

Settlement further specifies that 264 basis points of the interest income earned by TEP on the TEP loan will be recorded as a deferred credit and used to offset rates in the future, and that the balance of the interest income will be used to build the equity capitalization of TEP.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47811; File No. SR-CHX-2002-20]

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

May 7, 2003.

#### I. Introduction

On July 11, 2002, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to allow a specialist to limit his aggregate auto-execution exposure.<sup>3</sup> On August 13, 2002, the Exchange submitted Amendment No. 1 to the proposal.<sup>4</sup> On August 27, 2002, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>5</sup>

The proposed rule change was published for comment in the **Federal Register** on September 6, 2002.<sup>6</sup> No comments were received on this aspect

of the proposal.<sup>7</sup> On April 25, 2003, the Exchange filed Amendment No. 3 to the proposed rule change.<sup>8</sup> This order partially approves the proposed rule change.

#### II. Description of the Proposal

The CHX Rules provide for automatic execution of orders, *i.e.*, without manual intervention by the CHX specialist, if certain conditions are met.<sup>9</sup> Under the CHX Rules, each CHX specialist designates an "auto-execution threshold" for each issue.<sup>10</sup> The auto-execution threshold is a number of shares, greater than 99 shares that the specialist is willing to execute automatically. If a specialist receives an order that exceeds his designated auto-execution threshold, the order is automatically directed into the specialist's book for manual execution, unless the order-sending firm has elected to receive partial automatic executions, in which case a portion of the order will automatically execute, up to the size of the auto-execution threshold, and the balance of the order will be placed in the specialist's book for manual execution.

Under the current version of the CHX Rules, a CHX specialist has unlimited (and the CHX believes unwarranted) auto-execution exposure, because a rapid succession of orders entered into the MAX system at or below the specialist's auto-execution threshold are due an automatic fill at the prevailing National Best Bid or Offer ("NBBO") price. Therefore, the CHX believes that specialists may be required to provide more liquidity than they intend to through automatic executions.

To resolve this issue, the Exchange has proposed to amend CHX Article XX, Rule 37(b)(1) to limit a specialist's unintended automatic execution liability by incorporating an Aggregate

Share Threshold into the specialist's designated auto-execution parameters. The specialist can enable the Aggregate Share Threshold on an issue-by-issue basis. The functionality is entirely optional, however, and a specialist can still elect to provide additional liquidity guarantees.

Under this voluntary system enhancement, the specialist would agree to provide automatic execution (at the NBBO) of an aggregate number of shares (the "Aggregate Share Threshold"). Once an aggregate number of shares equal to the Aggregate Share Threshold was automatically executed, whether as a result of one order or numerous orders, subsequent orders would be directed into the specialist's book for manual execution. Under the proposed rule change, a specialist would then be obligated to either execute the order at a price and size equal to or better than the NBBO price and size at the time the order was received, or act as agent for the order to obtain the best available price on a marketplace other than the Exchange.

The Aggregate Share Threshold would reset after a prescribed amount of time designated by a specialist<sup>11</sup> and could never be set at a level less than the shares included in the specialist's own bid or offer.

The Exchange also proposes to relocate Article XX, Rule 43(d) to Rule 37(a), rendering the provisions of Rule 43(d) applicable to both over-the-counter and listed securities. This provision states that with respect to any market or marketable limit order not executed automatically, a specialist shall be obligated to either (a) manually execute such order at a price and size equal to or better than the NBBO price and size at the time the order was received; or (b) act as agent for such order in seeking to obtain the best available price for such order on a marketplace other than the Exchange, using order routing systems where appropriate.

#### III. Discussion

After careful review, the Commission finds that the proposed changes to CHX Article XX, Rules 37(a)(1), 37(a)(2), 37(b)(1) and 43(d) described above are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national

<sup>7</sup> The Commission received one comment addressing the Exchange's proposed change to the definition of "BBO price."

<sup>8</sup> See letter from Kathleen M. Boege, Assistant General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated April 24, 2003 ("Amendment No. 3"). In Amendment No. 3, the Exchange withdrew its request that the proposed rule change be approved on a pilot basis. Further, the Exchange made changes to the proposed definition of BBO price and requested partial approval of the portion of the proposed rule change dealing with issues other than the definition of BBO price. Because the only substantive changes contained in Amendment No. 3 involve this definition of BBO price, which the Commission is not approving in this order, the Commission similarly is not approving Amendment No. 3 at this time.

<sup>9</sup> See CHX Article XX, Rule 37(b)(6)(automatic execution of orders in listed securities); CHX Article XX, Rule 37(b)(7)(automatic execution of orders in OTC securities).

<sup>10</sup> See CHX Article XX, Rule 37(b)(1).

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

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

<sup>3</sup> In the proposed rule change, the Exchange also proposed a modified definition of the "BBO Price" and corresponding changes to the BEST Rule that would reflect the modified definition. The Commission is not approving those proposed changes in this order.

<sup>4</sup> See letter from Kathleen M. Boege, Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated August 9, 2002 ("Amendment No. 1").

<sup>5</sup> See letter from Kathleen M. Boege, Assistant General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated August 23, 2002 ("Amendment No. 2").

<sup>6</sup> See Securities Exchange Act Release No. 46436 (August 29, 2002), 67 FR 57048.

<sup>11</sup> A specialist choosing to enable the Aggregate Share Threshold functionality would be required to provide CHX staff with the designated time increment for each issue. The time increment would commence (and restart) upon any change in the NBBO.

securities exchange.<sup>12</sup> Specifically, the Commission finds that these proposed changes are consistent with the requirements of Section 6(b)(5) of the Act<sup>13</sup> because they are designed to facilitate transactions in securities; to remove impediments to and to perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers or dealers.<sup>14</sup>

The Commission believes that the proposed changes to CHX Article XX, Rule 37(a)(2) providing for an Aggregate Share Threshold achieve an appropriate balance between providing customers with efficient and prompt executions of orders and limiting the risk that specialists are exposed to by guaranteeing automatic executions. The Commission further finds that the proposed changes to CHX Article XX, Rule 37(b)(1) dealing with a specialist's obligations for manually handling market and marketable limit orders are consistent with the Act and the manner in which specialists currently handle orders for listed securities.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>15</sup> that the portion of proposed rule change (SR-CHX-2002-20) relating to CHX Article XX, Rules 37(a)(1), 37(a)(2), 37(b)(1) and 43(d), as discussed above, is approved.

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

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47814; File No. SR-MSRB-2002-12]

### Self-Regulatory Organizations; Order Granting Approval of a Proposed Rule Change and Amendment No. 1 Thereto by the Municipal Securities Rulemaking Board Relating to Amendments to Rules G-37, on Political Contributions and Prohibitions on Municipal Securities Business, G-8, on Books and Records, Revisions to Form G-37/G-38 and the Withdrawal of Certain Rule G-37 Questions and Answers

May 8, 2003.

#### I. Introduction

On September 26, 2002, the Municipal Securities Rulemaking Board ("Board" or "MSRB") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"), and rule 19b-4 thereunder,<sup>1</sup> a proposed rule change to amend rule G-37, on political contributions and prohibitions on municipal securities business, G-8, on books and records, revisions to Form G-37/G-38 and the withdrawal of certain rule G-37 Questions and Answers. On March 26, 2003, the MSRB amended the proposal. The proposed rule change revises the exemption process and the definition of municipal finance professional. Amendment No. 1 alters the text of the amendments to the rule language as it appears in the original filing. The proposed rule change, as modified by Amendment No. 1, was published in the **Federal Register** on April 8, 2003.<sup>2</sup>

The Commission received two comment letters on the proposed rule change.<sup>3</sup> This order approves the proposed rule change as modified by Amendment No. 1.

#### II. Summary of Comments

The Commission received two comment letters on the proposed rule change, both support the proposal.

The TBMA letter expresses support for the proposal because the TBMA believes that the changes will help

reduce some of the burdens associated with rule G-37. According to the TBMA letter, the proposed rule change, "will not undercut [rule G-37's] goal of maintaining the integrity of the municipal underwriting process."<sup>4</sup> Furthermore, TBMA believes that the changes are long overdue and urges the Commission to quickly adopt the proposal.<sup>5</sup> Similar to the TBMA letter, the ABA/ABASA letter provides support for the proposed rule change as a means to limit the costs and burdens associated with regulatory compliance. On the amended definition of municipal finance professional, the ABA/ABASA letter expressed that the changes will limit the "unintended consequences of preventing dealer firms from hiring otherwise qualified employees."<sup>6</sup> Additionally, the more flexible exemption process will provide some relief for "inadvertent violations" on rule G-37's ban on contributions.<sup>7</sup>

#### III. Discussion and Commission Findings

Section 19(b) of the Exchange Act<sup>8</sup> requires the Commission to approve the proposed rule change filed by the MSRB if the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder. After careful review of the proposed rule change and comment letters, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder, which govern the MSRB.<sup>9</sup> The language of section 15B(b)(2)(C) of the Act requires that the MSRB's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in regulating, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.<sup>10</sup>

The Commission acknowledges the MSRB Long-Range Plan, to assess rule G-37's requirements and resulting

<sup>12</sup> In approving this portion of the rule proposal, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> The Commission notes that it is not approving proposed Interpretation .01 to CHX Rule 37, nor the corresponding modifications to Rule 37 that would accompany this interpretation.

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

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

<sup>1</sup> 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4.

<sup>2</sup> See Release No. 34-47609 (April 1, 2003), 67 FR 17122.

<sup>3</sup> April 25, 2003, letter from John M. Ramsay, Senior Vice President and Regulatory Counsel, The Bond Market Association to Jonathan G. Katz, Secretary, Commission ("TBMA letter"); April 29, 2003, letter from Sarah Miller, American Bankers Association and ABA Securities Association to Jonathan G. Katz, Secretary, Commission ("ABA/ABASA letter").

<sup>4</sup> See TBMA letter at 1.

<sup>5</sup> *Id.* at 2.

<sup>6</sup> See ABA/ABASA letter at 2.

<sup>7</sup> *Id.*

<sup>8</sup> 15 U.S.C. 78s(b).

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

<sup>10</sup> 1015 U.S.C. 78o-4(b)(2)(C).