

## SECURITIES AND EXCHANGE COMMISSION

[Release 34-44831; File No. 600-22]

### Self-Regulatory Organizations; MBS Clearing Corporation; Notice of Filing and Order Approving a Request for an Extension of Temporary Registration as a Clearing Agency

September 21, 2001.

Pursuant to Section 19(a) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on August 24, 2001, MBS Clearing Corporation ("MBSCC") filed with the Securities and Exchange Commission ("Commission") an application requesting that the Commission grant MBSCC full registration as a clearing agency or in the alternative extend MBSCC's temporary registration as a clearing agency until such time as the Commission is able to grant MBSCC permanent registration.<sup>2</sup> The Commission is publishing this notice and order to solicit comments from interested persons and to extend MBSCC's temporary registration as a clearing agency through March 31, 2002.

On February 2, 1987, pursuant to Sections 17A(b) and 19(a) of the Act<sup>3</sup> and Rule 17Ab2-1 promulgated thereunder,<sup>4</sup> the Commission granted MBSCC registration as a clearing agency on a temporary basis for a period of eighteen months.<sup>5</sup> The Commission subsequently has extended MBSCC's registration through September 30, 2001.<sup>6</sup>

The Government Securities Clearing Corporation ("GSCC"), the Emerging Market Clearing Corporation ("EMCC"), and MBSCC are currently taking steps toward the integration of GSCC, EMCC, and MBSCC and the acquisition of these clearing agencies by The Depository Trust and Clearing Corporation. In order to have time to study the affect of the acquisition and integration on MBSCC's governance and organizational

structure, the Commission is extending MBSCC's registration as a clearing agency on a temporary basis through March 31, 2002.

Interested persons are invited to submit written data, views, and arguments concerning the foregoing application. Such written data, views, and arguments will be considered by the Commission in granting registration or institution proceedings to determine whether registration should be denied in accordance with Section 19(a)(1) of the Act.<sup>7</sup> Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the amended application for registration and all written comments will be available for inspection at the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. All submissions should refer to File No. 600-22 and should be submitted by October 19, 2001.

It Is Therefore Ordered that MBSCC's temporary registration as a clearing agency (File No. 600-22) be and hereby is extended through March 31, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44830; File No. SR-PCX-2001-37]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Changes in Marketing Fees

September 21, 2001.

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> notice is hereby given that on August 30, 2001, the Pacific Exchange, Inc. ("PCX") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items the PCX has prepared. 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 PCX proposes to change the amount of the marketing fee that it currently imposes on options transactions. A copy of the proposed new schedule of fees is available at the PCX and at the Commission. The PCX also proposes to rebate excess marketing fees on a monthly rather than a quarterly basis.

#### 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 PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it had received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The PCX has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of the statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The PCX currently collects a marketing fee of \$0.40 per market maker contract in equity options traded on the PCX.<sup>3</sup> Trades between market makers, including trades between market makers and Lead Market Makers ("LMMs") are not subject to the marketing fee.

The PCX segregates the funds by trading post and makes the funds available to LMMs for their use in attracting orders in the options traded at the posts. The LMMs are obligated to account to the PCX for the use that they make of the funds. The LMMs, and not the PCX, make all determinations concerning the amount that they may pay for orders, as well as the types, sizes, and other factors relating to orders that qualify for payment. The PCX provides administrative support to the LMMs, keeping track of the number of qualified orders each firm directs to the PCX and making the necessary debits and credits to the accounts of the LMMs and member firms.

The PCX periodically rebates to PCX market makers the marketing fees that the LMMs have not paid to order flow

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

<sup>2</sup> Letter from Jeffrey F. Ingber, Managing Director, General Counsel and Secretary, MBSCC (August 21, 2001).

<sup>3</sup> 15 U.S.C. 78q-1(b) and 78s(a).

<sup>4</sup> 17 CFR 240.17Ab2-1.

<sup>5</sup> Securities Exchange Act Release No. 24046 (February 2, 1987), 52 FR 3218.

<sup>6</sup> Securities Exchange Act Release Nos. 25957 (August 2, 1988), 53 FR 29357; 27079 (July 31, 1989), 54 FR 34212; 28492 (September 28, 1990), 55 FR 41148; 29751 (September 27, 1991), 56 FR 50602; 31750 (January 21, 1993), 58 FR 6424; 33348 (December 15, 1993), 58 FR 68183; 35132 (December 21, 1994), 59 FR 67743; 37372 (June 26, 1996), 61 FR 35281; 38784 (June 27, 1997), 62 FR 36587; 39776 (March 20, 1998), 63 FR 14740; 41211 (March 24, 1999), 64 FR 15854; 42568 (March 23, 2000), 65 FR 16980; and 44089 (March 21, 2001), 66 FR 1691.

<sup>7</sup> 15 U.S.C. 78s(a)(1).

<sup>8</sup> 17 CFR 200.30-3(a)(16).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 43290 (September 13, 2000), 65 FR 57213 (September 21, 2000) (order approving SR-PCX-00-30).

providers.<sup>4</sup> The amount refunded to each market maker is based on the percentage of the total marketing fees that the market maker paid at each trading post during the rebate period. Currently, the PCX rebates excess marketing fees to PCX market makers on a quarterly basis.

The PCX is proposing to eliminate its current fee of \$0.40 per contract and to replace it with new fees, per option issue, as set forth in the PCX's Schedule of Rates. Only the amount of the fee is being changed. The PCX intends to collect the marketing fees set forth in the Schedule of Rates beginning with the September trade month and continuing until further notice.

The PCX is also proposing to change its method of rebating excess marketing fees to market makers. Specifically, the PCX intends to rebate the fees on a monthly, rather than quarterly, basis.<sup>5</sup>

## 2. Basis

The PCX believes that the proposed rule change is consistent with Section 6(b) of the Act.<sup>6</sup> The PCX believes that the proposal has been designed to provide for the equitable allocation of dues, fees and other charges among its members and other persons using its facilities, and therefore furthers the objectives of Section 6(b)(4) of the Act.<sup>7</sup> The PCX also believes that its proposed change with respect to the rebating of excess marketing fees has been designed to facilitate transactions in securities and to promote just and equitable principles of trade, thereby furthering the objectives of Section 6(b)(5) of the Act.<sup>8</sup>

### B. Self-Regulatory Organization's Statement on Burden on Competition

The PCX does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The PCX received eleven written comment letters and e-mails on the

proposal.<sup>9</sup> Generally, these commenters maintained that the proposal should not be adopted because it would impair the quality of the PCX's markets by reducing depth and liquidity;<sup>10</sup> would raise antitrust concerns;<sup>11</sup> would adversely impact options prices;<sup>12</sup> would be difficult to detect or prevent an LMM's misuse of funds;<sup>13</sup> would constitute an improper delegation of authority to private parties;<sup>14</sup> would subject the PCX to litigation;<sup>15</sup> and, generally, would be unfair.<sup>16</sup>

The PCX believes that the vast majority of these concerns were addressed and resolved in the Commission's order approving the proposal of the International Securities Exchange ("ISE") concerning payment for order flow.<sup>17</sup> The PCX believes that the PCX's fee change proposal, like the ISE's proposal, is "a reasonable competitive response \* \* \* to the adoption of similar payment-for-order-flow programs on other exchanges."<sup>18</sup> The PCX contends that, because its proposal involves marketing fees that are set on a per issue basis, in amounts ranging from \$0 to \$1.00 per contract, it is substantially similar to the program of the Philadelphia Stock Exchange ("Phlx") whereby the Phlx imposes a \$1.00 fee in certain issues (*i.e.*, the "Top

120 Options on the Phlx") and \$0 in others.<sup>19</sup>

The PCX believes that its proposed rule change is reasonable and equitable because, like the ISE's payment for order flow program, its fee has been "designed to enable the Exchange to compete with other markets in attracting options business."<sup>20</sup> In this regard, the PCX asserts that it needs greater flexibility in its marketing fee structure in order to compete effectively with the other options exchanges.<sup>21</sup> According to the PCX, while payment for order flow fees may be unaffordable to some market makers, the Commission has found that "the determination to impose them is a business decision legitimately made by the Exchange in assessing the costs that must be assumed if it is to remain competitive as a market center."<sup>22</sup> The PCX also noted that, under its proposal, no distinctions are made among PCX members with respect to the amounts that they must pay.

The PCX also noted its disagreement with the contention of certain commenters<sup>23</sup> that the proposal would involve an improper delegation of authority from the PCX to private parties. The PCX asserted that, although it considered suggestions and other input from the PCX membership on the proposed rate schedule, it also considered objective data<sup>24</sup> and ultimately made the final determination itself as to the specific fees to be charged per issue by virtue of this rule filing. With regard to the antitrust concerns raised by some of the commenters, the PCX noted that it has consulted with its legal counsel on antitrust issues and concluded that the proposal is consistent with the antitrust laws.

As to the PCX's ability to detect and prevent an LMM's possible misuse of funds, the PCX cited to the Commission's order approving the ISE's payment for order flow program, in which the Commission stated that it "expects [that] the ISE, in fulfillment of its self-regulatory function, will be alert to any inappropriate expenditure of such funds, in the service of particular members, or for use of these funds to

<sup>4</sup> See Securities Exchange Act Release No. 44071 (March 13, 2001), 66 FR 15939 (March 21, 2001) (SR-PCX-01-08).

<sup>5</sup> Under the current quarterly rebate program, the PCX would issue a rebate for the quarterly period that includes the July, August, and September trade months. During the transition to monthly rebates, the PCX anticipates that it would rebate the excess funds that were collected for the July and August trade months, and thereafter begin administering the rebates on a monthly basis.

<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(4).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> These included the following: letter from Karim Tahawi (and other PCX market makers) to the PCX Board of Governors, dated July 23, 2001 ("Tahawi letter"); letter from David B. Bayless, Morrison & Foerster LLP, to the PCX Board of Governors, dated July 23, 2001 ("Bayless letter"); letter from Joel Greenberg, Susquehanna International Group, to Thomas E. Connaghan, PCX, dated August 9, 2001 ("Greenberg letter"); letter from Paul Liang, PCX Lessors Association, to the PCX Board of Governors (undated) ("Liang letter"); letter from the Pacific Exchange Market Maker Association to the PCX Board of Governors, dated August 14, 2001 ("PEMMA letter"); e-mail from Richard Cabanes, PCX market maker, to Stephen Edman, PCX, dated August 14, 2001 ("Cabanes e-mail"); e-mail from Jamison Strofs, PCX market maker, to Stephen Edman, PCX, dated August 15, 2001 ("Strofs e-mail"); e-mail from Mark Cormier, PCX market maker, to the PCX Rates and Charges Committee, dated August 15, 2001 ("Cormier e-mail"); e-mail from Mark Cormier, Pacific Research and Trading ("PRT"), to the PCX Rates and Charges Committee, dated August 15, 2001 ("PRT e-mail"); letter from Mark Cormier, PCX market maker, to the PCX Board of Governors (undated) ("Cormier letter"); e-mail from Ronald Chin to Mike King, PCX, dated August 22, 2001 ("Chin e-mail").

<sup>10</sup> Tahawi letter; Bayless letter; Liang letter; Carbanes letter; Strofs letter; Cormier e-mail; PRT e-mail; Cormier letter.

<sup>11</sup> Tahawi letter; Bayless letter; Greenberg letter; PEMMA letter; PRT letter; Cormier letter.

<sup>12</sup> Bayless letter; Liang letter.

<sup>13</sup> Bayless letter; PEMMA letter.

<sup>14</sup> Greenberg letter; PEMMA letter.

<sup>15</sup> Chin e-mail.

<sup>16</sup> Bayless letter.

<sup>17</sup> See Securities Exchange Act Release No. 43833 (January 10, 2001), 66 FR 7822 (January 25, 2001) ("ISE Release").

<sup>18</sup> *Id.*

<sup>19</sup> See Securities Exchange Act Release No. 43177 (August 18, 2001), 65 FR 54330 (August 25, 2000).

<sup>20</sup> ISE Release, *supra*.

<sup>21</sup> The PCX added that, in the ISE Release, the Commission stated that "the U.S. options markets are in the midst of profound and dynamic structural change, resulting from the intense competition for options order flow." ISE Release, *supra*.

<sup>22</sup> *Id.*

<sup>23</sup> Greenberg letter; PEMMA letter.

<sup>24</sup> According to the PCX, this data included trading volume per issue, PCX market share per issue, disposition of previous marketing fees collected, relative size of each trading crowd, and other such information.

encourage trades on other exchanges.”<sup>25</sup>

Finally, in support of its position, the PCX included the following quote from the Commission’s order approving the ISE’s payment for order flow proposal:

Payment for order flow assumes many different forms and guises—as numerous as the many different kinds of incentives granted to order flow providers to induce them to send their business to them. Without more, this form of payment or incentive—however objectionable to some—cannot be said to be in itself inconsistent with the Act while other forms are accepted as consistent with the Act. In this context, the ISE proposal cannot be said to constitute an undue burden on competition.<sup>26</sup>

In the light of all of the foregoing, the PCX believes that its proposal is consistent with the Act, the rules thereunder, and the Commission’s order approving the ISE’s payment for order flow plan.<sup>27</sup>

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

Because the PCX has designated the foregoing as a fee change pursuant to Section 19(b)(3)(A) of the Act<sup>28</sup> and Rule 19b-4(f)(2) thereunder,<sup>29</sup> the proposal has become effective immediately upon filing with the Commission. At any time within 60 days after the filing of the proposed rule change, the Commission may summarily abrogate the rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the

public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission’s Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-2001-37 and should be submitted by October 19, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>30</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44829; File No. SR-Phlx-2001-30]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. Relating to the Alternative Wheel Allocation Model

September 21, 2001.

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> notice is hereby given that on March 6, 2001, the Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Phlx submitted Amendment No. 1 on May 21, 2001.<sup>3</sup> The Commission is publishing this notice to solicit

comments on the proposed rule change, as amended, from interested persons.

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

The Phlx proposes, on a six-month pilot basis, to amend Exchange Options Floor Procedure Advice (“OFPA”) F-24, AUTO-X Contra-Party Participation, to allow specialists, on an issue-by-issue basis, to elect to implement a new order assignment model for contra-side participation in orders delivered via AUTOM and automatically executed via AUTO-X.<sup>4</sup> The proposed order assignment model set forth in new proposed Section (e)(ii) of OFPA F-24 is called the Alternative Wheel Allocation Model (“Model”).

The proposed new rule text is as follows. Proposed new language is in *italics*.

#### F-24 AUTO-X Contra-Party Participation (The Wheel)

- (a) No change.
- (b) No change.
- (c) No change.
- (d) No change.
- (e)(i) Wheel Rotation/Assigning

Contracts—AUTO-X participation shall be assigned to Wheel Participants on a rotating basis, beginning at a random place on the rotational Wheel each day, from those participants signed-on in that listed option at that time. At a minimum, the Wheel shall rotate and assign contracts depending upon the size of the AUTO-X guarantee, as follows.

1-10 contracts  
every 2 contracts;  
11-25 contracts  
every 5 contracts;  
26 and more  
every 10 contracts

The Options Committee, or its designees, may approve a Wheel rotation in a size larger than the minimum stated above, if requested by the specialist and Wheel participants. However, the Wheel may not rotate in a size larger than ten contracts.

Each remaining portion shall be successively assigned to individual Wheel Participants on that same basis.

<sup>4</sup> AUTOM is the Exchange’s electronic order delivery and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually; alternatively, certain orders are eligible for AUTOM’s automatic execution feature, AUTO-X. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor.

<sup>25</sup> ISE Release, *supra*.

<sup>26</sup> *Id.* (footnotes omitted).

<sup>27</sup> *Id.*

<sup>28</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>29</sup> 17 CFR 240.19b-4(f).

<sup>30</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> Letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated May 17, 2001 (“Amendment No. 1”). In Amendment No. 1 the Phlx amended the proposed rule change by deleting rule language which would have set forth a minimum participation percentage of 30% for specialists and a maximum participation percentage of 60% for any single Wheel participant. In addition, in Amendment No. 1 the Phlx further amended its proposal to specify that the “Review Period,” during which the specialist and crowd participants may earn Participation Units, will last a maximum of 14 calendar days. Finally, the Phlx corrected several minor typographical errors contained in the original filing. The substance of Amendment No. 1 is incorporated into the description of the proposed rule change in Section II.A., below.