

or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

The Commission has frequently raised serious concerns about payment for order flow and internalization.<sup>7</sup> Payment for order flow is of concern because brokers who are paid to send their customers' orders to one exchange have a conflict of interest that may reduce their commitment to the duty they owe their customers to find the best execution available. While payment for order flow has been a common practice in the equities markets for some time, only recently has payment for order flow developed in the options markets. Despite these concerns, however, the ISE's proposal involves the imposition of a fee, and the Act gives exchanges wide latitude to establish, revise, and collect fees and other charges without prior Commission approval. The Commission invites interested persons to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. In particular, the Commission asks persons who submit comments whether the payment for order flow facilitated by the ISE's proposal raises greater or different concerns than payment for order flow at other option exchanges. After receiving comments, and at any time within 60 days from the date the ISE filed its proposal, the Commission can decide to require the ISE to stop collecting the fee and await Commission approval of the Permanent Program.

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. Copies of such filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to File No. SR-ISE-00-24, and should be submitted by January 4, 2001.

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. 34-43678; File No. SR-PCX-00-08]

### Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to the Dissolution of the Appointments Committee

December 5, 2000.

#### I. Introduction

On March 20, 2000, the Pacific Exchange, Inc. ("PCX" or "Exchange") submitted to the Securities and Exchange Commission ("Commission" or "SEC") 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 eliminate the Options Appointment Committee and to transfer all of its powers to the Options Allocation Committee. On September 21, 2000, the Exchange submitted Amendment No. 1 to the proposal.<sup>3</sup> The proposed rule change was published for comment in the **Federal Register** on October 4, 2000.<sup>4</sup> No comments were received on the proposal. This order approves the proposal.

#### II. Description of Proposal

Currently, the PCX rules provide that it is the duty of the Options Appointment Committee to make recommendations to the Board of Governors regarding the appointment, assignment, retention, reassignment, transfer, and taking leave of the privileges to deal in and trade options to, by, and among members on the

Options Trading Floor.<sup>5</sup> The Options Appointment Committee is also responsible for appointing Market Makers and appointing and approving Lead Market Makers ("LMMs").<sup>6</sup> The Options Appointment Committee has the authority to relieve LMMs of their appointments, designate interim LMMs, and make determinations pertaining to LMM-related issues not within the jurisdiction of any other standing committee. Currently, the Options Allocation Committee allocates and reallocates issues and evaluates and monitors Market Makers, LMMs, and trading crowds. In the proposed rule change, the Exchange seeks to eliminate the Options Appointment Committee and to transfer all of its authority and duties to the Options Allocation Committee.

In this regard, the Exchange proposes to change all references to the "Options Appointment Committee" in PCX Rule 11.10(a) to the "Options Allocation Committee" and to transfer the language of PCX Rule 11.10(a), relating to the current duties of the Options Appointment Committee, to the Options Allocation Committee under new proposed PCX Rule 11.10(b)(2). The Exchange also proposes to renumber PCX Rule 11.10(b) as 11.10(a) and PCX Rule 11.10(c) as 11.10(b)(1). The Exchange proposes to change the references to the "Options Appointment Committee" in PCX Rules 6.35; 6.37; Commentary .08; 6.82(a)(1) and (3); 6.82(b)(1) and (2); 6.82(f)(3); 6.82(g)(1); and 6.82(h)(1) to the "Options Allocation Committee."

#### III. 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,<sup>7</sup> and in particular with the requirements of section 6(b) of the Act.<sup>8</sup> Specifically, the Commission believes that the proposed rule is consistent with the requirements of section 6(b)(5) of the Act<sup>9</sup> because it is designed to help perfect the mechanism of a free and open market and is not designed to permit unfair discrimination between customer and brokers or dealers.

The proposed rule change centralizes all rules relating to the approval,

<sup>7</sup> See Securities Exchange Act Release Nos. 43290 (September 13, 2000), 65 FR 57213 (September 21, 2000); 43228 (August 30, 2000), 65 FR 54330 (September 7, 2000); 43177 (August 18, 2000), 65 FR 51889 (August 25, 2000); 43112 (August 3, 2000), 65 FR 49040 (August 10, 2000); 42450 (February 23, 2000), 65 FR 10577 (February 28, 2000); 34902 (October 27, 1994), 59 FR 55006 (November 2, 1994). See also Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414 (December 1, 2000).

<sup>8</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> See letter from Cindy L. Sink, Senior Attorney, Regulatory Policy, PCX to Jennifer L. Colihan, Division of Market Regulation, Commission, dated September 20, 2000.

<sup>4</sup> See Securities Exchange Release No. 43342 (September 26, 2000), 65 FR 59242.

<sup>5</sup> See PCX Rules 6.35, 6.37, 6.82, and 11.10(c).

<sup>6</sup> See PCX Rules 6.35 and 6.82.

<sup>7</sup> In approving this rule proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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

<sup>9</sup> 15 U.S.C. 78f(b)(5).

evaluation, allocation to, and appointment of LLMs in one committee. The Commission finds that by doing so, it is likely that more consistent decisions regarding LLMs, and their role on the Exchange will be made. The Commission believes that this consistency will benefit customers and broker-dealers conducting business on the Exchange.

The Commission recognizes that currently, Market Makers and LLMs are not permitted to serve on the PCX Options Appointment Committee; however, they are permitted to serve on the PCX Options Allocation Committee. The Commission further recognizes that Market Makers and LLMs will continue to be permitted to serve on the Options Allocation Committee after it assumes the responsibilities of the Options Appointment Committee, and that this represents a change in the composition of persons who will make decisions regarding the appointments of Market Makers and LLMs.

The Commission does not believe it is contrary to the public interest, or the interests of PCX members, to allow Market Makers and LLMs to participate on the committee that appoints Market Makers and LLMs, make decisions to relieve LMMS of their appointments, designate interim LMMS, and make determinations pertaining to LMM-related issues not within the jurisdiction of any other standing committee.<sup>10</sup> The Commission expects that members of the Options Allocation Committee, including Market Makers and LLMs, will act fairly and in a non-discriminatory manner, and will recuse themselves from particular decisions, as appropriate. The Commission also expects that the Options Allocation Committee will continue to appoint only those members qualified for market maker positions, and will relieve Market Makers and LLMs of their positions only for appropriate reasons.

<sup>10</sup> The Commission notes that four of the nine members of the Chicago Board Options Exchange's ("CBOE") Modified Trading System Appointments Committee, which is responsible for the selection and removal of CBOE Designated Primary Market Makers ("DPM"), are Exchange members whose primary business is as a Market Maker, and two of the nine members are Exchange members whose primary business is as a Market Maker or as a DPM Designee. See CBOE Rule 8.80. In addition, the Philadelphia Stock Exchange's ("Phlx") Allocation, Evaluation and Securities Committee, which is the committee that appoints and evaluates specialists on the Phlx, and makes allocations, allows specialists and floor brokers to serve on the committee. See Phlx By-law Article X, Section 10-7.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43683; File No. SR-PHLX-00-67]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change and Amendment Nos. 1 and 2 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Related to PHLX Rule 1009A

December 6, 2000.

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 September 7, 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 and II below, which Items have been prepared by the PHLX.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change and Amendment Nos. 1 and 2 from interested persons and is simultaneously approving the proposal, as amended, on an accelerated basis.

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

The PHLX proposes to amend PHLX Rule 1009A, "Designation of the Index,"

<sup>11</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> On September 18, 2000, the PHLX amended the proposal to reflect the PHLX Rule 1009A(b)(6)(i), which established a concentration requirement for the Gold/Silver Index. See letter from Nandita Yagnik, PHLX, to Nancy Sanow, Senior Special Counsel, Division of Market Regulation ("Division"), Commission, dated September 15, 2000 ("Amendment No. 1"). The Commission approved the adoption of PHLX Rule 1009A(b)(6)(i) on July 25, 2000. See Securities Exchange Act Release No. 43070 (July 25, 2000), 65 FR 47551 (August 2, 2000) (order approving File No. SR-PHLX-00-69) ("July 25 Order"). On November 30, 2000, the PHLX amended the proposal to indicate that the PHLX will use Rule 19b-4(e) under the Act in accordance with the terms and conditions set forth in the order approving Rule 19b-4(e) under the Act. See letter from Carla Behnfeldt, Director, Legal Department New Product Development Group, PHLX, to Nancy Sanow, Division, Commission, dated November 30, 2000 ("Amendment No. 2").

provide for the listing and trading of narrow-based stock index options pursuant to Rule 19b-4(e) under the Act.<sup>4</sup>

The text of the proposed rule change is available at the Office of the Secretary, 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 PHLX 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 III below. The PHLX 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

The PHLX proposes to amend PHLX Rule 1009A(b) to provide for the listing and trading of narrow-based stock index options pursuant to Rule 19b-4(e) under the Act. The purpose of the proposal is to allow the PHLX to list and trade narrow-based index options immediately without filing a proposed rule change with the Commission under Section 19(b)(3)(A) of the Act prior to trading the product, as PHLX Rule 1009A(b) currently requires.

Currently, PHLX Rule 1009A(b) allows the PHLX to list and trade options on a narrow-based index 30 days after the Exchange files a proposal under Section 19(b)(3)(A) of the Act describing the index option, provided that the index meets the generic listing criteria set forth in PHLX Rule 1009A(b). The Commission release adopting Rule 19b-4(e) under the Act ("New Products Release"),<sup>5</sup> however, no longer requires a Section 19(b)(3)(A) filing and subsequent waiting period so long as the exchange relying on Rule 19b-4(e) under the Act has generic listing criteria approved by the Commission and meets certain other requirements.

The New Products Release indicated that products meeting the listing criteria

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

<sup>5</sup> See Amendment to Rule Filing Requirements for Self-Regulatory Organizations Regarding New Derivative Securities Products, Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998).