III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. 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 at the Commission's Public Reference Section, 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 CHX. All submissions should refer to File No. SR-CHX-95-04 and should be submitted by March 29, 1995.

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

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 and, in particular, with Section 6(b)(5) 11 and Section 11(b) 12 of the Act. The Commission believes that proposed interpretation and policy .03 to Rule 37 should further the objectives of Section 6(b)(5) and Section 11(b) through pilot program procedures designed to allow stops, in minimum variation markets, under limited circumstances that offer primary market price protection for customers whose orders are granted stops, while still adhering to traditional auction market rules of priority and precedence.13

In its orders approving the pilot procedures, ¹⁴ the Commission asked the CHX to study the effects of stopping stock in a minimum variation market. Specifically, the Commission requested information on (1) the percentage of

orders which received an out-of-range execution despite having been stopped; (2) whether limit orders on either side of the specialist's book were bypassed due to the execution of stopped orders at a better price (and to this end, the Commission requested that the CHX conduct a one-day review of all book orders in the five stocks receiving the greatest number of stops); and (3) specialist compliance with the pilot program's procedures.

The Exchange has submitted to the Commission several monitoring reports regarding its proposed interpretation of Rule 37. The Commission believes that, although these monitoring reports provide certain useful information concerning the operation of the pilot program, the Commission must conduct further analysis of the CHX data and, in particular, of the rule's impact on limit orders on the specialist's book before it can consider permanent approval thereof. To allow the Commission fairly and comprehensively to evaluate the CHX's use of its pilot procedures, without compromising the benefit that investors might receive under Rule 37, as amended, the Commission believes that it is reasonable to extend the pilot program until July 21, 1995.

First, the Exchange's latest monitoring report indicates that relatively few orders received an out-of-range execution despite having been stopped and, thus, did not benefit from the CHX proposal. The Commission believes that the pilot procedures provide a benefit to certain investors by offering primary market price protection to customers whose orders are granted stops in minimum variation markets. According to the CHX report, moreover, virtually all stopped orders were for 2,000 shares or less. In this respect, the proposed amendments should mainly

affect small public customer orders, which the Commission envisioned could most benefit from professional handling by the specialist.

Second, the CHX does not appear to believe that its proposed policy significantly disadvantages customer limit orders existing on the specialist's book.¹⁶ This conclusion is based on the Exchange's analysis of limit orders on the opposite side of the market at the time a stop was granted pursuant to the pilot program. As part of its analysis (which included a one-day review of the five stocks receiving the greatest number of stops), the CHX determined how often book orders which might have been entitled to an execution had the order not been stopped, in fact, were executed at their limit price by the close of the day's trading. In addition to aggregated data, the Exchange provided a detailed breakdown of the disposition of each order.

The Commission historically has been concerned that book orders may be bypassed when stock is stopped, especially in a minimum variation market.17 Based on the CHX's prior experience, the Commission did not have sufficient grounds to conclude that this long-standing concern had been alleviated. The Commission acknowledges, however, that the CHX's latest monitoring reports provide new information on this aspect of the pilot program. As a result, the Commission finds that additional time is necessary for the Commission to review such information and to ensure that Rule 37, as amended, does not harm public customers with limit orders on the specialist's book.

As for book orders on the same side of the market as the stopped stock, the Commission believes that the proposed requirements make it unlikely that these limit orders would be bypassed. Under the Exchange's pilot procedures, a stopped order can receive price improvement only if all preexisting CHX share volume at that price has been exhausted.

As for the pilot program's effect on limit orders on the same side of the market as the stopped stock, the CHX report suggests that a substantial majority of limit orders at the bid (for

^{11 15} U.S.C. 78f (1988).

^{12 15} U.S.C. 78f (1988)

¹³ For a description of CHX procedures for stopping stock in minimum variation markets, and of the Commission's rationale for approving those procedures on a pilot basis, *see* 1992 Approval Order, *supra*, note 3. The discussion in the aforementioned order is incorporated by reference into this order.

¹⁴ See supra, notes 3-6.

¹⁵ The Commission notes that this pilot program is intended to prevent orders from being executed outside the primary market range for the day (i.e., from establishing a new high or new low). Consistent with that policy, the CHX requires the specialist to execute stopped stock based on the next primary market sale. Specifically, if the next sale is at a better price, the stopped stock may depending on the depth of the specialist's limit order book at that price, receive price improvement. However, if the next primary market sale is at the stop price (or worse), the order can receive the stop price. If an order is executed at the stop price because the next sale creates a new primary market range, the pilot program may still have provided a benefit to investors, by preventing what would have been an out-of-range execution.

Conversely, an order may not benefit from the CHX proposal if, despite having been stopped, it ultimately receives an out-of-range execution. In a minimum variation market, this can occur if, by the close, (1) the primary market has not traded at the stop price and (2) *all* pre-existing limit orders on the CHX specialist's book at the better price have not been executed.

¹⁶ When stock is stopped, book orders on the opposite side of the market that are entitled to immediate execution lose their priority. If the stopped order then receives an improved price, limit orders at the stop price are bypassed and, if the market turns away from that limit, may never be executed.

¹⁷ See, e.g., SEC, Report of the Special Study of the Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess. Pt. 2 (1963). Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess. Pt. 2 (1963).