

MEMO# 12489

August 16, 2000

DECIMALS IMPLEMENTATION PLAN FOR THE EQUITIES AND OPTIONS MARKETS

[12489] August 16, 2000 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 44-00 SEC RULES COMMITTEE No. 106-00 RE: DECIMALS IMPLEMENTATION PLAN FOR THE EQUITIES AND OPTIONS MARKETS As we previously informed you, in January the Securities and Exchange Commission ordered the various U.S. stock exchanges (the "participants") to act jointly in discussing, developing, and submitting to the Commission a plan to implement decimal pricing in the equities and options markets (the "Decimals Implementation Plan" or the "Plan") beginning no later than July 3, 2000, and in implementing the Decimals Implementation Plan.¹ In June, the SEC modified its original order and required the exchanges to develop a plan that will provide for the implementation of decimal pricing on or before September 5, 2000. The resulting Plan is summarized below and a copy is attached.

I. PROPOSED IMPLEMENTATION PHASES In response to the Commission's order to produce a Decimals Implementation Plan, the participants have recommended a phased-in implementation consisting of four phases. As proposed, implementation would begin August 28, 2000 and be completed, with full implementation of decimal pricing for all equities and options, on or before April 9, 2001. The Plan would remain in effect until the Commission approves rules for each participant that designates the minimum increment by which equities and options are quoted or until any other date set by the Commission. The proposed implementation phases are as follows:

- Phase I -- Limited Exchange-Listed Issues (Monday, August 28, 2000) -- The initial phase would involve a minimum of 10 to 15 exchange-listed equity issues (and options on those equities) quoting in decimals per a recommended minimum price variation schedule (discussed below). During Phase I, the participants, with the cooperation of interested parties,² will evaluate the industry's transition to decimals.
- Phase IIA -- Additional Exchange-Listed Issues (Monday, September 25, 2000) -- Phase IIA would consist of a partial conversion of approximately 50 to 100 exchange-listed equity issues and options on those issues. This phase would continue through the last day the Plan is in effect, during

¹ See Memorandum to Equity Markets Advisory Committee No. 4-00 and SEC Rules Committee No. 15-00, dated January 31, 2000.

² As used in the Plan, the term "interested parties" includes the Securities Industry Association, the Depository Trust and its two operating subsidiaries, the National Securities Clearing Corporation and the Depository Trust Company, the Options Clearing Corporation, the Securities Industry Automation Corporation, the Intermarket Trading System Operating Committee, the Options Price Reporting Authority, and Consolidated Tape Association, and the Consolidated Quote Operating Committee.

² which time the participants would continue to evaluate the transition to decimal pricing and its impact on the industry, especially as they relate to capacity, liquidity, and trading patterns.

- Phase IIB -- Full Conversion of Exchange-Listed Issues and/or Options Checkpoint (November 2000 - April 2001) -- Phase

IIB would occur following a determination that full implementation of decimal pricing would not adversely impact the public. (See discussion under Checkpoint 3, below.) In Phase IIB, the participants may elect to fully convert all exchange-listed issues and/or all options issues (both exchange-listed and Nasdaq-listed) to decimal quoting. Any decision to fully convert exchange-listed issues and/or all options or to implement a penny pilot on options will be made during the period between November 2000 and April 2001 and a notice would be widely disseminated to the industry and the public at least 30 days prior to such conversion or implementation.

- Phase III -- Limited Nasdaq Issues (March 12, 2001) -- Nasdaq issues would begin to be phased in on or before March 12, 2001 and continue until the last day the Plan is in effect. Approximately 10- 15 Nasdaq equity issues will quote in decimals.
- Phase IV -- All Markets, Full Implementation (April 9, 2001) -- This phase would follow Checkpoint V, discussed below. As such, if the participants and interested parties are technically prepared for full implementation, and such implementation would not cause adverse impacts to the investing public, full implementation would begin on or before April 9, 2001 and continue through the last day that the Plan is in effect.
- Post-Phase-in Process -- The post phase-in process will begin at the end of the phase-in period and last no more than two months. During this time, the participants will review the phase-in period and the impact of decimal pricing on systems capacity, liquidity, and trading behavior. The participants will submit joint and/or individual studies that document the impacts of decimal pricing and that may contain a recommendation on whether there should be a uniform minimum increment for equities or options or both. Absent SEC action on the study and recommendations, no later than thirty days after the filing of the study each participant will submit proposed rule changes to the SEC to establish its choice of minimum increments by which equities or options will be quoted on its market.

3II. THE MINIMUM PRICE VARIATION

In connection with this phased-in implementation, the participants have recommended a Minimum Price Variation ("MPV") that would be applied until the last day the Plan is in effect. The recommended MPV schedule for quoting, to which the participants agreed to adhere, is as follows: for equity issues -- .01 MPV; for options issues quoted under \$3 a contract -- .05 MPV; and, for option issues quoted at \$3 a contract or greater -- .10 MPV.

III. CHECKPOINTS

The participants have identified five checkpoints where the participants will formally evaluate the results of the phase-in program and determine the industry's ability to implement decimal pricing without disruption to the investing public. These checkpoints are as follows:

- Checkpoint I -- Pre-implementation Evaluation (August 15, 2000) -- At this checkpoint the participants will poll the interested parties, review industry mandated testing results, and confer with the SEC on the industry's preparedness to proceed with Phase I (on August 28th).
- Checkpoint II -- Determine Readiness for Additional Exchange-Listed Issues (September 19, 2000) -- After polling the interested parties, the participants will confer with the SEC on the industry's preparedness to proceed with Phase II. By the end of July 2000, the participants will identify the additional equity issues and option on such issues to be quoted in decimals in Phase II.
- Checkpoint III -- Determine Readiness for Full Implementation of Exchange-Listed Issues and/or Options (November 1, 2000) -- After evaluating the results of Phases I and II, the participants may elect to fully convert all exchange-listed issues and/or all option issues (both exchange-listed and Nasdaq-listed) to decimal quoting or to implement a penny pilot in selected option issues.
- Checkpoint IV -- Limited Nasdaq Issues (March 5, 2001) -- The participants will poll the interested parties, review industry testing, and confer with the SEC on the industry's preparedness to proceed with Phase III on or before March 12th. In the beginning of January 2001, the Nasdaq will identify the Nasdaq equity issues to be quoted in decimals.
- Checkpoint V -- Determine Readiness for All Markets; Full Implementation (April 2, 2001) -- At the final checkpoint, the participants will evaluate the results of the first three phases of decimal quoting and, if they determine that they and the interested parties are technically prepared for full

implementation and that it would not adversely affect the investing public, they will proceed with full implementation of all-exchange listed issues and all Nasdaq issues and options thereon on or before April 9, 2001. 4IV. FALLBACKS The Plan also includes express provisions governing participant fallback to fractional pricing in the event there are problems with decimal pricing. These provisions differ depending upon the type of security involved, the extent of the problem (e.g., whether it is limited to a regional exchange), and the Phase within which it occurs. For example, for options quoting during Phase I and Phase II, there will be no intra-day fallback to fractional pricing and issues must quote on every exchange in the same format, either decimal or fraction. By contrast, however, for equity quoting during Phase I and Phase III there may be an intra-day fallback to fractional pricing as a last resort after all other efforts have been exhausted to remediate the problem. * * * *
Amy B.R. Lancellotta Senior Counsel Attachment Attachment (in .pdf format)

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