

amount of the Immediate Interest Payment will be retained if a Contract owner does not make a withdrawal of Contract value (including the exercise of the free-look right) before the first day of the second Contract year.

8. Applicants state that Valley Forge's right to recapture Immediate Interest Payments applied to purchase payments in the event of a withdrawal before the first day of the second Contract year, is designed to protect Valley Forge against Contract owners making large purchase payments in the first Contract year without affording it sufficient time to cover the cost of the Immediate Interest Payment, to its financial detriment. With respect to funds paid upon the return of Contracts within the free-look period, the amount payable by Valley Forge must be reduced by the allocated Immediate Interest Payment. Otherwise, Applicants state that purchasers could apply for Contracts for the sole purpose of exercising the free-look provision and making a quick profit.

9. Applicants submit that the provisions for recapture of any applicable Immediate Interest Payment under the Contracts or any Future Contract as set forth in this Application will not violate Sections 2(a)(32) and 27(i)(2)(A) of the 1940 Act. Nevertheless, to avoid any uncertainties, Applicants request an exemption from those Sections, to the extent deemed necessary, to permit the recapture of any Immediate Interest Payment under the circumstances described herein with respect to the Contracts and any Future Contracts, without the loss of the relief from Section 27 provided by Section 27(i).

10. Section 22(c) of the 1940 Act authorizes the Commission to make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, to accomplish the same purposes as contemplated by Section 22(a). Rule 22c-1 thereunder prohibits a registered investment company issuing any redeemable security, a person designated in such issuer's prospectus as authorized to consummate transactions in any such security, and a principal underwriter of, or dealer in, such security, from selling, redeeming, or repurchasing any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security.

11. Arguably, Valley Forge's recapture of the Immediate Interest Payment

might be viewed as resulting in the redemption of redeemable securities for a price other than one based on the current net asset value of VFL Separate Account. Applicants contend, however, that the recapture of the Immediate Interest Payment is not violative of Section 22(c) and Rule 22c-1.

Applicants argue that the recapture does not involve either of the evils that Rule 22c-1 was intended to eliminate or reduce, as far as reasonably practicable, namely: (1) the dilution of the value of outstanding redeemable securities of registered investment companies through their sale at a price below net asset value or their redemption or repurchase at a price above it, and (ii) other unfair results including speculative trading practices. To effect a recapture of an Immediate Interest Payment, Valley Forge will redeem interests in a Contract owner's Contract value at a price determined on the basis of current net asset value of VFL Separate Account. The amount recaptured will equal the amount of the Immediate Interest Payment that Valley Forge paid out of its general account assets. Although Contract owners will be entitled to retain any investment gain attributable to the Immediate Interest Payment, the amount of such gain will be determined on the basis of the current net asset value of VFL Separate Account. Thus, no dilution will occur upon the recapture of the Immediate Interest Payment. Applicants also submit that the second harm that Rule 22c-1 was designed to address, namely, speculative trading practices calculated to take advantage of backward pricing, will not occur as a result of the recapture of the Immediate Interest Payment. However, to avoid any uncertainty as to full compliance with the Act, Applicants request an exemption from the provisions of Section 22(c) and Rule 22c-1 to the extent deemed necessary to permit them to recapture the Immediate Interest Payment under the Contracts and Future Contracts.

Conclusion

Applicants submit that their request for an order is appropriate in the public interest. Applicants state that such an order would promote competitiveness in the variable annuity market by eliminating the need to file redundant exemptive applications, thereby reducing administrative expenses and maximizing the efficient use of Applicants' resources. Applicants argue that investors would not receive any benefit or additional protection by requiring Applicants to repeatedly seek exemptive relief that would present no

issue under the Act that has not already been addressed in the Application described herein. Applicants submit that having Applicants file additional applications would impair Applicants' ability effectively to take advantage of business opportunities as they arise. Further, Applicants state that if Applicants were required repeatedly to seek exemptive relief with respect to the same issues addressed in the application described herein, investors would not receive any benefit or additional protection thereby.

Applicants submit, based on the grounds summarized above, that their exemptive request meets the standards set out in Section 6(c) of the Act, namely, that the exemptions requested are necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act, and that, therefore, the Commission should grant the requested order.

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

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 00-11960 Filed 5-11-00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42759; File No. SR-PCX-99-39]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3, 4, 5, 6 and 7 to the Proposed Rule Change by the Pacific Exchange, Inc. Creating PCX Equities, Inc.

May 5, 2000.

I. Introduction

On October 7, 1999, the Pacific Exchange, Inc. ("PCX" 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" or "Exchange Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to create PCX Equities, Inc. ("PCX Equities"). The proposed rule change was published for comment in the **Federal Register** on December 6, 1999.³

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 42178 (Nov. 24, 1999), 64 FR 68136.

On November 24, 1999 and January 10, 2000, respectively, the PCX filed Amendment Nos. 1⁴ and 2⁵ to the proposal. On February 10, 2000, the PCX submitted Amendment No. 3 to the proposed rule change.⁶ On February 23, 2000, Amendment Nos. 1 and 2 were published in the **Federal Register**.⁷ On March 13, 2000, March 30, 2000, April 19, 2000, and May 1, 2000, the PCX submitted Amendment Nos. 4, 5, 6, and 7 respectively to the proposed rule change.⁸ The Commission received 26 comments regarding the proposal; all of the commenters supported the proposed rule change.⁹

This order approves the proposed rule change, as amended. In addition, the Commission is approving on an accelerated basis, and soliciting comments on, Amendment No. 3, 4, 5, 6 and 7.

⁴ See Letters from Brandon Becker, Wilmer, Cutler & Pickering, to Belinda Blaine, Associate Director, Division of Market Regulation ("Division"), SEC, dated November 24, 1999 and from Kathryn Beck, Senior Vice President, General Counsel and Corporate Secretary, PCX, to Kelly Riley, Attorney, Division, SEC, dated January 7, 2000 ("Amendment No. 1"). The January 7, 2000 letter contained the Form 19b-4 for Amendment No. 1.

⁵ See Letter from Brandon Becker, Wilmer, Cutler & Pickering, to Nancy J. Sanow, Senior Special Counsel, Division, SEC, dated January 7, 2000 ("Amendment No. 2").

⁶ See Letter from Brandon Becker, Wilmer, Cutler & Pickering, to Nancy J. Sanow, Senior Special Counsel, Division, SEC, dated February 9, 2000 ("Amendment No. 3"). In Amendment No. 3, the Exchange responded to comments and questions raised by the Division staff regarding the proposed rule change and amended certain proposed Rules of PCX Equities. In addition, the PCX submitted amendments to the proposed PCX Equities Certificate of Incorporation, the proposed PCX Equities Bylaws, the proposed PCX Equities Rules and the proposed PCX Rules. Finally, Amendment No. 3 contained a draft of the proposed shareholder's agreement.

⁷ See Securities Exchange Act Release No. 42419 (Feb. 11, 2000), 65 FR 9027.

⁸ See Letter from Cherie Macauley, Wilmer, Cutler & Pickering, to Nancy J. Sanow, Senior Special Counsel, Division, SEC, dated March 10, 2000 ("Amendment No. 4"); Letter from Brandon Becker, Wilmer, Cutler & Pickering, to Nancy J. Sanow, Senior Special Counsel, Division, SEC, dated March 29, 2000 ("Amendment No. 5"); Letter from Cherie Macauley, Wilmer, Cutler & Pickering, to Nancy J. Sanow, Senior Special Counsel, Division, SEC, dated April 18, 2000 ("Amendment No. 6"); and Letter from Cherie Macauley, Wilmer, Cutler & Pickering, to Nancy J. Sanow, Senior Special Counsel, Division, SEC, dated April 28, 2000 ("Amendment No. 7"). In Amendment No. 4, the Exchange amended the proposed PCX Constitution and selected proposed PCX Equities Rules. In Amendment No. 5, the Exchange amended selected proposed PCX Equities Rules and responded to comments raised by Division staff. In Amendment No. 6, the Exchange amended selected proposed PCX Equities Rules and proposed PCX Equities Equity Floor Procedure Advises. In Amendment No. 7, the Exchange amended selected proposed PCX Equities and PCX Rules, and incorporated into the proposed PCX rules the Plan of Delegation of Functions by the PCX to PCX Equities.

⁹ See *infra* note 30.

II. Description of the Proposal

The PCX proposes to create a Delaware stock corporation, to be called PCX Equities that will be a wholly-owned subsidiary of the PCX. PCX will transfer to PCX Equities all of the assets and liabilities that solely support the equities trading business and equities clearing business of the PCX. Upon restructuring, however, PCX will continue to be the self-regulatory organization ("SRO") for PCX Equities.¹⁰ The PCX proposes to authorize PCX Equities to issue Equity Trading Permits ("ETPs") and Equity Automated Systems Access Permits ("Equity ASAPs") that will entitle holders of the permits ("ETP Holders") and "Equity ASAP Holders") to trade equity securities on the newly-created PCX Equities. The proposal submitted by the PCX to create PCX Equities represent a significant departure from the Exchange's current structure.

According to the PCX, there are two principal reasons why the Exchange proposes to create the new PCX Equities subsidiary and to institute a system of trading permits. First, the PCX intends to separate the Exchange's equities operation into a subsidiary of PCX that will continue to share certain corporate functions with the Exchange's options business. By restructuring the equities business as a private stock corporation with business control and management by the directors, officers, and regulatory staff of PCX Equities, the Exchange believes that the new entity will have greater flexibility to develop and execute strategies designed to improve its competitive position than it has under the current membership structure. Second, the PCX intends to increase the revenue of its equities business by conferring trading privileges on the basis of trading permits (ETPs and Equity ASAPs), rather than requiring equities trading participants to bear the costs of a seat ownership.

PCX Equities will be run by its management with limited policy direction by members. As a result, certain committees that now administer many of the PCX's equity trading programs no longer exist. As discussed in more detail below, PCX Equities will have only three member committees: the Business Conduct Committee, the Member Advisory Committee, and the Nominating Committee. The management of PCX Equities will make all other business decisions regarding

the trading of equities on PCX Equities.¹¹

In other ways, the PCX Equities' structure represents significant changes to the way U.S. stock exchanges currently operate. As discussed below, PCX Equities will issue ETPs and Equity ASAPs to persons or entities that wish to engage in equity transactions on PCX Equities. These trading permits merely provide access to the PCX Equities' trading facilities and do not confer ownership rights on those persons or entities who purchase them. Accordingly, with certain exceptions discussed below, PCX Equities members will have limited voting rights and limited input into the administration of the affairs of PCX Equities.

The proposed rule change for implementing the restructuring includes: (i) The proposed Certificate of Incorporation for PCX Equities; (ii) the proposed Bylaws for PCX Equities; (iii) the proposed Rules for PCX Equities; (iv) changes to the PCX Constitution; and (v) changes to the PCX Rules.

A. PCX Equities

1. Corporate Status

PCX Equities will be created operates as a Delaware stock corporation. At this time, all of the issued shares of stock of PCX Equities will be owned by the PCX. Current PCX members will retain their memberships, and thus, their ownership interests in the PCX.

2. Regulation of PCX Equities

PCX Equities will operate as a subsidiary of PCX, which is a national securities exchange registered under Section 6 of the Act.¹² The PCX, as the SRO, retains ultimate responsibility for compliance by its members with the provisions of the Act and the rules and regulations thereunder. For this reason, ETP Holders and Equity ASAP Holders will be considered statutory "members" of PCX.

As a registered national securities exchange and the parent company of PCX Equities, the PCX will continue to carry out its statutory responsibilities to enforce compliance by ETP Holders and Equity ASAP Holders with the provisions of the federal securities laws and rules thereunder, as well as the Rules of PCX Equities, and to govern the administration of PCX Equities. In particular, to be effective any changes to the Rules and governing documents of

¹¹ For example, the management of PCX Equities will make decisions regarding the listing and delisting of equities listed on PCX Equities, although such decisions may be appealed to the PCX Equities Board Appeals Committee.

¹² 15 U.S.C. 78f.

PCX Equities must be approved by the PCX. Moreover, filing of changes to PCX Equities' Bylaws and Rules with the Commission pursuant to Section 19(b) of the Act¹³ and Rule 19b-4¹⁴ thereunder must be submitted by the PCX.

While ultimately responsible, the PCX has proposed to delegate specific self-regulatory responsibilities to PCX Equities, pursuant to a Delegation Plan.¹⁵ Specifically, PCX Equities will assume responsibility with respect to the equities business of the Exchange for, among other things: (i) Establishing and interpreting rules governing the activities of ETP Holders and Equity ASAP Holders; (ii) determining regulatory and trading policies relating to the business activities of ETP Holders and Equity ASAP Holders; (iii) assuring compliance with PCX Equities Rules and the federal securities laws; (iv) administering surveillance programs and systems and enforcing rules governing the conduct and trading activities of ETP Holders, ETP Firms,¹⁶ Equity ASAP Holders and their associated persons on PCX Equities; (v) examining and investigating ETP Holders, ETP Firms, Equity ASAP Holders and their associated persons to determine if they have violated the Rules of PCX Equities or the federal securities laws; (vi) administering the PCX Equities disciplinary program; (vii) conducting arbitrations, mediations and other dispute resolution programs; (viii) determining whether applicants need the requirements for holding an ETP or Equity ASAP; (ix) reviewing qualifications of persons wishing to register as associated persons of ETP Holders, ETP Firms, or Equity ASAP Holders; (x) placing restrictions on the business activities of ETP Holders, ETP Firms, Equity ASAP Holders and their associated persons consistent with the public interest, the protection of investors and the federal securities laws; (xi) establishing fees and changes; (xii) overseeing the operation of the PCX Equities trading facilities; (xiii) maintaining a communications network infrastructure for processing quotes, orders, transaction reports and

transaction comparisons; (xiv) collecting and consolidating information for the surveillance audit trail; (xi) developing and adopting rule changes for the collection, processing and dissemination of quote and transaction information; (xvi) developing and adopting rules, interpretations and policies to maintain and enhance the integrity, fairness, efficiency and competitiveness of PCX Equities; (xvii) administering the Exchange's involvement in the national market system ("NMS") plans; and (xviii) developing, administering and enforcing listing standards for securities traded on PCX Equities.

While PCX Equities has extensive delegated authority to administer and manage the equities trading business, the PCX retains the ultimate responsibility for the Rules and regulations of PCX Equities, as well as for its operation and administration. As part of its self-regulatory responsibilities, the PCX will review rulemaking and disciplinary decisions of PCX Equities and direct PCX Equities to take action that may be necessary to effectuate the purposes and functions of the Exchange Act. Thus, while PCX Equities will be a separate entity, it will still remain under the self-regulatory authority of the PCX.

3. Governing Documents and Rules

PCX Equities' Certificate of Incorporation, Bylaws and Rules will govern its activities. Proposed PCX Equities Rules 1, 2, and 3, which relate to qualifications for ETPs and Equity ASAPs and corporate governance matters, and proposed PCX Equities Rule 10, which relates to disciplinary procedures, reflect significant departures from existing PCX rules. The remaining Rules, although modified to reflect the issuance of ETPs and Equity ASAPs and the revised management structure, are similar to current PCX Rules. The Rules and Bylaws will reflect the status of PCX Equities as a wholly-owned subsidiary of PCX, under management of the PCX Equities Board of Directors ("PCX Equities Board") and its designated officers, and ultimately subject to the self-regulatory authority of the PCX.

4. PCX Equities Board of Directors

The PCX Equities Board will consist of no fewer than 10 or more than 12 directors. Currently, the Exchange contemplates that there will be 10 directors. The composition of the PCX Equities Board will be as follows:

- The Chief Executive Officer ("CEO") of PCX;
- The President of PCX Equities;

- Five public directors, at least three of whom must also be members of the Board of Governors of the PCX ("PCX Board");

- One allied person¹⁷ from an ETP Firm who is also a member of the PCX Board, and

- Two nominees of ETP Holders and Equity ASAP Holders (the "ETP/Equity ASAP Holder Directors").

The CEO of PCX, as the Incorporator, will appoint the initial PCX Equities Board. Subsequently, the PCX Equities Board will be nominated by the sitting PCX Equities Board, subject to the nominating procedures set forth below for the selection of two ETP/Equity ASAP Holder Directors. The PCX Equities Board will be elected by PCX, the sole shareholder. PCX will have the right to approve, remove, and replace any member of the PCX Equities Board by virtue of its status as sole shareholder, subject to the Bylaws. Any vacancy on the PCX Equities Board will be filled with a person who satisfies the classification associated with the vacant seat, *i.e.*, a member of the public or an ETP Holder or Equity ASAP Holder. To the extent that the number of PCX Equities Board seats is changed from the initially contemplated 10 members, at least 50 percent of the PCX Equities Board must be public directors, and at least 20 percent (but no fewer than two directors) must be directors who are ETP Holders or Equity ASAP Holders and are nominated by the Nominating Committee. The ETP/Equity ASAP Holder Directors will be nominated by the Nominating Committee or by petition of at least 10 percent of all ETP Holders and Equity ASAP Holders. If a petition is submitted, and a vote is held, the candidates selected by ETP Holders and Equity ASAP Holders must be supported by a plurality of all the ETP Holders and Equity ASAP Holders in the aggregate in order to be selected as a nominee to the PCX Equities Board. If no petition is filed, the nominees put forward the Nominating Committee will be deemed to be elected, and no separate vote of ETP Holders and Equity ASAP Holders will be held. Pursuant to a stockholders voting agreement, the PCX, as the sole stockholder, will agree to elect the ETP/Equity ASAP Holder Directors nominated by the PCX Equities Nominating Committee.¹⁸

¹⁷ An allied person is generally defined as a control person that is actively involved in the business of an ETP Firm or Equity ASAP Holder. See proposed PCX Equities Rule 1.1(b).

¹⁸ See Attachment No. 5 to Amendment No. 3, for the proposed Shareholder's Agreement, which requires the PCX to elect the slate submitted by the PCX Equities Nominating Committee.

¹³ 15 U.S.C. 78s(b).

¹⁴ 17 CFR 240.19b-4.

¹⁵ See Attachment No. 4 to Amendment No. 1, for the proposed Plan of Delegation of Functions by the PCX to PCX Equities ("Delegation Plan").

¹⁶ An ETP may be issued to either an individual or an entity, both of which must be registered broker-dealers pursuant to Section 15 of the Act. If an ETP is issued to an entity ("ETP Firm"), the firm must nominate an individual, approved by PCX Equities, to conduct business on PCX Equities' facilities. Such individual is also referred to as an ETP Holder. See proposed PCX Equities Rules 1.1(l) and (m).

5. Representation on PCX Board of Governors

The PCX Board is currently composed of 22 governors. The composition of the PCX Board will be modified as part of the restructuring to include one governor representing PCX Equities to provide input on the PCX Board. This governor ("ETP/Equity ASAP Holder Governor") will be nominated by the PCX Equities Nominating Committee or by a petition of at least 10 percent of all ETP Holders and Equity ASAP Holders and must be either an ETP Holder, an Equity ASAP Holder or an allied person of an ETP Firm or Equity ASAP Holder. Pursuant to the agreement between PCX Equities and the PCX, the PCX Board will appoint the person who is so nominated by ETP Holders and Equity ASAP Holders to the PCX Board.¹⁹

6. Committees

As discussed above, the PCX has proposed to eliminate its current committee structure for its equities business. The proposed Bylaws and proposed Rules of PCX Equities envision only three equity committees—the Nominating Committee, the Member Advisory Committee,²⁰ and the Business Conduct Committee.²¹ Except for the Nominating Committee, the CEO of PCX Equities will appoint the members of the equity committees for terms of one year. The CEO of PCX Equities also will appoint the Chair and Vice Chair of each equity committee. ETP Holders, Equity ASAP Holders, and public representatives may be appointed to serve on the equity committees.

a. *Nominating Committee.* The Nominating Committee will select two nominees for the ETP/Equity ASAP positions on the PCX Equities Board and one nominee for ETP/Equity ASAP position on the PCX Board. These nominees may be ETP Holders, allied persons²² of ETP Firms, or Equity ASAP Holders. The nominee for the PCX Board may be the same person as one of the nominees for the PCX Equities Board. The Nominating Committee will have seven members, six of whom will represent ETP Holders or Equity ASAP Holders. The composition of the Nominating Committee will represent proportionally²³ all ETP Holders and Equity ASAP Holders with each

member constituency having at least one representative. The seventh member will be a representative of the public. The Incorporator will appoint the initial Nominating Committee. Thereafter, the sitting Nominating Committee will nominate the six member representatives, and the PCX Equities CEO will appoint the public representative. Additional candidates for the Nominating Committee may be put forward by a petition of at least 10 percent of all ETP Holders and Equity ASAP Holders. If no petition is filed, the slate proposed by the sitting Nominating Committee will be deemed to be approved by ETP Holders and Equity ASAP Holders, and no separate vote of ETP Holders and Equity ASAP Holders will be held. If a petition is filed, the members will vote on the candidates for each position. A plurality will be needed for selection.²⁴

b. *Business Conduct Committee.* The Business Conduct Committee will have authority over the disciplinary process of the PCX Equities. It will be responsible for examining the business conduct and financial condition of PCX Equities members. Further, it will conduct hearings and render decisions in summary disciplinary proceedings. The Business Conduct Committee will be responsible for imposing sanctions for violations within the disciplinary jurisdiction of the PCX Equities. Finally, the Business Conduct Committee will require members to produce financial and operational reports. The Business Conduct Committee will have a proportional²⁵ composition of ETP Holders and Equity ASAP Holders, with a minimum of one representative from each member constituency.

c. *Member Advisory Committee.* The Member Advisory Committee will be responsible for advising the management of PCX Equities regarding disciplinary matters and off-board trading rules. As an equity committee, it will be subject to the provisions of proposed Rule 3.2. Thus, the Incorporator will appoint the initial members and the CEO of PCX Equities will appoint all subsequent members.

d. *Board Appeals Committee.* In addition to the equity committee, PCX Equities is proposed to have one Board committee, the Board Appeals Committee. The Board Appeals

Committee will be responsible for hearing appeals of Business Conduct Committee decisions, listing and delisting decisions made by the PCX Equities management, and sanctions imposed on members by the PCX Equities regulatory staff. The PCX Equities Board will appoint directors to serve on the Board Appeals Committee and may create any other Board committee it deems appropriate. Each Board Appeals Committee will consist of at least one public director and at least one ETP/Equity ASAP Holder Director.

7. Management

PCX equities will have a Chairman of the Board and a President, either of whom may be the CEO of PCX Equities. In addition, PCX Equities will have a Secretary and a Chief Regulatory Officer who will be appointed by, and serve at the pleasure of, the PCX Equities Board. The officers of PCX Equities will manage the business and affairs of PCX Equities, subject to the oversight of the PCX Equities Board, and, in some cases, subject to the approval of PCX as the sole stockholder and SRO.

8. Disciplinary Process

PCX Equities' disciplinary process will be similar to the existing PCX disciplinary process. The PCX Equities Chief Regulatory Officer, or his or her staff, will authorize the initiation of disciplinary actions and proceedings. The Business Conduct Committee will conduct hearings, render decisions, and impose sanctions. Decisions of the Business Conduct Committee may be appealed for review to the Board Appeals Committee. Decisions of the Board Appeals Committee may be appealed to the PCX Board. In addition, the PCX Board may on its own initiative order a review of any Board Appeals Committee decision. The decision of the PCX Board (or, if the PCX Board chooses not to hear an appeal, the decision of the Board Appeals Committee) shall be considered the final action of the Exchange. Thus, an aggrieved member may seek review of the Exchange's decision by the Commission.

9. Equity Listings and Delistings

The management of PCX Equities will list and delist securities in accordance with rules and standards comparable to those set forth in the PCX Rules and currently used by the Equity Listing Committee of the PCX. However, as described above, PCX Equities will not have the committee structure currently used by the PCX for decision-making, and, thus PCX Equities' management

¹⁹ See *id.*

²⁰ See Amendment No. 6 *supra* note 8.

²¹ However, the PCX Equities Board may appoint other committees as it deems appropriate.

²² See *supra* note 17.

²³ For example, if Equity ASAPs represent 34 percent of the total number of trading permits issued by PCX Equities, then Equity ASAPs will be entitled to two positions.

²⁴ Only those persons that hold either an ETP or Equity ASAP will have voting privileges. Thus, ETP Firms do not have a vote separate from their ETP. An ETP Holder that is nominated by an ETP Firm will cast its firm's vote.

²⁵ See *supra* note 23. The proportional composition of the Business Conduct Committee will be determined in the same manner as the Nominating Committee.

will make all decisions regarding listings and delistings.²⁶

10. Financial Information

PCX will transfer all of the assets and liabilities that solely support the equities business or equities clearing business to PCX Equities. Assets that support both the options and equities business will be retained as assets of PCX. Costs related to these shared assets will appear as inter-company charges to PCX Equities and will be defined in an agreement between PCX and PCX Equities.

Revenue generated by the equities activities, including ETP and Equity ASAP fees, specialist fees, tape fees and transaction fees, will accrue to PCX Equities. Direct expenses related to the equities activities, such as technology and personnel, will be charged to PCX Equities. Allocations of the cost of certain technology, regulatory and corporate functions will be charged to PCX Equities pursuant to an agreement between PCX Equities and PCX.

11. Agreement Between PCX and PCX Equities

Currently, the PCX's equities and options operations share certain infrastructure and personnel. After the completion of the restructuring, these shared assets will remain the property of PCX and the shared personnel will continue to be employed by PCX. In each case, however, PCX Equities will have access to those resources through inter-company contracts with PCX. In particular, PCX will contract to provide PCX Equities with certain management and support services and staff. The contract will include services for administration, membership, technology, finance and accounting, human resources and legal services. The agreement between PCX and PCX Equities will allocate charges for these services and staff between PCX and PCX Equities.

B. Equity Trading Permits and Equity ASAPs

1. Classes of Trading Permits and Privileges Conferred by ETPs and Equity ASAPs.

PCX Equities will be authorized to issue two types of equity trading permits: ETPs and Equity ASAPs. ETPs will authorize holders to trade equity securities on any facility of PCX Equities, including the trading floors, P/COAST, or Optimark, as a specialist, floor broker, or order flow firm. ETP Holders may engage in the trading of

equities in the same manner as currently practiced by PCX members who trade on the equity floors. Equity ASAP Holders, like current ASAP members, will have electronic access to PCX Equities via P/COAST, Optimark, and any other system approved by the PCX Equities Board, and will be entitled to limited trading privileges on the equities floor, in accordance with rules comparable to those set forth in the PCX Rules today.²⁷

An ETP or Equity ASAP does not grant its holder any right to trade options on the PCX. Any ETP Firm, ETP Holder or Equity ASAP Holder that wishes to trade options must be approved for and obtain a PCX membership pursuant to the PCX's standard application procedures.

ETP Holders and Equity ASAP Holders will have limited voting rights²⁸ and may nominate, through the Nominating Committee or by petition, two members to the PCX Equities Board and one member of the PCX Board. Unlike current ASAP members, Equity ASAP Holders will have these limited voting rights. ETPs and Equity ASAPs provide access to PCX Equities but do not confer ownership rights. Thus, neither ETP Holders nor Equity ASAP Holders will have any distribution or other ownership rights in PCX Equities or PCX by virtue of their status as an ETP Holder or Equity or ASAP Holder, or as a member of PCX.²⁹

2. Qualification for ETPs and Equity ASAPs

There will be no limit on the number of ETPs and Equity ASAPs issued by PCX Equities. PCX Equities will commence issuing ETPs and Equity ASAPs once the subsidiary is created. Current PCX members, PCX ASAP members, and any other interested persons or entities that are registered broker-dealers, may be granted PCX Equities trading permits through an application process. ETP and Equity ASAP qualifications will be substantially the same as the existing requirements for PCX membership and PCX ASAP membership, respectively.

The application process for applicants who are not current PCX members or ASAP members will be the same as the

PCX's current process. The decision to grant or deny an application for trading privileges will be made by officers of PCX Equities. The decision to deny an application may be reviewed by the Board Appeals Committee in accordance with the provisions of proposed PCX Equities Rule 10.

Current PCX members and ASAP members will be required to submit an application and pay the applicable fee, but less documentation will be required and the application processing time will be shorter.

3. ETP/Equity ASAP Rollout Process

The Exchange has proposed a nine-month rollout period during which equity specialists, floor brokers, their firms, and PCX seat owners may decide to convert to ETPs and current ASAP members can decide to convert to Equity ASAPs. The monthly fee be charged for ETPs during the rollout period will be closely correlated, but discounted, to the current prevailing monthly lease rate for PCX memberships and will decrease proportionately over that period until it reaches \$2,000 per month in the tenth month following inception. Equity ASAP Holders will be charged an annual fee of \$4,000.

During the rollout period, both PCX members and ETP Holders will be permitted to trade equities on the equity trading floors of the PCX. Similarly, both ASAP holders and Equity ASAP Holders will be provided automated system access as set forth in the proposed PCX Equities Rules.

At the end of the rollout period, all individuals executing equity trades through PCX Equities must hold either an ETP or an Equity ASAP. After the rollout period, PCX memberships will no longer confer rights to trade, to route orders, or to be a clearing give-up through the equity trading facilities of PCX Equities.

4. Cost of ETPs and Equity ASAPs

The fees for an ETP will be assessed on a monthly basis and the fee for an Equity ASAP will be assessed on a yearly basis. The fees will be set by PCX Equities at a fixed level but will be subject to change.

The management of PCX Equities will recommend changes to the initial rates and charges as deemed appropriate for the development of new business or in response to competitive changes. All such rate changes shall be subject to the approval of the PCX Board and filing with the Commission.

²⁶ Issuers will continue to have a right of appeal, as set forth in proposed PCX Equities Rules 5.5(m).

²⁷ Pursuant to proposed PCX Equities Rule 2.16, Equity ASAP Holders must execute 80 percent of their total trades and volume on PCX Equities through P/COAST, Optimark or other systems approved by PCX Equities. The balance of their total volume and trades on PCX Equities can be entered by telephone to a floor broker located in a firm booth on the trading floor.

²⁸ See *supra* note 24.

²⁹ As described further below, ETP Holders and Equity ASAP Holders are considered members of the PCX for statutory purposes. See *infra* Section IV.

5. Non-transferability of ETP and Equity ASAPS

ETPs and Equity ASAPS will not be transferable by sale or lease, but they may be transferred between individuals within the same firm in accordance with the proposed Rules of PCX Equities.

C. PCX

1. Options Trading

Current PCX members who made only equities or who trade equities and options of the PCX must obtain either an ETP or Equity ASAP by the end of the rollout period as described above. For those PCX members who currently trade only options on the PCX, the proposed restructuring will not affected their access to or activities on the PCX's options trading facilities. PCX memberships will continue to be required to transact options business on PCX. After the rollout period, however, PCX memberships will no longer confer rights to trade on the equity floors or electronically through the equity trading facilities or to be a clearing give-up for the equity trading facilities. After the completion of the restructuring, PCX memberships may be purchased, sold, or leased as they are today. The rights of PCX members upon the liquidation of PCX will remain unchanged.

2. National Market System Plans

The PCX currently is a participant in various NMS plans, including the Consolidated Tape Association ("CTA") Plan, the Consolidate Quotation System ("CQS") Plan, the Intermarket Trading System ("ITS") Plan and the Options Price Reporting Authority ("OPRA"). These plans are joint industry plans for SROs that address last sale reporting, quotation reporting, intermarket trading, and options last sale and quote reporting, respectively. Following the creation of PCX Equities, PCX, in its continuing role as the SRO, will continue to serve as the voting member of these NMS Plans. Nevertheless, PCX expects that, for those plans that relate to equity trading, *i.e.*, the CTA Plan, the CQS Plan and the ITS Plan, a PCX Equities representative will serve as the PCX's representative in dealing with these plans.

III. Summary of Comments

The Commission received 26 comment letters on the proposal. All 26 commenters supported the proposal to create PCX Equities.³⁰ Many

commenters believe that the proposed structure will allow PCX to better compete with alternative trading venues and that the restructuring is critical to restore the PCX's equities trading business to profitability.

IV. Discussion

After careful review, 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.³¹ In particular, the Commission believes that the proposal is consistent with the requirements of Sections 6(b)(1), 6(b)(2), 6(b)(3), 6(b)(4), 6(b)(5), 6(b)(6), 6(b)(7), and 6(b)(8).³²

This proposal represents a significant departure from the traditional member-based exchange structure. The PCX proposes to institute a new framework by creating a separate corporation, PCX Equities, to house its equities trading and related clearing functions. In moving to a corporate structure for its

December 23, 1999; Douglas Rountree, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Scott Elisha, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Robert Pagnini, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Jeffrey C. Hauke, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Donald M. Abramson, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Kenneth Fong, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Ronald Chin, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Ray Crown, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Douglas J. Engmann, President and CEO, ABN-AMRO, to Jonathan G. Katz, Secretary, SEC, dated December 28, 1999; Robert G. Kirby, Capital Guardian Trust Co., to Jonathan G. Katz, Secretary, SEC, dated December 22, 1999; Craig A. Resnick, to Jonathan G. Katz, Secretary, SEC, dated December 30, 1999; Allan Leong, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; John W. Brown and L. Matthew Adams, Managing Members, M.J.T. Securities, LLC, to Jonathan G. Katz, Secretary, SEC, dated December 27, 1999; Douglas Gooding, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Edward Doherty, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Larry Colvin, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Richard and Vivian Chapnick, Members, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Mark Gattly, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Dr. Martin Jansen, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Sheldon Cohen, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Edward Hager, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Daniel A. Gooze, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Joseph Breger, Member, PCX, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999; Carol O'Neill, to Jonathan G. Katz, Secretary, SEC, dated December 21, 1999.

³¹ In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³² 15 U.S.C. 78f(b)(1)-(8).

equities business, PCX will not confer on its equity trading participants the exact same rights and benefits that otherwise accrue to existing Exchange members. In lieu of memberships, PCX Equities will issue trading permits, *i.e.*, ETPs and Equity ASAPS, to those persons and entities that wish to effect transactions in equity securities on the Exchange's trading floors or facilities. Instead of an ownership right in the Exchange that may be bought, sold, or leased, a trading permit will provide its holder solely with the ability to trade equity securities on PCX Equities or through its facilities.

Traditionally, national securities exchanges have been structured as membership organizations. While this type of organization has proved suitable for the exchanges over the years, the Commission clarified in the ATS Release³³ that other structures could also satisfy the requirements of the Act. The Commission has considered the issues raised under the Act by PCX Equities' proposed corporate structure and its issuance of trading permits and finds that the proposal is consistent with the requirements of the Act.

As discussed further below, while PCX is proposing to delegate some of its responsibilities and functions to PCX Equities, as the statutory SRO and registered exchange PCX will remain ultimately responsible for the activities of PCX Equities and its ETP and Equity ASAP Holders. Moreover, the structure and rules of PCX Equities assure fair representation of the ETP and Equity ASAP Holders, consistent with the Act.

A. PCX Responsibilities and Delegation of Self-Regulatory Authority

Although ETPs and Equity ASAPS are not like the traditional memberships of the Exchange, the holders of such permits are considered members of the PCX for purposes of the Act.³⁴ In proposed PCX Equities Rules 1.1(l) and (j), ETP Holders and Equity ASAP Holders have been specifically defined as members of the PCX consistent with Section 3(a)(3)(A) of the Act.³⁵ Section 3(a)(3)(A) defines a member with respect to a national securities exchange as a natural person who is permitted to effect transactions on the floor of an exchange without the services of another person acting as a broker, any

³³ See *Regulation of Exchanges and Alternative Trading Systems*, Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) ("ATS Release").

³⁴ In this order, the term "member" refers to an ETP Holder, ETP Firm or an Equity ASAP Holder, which are considered statutory members of the PCX for purposes of the Act.

³⁵ 15 U.S.C. 78c(a)(3)(A).

³⁰ See Letters from Arnold Staloff, President and CEO, Bloom Staloff, to Jonathan G. Katz, Secretary, SEC, dated December 17, 1999; Leopold Korins, President and CEO, Securities Traders Association, to Jonathan G. Katz, Secretary, SEC, dated

registered broker or dealer with which such natural person is associated, or any other registered broker-dealer that agrees to be regulated by the Exchange. Thus, as members of the PCX, ETP Holders and Equity ASAP Holders and their related firms and associated persons will be subject to the self-regulatory authority of the PCX.

As part of its restructuring proposal, PCX has filed with the Commission a Delegation Plan, pursuant to which the PCX proposes to delegate to PCX Equities certain self-regulatory functions and responsibilities.³⁶ PCX, however, retains ultimate self-regulatory authority over decisions made and policies implemented by PCX Equities pursuant to the Delegation Plan, and the PCX remains the SRO responsible for the statutory obligations under the Act.³⁷ The Exchange proposes that the Delegation Plan become part of the Rules of the PCX and, thus, may only be amended upon Commission approval.³⁸

Upon approval of this proposal, PCX Equities will have the delegated authority to, among other things, determine regulatory and trading policies relating to the business conduct and trading activities of ETP Holders, Equity ASAP Holders, and associated persons, develop and adopt necessary and appropriate rule changes, monitor the qualifications of ETP Holders, ETP Firms and Equity ASAP Holders, initiate disciplinary actions to assure compliance with the Rules and procedures of PCX Equities and the federal securities laws, establish and assess fees, and oversee the operation of PCX Equities' trading facilities.

The Commission finds that the PCX's plan of delegation is consistent with the requirements of Section 6(b)(1) of the Act, which requires that an exchange be organized and have the capacity to carry out the purposes of the Act.³⁹ While the PCX has delegated many of its responsibilities to PCX Equities, it retains ultimate responsibility for ensuring that its equities business is conducted in a manner consistent with the requirements of the Act. Under the Delegation Plan and the Rules of the Exchange, PCX will continue to carry out its statutory responsibilities to enforce compliance by ETP Holders and

Equity ASAP Holders, as members of the Exchange, with the Rules of PCX Equities and the federal securities laws and regulations, and will continue to have ultimate responsibility for the administration and enforcement of rules governing the operation of the equities trading business.

PCX also will continue to review and submit to the Commission any proposed changes to PCX Equities' Rules.⁴⁰ In addition, PCX will retain the authority to review disciplinary and other regulatory decisions of PCX Equities. These types of checks and balances should ensure that the PCX remains aware of the affairs of its equities business conducted through PCX Equities, and that its equities business is conducted in a manner consistent with the Act.

B. Corporate Structure and Governance of PCX and PCX Equities

1. PCX Equities Board of Directors

As a separate corporate entity, PCX Equities will have its own board of directors and officers that will administer its day-to-day operations. The Commission believes that the PCX Equities' proposed corporate structure is consistent with the Act.

Under Section 6(b)(3) of the Act,⁴¹ the rules of an exchange must assure that its members are fairly represented in the selection of its directors and in the administration of its affairs. Section 6(b)(3)'s fair representation requirement allows statutory members to have a voice in an exchange's use of its self-regulatory authority. Moreover, this statutory requirement helps to ensure that members are protected from unfair, unfettered actions by an exchange pursuant to its rules, and that, in general, an exchange is administered in a way that is equitable to all those who trade on its market or through its facilities.

In traditional exchanges, the fair representation requirement is easily satisfied because most members, as owners of the exchange, vote for the governing board, which, in turn, administers the activities of the exchange. Thus, the majority of members have a voice in all aspects of exchange governance and decision-making, including disciplinary rules, disciplinary appeals, and any exchange rules governing trading off the exchange.

⁴⁰ The PCX Board must review and ratify all PCX Equities proposed rule changes before they are submitted to the SEC. See Delegation Plan, *supra* note 15, and proposed PCX Equities Rule 3.4.

⁴¹ 15 U.S.C. 78f(b)(3).

In comparison, a demutualized exchange that is organized as a corporation (as in the case of PCX Equities), by definition, is characterized by the separation of the ownership interest in the exchange from the right to trade. Thus, such exchanges must find alternative ways to ensure that those persons or entities that trade on the exchange without owning an interest in the exchange have a voice in the selection of directors and the administration of the exchange. Otherwise, the governing body potentially could use its self-regulatory authority to act solely in its own commercial interest, to the detriment of members.

In addition, to make sure that the public interest is adequately represented in an exchange's decision-making process, Section 6(b)(3) of the Act⁴² states that an exchange's rules must provide that one or more of its directors be representative of issuers and investors, and not associated with a member of the exchange, or with any broker-dealer.

The Commission finds that the PCX Equities' Board, as proposed by PCX, is structured in a manner that satisfies both the fair representation and public participation requirements of Section 6(b)(3) of the Act.⁴³ As noted above, the PCX proposes that the PCX Equities Board shall consist of no fewer than 10 and no more than 12 directors. The composition is currently contemplated to be: (i) The CEO of PCX; (ii) the President of PCX Equities;⁴⁴ (iii) five public directors, at least three of whom must also be members of the PCX Board; (iv) one allied person from an ETP Firm who is also a member of the PCX Board; and (v) two ETP/Equity ASAP Holder Directors.

Regardless of the size of the PCX Equities Board, at least 20 percent of the seats, but in no event fewer than two seats, must be nominated and held by PCX Equities members (*i.e.*, ETP or Equity ASAP Holders).⁴⁵ PCX also proposes to amend the composition of its Board of Governors to include a Governor position for an ETP Holder or Equity ASAP Holder.⁴⁶ PCX Equities members therefore will have input in

⁴² *Id.*

⁴³ *Id.*

⁴⁴ Employees of PCX Equities and PCX are classified as industry members.

⁴⁵ See proposed PCX Equities Bylaws, Article III, Section 3.02(a).

⁴⁶ See proposed PCX Constitution, Article III, Section 2(b).

³⁶ See *supra* note 15.

³⁷ The Commission notes that the PCX will be the sole shareholder of the PCX Equities. If the PCX's interest in PCX Equities is diluted in the future by, among other things, the sale of additional interests to other persons or entities, PCX Equities may be required to register as an exchange in its own right, pursuant to Section 6 of the Act. The Commission expects the PCX to notify the Commission before its interest in PCX Equities is in any way diminished.

³⁸ See Amendment No. 7, *supra* note 8.

³⁹ 15 U.S.C. 78f(b)(1).

the administration of the affairs of PCX Equities and the Exchange.⁴⁷

In addition, the PCX Equities Board, as proposed, contains 50 percent public representation. The PCX has proposed that a public director be defined as a person not affiliated with a broker or dealer. This definition is consistent with the definition currently found in the PCX Constitution.⁴⁸ While the Commission is satisfied that this definition is consistent with the Act, it encourages the PCX to consider amending this definition in the future to exclude those persons that may have a material business relationship with the Exchange or PCX Equities.⁴⁹

The Commission has previously stated its belief that the inclusion of public, non-industry representatives on exchange oversight bodies is critical to make certain that an exchange actively works to protect the public interest in the exchange governance process.⁵⁰ Further, public representatives help to ensure that no single group of market participants has the ability to systemically disadvantage other market participants through the exchange governance process. The Commission believes that public directors can provide unique, unbiased perspectives, which should enhance the ability of the PCX Equities Board to address issues in a non-discriminatory fashion and foster the integrity of PCX Equities. In this way, the public directors may help to prevent unfair discrimination between customers, issuers, brokers, or dealers in the administration of PCX Equities, and protect investors and the public interest, consistent with the provisions Section 6(b)(5) of the Act.⁵¹

2. PCX Equities' Committees⁵²

In an effort to streamline its management, the PCX has proposed to eliminate many of the committees currently used in the administration of the affairs of PCX's equities activities. PCX Equities will have four committees,

which will provide limited member involvement in the administration of the day-to-day operations of the Exchange.⁵³ Specifically, there will be a Nominating Committee, a Business Conduct Committee, and a Member Advisory Committee. In addition, PCX Equities will have one Board committee, the Board Appeals Committee.

a. *Nominating Committee.* The Nominating Committee of PCX Equities will be responsible for the selection of the ETP/Equity ASAP Holder Directors and the ETP/Equity ASAP Holder Governor. Under the PCX's proposal, the PCX Equities Nominating Committee will nominate two candidates for the PCX Equities Board and one candidate for the PCX Board.⁵⁴ These candidates will represent ETP Holders and Equity ASAP Holders on the respective Boards. The Nominating Committee will consist of seven members, six of whom will be ETP Holders or Equity ASAP Holders or allied persons of ETP Firms or Equity ASAP Holders and one of whom will be a member of the public. Each member constituency (*i.e.*, ETP Holders and Equity ASAP Holders) must have representation on the Nominating Committee that is equal to or greater than its percentage representation among all trading permit holders, with a minimum of one representative from each member constituency.⁵⁵

Each year, the Nominating Committee will propose a slate of two eligible candidates for the PCX Equities Board and one eligible candidate for the PCX Board.⁵⁶ The slate put forth by the Nominating Committee will automatically be deemed to be selected by the members of PCX Equities without an actual vote. Members, however, will be able to submit additional candidates by way of petition. If 10 percent of all PCX Equities members counted as a single unit support an additional candidate, such candidate will be added to the slate and an actual member vote will be held to select the two nominees for the PCX Equities Board, or the one

nominee for the PCX Board, or the nominees for both Boards, as the case may be.

The Commission finds that the composition of the Nominating Committee is consistent with the requirements of Section 6(b)(3) of the Act.⁵⁷ Because the Nominating Committee is responsible for selecting member representatives for the PCX Equities Board and the PCX Board, its composition should generally reflect the composition of the members (*i.e.*, the users) of the exchange. The Commission finds that the PCX Equities Nominating Committee's composition assures that both ETP Holders and Equity ASAP Holders will be represented in the selection of their PCX Equities Board and PCX Board representatives by providing that each constituency is proportionally represented, with a minimum of one person from each constituency.

Further, the Commission believes that the selection process provides members with an additional opportunity to select their directors, consistent with the requirements of Section 6(b)(3).⁵⁸ Although the slate of the Nominating Committee will be automatically deemed selected without a member vote, PCX Equities members are able to actively participate in the nomination process by way of petition. Thus, if a group of members is dissatisfied with the Nominating Committee's proposed slate, the PCX Equities members have the ability to force a member vote by petitioning to add a candidate. The Commission believes that the petition process is a fair and reasonable way for members to be involved in the selection of their representatives for the PCX Equities Board and PCX Board.

b. *Business Conduct Committee.* The Business Conduct Committee will have the following functions and authority: (i) To examine the business conduct and financial condition of ETP Holders, ETP Firms and Equity ASAP Holders and their associated persons; (ii) to conduct hearings and render decisions in summary disciplinary actions and proceedings; (iii) to impose appropriate sanctions of expulsion, suspension, fine, censure or any other fitting sanctions where the Committee finds that a violation within the disciplinary jurisdiction of PCX has been committed; and (iv) to require the production of detailed financial reports of an ETP Holder, ETP Firm, or Equity ASAP Holder.

The Business Conduct Committee will not have a fixed size. Rather, the PCX

⁴⁷ PCX Equities members will also play a role in the process to nominate a Governor for the PCX Board. See Section IV.B.2.a, *infra*.

⁴⁸ See PCX Constitution Article II, Section 1(a).

⁴⁹ The Commission notes that the National Association of Securities Dealers, Inc. ("NASD") and the Chicago Stock Exchange, Inc. ("CHX") currently classify their board members as either industry/member, non-industry or public. The PCX Equities' definition of public is comparable to the NASD and CHX definition of non-industry. In contrast, the public member defined by the NASD and CHX as a person who has no material business relationship with a broker or dealer or the Association or the exchange, as the case may be. See NASD By-laws, Article I; CHX Constitution, Sections 2 and 10.

⁵⁰ See ATS Release, *supra* note 33.

⁵¹ 15 U.S.C. 78f(b)(5).

⁵² See generally proposed PCX Equities Rule 3.

⁵³ If PCX Equities decides to establish an executive committee, the Commission believes that its composition should reflect the composition of the PCX Equities Board.

⁵⁴ But see note 56, *infra*.

⁵⁵ For example, if Equity ASAP Holders constituted 10 percent of all trading permit holders on the PCX Equities, they would be entitled to at least one Equity ASAP representative on the Nominating Committee. If, however, the number of Equity ASAP Holders grew to 34 percent of all trading permit holders, then the Nominating Committee would have to include at least two Equity ASAP Holder representatives.

⁵⁶ A single person may be nominated for one of the ETP/Equity ASAP Holder Director positions and the ETP/Equity ASAP Holder Governor position. See proposed PCX Equities Rule 3.2(b)(2)(C)(1).

⁵⁷ 15 U.S.C. 78f(b)(3).

⁵⁸ *Id.*

Equities' management may determine the size of the Committee, as it deems appropriate. In addition to members of the public, the Business Conduct Committee will have proportional representation of ETP Holders and Equity ASAP Holders, with a minimum of one ETP Holder or allied person of an ETP Firm, and one Equity ASAP Holder or allied person of an Equity ASAP Holder, similar to that required for the Nominating Committee.⁵⁹ Therefore, all constituencies of the PCX Equities are guaranteed some input into the decisions of the Business Conduct Committee.

The Commission finds that the stated functions of the Business Conduct Committee, as set forth in the PCX Equities Rules, are consistent with the Act. The Rules relating to the Business Conduct Committee are consistent with Section 6(b)(6)⁶⁰ of the Act because they provide the committee with the authority to ensure that members are appropriately disciplined for violations of PCX Equities' Rules, as well as for violations of the rules and regulations of the of the Act.

In the Commission's view, the proposed composition of the Business Conduct Committee is consistent with the requirements of Sections 6(b)(3)⁶¹ and 6(b)(7)⁶² of the Act because it contains a member from each member constituency and thus provides both ETP Holders and Equity ASAP Holders with a fair and representative voice in the administration of PCX Equities' affairs, in particular, disciplinary proceedings. The Commission believes that there should be a level of actual member involvement in the disciplinary process of a demutualized exchange, similar to that practiced today on traditional member-owned exchanges. The Commission believes that exchange members should be permitted to participate in disciplinary proceedings by serving as members of the hearing panels that oversee the disciplinary process, and should also be included in the panels or committees that hear appeals in order to promote procedural fairness. The Commission finds that the proposed Business Conduct Committee adequately meets these goals.

c. *Member Advisory Committee.* The PCX has proposed to establish a Member Advisory Committee, which will act in an advisory capacity

regarding rule changes that relate to disciplinary matters and off-board trading rules. The CEO of PCX Equities will appoint the members of this committee for one-year terms, and any member in good standing may be eligible to be appointed to the Committee.

The Commission believes that the Member Advisory Committee should provide members with the ability to provide input into the self-regulatory process. Members, by virtue of their positions, have first-hand knowledge about the workings of the markets. The Member Advisory Committee should help prevent potentially inappropriate or discriminatory disciplinary rules and off-board trading rules from being adopted by PCX Equities and help to ensure that the rules of PCX Equities are consistent with just and equitable principles of trade.

d. *Board Appeals Committee.* Decisions of PCX Equities made by the Business Conduct Committee and the staff of PCX Equities relating to, among other things, disciplinary matters, issuances of trading permits, and listings and delistings, may be appealed to the Board Appeals Committee. The Board Appeals Committee, which will be appointed by the PCX Equities Board, will include at least one public director of the PCX Equities Board and at least one ETP/Equity ASAP Holder Director.⁶³

The Commission finds that the proposed composition and authority of the Board Appeals Committee are consistent with Section 6(b)(3)⁶⁴ and Section 6(b)(7)⁶⁵ of the Act, respectively.⁶⁶ The Board Appeals Committee will have of at least one ETP/Equity ASAP Holder Director that will represent the membership in helping assure that decisions of the Business Conduct Committee and the staff are made in a fair and impartial manner. In addition, the PCX's proposal is consistent with Section 6(b)(7)'s⁶⁷ requirement that an exchange establish fair procedures for disciplining members and persons associated with members, denying memberships, barring persons from seeking to become members, and prohibiting or limiting access to services. The Board Appeals Committee, as proposed, has appellate

jurisdiction over various categories of disciplinary proceedings and other regulatory decisions, such as denials of ETP and Equity ASAP applications, issuances of floor citations and minor rule plan sanctions, delisting decisions, and sanctions for violations of PCX Equities' Bylaws, Rules, policies, regulations and procedures promulgated under the Act. Moreover, aggrieved PCX Equities members may appeal the decision of the Board Appeals Committee to the PCX Board of Governors and, ultimately, to the Commission.⁶⁸

In sum, the Commission finds that the Board Appeals Committee's structure and jurisdiction appears to provide for a fair procedure for disciplining members and associated persons and overseeing the denial of access to PCX Equities or its services, in satisfaction of the standards set forth in Section 6(b)(7) of the Act.⁶⁹

C. Proposed PCX Equities Rules

The majority of the rules proposed by PCX to govern PCX Equities' trading operations are closely patterned on PCX's existing rules.⁷⁰ The proposed rules contain changes to reflect the new structure whereby trading permits will be issued to persons or entities conducting business on PCX Equities. With the exception of proposed PCX Equities Rules 1, 2, 3, and 10, the proposed PCX Equities Rules are substantially similar and generally consistent with the PCX Rules that were previously filed with and approved by the Commission. In some cases, existing rules have been restated and clarified and obsolete references have been deleted to reflect the new equities subsidiary.

1. Proposed PCX Equities Rule 1

Proposed PCX Equities Rule 1 defines the terms and references (e.g., ETP Holder) that are used throughout the proposed rules to ensure uniformity and to conform rule terminology to the demutualized entity. The Commission finds that proposed PCX Equities Rule 1 is consistent with Section 6(b)(5) of the Act, which requires, among other things, that the rules of an exchange be designed to facilitate transactions in securities and to remove impediments to and perfect the mechanism of a free and open market and a national market system and not to permit unfair

⁵⁹ See *supra* note 55 for an example of how the proportional composition of the Nominating Committee will be determined. The Business Conduct Committee's composition will be determined using the same method.

⁶⁰ 15 U.S.C. 78f(b)(6).

⁶¹ 15 U.S.C. 78f(b)(3).

⁶² 15 U.S.C. 78f(b)(7).

⁶³ See Amendment No. 6, *supra* note 8, and proposed PCX Equities Rule 3.3(a)(1)(A).

⁶⁴ 15 U.S.C. 78f(b)(3).

⁶⁵ 15 U.S.C. 78f(b)(7).

⁶⁶ At a minimum, the Commission believes that any committee responsible for appeals of disciplinary matters should have an equal number of non-industry or public members as it has industry members.

⁶⁷ *Id.*

⁶⁸ See proposed PCX Equities Rule 10.8.

⁶⁹ 15 U.S.C. 78f(b)(7).

⁷⁰ As stated earlier, the PCX Equities' Rules remain the Rules of the PCX for purposes of the Act and any proposed changes to those Rules must be submitted by the PCX to the Commission for approval, under Section 19(b) of the Act.

discrimination between customers, issuers, brokers or dealers.⁷¹ The Commission believes that these definitions are necessary and appropriate additions to the existing PCX Rules because they provide an important overview of the restructured PCX Equities entity and its members (*i.e.*, ETP Holders and Equity ASAPs Holders).

2. Proposed PCX Equities Rule 2

Proposed PCX Equities Rule 2 describes the application process, the qualification requirements and other requirements for holding an ETP or Equity ASAP. Although these provisions are similar to the requirements and procedures currently found in PCX Rule 1 and the PCX Constitution, the PCX made certain substantive changes to the application and qualification requirements to reflect the characteristics of the new ETPs and Equity ASAPs.

PCX Equities will issue these permits to persons that satisfy the respective qualification requirements.⁷² The qualification requirements and the application process have been modeled after the current procedures and rules employed by the PCX for PCX memberships and PCX ASAPs. The PCX has stated that it will not limit the number of permits that it will issue. Current PCX members will need to submit an application and pay a fee to receive a trading permit, but because they have already satisfied the requirements for PCX membership, the process will be less time intensive. For new applicants, the process will be substantially similar to the current PCX process except that the approval and disapproval decisions will be made by the management of PCX Equities instead of a membership committee. The Commission finds that the PCX has satisfied the requirements of Section 6(b)(2) of the Act⁷³ because it has proposed rules that will enable any broker-dealer registered under Section 15 of the Act⁷⁴ that satisfies the qualification requirements to become a member of the Exchange.

3. Proposed PCX Equities Rule 3

Proposed PCX Equities Rules 3.1 through 3.3 discuss in detail the proposed committee structure. These proposed rules cover the functions and compositions of the Business Conduct Committee, Nominating Committee, Member Advisory Committee, and the

Board Appeals Committee. For the reasons discussed in Section IV.B., above, the Commission finds that these Rules are consistent with the Act.

Proposed PCX Equities Rules 3.4 through 3.6 discuss the proposed delegation of authority from the PCX to PCX Equities. For the reasons discussed in Section IV.A., above, the Commission finds that the proposed delegation of self-regulatory authority from the PCX to PCX Equities is appropriate and consistent with the Act.

4. Proposed PCX Equities Rule 10

Proposed PCX Equities Rule 10 sets forth the disciplinary process for PCX Equities.⁷⁵ While proposed PCX Equities Rule 10 is substantially similar to the current PCX disciplinary procedures, the PCX has submitted some substantive changes relating to the independence of the PCX Equities regulatory staff and *ex parte* communications. The Commission finds that the disciplinary provisions contained in proposed PCX Equities Rule 10 are consistent with Sections 6(b)(5), 6(b)(6) and 6(b)(7) of the Act.⁷⁶ Section 6(b)(5) generally requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices and to protect investors and the public interest.⁷⁷ Section 6(b)(6) requires, among other things, that the rules of an exchange provide that its members shall be appropriately disciplined for violations of the Act, the rules and regulations thereunder, or the rules of an exchange.⁷⁸ Section 6(b)(7) requires that the rules of an exchange, among other things, should provide a fair procedure for disciplining members.⁷⁹

Pursuant to proposed PCX Equities Rule 10.2, although any person, including PCX Equities Board members and PCX Equities committee members, will be permitted to bring potential violations to the attention of the PCX Equities' regulatory staff, the regulatory staff will have the exclusive authority to determine whether to investigate potential violations within the disciplinary jurisdiction of the PCX Equities. The Commission believes that this provision should prevent commercial interests of members from improperly influencing the disciplinary process, consistent with the

requirements of Section 6(b)(7).⁸⁰ This aspect of the proposed Rule should help to ensure that the disciplinary process operates in a fair manner without potential improper, unrelated business influences.

The Commission believes that the Exchange has struck an appropriate balance by permitting PCX Equities' directors and committee members to submit complaints alleging possible violations of PCX Equities Rules and violations of the Act to the regulatory staff of PCX Equities for investigation, but then prohibiting them from further participation in the investigation or proceedings. In this way, the directors and committee members continue have the ability to bring potential violations to the attention of the regulatory staff, but are not given undue control and influence over the proceedings.

The Commission further finds that the explicit prohibition in the proposed Rule against interference by the PCX Equities Board and other non-regulatory staff persons with any pending investigation or disciplinary proceeding is appropriate. The proposed Rule ensures that persons responsible for investigations and disciplinary proceedings should enjoy autonomy and independence.

Proposed PCX Equities Rule 10.4 provides that only the regulatory staff of PCX Equities has the authority to determine whether there is probable cause to issue a formal complaint, *i.e.*, probable cause for finding that a violation within the disciplinary jurisdiction of PCX Equities has occurred and that further proceedings are warranted. The Commission believes that giving the regulatory staff independence will allow for a vigorous and evenhanded enforcement program.

Proposed PCX Equities Rule 10.3 defines and prohibits *ex parte* communications between various participants in the disciplinary process and members of the PCX Equities Board and PCX Board. In the Commission's view, it is appropriate to prohibit *ex parte* communications between the persons, committees and panels responsible for overseeing the disciplinary process, and the parties or their representatives during disciplinary proceedings. The Commission believes that the boundaries set out in the proposed rule defining the prohibited communications should help ensure that no party can unfairly advance his or her position in an investigation or disciplinary proceedings through discussion or other communication outside of the proceeding's forum.

⁷¹ 15 U.S.C. 78f(b)(5).

⁷² See generally proposed PCX Equities Rule 2.

⁷³ 15 U.S.C. 78f(b)(2).

⁷⁴ 15 U.S.C. 78o.

⁷⁵ The Commission recently approved substantially similar proposed changes to the PCX disciplinary Rules. See Securities Exchange Act Release No. 42750 (May 4, 2000) (File No. SR-PCX-99-10).

⁷⁶ 15 U.S.C. 78f(b)(5)-(7).

⁷⁷ 15 U.S.C. 78f(b)(5).

⁷⁸ 15 U.S.C. 78f(b)(6).

⁷⁹ 15 U.S.C. 78f(b)(7).

⁸⁰ *Id.*

Therefore, the Commission finds that the proposed Rule regarding *ex parte* communications is consistent with the requirements of Sections 6(b)(7) by establishing procedures that provide a fair disciplinary forum.

The Commission finds therefore that proposed PCX Equities Rule 10 provides that ETP Holders, ETP Firms, Equity ASAP Holders and associated persons are to be appropriately disciplined, and provides a fair procedure for them for violations of the Act, the rules or regulations thereunder, or the rules of the exchange in accordance with Sections 6(b)(6)⁸¹ and 6(b)(7).⁸²

D. Costs of ETPs and Equity ASAPs

In connection with the new trading permits, the PCX has proposed a new fee structure for its members. ETP Holders will pay a fixed monthly amount to PCX Equities, while Equity ASAP Holders will pay a fixed annual amount. The PCX has proposed a graduate fee schedule for ETP's during the first nine months after PCX Equities has been established, which will be correlated to the current prevailing monthly lease rate for PCX memberships.

The Commission finds that the proposed trading permit fees to be consistent with the requirements of Section 6(b)(4) of the Act⁸³ that the Exchange allocate its fees fairly among its members. The Exchange has proposed fees based on the type of permit issued and, thus, the fees are based on the type of access and services provided to members. The Commission finds that establishing the fees in this manner to be consistent with Section 6(b)(4) of the Act.⁸⁴

E. Amendment Nos. 3–7

For the reasons discussed below, the Commission finds good cause for approving Amendment Nos. 3 through 7 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**.

1. Amendment No. 3

Amendment No. 3 sets forth proposed changes to the proposed PCX Equities Certificate of Incorporation, proposed PCX Equities Bylaws, proposed PCX Equities Rules 1–7 and 10–12, as well as the proposed PCX Equities Equity Floor Procedure Advices. Amendment No. 3 also amends PCX Rules 2 and 3 to reflect changes made to the

corresponding proposed PCX Equities Rules. With the exception of a change to the proposed disciplinary Rule governing *ex parte* communications, the proposed changes in Amendment No. 3 are technical, non-substantive amendments that serve to clarify the intent and application of the proposed rule or correct language or typographical errors.

Proposed PCX Equities Rule 10.3 prohibits certain *ex parte* communications, and contains procedures that require disclosure and a hearing to show cause why the claim or defense of a party that received, and benefited from, a prohibited communication should not be disposed of by an adverse summary decision. In Amendment No. 3, the Exchange added a provision to this proposed Rule that states that a member of the Business Conduct Committee or Conduct Panel must recuse himself or herself from participation in such a hearing if the member has a conflict of interest or bias, or if circumstances otherwise exist where his or her fairness might reasonably be questioned.

The Commission finds that the addition of this provision will increase the level of fairness and impartiality in disciplinary proceedings and will aid in the dispassionate application of the disciplinary rules. The Commission believes that the PCX has proposed a reasonable standard under which an adjudicator or participant in the disciplinary process must recuse himself or herself or face disqualification by the Chief Regulatory Officer, or in the event that the Chief Regulatory Officer has a conflict, by the CEO.

In addition, in Amendment No. 3, the Exchange submitted for the Commission's review a draft Shareholder Agreement. Under the terms of the Shareholder Agreement, the PCX agrees to vote all outstanding shares of the PCX Equities to elect to the PCX Equities Board the two representatives of ETP Holders and Equity ASAP Holders nominated by the Nominating Committee, pursuant to proposed PCX Equities Rule 3.⁸⁵

The Commission believes that Amendment No. 3 does not significantly alter the original proposal, which was subject to a full notice and comment period. Moreover, the Commission believes that the changes made to the proposed rules, as well as to the Shareholder Agreement strengthen the

proposal and further ensure the Exchange's compliance with the Act through its subsidiary, PCX Equities. Therefore, the Commission finds that granting accelerated approval to Amendment No. 3 is appropriate and consistent with Section 19(b)(2) of the Act.⁸⁶

2. Amendment No. 4

In Amendment No. 4, the PCX proposes to change the number of floor members required to be on the PCX Board at all times from five to two, as is currently required in the PCX Constitution. This change is proposed to make the proposed PCX Constitution consistent with the current PCX Constitution.⁸⁷ Amendment No. 4 also sets forth changes to proposed PCX Equities Rule 4 and 10 to ensure that the language of the proposed rules appropriately reflects the new structure of PCX Equities by changing references to "members" and the "Exchange" to "ETO Holders," "ETP Firms," "Equity ASAP Holders," and the "Corporation."

The changes in proposed Amendment No. 4 merely reflect the proposed PCX Equities structure and make the filing consistent with current PCX Rules. Further, the Commission finds that Amendment No. 4 does not significantly alter the original proposal, which was subject to a full notice and comment period. Therefore, the Commission finds that granting accelerated approval to Amendment No. 4 is appropriate and consistent with Section 19(b)(2) of the Act.

3. Amendment No. 5

In Amendment No. 5, the PCX sets forth changes to proposed PCX Equities Rules 6 and 7. Specifically, Amendment No. 5 makes several technical, non-substantive changes to the proposal, such as identifying appropriate cross-references, accurately and fully transferring the PCX rules into the PCX Equities Rules, and correctly applying the proposed Rules to ETP Holders, ETP Firms and Equity ASAP Holders.

The Commission believes that Amendment No. 5 does not significantly alter the original proposal, which was subject to a full notice and comment period. Therefore, the Commission finds that granting accelerated approval to Amendment No. 5 is appropriate and consistent with Section 19(b)(2) of the Act.

⁸¹ 15 U.S.C. 78f(b)(6).

⁸² 15 U.S.C. 78f(b)(7).

⁸³ 15 U.S.C. 78f(b)(4).

⁸⁴ *Id.*

⁸⁵ As noted earlier, the Commission believes that any modification to the equity ownership of PCX Equities may raise regulatory issues, and thus expects the PCX to notify the Commission in such an event.

⁸⁶ 15 U.S.C. 78s(b)(2).

⁸⁷ See PCX Constitution Article III, Section 2(b); see also Securities Exchange Act Release No. 42235 (December 14, 1999), 64 FR 71839 (December 22, 1999).

4. Amendment No. 6

Amendment No. 6 sets forth proposed changes to the proposed PCX Equities Rules 3, 8, 9, 10, 12, and 13, as well as the proposed PCX Equities Equity Floor Procedure Advices. The Amendment makes changes to the process by which PCX Equities members may submit petitions to nominate candidates for positions on the Nominating Committee, the PCX Equities Board, and the PCX Board. The composition requirements of the Nominating Committee, the Business Conduct Committee and the Board Appeal Committee were also further defined. Also, the Exchange created the Member Advisory Committee.

In addition, the Amendment contained minor revisions to *ex parte* communication Rules. Finally, the Exchange submitted technical, non-substantive amendments to the proposed rule language that serve to clarify the intent of the proposed Rules or correct textual or typographical errors.

Proposed PCX Equities Rule 3.2(b)(1)(A) describes and sets forth the composition requirements of the Business Conduct Committee. In Amendment No. 6, the Exchange revised this proposed Rule to state that the Business Conduct Committee shall have proportional representation of all ETP Holders and Equity ASAP Holders, with a minimum of one ETP Holder or allied person of an ETP Firm and one Equity ASAP Holder or an allied person of an Equity ASAP Holder.⁸⁸ Similarly, in Amendment No. 6, the Exchange revised proposed PCX Equities Rule 3.2(b)(2)(A), which sets forth the composition of the Nominating Committee, to provide that the six ETP Equity ASAP Holder representatives on the Nominating Committee shall represent proportionally all ETP Holders, ETP Firms, and Equity ASAP Holders, with a minimum of one ETP Holder or allied person of an ETP Firm and one Equity ASAP Holder or allied person of an Equity ASAP Holder.⁸⁹

Proposed PCX Equities Rules 3.2(b)(2)(B)(i) and 3.2(b)(2)(C)(i) describe the process by which members are appointed to the Nominating Committee and, in turn, the process by which the Nominating Committee facilitates selection of the ETP Holders or Equity ASAP Holders for the PCX Equities Board and the PCX Board. These proposed Rules include a provision whereby ETP Holders and Equity ASAP Holders in good standing

may submit a written petition to the Nominating Committee to nominate additional eligible candidates to fill ETP Holder and Equity ASAP Holder positions on the Nominating Committee⁹⁰ and on the PCX Board and PCX Equities Board⁹¹ during the next term. In Amendment No. 6, the PCX reduced the aggregate percentage of ETP Holders and Equity ASAP Holders necessary to successfully petition to nominate such candidates from 20 percent to 10 percent.

In addition, in Amendment No. 6, the PCX proposed new PCX Equities Rule 3.2(b)(2)(C)(3), which establishes a Member Advisory Committee that shall act in an advisory capacity regarding proposed rule changes relating to disciplinary matters and off-board trading rules.

Proposed PCX Equities Rule 3.3(a) governs the composition of the Board Appeals Committee. In Amendment No. 6, the PCX revised this Rule to require that each Board Appeals Committee will contain at least one public director and at least one ETP/Equity ASAP Holder Director.

The Commission finds that the above revisions to the composition requirements for the PCX Board, PCX Equities Board and PCX Equities' committees represent reasonable standards intended to satisfy the fair representation and public participation standards required by Section 6(b)(3).⁹² In addition, PCX's proposed reduction of the percentage of ETP Holders and Equity ASAPs Holders necessary to successfully petition the Nominating Committee for the addition of alternative candidates is a reasonable proposal designed to ensure fair representation of the PCX membership on the Nominating Committee and PCX Board and PCX Equities Board.

Finally, in Amendment No. 6, the PCX made revisions to several of PCX Equities' disciplinary rules relating to *ex parte* communications. In proposed PCX Equities Rule 10.3(a)(1)–(3), the PCX inserted language to prohibit any interested PCX Equities staff with knowledge of a pending investigation or disciplinary proceeding from making, or knowingly causing to be made, an *ex parte* communication. The PCX also amended proposed PCX Equities Rule 10.3(c) to allow for a disciplinary committee to issue to interested PCX Equities staff responsible for an *ex parte* communication, or who benefited from such a communication, an order to show cause why the claim, defense, or

interest should not be adversely affected by reason of such *ex parte* communication.

The Commission finds that the addition of this provision will increase the level of fairness and impartiality in disciplinary proceedings and will aid in the even-handed application of the disciplinary rules. The Commission believes that the PCX has proposed reasonable standards intended to prevent *ex parte* communications involving PCX Equities staff, which satisfies the requirements of Section 6(b)(7) of the Act.⁹³

Overall, the Commission finds that the PCX's proposed changes in Amendment No. 6 strengthen and clarify the proposed rule change. Therefore, the Commission finds that granting accelerated approval to Amendment No. 6 is appropriate and consistent with Section 19(b)(2) of the Act.

5. Amendment No. 7

In Amendment No. 7, the Exchange deleted PCX Rule 3 regarding listings and delistings because these provisions will now be part of the PCX Equities Rules. In addition, the PCX proposed to add the Delegation Plan to its Rules as proposed PCX Rule 14. In the Amendment, the Exchange also clarified that summary suspensions, permitted pursuant to PCX Equities Rule 11.2(a), will only be enforced for violations of the Rules of PCX Equities. Finally, the Exchange proposed non-substantive, technical amendments to the language of the proposed PCX Equities Rules.

The Commission finds that proposed changes in Amendment No. 7 further strengthen and clarify the proposed rule change. The Commission believes that Amendment No. 7 does not significantly alter the original proposal, which was subject to a full notice and comment period. Therefore, the Commission finds that granting accelerated approval to Amendment No. 7 is appropriate and consistent with Section 19(b)(2) of the Act.

F. Summary of Commission's Findings

In sum, as discussed above, the Commission believes the proposal to create PCX Equities 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 proposal is consistent with the requirements of Sections

⁸⁸ See *supra* note 55.

⁸⁹ *Id.*

⁹⁰ See proposed PCX Equities Rule 3.2(b)(2)(B)(i).

⁹¹ See proposed PCX Equities Rule 3.2(b)(2)(C)(i).

⁹² 15 U.S.C. 78f(b)(3).

⁹³ 15 U.S.C. 78f(b)(3).

6(b)(1), 6(b)(2), 6(b)(3), 6(b)(4), 6(b)(5), 6(b)(6), 6(b)(7), and 6(b)(8).⁹⁴

In addition, the Commission finds that the proposal is consistent with the requirements of Section 6(b)(1) of the Act.⁹⁵ Section 6(b)(1) requires that an exchange be so organized and have capacity to carry out the purposes of the Act. According to the PCX, all revenue generated by the equities business, including ETP and Equity ASAP fees, specialist fees, tape fees, and transaction fees will accrue to PCX Equities.

Further, the PCX has committed to provide PCX Equities with the resources necessary for it to carry out its delegated responsibilities. The Commission expects that the PCX, as the registered exchange ultimately responsible for compliance with the provisions of the Act, will continue to properly fund its subsidiary for such purposes. In addition, the PCX has committed to provide certain services and facilities to help support PCX Equities' trading operations. These services and facilities and their costs will be specifically defined in an agreement between PCX and PCX Equities. The Commission finds that these provisions should enable PCX Equities to fulfill the requirements imposed by the Act, consistent with the PCX's self-regulatory requirements.

Finally, the Commission finds that the proposal is consistent with Section 6(b)(8) of the Act,⁹⁶ which requires that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance with the Act. The Commission does not believe that the proposed structure will impose any inappropriate burdens on competition.⁹⁷

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 3–7, including whether the proposed amendments are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609. Copies of the submission, all

subsequent amendments, all written statements with respect to the proposed amendment that are filed with the Commission, and all written communications relating to the 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. Copies of such filing also will be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR–PCX–99–39 and should be submitted by June 2, 2000.

VI. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁹⁸ that the proposed rule change (SR–PCX–99–39), as amended, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹⁹

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00–11920 Filed 5–11–00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–42762; File No. SR–PHLX–00–37]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Starting the Automatic Price Improvement Feature and the Mandatory Manual Double-up Double-down Price Protection Feature at (9:30 A.M.)

May 5, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ notice is hereby given that on April 20, 2000, the Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) 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 Exchange. 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 Phlx proposes to begin the Automatic Price Improvement feature (“API”) of the Philadelphia Stock Exchange, Inc. Automatic Communication and Execution (“PACE”) System at 9:30 A.M. instead of 9:45 A.M. In addition, the Exchange also proposes to begin the Mandatory Manual Double-up Double-down price protection at 9:30 A.M. instead of 9:45 A.M. The Text of the proposed rule change is available at the Office of the Secretary, the Phlx and at the Commission.

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 IV below. The Exchange 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

PACE is the Exchange's automated order routing and execution system on the equity trading floor. The PACE System accepts orders for automatic or manual execution in accordance with the provisions of Phlx Rule 229, which governs the PACE System and defines its parameters. The API feature of the PACE System allows the specialist to voluntarily provide automatic price improvement to market and marketable limit orders to all customers in a security for orders which are 599 shares or less, and when the PACE quote² is ³/₁₆ or ¹/₈ for greater.³

The specialist must provide Mandatory Manual Double-up Double-down price protection where the specialist does not agree to use the API

² The PACE quote consists of the best bid/offer among the American, Boston, Cincinnati, Chicago, New York, Pacific and Philadelphia Stock Exchanges. See Phlx Rule 229.

³ See Phlx Rule 229, Commentary .07(c)(i).

⁹⁴ 15 U.S.C. 78f(b)(1) through (b)(8).

⁹⁵ 15 U.S.C. 78f(b)(1).

⁹⁶ 15 U.S.C. 78f(b)(8).

⁹⁷ The Commission notes that this Section 6(b)(8) finding does not extend to all of the Rules proposed to be PCX Equities Rules. As described above, the majority of the Rules intended to become the Rules of PCX Equities were incorporated from the PCX Rules in their entirety without substantive change and were previously subject to Commission review. Thus, the current finding is limited only to those PCX Equities Rules that have been specifically amended to reflect the restructuring.

⁹⁸ 15 U.S.C. 78s(b)(2).

⁹⁹ 17 CFR 200.30–3(a)(12).

¹ 15 U.S.C. 78s(b)(1).