

Fund ("Regional Fund," and together with Large Cap Fund, the "Funds"). The Adviser, a Minnesota corporation, serves as investment adviser to the Funds and is registered as an investment adviser under the Investment Advisers Act of 1940. The Adviser is record holder of more than 5% of the outstanding shares of Regional Fund.

2. On February 20, 2000, the boards of directors of each Funds (together, the "Boards"), including the directors who are not "interested persons," as defined in section 2(a)(19) of the Act ("Independent Directors"), unanimously approved an agreement and plan of reorganization (the "Reorganization Agreement") under which Large Cap Fund will acquire the assets and liabilities of Regional Fund in exchange for Large Cap Fund shares (the "Reorganization"). The Large Cap Fund shares exchanged will have an aggregate net asset value equal to the aggregate net asset value of the Regional Fund's shares determined at the effective time of the Reorganization (the "Effective Time"), currently anticipated to occur on June 30, 2000. The net asset value per share of each Fund's shares will be determined in the manner set forth in the respective Fund's current prospectus and statement of additional information. At the Effective Time, Regional Fund will liquidate and distribute *pro rata* to its shareholders the Large Cap Fund shares.

3. Applicants state that the investment objectives of Large Cap Fund are identical to those of Regional Fund. Neither Large Cap Fund nor Regional Fund imposes any sales charges or distribution related fees. No sales charges will be imposed upon Regional Fund shareholders in connection with the Reorganization. The Adviser will pay the expenses of the Reorganization.

4. The Boards, including all of the Independent Directors, determined that the Reorganizations is in the best interests of each Fund, and that the interests of the existing shareholders of each Fund would not be diluted as a result of the Reorganization. In assessing the Reorganization, the Boards considered various factors, including: (a) The compatibility of each Fund's investment objectives and principal investment strategies; (b) the terms and conditions of the Reorganization; (c) the expense ratio of each Fund; and (d) the tax-free nature of the Reorganization.

5. The Reorganization is subject to a number of conditions, including that: (a) The Reorganization Agreement is approved by the Regional Fund shareholders; (b) the Funds receive an opinion of counsel that the

Reorganization will be tax-free; and (c) applicants receive exemptive relief from the Commission as requested in the application. The Reorganization Agreement may be terminated and the Reorganization abandoned at any time prior to the Effective Time if either Board determines that circumstances have changed to make the Reorganization inadvisable. Applicants agree not to make any material changes to the Reorganization Agreement without prior Commission approval.

6. A registration statement on Form N-14 containing a combined prospectus/proxy statement was filed with the Commission on April 10, 2000, and became effective on May 10, 2000. Proxy solicitation materials were mailed to Regional Fund's shareholders on May 23, 2000. A special meeting of Regional Fund shareholders is scheduled for June 15, 2000.

Applicants' Legal Analysis

1. Section 17(a) of the Act generally prohibits an affiliated person of a registered investment company, or an affiliated person of such a person, acting as principal, from selling any security to, or purchasing any security from, the company. Section 2(a)(3) of the Act defines an "affiliated person" of another person to include (a) any person directly or indirectly owning, controlling, or holding with power to vote 5% or more of the outstanding voting securities of the other person; (b) any person 5% or more of whose securities are directly or indirectly owned, controlled, or held with power to vote by the other person; (c) any person directly or indirectly controlling, controlled by, or under common control with the other person; and (d) if the other person is an investment company, any investment adviser of that company.

2. Rule 17a-8 under the Act exempts from the prohibitions of section 17(a) mergers, consolidations, or purchases or sales of substantially all of the assets of registered investment companies that are affiliated persons, or affiliated persons of an affiliated person, solely by reason of having a common investment adviser, common directors, and/or common officers, provided that certain conditions set forth in the rule are satisfied.

3. Applicants believe that because the Funds may be deemed to be affiliated by reasons other than having a common investment adviser, common directors, and/or common officers, they may not be able to rely on rule 17a-8 in connection with the Reorganization. Applicants state that the Adviser holds of record more than 5% of the outstanding securities of Regional Fund, and holds

or shares voting power and/or investment discretion with respect to a portion of these shares.

4. Section 17(b) of the Act provides, in relevant part, that the Commission may exempt a transaction from the provisions of section 17(a) if evidence establishes that the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned, and that the proposed transaction is consistent with the policy of each registered investment company concerned and with the general purposes of the Act.

5. Applicants request an order under section 17(b) of the Act exempting them from section 17(a) to the extent necessary to complete the Reorganization. Applicants submit that the Reorganization satisfies the standards of section 17(b) of the Act. Applicants state that the terms of the Reorganization are reasonable and fair and do not involve overreaching. Applicants state that the investment objectives of Regional Fund and Large Cap Fund are identical. Applicants also state that the Boards, including all of the Independent Directors, have determined that the participation of each Fund in the Reorganization is in the best interests of each Fund and that such participation will not dilute the interests of shareholders of each Fund. In addition, Applicants state that the Reorganization will be based on the Funds' relative net asset values.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42824; File No. SR-CBOE-99-40]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Operation of Retail Automatic Execution System; Nine-Month Pilot Program

May 25, 2000.

I. Introduction

On July 29, 1999, the Chicago Board Options Exchange, Inc. ("CBOE" 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")¹ and Rule 19b-4 thereunder,² a proposal to permit the appropriate CBOE Floor Procedure Committee ("FPC") to implement a new order assignment procedure for the Exchange's Retail Automatic Execution System ("RAES"). The new RAES order assignment procedure is called the "100 Spoke RAES Wheel." On January 21, 2000, the Exchange filed Amendment No. 1 to the proposed rule change.³ On February 14, 2000, the Commission published the proposed rule change and Amendment No. 1 in the **Federal Register**.⁴ The Commission received no comments on the proposal. This order approves the proposed rule change, as amended, for a pilot period of nine months through February 28, 2001.

II. Description of the Proposal

RAES is a part of the CBOE's order routing system that automatically executes customer market and marketable limit orders that fall within designated order size parameters. The maximum order size eligible for entry into RAES is 50 contracts for all classes of equity options and most classes of index options.⁵ All designated primary market makers ("DPMs") of a particular option class are required to log on RAES for that class; other market makers who trade that class on the floor may log on RAES but are not required to do so.⁶ When RAES receives an order, the system automatically attaches to the order its execution price, generally determined by the prevailing market quote at the time of the order's entry to the system, and a participating market maker will be designated as the counterparty on the trade.⁷ Participating market makers are assigned by RAES on a rotating basis, with the first market

maker selected at random from the list of logged-on market makers.⁸

In its filing, the Exchange described that its PFCs currently have two options by which to allocate RAES orders: The "entire order" procedure and "Variable RAES." Under the entire order procedure, RAES orders are assigned to market makers participating on RAES one order at a time to the market maker next in line on the "RAES Wheel." When a particular market reaches his or her turn on the Wheel, the market maker is assigned one entire order whether the order is for one contract or for the maximum number of contracts eligible for entry into RAES for that particular class of options. By contrast, under Variable RAES, for each options class in which market makers participates in RAES, market makers are permitted to designate the maximum number of contracts that they are willing to buy or sell each time it is their turn on the RAES Wheel, provided that the number of contracts selected is equal to or greater than a minimum number selected by the FPC.⁹ CBOE represents that its FPCs now employ Variable RAES for both equity options and index options.¹⁰

The current proposal provides the appropriate FPC with a third choice for apportioning RAES trades among participating market makers, the "100 Spoke RAES Wheel." Under the 100 Spoke RAES Wheel, RAES orders will be assigned to logged-in market makers according to the percentage of their in-person agency contracts (excluding RAES contracts) traded in that class compared to all of the market maker in-person agency contracts (excluding RAES contracts) traded during the review period. Agency contracts are defined as contracts that are represented by an agent and do not include contracts traded between market makers in person in the trading crowd. The CBOE represents that in-person agency contracts include trades by a market maker against a booked order or an order represented by a broker in the trading crowd, whether that order is for the account of another broker-dealer or for the account of a customer.¹¹ Agency

contracts do not include contracts executed through RAES.

Under the 100 Spoke RAES Wheel, on each revolution of the Wheel, each participating market maker who is logged on RAES at the time will be assigned a number of agency contracts that replicates the percentage of contracts on RAES that he or she traded in-person in that class during the review period, subject to the exceptions described below. The appropriate FPC will determine the review period but in no event may it set the review period for a period greater than two weeks. At the end of each review period, the appropriate FPC will recalculate the percentage of RAES orders to be distributed to each market maker participating on the 100 Spoke RAES Wheel. The percentage allotted to a particular market maker will be the same as the percentage of in-person agency contracts traded by that market maker in the Exchange crowd during the previous review period.¹² Any market maker that logs on the system during a particular review period will be guaranteed to receive an entitlement during that review period of no less than 1 percent of RAES contracts, or one "spoke" as explained below.¹³

The RAES Wheel may be envisioned as having a number of "spokes," each generally representing 1 percent of the total participation of all market makers in the class. Thus, a market maker generally will be assigned one spoke for each 1 percent of his or her market maker participation during the review period. If all market makers who traded in-person agency contracts in that option class during the review period are logged on RAES, no other market makers are logged on, the RAES Wheel

Assistant Director, and Gordon Fuller, Special Counsel, Division of Market Regulation, SEC, (May 1, 2000).

¹² All designees of the same DPM unit will have their percentage aggregated into a single percentage for the DPM unit. Because of this methodology, the DPM unit can still receive its entitled percentage even if any particular designee is not logged on RAES at the time.

¹³ The minimum entitlement applies to any market maker in a particular option class who logs on RAES during a given review period. Thus, new market makers who have not yet had time to acquire market share on the trading floor will be allocated a single spoke if they log on RAES during the first review period they traded that class on the Exchange floor. Similarly, an existing market maker who was on vacation for the whole of the previous review period, who thus had no trading history during that review period, would receive a one-spoke allocation if he or she logged on RAES during the first review period immediately following his or her return. Telephone conversation between Timothy Thompson, Director, Regulatory Affairs, and Anthony Montesano, Vice President, Trading Operations Department, CBOE; and Gordon Fuller, Special Counsel, and Michael Gaw, Attorney, Division of Market Regulation, SEC (May 19, 2000).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Timothy Thompson, Director, Regulatory Affairs, CBOE, to Nancy Sanow, Assistant Director, Division of Market Regulation, SEC, dated January 19, 2000.

⁴ See Securities Exchange Act Release No. 42396 (February 7, 2000), 65 FR 7404 (February 14, 2000).

⁵ See CBOE Rule 6.8(e).

⁶ Generally, a market maker may log on RAES in a particular equity option class (other than DJX) only in person and may continue on the system only so long as he or she is present in that trading crowd. Accordingly, a member generally may not remain on the RAES system and must log off the system when he or she has left the trading crowd, unless the departure is for a brief interval. See CBOE Rule 8.16(a)(iii). In option classes designated by the appropriate Market Performance Committee, any market maker who has logged on RAES at any time during an expiration month must log on the RAES system in that option class whenever he or she is present in that trading crowd until the next expiration. See CBOE Rule 8.16(b).

⁷ See CBOE Rule 6.8(a)(ii).

⁸ See CBOE Rule 6.8(d)(i).

⁹ CBOE Rule 6.8, Interpretation .06(b). See Securities Exchange Act Release No. 41821 (September 1, 1999), 64 FR 50313 (September 16, 1999) (approving implementation of Variable RAES).

¹⁰ Telephone conversation between Timothy Thompson, Director, Regulatory Affairs, CBOE, and Gordon Fuller, Special Counsel, Division of Market Regulation, SEC (May 16, 2000).

¹¹ Telephone conversation between Timothy Thompson, Director, Regulatory Affairs, and Anthony Montesano, Vice President, Trading Operations Department, CBOE; and Nancy Sanow,

would consist of 100 spokes, representing 100 percent of all market maker activity during the review period. Normally, one spoke on the Wheel would be equivalent to one contract, except that the appropriate FPC may establish a larger spoke size. For example, setting the spoke size to five contracts would redefine the RAES Wheel for a particular option class as a Wheel of 500 contracts. Changing the spoke size (and thus, the Wheel size) would not change the participation percentages of the individual market makers.¹⁴

For example, if there are twelve market in a crowd, consisting of ten veteran market makers each of whom accounted for 10 percent of total market maker trading (exclusive of RAES trades) during the review period, and two new market makers, and if nine of the veteran makers and both of the new market makers are logged on RAES, the RAES Wheel would consist of 92 spokes (ten spokes for each of the nine veteran market makers, and one spoke for each of the two new market makers),¹⁵ accounting for 92 contracts in a complete revolution of the Wheel. In this case, each of the veteran market makers would participate in ten out of every 92 contracts traded on RAES, and the two new market makers would each receive one out of every 92 contracts.

A wedge is the maximum number of spokes that may be assigned to a market maker in any one "hit" during a rotation of the RAES Wheel. The purpose of the wedge is to break up the distribution of contracts into smaller groupings to reduce the exposure of any one market maker to market risk. If the size of the wedge is smaller than the number of spokes to which a particular market maker may be entitled based on his or her participation percentage, that market maker would receive one or more additional assignments during one revolution of the RAES Wheel. For example, in the case where one spoke is equal to one contract and the market

maker's participation percentage is 15 percent (entitling it to 15 contracts on one RAES Wheel revolution, *i.e.*, 15 percent of 100) and the wedge size is ten, that market maker first would be assigned ten contracts on the RAES Wheel and then five contracts at a different place on the RAES Wheel during that same revolution. Thus, in one complete revolution of the RAES Wheel, the market maker would be assigned two times for a total of 15 contracts (assuming one contract per spoke), consisting of ten-contract assignment and one five-contract assignment. The wedge size would be variable at the discretion of the appropriate FPC and may be established at different levels for different classes, or at the same level for all classes.

III. Discussion

A. General

After careful review, the Commission finds that implementation of the proposed rule change on a pilot basis is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Sections 6(b)(5) and 6(b)(8) of the Act.¹⁶ Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to facilitate transactions in securities, to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest.¹⁷ Section 6(b)(5) also requires that those rules not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Finally, Section 6(b)(8) of the Act requires that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

B. An Important Step Forward

Currently, RAES assigns orders randomly to market makers who are logged on the system. The Commission believes that the 100 Spoke RAES Wheel takes an important step forward by rewarding those market makers who consistently execute a greater portion of agency orders in the trading crowd, rather than randomly assigning contracts to all market makers logged on

RAES. Although the 100 Spoke RAES Wheel does not reward a market maker for improving the Exchange's displayed quotation, it does reward the market maker for providing liquidity to orders in the trading crowd by linking the market maker's percentage of RAES contracts to the percentage of agency contracts it executed in the trading crowd. The Commission finds that it is consistent with the Act's purpose for the CBOE to take this step.

Under the two existing means of allocation, the size of the order assigned to a particular market maker is determined randomly.¹⁸ Under the entire order procedure, it is theoretically possible for a market maker who accounts for a significant percentage of in-person agency contracts in a given class of options to be randomly assigned only a minimal number of contracts with each turn of the Wheel. Conversely, a market maker who accounts for only a small percentage of the in-person agency contracts traded in the same option class could be randomly allocated on RAES the maximum number of contracts possible. The 100 Spoke RAES Wheel, however, will more closely allocate the percentage of contracts that a particular market maker can receive on a single revolution of the Wheel to the percentage of in-person agency contracts (excluding RAES contracts) traded on CBOE by that market maker. With the 100 Spoke RAES Wheel, market makers will have a greater incentive to compete effectively for orders in the crowd, and this, in turn, should benefit investors and promote the public interest.

The Commission also views the "wedge" system, which limits the number of "spokes" each market maker may be assigned consecutively, not to impose any unnecessary burden on competition, consistent with Section 6(b)(8) of the Act. The wedge system will not effect the *number* of contracts to which each market maker is entitled for each revolution of the Wheel, but only the *timing* of the assignment of contracts to each market maker. The wedge system ensures that each market maker eligible to participate during a particular review period will be assigned at least some contracts before market makers entitled to a greater number of spokes are assigned all of their contracts in a given revolution. The wedge system also reduces the exposure of market makers to market risk by breaking up the distribution of contracts into smaller groupings.

¹⁴ The CBOE has stated that Variable RAES and the 100 Spoke RAES Wheel cannot operate concurrently for trading in a given option class. Similarly, the "entire order" allocation procedure and the 100 Spoke RAES Wheel cannot operate concurrently for trading in a given option class. Telephone conversation between Timothy Thompson, Director, Regulatory Affairs, and Anthony Montesano, Vice President, Trading Operations Department, CBOE; and Gordon Fuller, Special Counsel, and Michael Gaw, Attorney, Division of Market Regulation, SEC (May 19, 2000).

¹⁵ The one-spoke allocation for each of the two new market makers would apply only during their initial review period. See *supra* note 13. After that initial review period, each of the two new market makers would be entitled to the number of spokes they had earned during the applicable review period.

¹⁶ 15 U.S.C. 78f(b)(5) and 78f(b)(8).

¹⁷ In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiently, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁸ However, under Variable RAES, the market maker has some flexibility in limiting the extent of its exposure during each revolution of the Wheel.

It is important to stress that implementation of the 100 Spoke RAES Wheel will have no effect on the prices offered to customers. Under CBOE Rule 6.8(a)(ii), RAES automatically provides to each retail customer order its execution price, generally determined by the prevailing market quote at the time of the order's entry into the system. The 100 Spoke RAES Wheel merely provides for a different contract allocation system than currently exists for automatic execution of small retail orders.

C. Pilot Program

The Commission is approving this proposal on a nine-month pilot basis, through February 28, 2001. As indicated above, the Commission anticipates that the 100 Spoke RAES Wheel will encourage market makers to compete effectively for order flow in the trading crowds, thus benefiting investors and serving the public interest. The Commission, however, intends to review the Exchange's experience with the 100 Spoke RAES Wheel during the course of the pilot program.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-CBOE-99-40) is approved on a pilot basis, through February 28, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42907; File No. SR-NASD-00-32]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Nasdaq's Transaction Credit Pilot Program

June 7, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 6, 2000, the National Association of Securities Dealers, Inc. ("NASD"

"Association"), through its wholly owned subsidiary The Nasdaq Stock Market, Inc. ("Nasdaq"), 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 Nasdaq. Nasdaq has designated this proposal as one establishing or changing a due, fee, or other charge imposed by the Association under Section 19(b)(3)(A)(ii) of the Act,³ which renders the proposal effective upon filing with the Commission. 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

Nasdaq proposes to amend NASD Rule 7010, System Services, to extend Nasdaq's transaction credit pilot program for an additional six months for Tape A reports, and reinstate for nine months the pilot for Tape B reports. The text of the proposed rule change is below. Proposed new language is in italics. Proposed deletions are in brackets.

* * * * *

7010 System Services

(a)-(b) No Change

(c)

(1) No Change

(2) Exchange-Listed Securities Transaction Credit. For a pilot period, qualified NASD members that trade securities listed on the NYSE and Amex in over-the-counter transactions reported by the NASD to the Consolidated Tape Association may receive from the NASD transactions credits based on the number of trades so reported. To qualify for the credit with respect to Tape A reports, an NASD member must account for 500 or more average daily Tape A reports of over-the-counter transactions as reported to the Consolidated Tape during the concurrent calendar quarter. *To qualify for the credit with respect to Tape B reports, an NASD member must account for 500 or more average daily Tape B reports of over-the-counter transactions as reported to the Consolidated Tape during the concurrent calendar quarter.* If an NASD member is so qualified to earn credits based *either* on its Tape A activity, *or its Tape B activity, or both*, that member may earn credits from *one or both pools* [the Tape A pool] maintained by the NASD, *each* [such] pool representing 40% of the revenue paid by the Consolidated Tape Association to the NASD *for each of Tape A and Tape B transactions.* A qualified NASD member may earn credits from *the pools* [the Tape A pool] according to the member's pro rata share of the NASD's over-the-counter trade reports in *each of* Tape A

and Tape B for each calendar quarter starting with [January 1, 2000, and ending with the calendar quarter starting on April 1, 2000] *July 1, 2000 for Tape A reports (April 1, 2000 for Tape B reports) and ending with the calendar quarter starting on October 1, 2000.*

* * * * *

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

In its filing with the Commission, Nasdaq 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. Nasdaq 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

Nasdaq proposes to extend until December 31, 2000, its pilot program to provide a transaction credit⁴ to NASD members that exceed certain levels of trading activity in exchange-listed securities. Nasdaq proposes to extend by six months the pilot for over-the-counter ("OTC") trades in securities listed on the New York Stock Exchange ("NYSE") (*i.e.*, from July 1, 2000 to December 31, 2000) and re-institute and extend by nine months the pilot for OTC trades in securities listed on the American Stock Exchange ("Amex") (*i.e.* from April 1, 2000 to December 31, 2000). The NASD established its transaction credit pilot to find ways to lower investor costs associated with trading listed securities, and to respond to steps taken by other exchanges that compete with Nasdaq for investor order flow in those issues.

Nasdaq's Third Market is a quotation, communication, and execution system that allows NASD members to trade stocks listed on the NYSE and the Amex. The Third Market competes with regional exchanges like the Chicago Stock Exchange ("CHX") and the Cincinnati Stock Exchange ("CSE") for retail order flow in stocks listed on the NYSE and Amex. The NASD collects quotations from broker-dealers that trade these securities OTC and provides such quotations to the Consolidated Quotation System for dissemination.

⁴ The transaction credit can be applied to any and all changes imposed by the NASD or its non-self-regulatory organization affiliates. Any remaining balance may be paid directly to the member.

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(ii).