS Best Bid (for a sell order), Enhanced SuperMAX shall "stop" the order at the ITS Best Offer (for a buy order) or at the ITS Best Bid (for a sell order) for a Time Out Period (as defined below). Once stopped, the order shall be guaranteed an execution at the stopped price or better. The Time Out Period shall be the time specified by the specialist, and approved by the Exchange, on a security-by-security basis. Such Time Out Period may be changed by a specialist no more frequently than once a month and may be no less than 30 seconds. If a specialist does not specify a specific Time Out Period, the Time Out Period shall be 30 seconds.

(ii) In the event that a small agency market order to buy or sell is received in a security in which Enhanced SuperMAX has been enabled, and the order is not stopped under (1)(i) above, Enhanced SuperMAX shall immediately execute the order at the ITS Best Offer (for a buy order) or at the ITS Best Bid (for a sell order).

(2) Pricing.

(i) In the event that an order has been stopped in accordance with subsection (1)(i) above, it shall be executed at $\frac{1}{16}$ th of a point better than the stopped price immediately after the first (i.e., next) primary market sale that occurs during the Time Out Period, but only if such next primary market sale is at least $\frac{1}{8}$ th of a point lower than (for a buy order) or higher than (for a sell order) the stopped price.

(ii) In the event that an order has been stopped in accordance with subsection (1)(i) above, it shall be executed at the stopped price immediately after the first (i.e., next) primary market sale that occurs during the Time Out Period, but only if such next primary market sale is less than $\frac{1}{8}$ th of a point lower than (for a buy order) or higher than (for a sell order) the stopped price.

(iii) In the event that an order has been stopped in accordance with subsection (1)(i) above, it shall be executed at the stopped price immediately at the end of the applicable Time Out Period if no sale of the security has occurred in the primary market during such Time Out Period.

(3) Operating Time.

Enhanced SuperMAX will operate each day that the Exchange is open for trading from 8:45 a.m. (C.T.) until the close of the Primary trading Session. A specialist may enable or remove Enhanced SuperMAX for a particular security only on one given day each month, as determined by the Exchange from time to time. Notwithstanding the previous sentence, during unusual market conditions, individual securities

or all securities may be removed from Enhanced SuperMAX with approval of two members of the Committee on Floor Procedure.

(4) Timing.

Orders entered into Enhanced SuperMAX shall be immediately executed upon completion of the algorithm without any delay (i.e., 0 seconds).

(5) Applicability to Odd-Lots.

Although an order generated by the Odd-Lot Execution Service ("OLES") is a professional order (because it is deemed to be for the account of a broker-dealer), it is nonetheless eligible for Enhanced SuperMAX execution if: (i) the issue is on Enhanced SuperMAX, (iii) it is an order for 200 shares or less, and (iii) it is an OLES passively driven, system-generated market order (and not an activity managed order).

(6) Out of Range.

Notwithstanding anything herein to the contrary, Enhanced SuperMAX will not automatically execute an order if such execution would result in an out of range execution.

(7) Other.

Any eligible order in a security included in Enhanced SuperMAX, which is manually presented at the Specialist post by a floor broker must also be guaranteed an execution by the Specialist pursuant to the criteria set forth in (1) and (2) above. In the event that a contra side order which would better a Enhanced SuperMAX execution is presented at the post, the incoming order which is executed pursuant to the Enhanced SuperMAX criteria must be adjusted to the better price.

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 III 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

On May 22, 1995, the Commission approved a proposed rule change of the CHX that allows specialists on the

Exchange, through the Exchange's MAX system, to provide order execution guarantees that are more favorable than those required under CHX Rule 37(a), Article XX.² That approval order contemplated that the CHX would file with the Commission specific modifications to the parameters of MAX that are required to implement various options available under this new rule.

The CHX now proposes to amend the SuperMAX program and Enhanced SuperMAX programs. SuperMAX and Enhanced SuperMAX are two existing CHX programs within the MAX System that use computerized algorithms to provide automated price improvement. Both of these programs have been approved by the Commission on a permanent basis.³

Background. In 1997, virtually every registered national securities exchange and national securities association changed its minimum trading variation to one sixteenth of a point or smaller. Although the CHX made some technical changes to its SuperMAX and Enhanced SuperMAX programs at that time in light of assumptions as to the smallest minimum variation that were contained in the text of the SuperMAX and Enhanced SuperMAX rules, the CHX did not change the algorithms to reflect the additional price improvement opportunities that are available because of trading in sixteenths.⁴ The purpose of the proposed rule change is to amend the existing programs to both simplify the price improvement algorithms and increase the number of orders that are eligible for price improvement due to the smaller minimum trading variation. Rather than amending the existing text of the SuperMAX and Enhanced SuperMAX rules, the text of the existing rule has been deleted and replaced with new language. This was done to permit the Exchange to re-write the rule, with non-substantive changes, to clarify some language in the old rule that may have been ambiguous.

Proposal. The existing SuperMAX and Enhanced SuperMAX programs are voluntary programs in which a specialist may choose to participate. Participation is on a security-by-security

² See Securities Exchange Act Release No. 35753 (May 22, 1995), 60 FR 28007 (May 26, 1995) (File No. SR-CHX-95-08).

³ See Securities Exchange Act Release No. 32631 (July 14, 1993), 58 FR 39069 (July 21, 1993) (File No. SR-MSE-93-10) (Order approving SuperMAX on a permanent basis), Securities Exchange Act Release No. 38338 (February 26, 1997), 62 FR 10102 (March 5, 1997) (File No. SR-CHX-97-02) (Order approving Enhanced SuperMAX on a permanent basis).

⁴ See Securities Exchange Act Release No. 38816 (July 3, 1997), 62 FR 37325 (July 11, 1997) (File No. SR-CHX-97-18).

basis and is currently limited to Dual Trading System issues (*i.e.*, issues traded on both the CHX and either the New York Stock Exchange or American Stock Exchange). A specialist can only activate and de-activate the program with respect to a given security once a month (a date determined by the specialist). Once activated with respect to a security, small agency market orders⁵ in markets quoted with a spread of $\frac{1}{4}$ point or more are eligible for automated price improvement. Once eligible, the program runs through an algorithm that may provide price improvement under certain circumstances. The existing SuperMAX program provides price improvement to the order if executing the order at the ITS BBC⁶ (the ITS best offer for a buy order, and the ITS best bid for a sell order) would create either a double uptick or double down tick based on the last primary market sale. The program also provides price improvement if such an execution would result in greater than a $\frac{1}{8}$ th point price change from the last primary market sale. Under the existing Enhanced SuperMAX program, rather than executing an order based on the last primary market sale, eligible orders are "stopped" at the ITS BBO and are executed with reference to the next primary market sale. The Enhanced SuperMAX program also includes a time-out feature whereby if there are no executions in the primary market after the order has been stopped for a designated time period, the order is executed at the stopped price at the end of such period. Such period, known as a time out period, is pre-selected by a specialist on a stock-by-stock basis on the size of the order, may be changed by a specialist no more frequently than once a month and may be no less than 30 seconds.

This proposed rule change simplifies the pricing algorithms used by SuperMAX and Enhanced SuperMAX and provides a greater opportunity for price improvement.

Under the new simplified algorithm for SuperMAX, small agency market orders⁷ would now be eligible for price

improvement if the market for the security is quoted with a spread of $\frac{1}{8}$ of a point or greater (rather than the $\frac{1}{4}$ point spread that is required under the existing rule). In addition, the double-up/double down concept has been eliminated. The simplified algorithm will now provide $1\frac{1}{16}$ th of a point price improvement from the ITS BBO if an execution at the ITS BBO would be at least $\frac{1}{8}$ th point higher than (for a buy order) or lower than (for a sell order) the last primary market sale. Basically price improvement is given under certain circumstances when the security is trading between the spread. All other aspects of the existing algorithm, including operating time, timing of execution, applicability to odd-lots, and out of range situations, remain the same.

The Exchange has compared the proposed changes to SuperMAX with the existing SuperMAX algorithm and believes that the new algorithm will provide price improvement to a greater number of trades. Using data for January 1998, the Exchange determined that the proposed changes to the algorithm would have resulted in over 32,000 trades receiving price improvement (for a total savings of \$329,000 to customers), as opposed to the 5800 trades that received price improvement (for a total savings of \$126,000 to customers) under the existing SuperMAX program. This means that the changes to SuperMAX would have resulted in customers receiving 203,000 additional dollars of price improvement over the Exchange's existing SuperMAX algorithm.

With respect to Enhanced SuperMAX, the Exchange proposes to make this program an add-on feature for securities for which the SuperMAX program has already been activated, rather than a stand-alone program. As stated in the Exchange's Report on the operation of the Enhanced SuperMAX program that was provided to the Commission in advance of the Commission's permanent approval of Enhanced SuperMAX program, taken as a whole, the existing SuperMAX program provides more price improvement than the existing Enhanced SuperMAX program. The Exchange believes that interconnecting the two programs will encourage more specialists to enable the SuperMAX program, with greater resulting price improvement, since the Enhanced SuperMAX program will only be available when SuperMAX is enabled. Currently, some specialists have only turned on the Enhanced SuperMAX program without enabling the SuperMAX program.

Under the new simplified algorithm for Enhanced SuperMAX, small agency

market orders⁸ would be eligible for price improvement if the market for the security is quoted with a spread of $\frac{3}{16}$ th of a point (rather than the $\frac{1}{4}$ point spread that is required under the existing rule). In addition, the double-up/double down concept currently in place to determine whether an order is stopped has been eliminated. The simplified algorithm will now "stop" an eligible order at the ITS BBO if an execution at the ITS BBO would be at least $\frac{1}{16}$ th point higher than (for a buy order) or lower than (for a sell order) the last primary market sale. (This stopping algorithm is identical to the new algorithm above for Super MAX.) Once stopped, an order would receive $\frac{1}{16}$ th price improvement over the stopped price if the next primary market sale occurs before the end of the Time Out Period and the sale is at least $\frac{1}{8}$ th of a point lower than (for a buy order) or higher than (for a sell order) the stopped price. As is the case for SuperMAX, all other aspects of the existing algorithm, including operating time, timing of execution, applicability to odd-lots, and out of range situations, remain the same.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b)(5) of the Act in that it is designed to promote just and equitable principles of trade, to remove impediments and to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The proposed rule change accomplishes these ends by increasing the number of trades that will be eligible for automated price improvement.

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.

⁸ Under the proposal, small agency market orders for Enhanced SuperMAX would be orders from 500 shares to 2099 shares (or a greater amount chosen by the specialist). Notwithstanding the 500 share minimum order size contained in the rule, the smallest size order eligible for Enhanced SuperMAX must always be at least one share greater than the largest size order in such security that is eligible for SuperMAX. In other words, if a specialist voluntarily increases the maximum order size for SuperMAX, the minimum order size for Enhanced SuperMAX must be increased accordingly.

⁵ For SuperMAX, small agency market orders are orders from 100 shares to 599 shares (or a greater amount chosen by the specialist). For Enhanced SuperMAX these are orders from 100 shares to 1099 shares (or a greater amount chosen by the specialist).

⁶ As used in the CHX rules, ITS BBO means the best bid or offer among the American, Boston, Cincinnati, Chicago, New York, Pacific, Philadelphia or the Intermarket Trading System/Computer Assisted Execution System quote. See CHX Art. XX, Rule 37(a)(2).

⁷ Under the proposal, small agency market orders for SuperMAX would be orders from 100 shares to 499 shares (or a greater amount chosen by the specialist).

III. 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. 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-CHX-98-09 and should be submitted by June 18, 1998.

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

Within 35 days of the publication of the 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 self-regulatory organization consents, the Commission will:

- A. By order approve such proposed rule change, or
- B. Institute proceedings to determine whether the proposed rule change should be disapproved.

V. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

The Commission finds that part of the Exchange's proposal modifying the price improvement algorithm amending SuperMAX is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁹ which requires that the rules of an exchange be designed, among other things, 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.¹⁰ The Commission believes, in light of the industry's move to trading in finer increments last year, that CHX's modification to its price improvement algorithms will provide investors a meaningful opportunity for price improvement when securities trading in 1/16ths have a spread of 1/8 point or greater. In addition, the Commission finds that the new SuperMAX and Enhanced SuperMAX rules provide greater price improvement opportunities for investors because the criteria for when such opportunities are available has been simplified. The Commission believes that because the opportunity for price improvement is automatic and without any specialist intervention, SuperMAX¹¹ and Enhanced SuperMAX facilitate order interaction and enhance the execution of customer orders consistent with Section 6(b)(5) of the Act. The Commission notes that while SuperMAX and Enhanced SuperMAX are voluntary programs that specialists choose to participate in for Dual Trading Systems issues, providing a greater number of investors an opportunity to achieve price improvement is compatible with the view expressed in the Order Handling release.¹²

The Commission therefore finds good cause for granting partial approval to the proposed rule change (SR-CHX-98-09) with respect to the adoption of a new SuperMAX prior to the thirtieth day after date of publication of notice of filing thereof in the **Federal Register**. The Commission is granting this partial approval on a temporary basis, until August 20, 1998.

The Commission is therefore granting accelerated approval for the new SuperMAX algorithm on a temporary basis, until August 20, 1998.¹³ The Commission is deferring action on the new Enhanced SuperMAX to provide interested parties an opportunity to comment on the proposal. In addition,

⁹ In approving this rule, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ The CHX presently has the ability to install the new SuperMAX algorithm.

¹¹ See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996).

¹² The proposal to permanently adopt the new SuperMAX will be considered with the proposal to approve the adoption of the new Enhanced SuperMAX.

the Commission and the CHX will have the opportunity to review the implementation of the new SuperMAX algorithm.

The changes to the SuperMAX algorithm will be phased in during the next month. Until the Enhanced SuperMAX proposal is adopted, the existing Enhanced SuperMAX algorithm will continue to apply. In those instances where a security is both on the new SuperMAX algorithm and the old Enhanced SuperMAX algorithm, the size of the order will determine which algorithm is used. The introductory paragraph of existing Rule 37(e) that describes the interaction between SuperMAX and Enhanced SuperMAX for a security on both systems shall be deemed to be amended such that if an order is for between 100 shares and 499 shares, the new SuperMAX algorithm shall apply, and if the order is for 500 shares or more (up to the 2099 shares or such greater amount specified by the specialist and approved by the Exchange), the old Enhanced SuperMAX algorithm shall apply.

It is Therefore *Ordered*, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-CHX-98-09) be, and hereby is, approved in part and on a temporary basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40014; File No. SR-MSRB-98-1]

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Relating to Interpretation of Rule G-38 on Consultants Concerning Bank Affiliates and the Definition of Payment

May 20, 1998.

I. Introduction

On January 12, 1998,¹ the Municipal Securities Rulemaking Board ("Board")

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(1)(12).

¹ On November 13, 1997, the Board filed the same proposal as a Q&A under Section 19(b)(3)(A) of the Act, which rendered the proposal effective upon receipt of the filing by the Commission. See Securities Exchange Act Rel. No. 39391 (December

⁹ 15 U.S.C. 78f(b)(5).