

For the Commission by the Division of Investment Management, under delegated authority.

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*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41392; File No. S7-24-89]

### Joint Industry Plan; Solicitation of Comments and Approval of Request To Increase the Number of Securities Eligible for Trading Pursuant to the Reporting Plan for Nasdaq/National Market Securities Traded on an Exchange on an Unlisted or Listed Basis, Submitted by the Chicago Stock Exchange, Inc.

May 12, 1999.

#### I. Introduction

On November 6, 1998, the Chicago Stock Exchange, Inc. ("CHX"), submitted to the Securities and Exchange Commission ("Commission" or "SEC") a request to increase the number of Nasdaq National Market ("Nasdaq/NM") securities eligible for trading<sup>1</sup> pursuant to the Joint Transaction Reporting Plan for the National Market Securities Traded on an Exchange on an Unlisted or Listed Basis ("Plan").<sup>2</sup> The Commission is approving the request to expand the number of

<sup>1</sup> Section 12(f) of the Securities Exchange Act of 1934 ("Act") describes the circumstances under which an exchange may trade a security that is not listed on the exchange, *i.e.*, by extending unlisted trading privileges ("UTP") to the security. See 15 U.S.C. 781(f). Section 12(f) required exchanges to apply to the Commission before extending UTP to any security. In order to approve an exchange UTP application for a registered security not listed on any exchange ("OTC/UTP"), Section 12(f) required the Commission to determine that various criteria had been met concerning fair and orderly markets, the protection of investors, and certain national market initiatives. Section 12(f) was amended on October 22, 1994; the amendment removed the application requirement. OTC/UTP is now allowed only pursuant to a Commission order or rule, which is to be issued or promulgated under essentially the same standards that previously applied to Commission review of UTP applications. The present order fulfills these Section 12(f) requirements.

<sup>2</sup> The signatories to the Plan, *i.e.*, the National Association of Securities Dealers, Inc. ("NASD"), the CHX (previously, the Midwest Stock Exchange, Inc.), the Philadelphia Stock Exchange, Inc. ("Phlx"), and the Boston Stock Exchange, Inc. ("BSE"), are the "Participants." The BSE, however, joined the Plan as a "Limited Participant," and reports quotation information and transaction reports only in Nasdaq/National Market (previously referred to as "Nasdaq/NMS") securities listed on the BSE. Originally, the American Stock Exchange, Inc., was a Participant to the Plan, but did not trade securities pursuant to the Plan, and withdrew from participation in the Plan in August 1994.

eligible securities that may be traded by the CHX pursuant to the Plan from 500 to 1000.

#### II. Background

The Commission originally approved the Plan on June 26, 1990.<sup>3</sup> The Plan governs the collection, consolidation and dissemination of quotation and transaction information for Nasdaq/NM securities listed on an exchange or traded on an exchange pursuant to unlisted trading privileges.<sup>4</sup> The Commission originally approved trading pursuant to the Plan on a one-year pilot basis, with the pilot period to commence when transaction reporting pursuant to the Plan commenced. Accordingly, the pilot period commenced on July 12, 1993. The Plan has been in operation on a pilot basis since that time.<sup>5</sup>

#### III. Discussion

Prior to 1985, the Commission generally did not permit exchanges to extend unlisted trading privileges to non-exchange listed securities such as Nasdaq/NM securities. However, in 1985, the Commission began to permit exchanges, on a temporary basis and subject to certain limitations, to extend

<sup>3</sup> See Securities Exchange Act Release No. 28146 (June 26, 1990), 55 FR 27917 (July 6, 1990) ("1990 Approval Order"). See also 1994 Extension Order, *infra* note 5 (providing a detailed discussion of the history of unlisted trading privileges in OTC securities, and the events that led to the plan and pilot program).

<sup>4</sup> See Section 12(f) of the Act. See also December 1998 Extension Order, *infra* note 5, for a more in depth description of the Plan.

<sup>5</sup> See Stock Exchange Act Release No. 34371 (July 13, 1994), 59 FR 37103 (July 20, 1994) ("1994 Extension Order"), Securities Exchange Act Release No. 35221 (January 11, 1995), 60 FR 3886 (January 19, 1995); Securities Exchange Act Release No. 36102 (August 14, 1995), 60 FR 43626 (August 22, 1995); Securities Exchange Act Release No. 36226 (September 13, 1995), 60 FR 49029 (September 21, 1995); Securities Exchange Act Release No. 36368 (October 13, 1995), 60 FR 54091 (October 19, 1995); Securities Exchange Act Release No. 36481 (November 13, 1995), 60 FR 58119 (November 24, 1995); Securities Exchange Act Release No. 36589 (December 13, 1995), 60 FR 65696 (December 20, 1995); Securities Exchange Act Release No. 36650 (December 28, 1995), 61 FR 358 (January 4, 1996); Securities Exchange Act Release No. 36934 (March 6, 1996), 61 FR 10408 (March 13, 1996); Securities Exchange Act Release No. 36985 (March 18, 1996), 61 FR 12122 (March 25, 1996); Securities Exchange Act Release No. 37689 (September 16, 1996), 61 FR 50058 (September 24, 1996); Securities Exchange Act Release No. 37772 (October 1, 1996), 61 FR 52980 (October 9, 1996); Securities Exchange Act Release No. 38457 (March 31, 1997), 62 FR 16880 (April 8, 1997); Securities Exchange Act Release No. 38794 (June 30, 1997), 62 FR 36586 (July 8, 1997); Securities Exchange Act Release No. 39505 (December 31, 1997), 63 FR 1515 (January 9, 1998); Securities Exchange Act Release No. 40151 (July 1, 1998), 63 FR 36979 (July 8, 1998) ("July 1998 Extension Order"); and Securities Exchange Act Release No. 40896 (December 31, 1998), 64 FR 1834 (January 12, 1999) ("December 1998 Extension Order").

unlisted trading privileges to a maximum of twenty five securities. These limitations, to required the NASD and the exchanges to enter into a plan for consolidated transaction and quotation dissemination of the UTP securities.<sup>6</sup> In 1986, the Midwest Stock Exchange (now the CHX) entered into an interim plan which subsequently was superseded by the Plan, which is currently operating on a pilot basis. In 1990, the Commission expanded the maximum number of eligible securities to 100,<sup>7</sup> and in 1995, the Commission approved a request by the CHX<sup>8</sup> to further increase the number to 500.<sup>9</sup> Accordingly, CHX today trades up to 500 Nasdaq/NM securities pursuant to unlisted trading privileges.

The CHX would now like to raise the number of UTP-eligible securities from 500 to 1000. In commenting on the Commission's July 1998 Extension Order, the CHX asked the Commission to expand the number of Nasdaq stocks eligible for unlisted trading from 500 to 1000 issues.<sup>10</sup> In support of the proposal, the CHX cited to the Commission's approval of the previous increase. Further, the Exchange believes that investors directly benefit from the proposal because the CHX is the only auction-based market for Nasdaq securities. In the December 1998 Extension Order, the Commission solicited comment regarding the CHX's request.<sup>11</sup>

The Commission received two comment letters addressing the CHX's proposal, as well as two letters from the CHX responding to the NASD's letter.<sup>12</sup>

<sup>6</sup> See Securities Exchange Act Release No. 22412 (September 16, 1985), 50 FR 38640.

<sup>7</sup> See 1990 Approval Order, *supra* note 3.

<sup>8</sup> See letter from George T. Simon, Foley and Lardner, to Katherine England, Assistant Director, Commission, dated January 9, 1995.

<sup>9</sup> See Release No. 34-36102, *Supra* note 5.

<sup>10</sup> See letter from George T. Simon, Foley and Lardner, to Robert Colby, Commission, dated November 6, 1998. In response to a request by the Commission for additional information, the CHX submitted a second letter regarding its proposal. See letter from Patricia L. Levy, CHX, to Mariane H. Duffy, SEC, dated January 27, 1999. In this letter, the CHX represented that 485 Nasdaq stocks are currently assigned to its specialists and due to the 500 issue limit, it had to drop 18 Nasdaq stocks. Additionally, the Exchange represented its capacity to handle the increase to 1000 issues and, further noted that despite a recent increase in volume, excess capacity remains. The CHX also represented that it is in the process of expanding its capacity. *Id.*

<sup>11</sup> See December 1998 Extension Order, *supra* note 5.

<sup>12</sup> See letter from Robert E. Aber, Senior Vice President and General Counsel, NASD, to Jonathan G. Katz, Secretary, Commission, dated February 12, 1999 ("NASD Letter"); letter from Gene L. Finn, Finn Associates, to Jonathan G. Katz, Secretary, Commission, dated February 11, 1999; letter from

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The NASD states that it opposes the expansion to 1000 securities. First, the NASD notes that over-the-counter market makers are not able to trade the most actively traded exchange listed securities and argues that it is still trying to obtain access to trading of non-19c-3 securities through the Intermarket Trading System/Computer Assisted Execution System ("ITS/CAES") linkage.<sup>13</sup> Second, the NASD raised concerns regarding autoquoting.<sup>14</sup> The NASD argues that the proposal could create significant message traffic in the Nasdaq system, as well as needless and avoidable capacity repercussions for Nasdaq. Moreover, the NASD believes that the proposal is not consistent with the Act because it believes that the expansion would not serve to achieve the goals of unlisted trading privileges since "data gathered by the NASD's Economic Research Department shows that a significant portion of the CHX specialist quotes are not competitive."<sup>15</sup> The NASD asserts that: CHX specialists are almost never at the national best bid/best offer ("NBBO") in the securities in which they make a market; CHX specialists account for a disproportionate number of quote updates; CHX specialists account for an insignificant portion of the volume in the securities in which they make a market; and CHX specialists have a disproportionately higher quote to trade ratio than Nasdaq market makers. For these reasons, the NASD concludes that permitting CHX specialists to trade an additional 500 securities might harm market quality. Finally, the NASD submitted statistical data regarding CHX and NASD volume in OTC/UTP securities, as well as quotation information concerning securities quoted under the Plan, to support its supposition to the proposal.

The CHX submitted a third letter responding to the NASD's comments.<sup>16</sup> In the third letter, the CHX provided statistical information to refute the position of the NASD. Further, the CHX addressed the NASD concerns regarding

Patricia L. Levy, Senior Vice President and General Counsel, CHX, to Jonathan G. Katz, Secretary, Commission, dated March 3, 1999 ("CHX Letter No. 3"); and letter from George T. Simon, Foley and Lardner, to Robert Colby, Deputy Director, Division of Market Regulation, Commission, dated April 1, 1999.

<sup>13</sup>See Securities Exchange Act Release No. 40260 (July 24, 1998), 63 FR 40748 (July 30, 1998) requesting comments on whether to extend the ITS/CAES linkage to non-19c-3 securities.

<sup>14</sup>See Autoquoting is the computerized updating of stock prices. The CHX allows its members to autoquote Plan securities. The NASD generally prohibits this conduct, in part to ensure adequate capacity. See NASD IM-4613.

<sup>15</sup>See NASD Letter, *supra* note 12.

<sup>16</sup>See Letter CHX Letter No. 3, *supra* note 12.

ITS/CAES, autoquote, and the goals of unlisted trading privileges. The CHX further noted that the Commission approved the previous expansion from 100 to 500 securities, notwithstanding similar comments from the NASD regarding ITS/CAES at that time. The CHX also challenged the validity of the NASD's capacity concerns resulting from the CHX member's use of autoquote.

The Commission does not find the NASD's arguments determinative and believes that it is appropriate at this time to expand the number of Nasdaq/NM securities that the CHX may trade under the Plan. As noted, the Commission has separately solicited comment on the issue of expanding the ITS/CAES linkage to non-19c-3 securities. Although CHX autoquoting substantially increases capacity burdens of Nasdaq, the Commission does not view these quotes as in themselves negative for the markets. Nor has the Commission received evidence that expanding the number of securities would otherwise have a negative effect on the markets or on the protection of investors. On the contrary, the Commission believes this expansion, from 500 to 1000 Nasdaq/MN securities has the potential to enhance competition and result in better executions for investors. The expansion should enhance the protection of investors and the public interest, further competition, increase the transparency of the markets, and is a prudent approach that will enable the Participants and the Commission to gain useful, instructive experience concerning operation of the Joint OTC/UTP Plan and its competitive effects, pending permanent approval of the Plan. In addition, the Commission notes that it will continue to monitor the CHX's ability to perform its responsibilities under the Joint Plan.

#### IV. Solicitation of Comment

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 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed amendment that are filed with the Commission, and all written communications relating to the proposed amendment 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. All submissions should refer to File No. S7-24-89 and should be submitted by June 11, 1999.

#### V. Conclusion

The Commission finds that it is consistent with Section 11A of the Act to increase the number of UTP-eligible Nasdaq/NM securities that the CHX may trade from 500 to 1000 securities.<sup>17</sup> In reviewing the proposal described herein, the Commission has considered the public trading activity in Nasdaq/NM securities, the character of the trading, the impact of the increase on the existing markets for the securities and the desirability of removing impediments to, and the progress that has been made towards, development of a national market system.<sup>18</sup> Specifically, the Commission believes that the expansion should increase transparency and serve to provide the Participants with additional information to evaluate the effects of the proposed course of action for the pilot program. This, in turn, should further the objectives of the Act in general, and specifically those set forth in Sections 12(f) and 11A of the Act and in Rule 11Aa3-1 and Rule 11Aa3-2 thereunder.

*It is therefore ordered*, Pursuant to Sections 12(f) and 11A of the Act and (c)(2) of Rule 11Aa3-2 thereunder, that the CHX's request to expand the number securities eligible for trading pursuant to the Joint Transaction Reporting Pan for Nasdaq/National Market securities traded on an exchange on an unlisted or listed basis is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41391]

### Notice of Intention To Cancel Registrations of Certain Transfer Agents

May 12, 1999.

Notice is given that the Securities and Exchange Commission ("Commission")

<sup>17</sup>The Commission has considered the proposal's impact on efficiency, competition and capital formation.

<sup>18</sup> 15 U.S.C. 781(f)(1)(E)(i) and (ii).

<sup>19</sup> 17 CFR 200.30-39a(29).