

change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 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 Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of NSCC. All submissions should refer to File No. SR-NSCC-00-10 and should be submitted by January 8, 2001.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>4</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43689; File No. SR-NYSE-98-25]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the New York Stock Exchange, Inc. Relating to the Creation of a Floor Audit Trail

December 7, 2000.

#### I. Introduction

On August 4, 1998, the New York Stock Exchange, Inc. ("NYSE" 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<sup>2</sup> thereunder, a proposed rule change. In its proposal, the NYSE seeks to adopt new provisions in NYSE Rule 123, to provide for the capturing of details of an order systemically on the Floor of the Exchange. The proposed provisions require that the details of all orders be recorded in an electronic

system prior to being represented or executed on the Floor. On December 21, 1998, and June 8, 1999, respectively, the Exchange filed Amendment Nos. 1 and 2 to the proposed rule change.<sup>3</sup> The proposed rule change, including Amendment Nos. 1 and 2, was published for comment in the **Federal Register** on August 12, 1999.<sup>4</sup> The Commission received no comments on the proposed rule change and this order approves it.

#### II. Description of the Proposal

The Exchange has proposed a series of initiatives to strengthen the regulation of activities of members on the Floor. In this filing, the Exchange proposes to adopt new provisions in NYSE Rule 123 for recording the details of an order, as well as any modification or cancellation of such order, in an electronic system prior to representing or executing an order on the Floor.

The proposed amendment to NYSE Rule 123 defines an order as any written, oral or electronic instruction to effect a transaction. Paragraph (e) of the proposed rule requires that, prior to being represented, an order, including any changes in its terms and any cancellations, must be entered into an electronic system that records the order details and records the time the order details were entered into the system and the time of any modification or cancellation. Nevertheless, the proposed rule excludes transactions initiated on the Floor and executed by a registered competitive market maker, a competitive trader or a specialist for their own account, as such trades may be initiated on the Floor and are already reported to the Exchange. In addition, the proposed rule provides that members may use either a proprietary or an Exchange system to comply with the rule, and if a proprietary system is used, order details must be sent to a designated NYSE database.

The proposal requires that, other than as noted above, before representing or executing an order on the Floor, a member, whether acting as agent for another member on the Floor or otherwise, is obligated to make sure that the details of such order have been entered in an electronic system in accordance with the requirements of the rule. The Exchange represents that the

details of the order may be entered into the system by an individual or organization other than the member who is representing or executing the order, but if this were to occur, the member with the order could not represent or execute the order until the details of the order were recorded in an electronic system.

According to the NYSE, this proposed rule change does not replace existing requirements for recording orders contained in Exchange or Commission rules. For example, NYSE Rule 123, under the heading "Receipt of Orders," requires each member to preserve for three years a record of every order received by that member on the Floor from off the Floor, including the time when such order was received. NYSE Rule 410 requires each member or member organization to preserve for three years a record of every order transmitted to the Floor or received and carried to the Floor by such member or member organization, including the name and amount of security, the terms of the order, the time it was transmitted or received, and the time an execution report was received.

The proposal requires that members enter the following order details: symbol; clearing member organization; order identifier (as assigned by the member or member organization recording the order details)<sup>5</sup> that uniquely identifies the order; identification of member or member organization recording order details; quantity; side of market (e.g., buy, sell long, sell short, sell short exempt); designation as market, limit, stop or stop limit; limit price, stop price and stop limit price (if applicable); time in force (e.g., day, GTC, GTX);<sup>6</sup> designation as held or not held;<sup>7</sup> special conditions (e.g., Rule 10b-18, "G" order and any request by a customer that an order not be displayed); and, a system-generated timestamp. The proposed rule would also require the systematic entry of such other details as the Exchange may require from time to time.

Along with this rule change, the Exchange proposes to design a database

<sup>5</sup> According to the Exchange, its Broker Booth Support System ("BBSS") automatically assigns a unique order identifier to the order, but a member or member organization can choose instead to override this feature and assign its own unique identifier.

<sup>6</sup> The Exchange represents that an order designated as good until a specific time will be recorded in a separate memo field (rather than in the time in force field) as a special condition or special instruction.

<sup>7</sup> The Exchange represents that this designation will also be recorded in a separate memo field (or fields) that will allow other special instructions and special conditions to be entered in a free format.

<sup>4</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 letters from James E. Buck, Senior Vice President, NYSE, to Richard Strasser, Assistant Director, Division of Market Regulation ("Division"), Commission, dated December 18, 1998; and from Daniel P. Odell, Assistant Secretary, NYSE, to Richard Strasser, Division, Commission, dated June 7, 1999.

<sup>4</sup> See Securities Exchange Act Release No. 41706 (August 4, 1999), 64 FR 44069.

system that it believes will enable compliance with this rule and enhance the ability of its BBSS to support various trading floor business models, while minimizing the impact on the timely execution of orders. According to the NYSE, these systems are being developed in consultation with various member committees as well as the individuals on the Upstairs Traders Advisory Committee and the Exchange Traders Advisory Committee. In addition, the Exchange represents that it has interviewed individual brokers, member firm technology departments, and service bureaus.

In addition to recording the data elements required by NYSE Rule 123, the Exchange represents that its database system will be able to record optional order data elements, including special instructions (*e.g.*, go along, percent of volume), account type identifier (this is optional on order entry but mandatory on submission to trade comparison for audit trail), account number and any other information the firm chooses to include in the record, provided it is consistent with the format(s) accepted by the Exchange.

The Exchange also plans to modify the existing BBSS to enable compliance at trading floor booths for firms that choose an NYSE (versus a proprietary) system to comply with the proposed rule. According to the Exchange, the BBSS enables firms to enter orders that are phoned to the Floor to receive orders delivered to the booth systemically via a proprietary system/NYSE system interface; and to enter orders from off-floor using an NYSE system. The Exchange represents that the planned enhancements to BBSS are designed to support entry of all order types and all required information as well as to speed data entry by providing quick entry templates and other data entry enhancements. The Exchange believes that the BBSS upgrade would also improve order and information management features resulting in operational efficiencies for the firms.

According to the Exchange, BBSS currently is capable of accepting orders with prices per share as low as \$.01 and as high as \$99,999.<sup>8</sup> However, in the event that BBSS cannot accommodate an order at the time NYSE Rule 123

<sup>8</sup> Previously, BBSS could not accept orders with orders fractional prices less than 1/64th or integer prices greater than \$99,999. The Exchange has updated the BBSS capacity to accommodate decimal pricing. The Exchange represents that under the new parameters, all orders should be compatible for entry into BBSS. Telephone conversation between Donald Siemer, Director, Market Surveillance, NYSE, and Florence Harmon, Senior Special Counsel, Division, Commission, on November 20, 2000.

becomes effective, the Exchange represents that brokers relying on BBSS to comply with the Rule would be exempt for orders that could not be entered through BBSS until such time as BBSS is compatible with the entry of such orders. According to the Supplementary Material of the proposed rule, orders that by their terms are incompatible for entry in an Exchange system relied on by a Floor member to record the details of the order in compliance with the proposed rule shall be exempt from the order entry requirements of the proposed rule. However, if a proprietary system is used, the proposed rule requires that the system must be capable of transmitting details of all orders to the Exchange database.

With regards to system specifications, the NYSE represents that its systems development plan includes building a new database to collect and consolidate records of orders in NYSE systems and orders that are sent to the Exchange Floor for execution through a member firm's proprietary system. Further, the NYSE represents that its systems will be designed to provide for members firms' proprietary systems interface to the NYSE database in Common Message Switch ("CMS"), Financial Information Exchange Protocol ("FIX"), or other NYSE-approved industry standard format. According to the NYSE, such systems must submit a copy of the order details to the NYSE database upon receipt of the order by the member firm's proprietary system on the Floor.<sup>9</sup> In addition, the NYSE requires an "as of" time indicator for orders entered late due to system problems, and if this occurs, member firms would have to notify the Exchange by the end of the following day and provide documentation of the system problem that necessitated the use of an "as of" time indicator.

The Exchange represents that it intends to communicate its system plan to member firms, then finalize NYSE system specifications, and issue interface specifications to member firms. The effective date of the proposed rule will be based on the implementation of enhancements to NYSE systems as well as the state of readiness of the member firm community. The Exchange represents

<sup>9</sup> According to the Exchange, "upon receipt" means as soon as practicable, but no later than 60 seconds after receipt. This 60 seconds is intended to provide flexibility in implementation and is not intended to be incorporated into proprietary systems; *e.g.*, a system that was programmed to routinely transmit a copy to the Exchange database system 60 seconds after receipt of an order would not comply with the system requirement.

that the NYSE systems have been tested; however, the implementation date is still subject to the completion of specification and design work, as well as the finalization of development, and cutover schedules.<sup>10</sup>

The Exchange believes that the implementation of this system will allow the NYSE to track more accurately via systemic records whether an order has been received on the Floor prior to its execution. The Exchange also believes it would address the issue of falsification of order entry times. Therefore, the Exchange believes that its ability to surveil for anomalous trading situations—such as on-floor trading and the creation of inaccurate records, frontrunning of orders, and improper execution of customers' orders—will be enhanced.

With regards to the enforcement of violations of the proposed rule, the NYSE represents that if it determines that a particular violation of this proposed rule is minor in nature, it could issue a cautionary letter. Moreover, the NYSE represents that it would consider seeking approval to add the proposed provisions of NYSE Rule 123 to the list of rules contained in NYSE Rule 476A, which provides for the imposition of fines for minor violations of rules. In those instances where the investigation reveals a more serious violation or repetitive violations of NYSE Rule 123, the Exchange represents that it would commence disciplinary procedures under NYSE Rule 476.<sup>11</sup>

### III. Discussion

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 the requirements of Section 6(b).<sup>12</sup> Specifically, the Commission believes that by strengthening the Exchange's ability to examine and surveil activities on the Exchange Floor, the proposal is consistent with the Section 6(b)(5)<sup>13</sup>

<sup>10</sup> Telephone conversation between Donald Siemer, Director, Market Surveillance, NYSE, and Jennifer Colihan, Attorney, Division, Commission, on November 21, 2000. The Commission notes, however, that pursuant to the SEC Order, Phase I of the Floor Audit Trail must be implemented within nine months after the date of this approval order. See In the Matter of New York Stock Exchange, Inc., SEC Release No. 34-41574, June 29, 1999; Administrative Proceeding File No. 3-9925 ("SEC Order").

<sup>11</sup> The Exchange represents that it does not include specific reference to disciplinary matters in each rule because it believes the language in NYSE Rules 476 and 476A is all-encompassing.

<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.<sup>14</sup>

The proposed rule change is intended to fulfill some of the undertakings contained in the order issued by the Commission relating to the settlement of an enforcement action against the NYSE for failure to enforce compliance with Section 11(a) and Rule 11a-1 of the Act and NYSE rules 90, 95, and 111.<sup>15</sup> The SEC Order found that the NYSE's floor broker regulatory program suffered from two major deficiencies: (1) The NYSE failed to take appropriate action to police for profit-sharing or other performance-based compensation of independent floor brokers; and (2) the NYSE suspended its routine independent floor broker surveillance for extensive periods of time.<sup>16</sup> In addition, although not part of the findings in the SEC Order, the Commission's initial and amended complaints and the Office of the United States Attorney for the Southern District of New York's indictment charged, among other things, that independent floor brokers profited from the information they acquired on the NYSE floor by trading ahead of customer orders and, in some instances, engaging in frontrunning in violation of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Act and rule 10b-5 thereunder.

As part of the SEC Order, the NYSE agreed and was ordered to continue the development and implementation of an electronic floor system ("Phase I Floor Audit Trail") that will be used to enter details related to orders before these orders can be represented on the trading floor. To accomplish this undertaking, the NYSE was ordered to submit a proposed rule change setting forth the complete details and specifications of the Phase I Floor Audit Trail, and to fully implement the Phase I Floor Audit Trail nine months after Commission approval of the proposal. This proposed rule change addresses this undertaking. The Commission believes that, by strengthening the Exchange's ability to examine and surveil members' activities on the Exchange Floor, the proposed

rule change is consistent with and is an important step toward satisfying certain of the undertakings relating to oversight of the trading floor.

The proposal requires that members and member organizations enter the details of an order before they can represent or execute the order on the floor of the Exchange. Among other things, the member must electronically time stamp the order before representing or executing it on the floor and must record any changes in the terms of the order or cancellations of the order.<sup>17</sup> The Commission finds that requiring members and member organizations to electronically record the details of an order before representing or executing the order on the floor will enhance the Exchange's ability to deter and detect violations of the securities laws and the Exchange's rules, such as trading ahead of customer orders or frontrunning. Specifically, the rule enhances the NYSE's ability to track the handling of an order from receipt until execution. For example, this information can be used to reconstruct markets to determine whether an independent floor broker traded ahead of a customer order. The Commission also finds that enhancing the surveillance of members' activities on the floor is consistent with the Exchange's responsibility, under Section 6(b)(5) of the Act, to prevent fraudulent and manipulative acts and practices.

#### IV. Conclusion

*It Is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-NYSE-98-25) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43700; File No. SR-NYSE-00-48]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc. To Reduce the Maximum Original Listing Fee and To Impose a New Allocation Fee on Exchange Specialists

December 11, 2000.

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 hereby is given that on November 29, 2000, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The NYSE proposes to reduce the maximum original listing fee applicable to companies listing on the Exchanged and to recapture the lost revenue through an allocation fee imposed on Exchange specialists. The proposed rule change is available at the principal office of the NYSE and at the Commission's Public Reference Room.<sup>3</sup>

#### 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 NYSE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received regarding the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The NYSE has prepared summaries set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

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

<sup>3</sup> According to the NYSE, the proposed specialist allocation fee would not appear in the NYSE's rules or price list. Therefore, with respect to this part of the filing, there is no proposed rule text as such. The NYSE will notify affected members of the new fee via an information circular. Telephone conversation between James F. Duffy, Senior Vice President and Associate General Counsel, NYSE, and Michael Gaw, Attorney-Adviser, Division of Market Regulation, Commission, on December 11, 2000.

<sup>14</sup> In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>15</sup> See note 10, *supra*.

<sup>16</sup> *Id.*

<sup>17</sup> The Commission notes that in a pending proposed rule change, the NYSE is proposing to require that members synchronize business clocks to record the date and time of any event that the Exchange requires to be recorded. See SR-NYSE-99-51 (proposal to implement Phase II of the Floor Audit Trail System).

<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> 17 CFR 200.30-3(a)(12).