

DTC's proposal, stating generally that the destruction of the non-transferable securities certificates would promote efficiency and would reduce expenses within the securities industry.<sup>8</sup>

#### IV. Discussion

We note that Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to assure the safeguarding of funds and securities which are in its custody or control or for which it is responsible.<sup>9</sup> In Section 17A(a)(1)(B) of the Act, Congress stated its finding that inefficient procedures for clearance and settlement imposed unnecessary costs on public investors.<sup>10</sup> Section 17(a) of the Act and Rule 17a-1 thereunder provides that a registered clearing agency must maintain certain records for a period of five years.<sup>11</sup> (The Commission has previously taken the position that Rule 17a-1 includes records pertaining to worthless securities certificates.)<sup>12</sup>

DTC correctly stated in its rule proposal that the Commission has twice approved DTC programs that authorized DTC to destroy certain securities certificates. In 1990, the Commission approved a proposed rule change enabling DTC to destroy certificates representing expired and worthless warrants, rights, and put options, provided DTC maintained copies of such certificates for seven years after their destruction.<sup>13</sup> In 2001, the Commission approved a DTC proposed rule change that authorized DTC to destroy matured book-entry only ("BEO") debt securities certificates, together with their related DTC letters of transmittal and DTC redemption summary payment forms, provided that DTC maintain microfilm or computer images of these BEO certificates and related paperwork for ten years following their destruction.<sup>14</sup> In both cases, the Commission indicated that it

Division, Securities Industries Association (February 6, 2004); Thomas Davis, Morgan Stanley (received March 1, 2004); and Jack R. Weiner, Managing Director & Deputy General Counsel, DTC (June 2, 2004).

<sup>8</sup> One commenter, Wachovia Securities, while supportive of DTC's proposal, appeared to raise the issue of the possibility of non-transferable securities certificates returning to circulation in the marketplace. In response, DTC submitted a comment letter stating that it had contacted the commenter to discuss the commenter's issue and that the commenter was supportive of the proposal and that the Commission should move forward with approving the proposal.

<sup>9</sup> 15 U.S.C. 78q-1(b)(3)(A).

<sup>10</sup> 15 U.S.C. 78q-1(a)(1)(B).

<sup>11</sup> 15 U.S.C. 78q(a); 17 CFR 240.17a-1.

<sup>12</sup> *Supra* note 3.

<sup>13</sup> *Supra* note 3.

<sup>14</sup> *Supra* note 4.

avored the efficiencies involved in eliminating custodial services for certain categories of worthless securities certificates provided there are proper disposal procedures in place and proper records being maintained of the destroyed certificates.

We note that DTC's new program provides that: (1) The securities certificates in question must have been held by DTC in non-transferable status for at least six years before DTC may destroy them and (2) DTC will maintain electronic images of the destroyed certificates for at least six years after the certificates are destroyed. Thus, for recordkeeping purposes, the certificates will be available either in original form or in imaged form for two consecutive periods of not less than six years, a total of not less than 12 years.<sup>15</sup>

In this case, we believe that the protections required by Section 17A(b)(3)(F) and goals set forth in Section 17A(a)(1)(B) of the Act and other applicable provisions are met by DTC's proposal. The new DTC program provides for: (1) Secure certificate disposal procedures that will be overseen and witnessed by DTC personnel and (2) appropriate certificate imaging and recordkeeping.

#### V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-2003-09) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>15</sup> See also Rules 17Ad-6(c) and 17Ad-7(d) under the Act, whereby transfer agents are required to maintain cancelled certificates for "not less than six years." 17 CFR 240.17Ad-6(c) and 17Ad-7(d).

<sup>16</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49942; File No. SR-PCX-2004-12]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the Pacific Exchange, Inc. Creating an Additional Processing Capability for PNP Orders Called "PNP Plus"

June 29, 2004.

On February 23, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly-owned subsidiary, PCX Equities, Inc., filed with the Securities and Exchange Commission ("Commission"), 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 amend the rules governing the Archipelago Exchange ("ArcaEx") to create an additional processing capability for Post No Preference ("PNP") Orders designated as PNP Plus. On April 23, 2004, PCX submitted Amendment No. 1 to the proposal.<sup>3</sup> PCX submitted Amendments No. 2<sup>4</sup> and 3<sup>5</sup> on April 28, 2003 and May 11, 2004, respectively. The proposed rule change, as amended, was published for notice and comment in the **Federal Register** on May 24, 2004.<sup>6</sup> The Commission received no comment letters on the proposal.

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

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

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

<sup>3</sup> See letter from Steven B. Matlin, Senior Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated April 22, 2004 ("Amendment No. 1"). Amendment No. 1 superseded and replaced the original rule filing in its entirety. In Amendment No. 1, the PCX changed the proposal to make PNP Plus Order election an order-by-order designation, made conforming and clarifying changes in the rule text, and provided an example of how a PNP Plus Order would be processed.

<sup>4</sup> See letter from Steven B. Matlin, Senior Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated April 27, 2004 ("Amendment No. 2"). In Amendment No. 2, the PCX corrected typographical errors and made clarifying changes in the rule text.

<sup>5</sup> See letter from Steven B. Matlin, Senior Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 10, 2004 ("Amendment No. 3"). In Amendment No. 3, the PCX made a clarifying edit to the rule text.

<sup>6</sup> See Securities Exchange Act Release No. 49713 (May 17, 2004), 69 FR 29609.

exchange<sup>7</sup> and, in particular, the requirements of Section 6(b)(5) of the Act.<sup>8</sup> Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanisms of a free and open market and national market system, and, in general, to protect investors and the public interest.

The Commission notes that the proposed rule change creates an additional processing capability for PNP Orders designated as PNP Plus. While an ordinary PNP Order is automatically cancelled in the event that such order locks or crosses the national best bid or offer ("NBBO"), a PNP Plus designation would avoid such cancellation in the event that the PNP Order would lock or cross the NBBO by re-pricing the PNP Order by one penny greater than the national best bid (for sell orders) or one penny lower than the national best offer (for buy orders) and posting the re-priced PNP Order in the ArcaEx Book. With each subsequent change in the NBBO, the PNP Order would continue to be re-priced and re-posted in this manner until such time that the original PNP Order price would not lock or cross the NBBO, at which time the PNP Order would revert to its original price. The Commission notes that such order would be assigned a new price time priority as of the time of each re-posting in the ArcaEx Book. The Commission believes that the PNP Plus designation should extend additional flexibility to PNP Orders and that it should provide ETP Holders and Sponsored Participants with enhanced trading options. Further, the Commission believes that the proposed rule change should help improve the efficiency of order interaction on ArcaEx by increasing the opportunity for PNP Orders to execute, while avoiding locked and crossed markets. Therefore, the Commission finds that the proposed rule change, as amended, is consistent with the Act.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>9</sup> that the proposed rule change (SR-PCX-2004-

12), as amended by Amendment Nos. 1, 2, and 3, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49949; File No. SR-PCX-2004-55]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to a Twelve-Month Extension of the Automatic Execution System Book Function Pilot Program

June 30, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on June 28, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by PCX. PCX filed the proposed rule change as "non-controversial" pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6)<sup>4</sup> thereunder. 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

PCX is proposing to amend its rules to extend the Automatic Execution System ("Auto-Ex") Book Function Pilot Program for one year until June 30, 2005. The text of the proposed rule change is available at PCX 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, PCX 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. PCX 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

On June 22, 2001, the Commission approved, on a one-year pilot basis, the Exchange's proposal to amend PCX Rule 6.87, which allows automatic executions of orders in the Exchange's Limit Order Book when those orders become marketable.<sup>5</sup> On June 17, 2002, the Commission approved a one-year extension of the pilot program.<sup>6</sup> On June 17, 2003, the Commission approved a one-year extension of the pilot program.<sup>7</sup> The pilot program is currently set to expire on June 30, 2004.

The Auto-Ex<sup>8</sup> Book Function of the Pacific Options Exchange Trading System ("POETS") permits orders in the Limit Order Book to be executed via the Auto-Ex system when those orders become marketable subject to certain procedures. The function may be used when one or more orders in the Limit Order Book become marketable, as indicated by a locked or crossed market being displayed on the trading floor. When this occurs, the Lead Market Maker may direct the Order Book Official to initiate the Auto-Ex Book Function, which will cause marketable orders in the Limit Order Book to be automatically executed against the accounts of Market Makers who are participating on the Auto-Ex system at the time.

The Exchange is requesting an additional extension of the pilot program for one year from June 30, 2004 through June 30, 2005. The Exchange represents that the added time permits the Exchange to phase-in the Exchange's new trading platform for options, "PCX

<sup>5</sup> See Exchange Act Release No. 44468 (June 22, 2001), 66 FR 34505 (June 28, 2001).

<sup>6</sup> See Exchange Act Release No. 46082 (June 17, 2002), 67 FR 42307 (June 21, 2002).

<sup>7</sup> See Exchange Act Release No. 48043 (June 17, 2003), 68 FR 37190 (June 23, 2003).

<sup>8</sup> Auto-Ex is the Exchange's Automated Execution system feature of POETS for market or marketable limit orders. POETS is the Exchange's automated trading system comprised of an options order routing system, an automatic execution system ("Auto-Ex"), an on-line limit order book system and an automatic market quote update system. Option orders can be sent to POETS via the Exchange's Member Firm Interface ("MFI"). Market and marketable limit orders sent through the MFI will be executed by Auto-Ex if they meet order type and size requirements of the Exchange.

<sup>7</sup> In approving this proposed rule change, the Commission notes that it 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)(5).

<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 217 CFR 240.19b-4.

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

<sup>4</sup> 17 CFR 240.19b-4(f)(6).