include customer account identification, order number, time of order receipt and, in addition, must include in the terms of the order, some price-specific instruction provided by the customer.

The Commission is adding the requirement that the customer provide some price-specific instructions or indications to assure that the customer has had an opportunity to determine a price at which the transaction should be executed, in that exchange markets, unlike OTC markets, contemplate agency as well as principal-to-principal transactions. The Commission notes that, unlike trading on most other markets and the futures exchanges,52 there will be no published or otherwise open or publicly, readily available bid or offer prices for transactions executed using special execution procedures.53 The only pricing data that would be publicly available to the customer is the post-execution report of previous transactions, required to be disseminated by paragraph (e)(2) of Rule 36.3.54

Under these circumstances, the Commission believes that requiring some price indication, rather than just specifying "market price," for instance, provides a means to help the customer determine whether the FCM or floor broker is fulfilling his fiduciary duty to exercise due diligence in the execution of the customer's order. It also is intended to improve the enforceability of section 36.9, which prohibits fraud and manipulation in connection with section 4(c) contract market transactions.

The customer-provided, price-specific information could take various forms. A "limit order" or an order that contains a specific, negotiated price at which the customer wants the order to be executed may be examples of such information. A customer-provided maximum price on a

buy order or minimum price on a sell order also would fulfill the requirement. In addition, where special execution procedures may be used to fill large orders that cannot be filled in a single transaction, thereby requiring partial executions at different times and prices to obtain a complete fill, a customerprovided range of acceptable prices at which transactions could be executed to fill the order would meet the requirement.

In proposing section 36.3, the Commission indicated that regulations for which exchange alternatives could be submitted include the audit trail requirements of Commission Rule 1.35.55 A Commission Administrative Law Judge urged the Commission not to amend Commission Rule 1.35(a-1), which generally requires FCMs, introducing brokers and contract market members to identify customer accounts upon receipt before the trades are executed.56 According to this commenter, "[e]ven the most sophisticated clients will be unable to protect their own interest if the Commission omits th[is] very tool such clients would use to detect fraud.'

The Commission agrees that customer account identification can be an important component in detecting customer abuse. The information required to be recorded on the written record that must be created by the FCM or floor broker for each section 4(c) contract market customer order exceeds that required by Commission Rule 1.35(a-1). In addition to account identification, order number and time of order receipt, the written record must include the terms of the order. including, as previously discussed, some price-specific instructions from the customer.

## c. Combination Transactions

Paragraph (d) of section 36.3 provides that if they meet certain additional requirements, section 4(c) contract market rules could permit transactions to be executed using a combination of special execution procedures and competitive on-floor procedures. The exchange could require, for example, that some, or all, of any section 4(c) contract market transactions negotiated using special execution procedures be exposed to the floor for execution.<sup>57</sup> In this regard, the CSCE commented

The Commission believes, however, that the exchanges should be free to develop approaches that would best serve the identified needs of their customers consistent with the rule. In this connection, exchange rules permitting the use of combined procedures would be required to set forth the circumstances under which such transactions could or should occur competitively on-floor, *i.e.*, under what conditions, when, and to what extent any portion of a section 4(c) contract market order should be exposed to the pit.

Of course, each exchange will continue to have an affirmative obligation under sections 5 and 5a of the Act and Commission Rules 1.51 and 1.52 to carry out a program for the enforcement of its rules relating to the trading of section 4(c) contract market transactions. This includes, in particular, those rules relating to special execution procedures and the associated procedures that the exchange has in place to address the maintenance of orderly markets which are free from fraud and other abuses. As stated above, the Commission will evaluate its experience with section 4(c) contract market transaction special execution procedures after their implementation and determine whether further specific guidance is necessary or appropriate.

In addition, exchange rules that permit section 4(c) contract market transactions to be executed using any combination of special execution procedures and competitive on-floor procedures must provide that any transaction executed using special execution procedures must be in compliance with the requirements of paragraphs (b) and (c) of section 36.3, discussed above. As previously stated, any section 4(c) contract market transaction executed competitively on-floor must comply with applicable

<sup>&</sup>lt;sup>52</sup>Trades executed directly between customers, in the securities "fourth market," do not have any price reporting or other pricing requirements.

<sup>53</sup> Unlike auction markets or markets with designated market makers, prices for transactions using special execution procedures would be determined through negotiation. Nonetheless, Exchange rules could require that members maintain and disseminate bid and offer prices.

<sup>&</sup>lt;sup>54</sup> Certain trades executed by affiliated investment companies, however, have a pricing restriction imposed by Regulation 17a–7, 17 CFR § 270.17a–7 (1995). Under this regulation, transactions that are (1) at current market prices, (2) between certain affiliates, and (3) reviewed by the affiliates' boards, are exempt from the prohibition against affiliated investment company transactions contained in Section 17 of the Investment Company Act of 1940. Pension law also imposes some restrictions on transactions between affiliated entities. The exchanges may want to impose their own restrictions on the pricing of affiliated transactions in this market in order to attract customers who operate under such restrictions.

<sup>55 59</sup> FR at 54145.

 $<sup>^{56}\</sup>mbox{This}$  commenter also made a passing reference to Rule 1.35(a-2), but did not provide any further explanation.

<sup>&</sup>lt;sup>57</sup>New York Stock Exchange ("NYSE") Rule 76, which governs cross trading, requires that a member who has set up a block trade and is bringing it to the floor to be crossed first announce the proposed

bid, offer, and transaction size to the floor. The member must then wait a reasonable amount of time to allow the "crowd" (including specialists) to trade against either side before completing the transaction. In addition, NYSE Rule 127 provides that members who bring block trades to the floor that are priced outside current quotations must permit the crowd to participate in a portion of the block. See also NYSE Rule 72, which provides priority to an agency cross transaction where both orders consist of 25,000 shares or more. See also SEC Release No. 34-35837 (June 12, 1995)(order approving proposed NYSE rule changes that prevent members with knowledge of block orders for execution after the close from effecting transactions in that stock with the intention of reversing the position by participating in the contraside of the block trade and that require members to establish and maintain procedures reasonably designed to review block trading activities). that "it is inappropriate, in the case where transactions can occur both in the pit and off the floor, to not require a potential trade to be exposed to the pit.