

7. Applicants further submit that the recapture of any Credit only applies in relation to the risk of anti-selection against the Companies. Anti-selection can generally be described as a risk that owners obtain an undue advantage based on elements of fairness to the Companies and the actuarial and other factors taken into account in designing the Contracts and Future Contracts. The Companies provide the Credit from their general account assets on a guaranteed basis. Thus, they undertake a financial obligation that contemplates the retention of the Contracts and Future Contracts by their owners over an extended period, consistent with the long-term nature of retirement planning. The Companies generally expect to recover their costs, including Credits, over an anticipated duration while a Contract or Future Contract is in force. The right to recapture Credits applied to contributions made within the first twelve months after issuance protects the Companies against the risk that an owner will purchase a Contract or Future Contract or make larger or additional contributions with the knowledge that the contingency that triggers payment of a benefit is likely or about to occur. With respect to refunds paid upon the return of a Contract or Future Contract during the free look period, the amount payable by the Companies must be reduced by the amount of the Credit. Otherwise, investors could purchase a Contract or Future Contract for the sole purpose of exercising the free look provision and making a quick profit.

8. Applicants submit that the provisions for recapture of Credits under the Contracts and Future Contracts do not violate sections 2(a)(32) and 27(i)(2)(A) of the Act. Sections 26(e) and 27(i) were added to the Act to implement the purposes of the National Securities Markets Improvement Act of 1996 and Congressional intent. The application of a Credit to contributions made under the Contracts should not raise any questions as to the Companies' compliance with the provisions of section 27(i). However, to avoid any uncertainty as to full compliance with the Act, Applicants request an exemption from sections 2(a)(32) and 27(i)(2)(A), to the extent deemed necessary, to permit the recapture of any Credit under the circumstances summarized herein without the loss of relief from section 27 provided by section 27(i).

9. Rule 22c-1 under the Act prohibits a registered investment company issuing any redeemable security, a person designated in such issuer's

prospectus as authorized to consummate transactions in any such security, and a principal underwriter of, or dealer in, such security, from selling, redeeming, or repurchasing any such security except at a price based on the current net asset value of such security next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security.

10. The Companies' recapture of a Credit might arguably be viewed as resulting in the redemption of redeemable securities for a price other than one based on the current accumulation unit value of the Accounts. Applicants contend, however, that the recapture of the Credit does not violate Rule 22c-1. To effect a recapture of a Credit, the Companies will redeem interests in a Contract at a price determined on the basis of the current accumulation unit value(s) of the subaccount(s) to which the owner's Contract value is allocated. The amount recaptured will equal the amount of the Credit paid out of the Companies' general account assets. Although the owner will be entitled to retain any investment gain attributable to the Credit, the amount of that gain will be determined on the basis of the current accumulation unit values of the applicable subaccounts. Thus, no dilution will occur upon the recapture of the Credit. Applicants also submit that the second harm that Rule 22c-1 was designed to address, namely speculative trading practices calculated to take advantage of backward pricing, will not occur as a result of the recapture of the Credit. Because neither of the harms that Rule 22c-1 was meant to address is found in the recapture of the Credit, Rule 22c-1 should not apply to any Credit. However, to avoid any uncertainty as to full compliance with the Act, Applicants request an exemption from the provisions of Rule 22c-1 to the extent deemed necessary to permit them to recapture the Credit under the Contracts and Future Contracts.

Conclusion

Applicants submit that their request for an order that applies to the Accounts and any other Accounts established by the Companies, in connection with the issuance of the Contracts and Future Contracts, is appropriate and in the public interest. Applicants state that such an order would promote competitiveness in the variable annuity market by eliminating the need to file redundant exemptive applications, thereby reducing administrative expenses and maximizing the efficient use of Applicants' resources. Applicants

undertake that Future Contracts funded by the Accounts or by Other Accounts will be substantially similar to the Contracts in all material respects. Applicants state that investors would not receive any benefit or additional protection by requiring Applicants to repeatedly seek exemptive relief that would present no issue under the Act that has not already been addressed in the application. Applicants submit that having Applicants file additional applications would impair Applicants' ability to take advantage of business opportunities as they arise. Further, Applicants state that if Applicants were required repeatedly to seek exemptive relief with respect to the same issues addressed in the application described herein, investors would not receive any benefit or additional protection thereby.

Applicants submit, based on the grounds summarized above, that their exemptive requests meet the standards set out in section 6(c) of the Act and that the Commission should, therefore, grant the requested order.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45081; File No. S7-24-89]

Joint Industry Plan; Order Granting Approval of Amendment No. 12 to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Exchange-Listed Nasdaq/National Market System Securities and for Nasdaq/National Market System Securities Traded on Exchanges on an Unlisted Trading Privileges Basis; Submitted by the National Association of Securities Dealers, Inc., the Pacific Exchange, Inc. and the Boston, Chicago, Philadelphia, and Cincinnati Stock Exchanges

November 19, 2001.

I. Introduction

On August 29, 2001, the Cincinnati Stock Exchange Inc. ("CSE") on behalf of itself and the National Association of Securities Dealers, Inc. ("NASD"), the Boston Stock Exchange, Inc. ("BSE"), the Chicago Stock Exchange, Inc. ("Chx"), the Pacific Exchange, Inc. ("PCX"), and the Philadelphia Stock

Exchange, Inc. ("PHLX") (collectively, "Participants"),¹ as members of the operating committee ("Operating Committee")² of the Plan submitted to the Securities and Exchange Commission ("SEC" or "Commission") Amendment No. 12 to the Plan, pursuant to Rule 11Aa3-2 under the Securities Exchange Act of 1934 ("Act").³ On September 18, 2001, the Participants submitted an amendment to Amendment No. 12.⁴ Notice of the proposed 12th Amendment, as amended, was published for comment in the **Federal Register**.⁵ The Commission received four comment letters on the proposed Plan Amendment⁶ and a response to the comments from the Operating Committee,⁷ as well as a response to the issues raised by Knight from the CSE and PCX/Archipelago.⁸ This order approves the 12th Amendment to the Plan for nine months through August 19, 2002.

Extension of Unlisted Trading Privileges ("UTP") In addition, the PCX requested that the Commission extend UTP to all Nasdaq National Market securities ("Nasdaq/NM securities")⁹ and to Nasdaq SmallCap securities ("SmallCap securities").¹⁰ The

Commission solicited comment on the request to extend UTP to Nasdaq/NM securities¹¹ and received four comment letters.¹² In connection with the publication of the 12th Amendment, the Commission solicited comment on extending UTP to SmallCap securities.

II. Background

The Plan governs the collection, consolidation, and dissemination of quotation and transaction information for Nasdaq/NM securities listed on an exchange or traded on and exchange pursuant to UTP.¹³ The Plan provides for the collection from Participants, and the consolidation and dissemination to vendors, subscribers and others, of quotation and transaction information in "eligible securities."¹⁴ The Plan also contains various provisions concerning its operation and sets out the responsibilities of the Participants with respect to each other and the Plan Processor.

The Commission approved the Plan on a pilot basis on June 26, 1990.¹⁵ The parties did not begin trading until July 12, 1993, accordingly, the pilot period commenced on July 12, 1993. The Plan has since been in operation on a pilot basis.¹⁶

III. Description of the Amendment

The complete text of the Plan, as amended, was published in the **Federal Register**.¹⁷ The following is a summary of the significant changes made by the 12th Amendment.

First, the name of the Plan has been changed. Second, the BSE and the Amex were added as Participants¹⁸ and references in the Plan to the status of a Limited Participant¹⁹ have been eliminated. Third, the definition of "eligible security" has been amended to include Small Cap securities.²⁰ Fourth, the Participants established the voting and quorum requirements for Committee meetings and the manner in which formal actions may be taken on behalf of the committee. Fifth, a process for selecting a new Securities information Processor ("SIP" or "Processor") for the Plan was established.²¹

Sixth, the section of the Plan that discusses the functions of the Processor (Section VI) was amended to clarify the priority rules. Specifically, if an

(December 13, 1995), 60 FR 65696 (December 20, 1995); 36650 (December 28, 1995), 61 FR 358 (January 4, 1996); 36934 (March 6, 1996), 61 FR 10408 (March 13, 1996); 36985 (March 18, 1996), 61 FR 12122 (March 25, 1996); 37689 (September 16, 1996), 61 FR 50058 (September 24, 1996); 37772 (October 1, 1996), 61 FR 52980 (October 9, 1996); 38457 (March 31, 1997), 62 FR 16880 (April 8, 1997); 38794 (June 30, 1997) 62 FR 36586 (July 8, 1997); 39505 (December 31, 1997) 63 FR 1515 (January 9, 1998); 40151 (July 1, 1998) 63 FR 36979 (July 8, 1998); 40896 (December 31, 1998), 64 FR 1834 (January 12, 1999); 41392 (May 12, 1999), 64 FR 27839 (May 21, 1999) ("May 1999 Approval Order"); 42268 (December 23, 1999), 65 FR 1202 (January 6, 2000); 43005 (June 30, 2000), 65 FR 42411 (July 10, 2000); 44099 (March 23, 2001), 66 FR 17457 (March 30, 2001); and 44348 (May 24, 2001), 66 FR 29610 (May 31, 2001); 44552 (July 13, 2001), 66 FR 37712 (July 19, 2001); 44694 (August 14, 2001), 66 FR 43598 (August 20, 2001); 44804 (September 17, 2001), 66 FR 48299 (September 19, 2001); 44937 (October 15, 2001), 66 FR 53271 (October 19, 2001).

¹⁷ See note 5 *supra*.

¹⁸ This change was effective on filing. See note 5 *supra*.

¹⁹ Section III had defined a Limited Participant to mean a registered national securities exchange whose participation in the Plan was restricted to reporting to the processor quotation information and transaction reports in Nasdaq/NM securities listed on that exchange. The only Limited Participant was the BSE.

²⁰ See NASD Rule 4200 for the definition of SmallCap security.

²¹ The Committee included this section of the Plan pursuant to the discussion in the order approving the proposed rule change by the NASD relating to the establishment of the Nasdaq Order Display Facility and Order Collector Facility and modifications of the Nasdaq Trading Platform ("SuperMontage Order"). See Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001). In the SuperMontage Order, the Commission directed the Participants to negotiate a revised Plan to, among other things, provide for either a fully viable alternative exclusive SIP for all Nasdaq securities, or a fully viable alternative non-exclusive SIP.

¹ The CSE was elected chair of the Operating Committee for the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Exchange-Listed Nasdaq/National Market System Securities and for Nasdaq/National Market System Securities Traded on Exchanges on an Unlisted Trading Privileges Basis ("Plan") by the Participants.

² The Operating Committee is made up of all the Participants.

³ 17 CFR 240.11Aa3-2.

⁴ See letter from Jeffrey T. Brown, Committee Chairman, CSE, to Jonathan G. Katz, Secretary, SEC, dated August 29, 2001.

⁵ Securities Exchange Act Release No. 44822 (September 20, 2001), 66 FR 50226 (October 2, 2001).

⁶ See letters to Jonathan G. Katz, Secretary, SEC, from Jon Kroeper, Vice President, Regulatory Policy/Strategy, Instinet, dated October 25, 2001 ("Instinet"); Cameron Smith, General Counsel, Island, dated October 26, 2001 ("Island"); Michael T. Dorsey, Senior Vice President, General Counsel, and Secretary, Knight Trading Group, dated November 1, 2001 ("Knight"); and Michael J. Ryan, Jr., Executive Vice President and General Counsel, American Stock Exchange ("Amex"), dated November 14, 2001.

⁷ See letter from Jeffrey T. Brown, Chairman, Operating Committee, to Jonathan G. Katz, Secretary, SEC, dated November 14, 2001.

⁸ See letter from Jeffrey T. Brown, CSE and James P. Selway, PCX/Arca to Jonathan G. Katz, Secretary, SEC, dated November 14, 2001 ("CSE/Arca letter").

⁹ See letter from Thomas E. Connaghan, Senior Vice President, Equities, PCX, to Messrs. Robert L.D. Colby, Deputy Director, Division of Market Regulation, SEC and Robert E. Aber, Senior Vice President and General Counsel, The Nasdaq Stock Market, Inc., dated October 16, 2000.

¹⁰ See letter from Mr. Connaghan to Messrs. Colby and Aber, dated November 20, 2000.

¹¹ See Securities Exchange Act Release No. 43545 (November 9, 2000), 65 FR 69581 (November 17, 2000).

¹² See letters from Roger Phillips to Mr. Colby, undated ("Phillips"); Steven E. Kamensky, Security Traders, Inc. to Secretary, SEC, dated December 4, 2000 ("Kamensky"); Richard G. Ketchum, President, The Nasdaq Stock Market, Inc., to Jonathan G. Katz, Secretary, SEC, dated December 5, 2000 ("Nasdaq"); and Michael T. Dorsey, Senior Vice President and General Counsel, and Knight Trading Group to Jonathan G. Katz, Secretary, SEC, dated December 13, 2000 ("Knight letter").

¹³ Section 12 of the Act generally requires an exchange to trade only those securities that the exchange lists, except that Section 12(f) of the Act permits UTP under certain circumstances. For example, Section 12(f) of the Act, among other things, permits exchanges to trade certain securities that are traded over-the-counter ("OTC/UTP"), but only pursuant to a Commission order or rule. 15 U.S.C. 78l(f). For a more complete discussion of the Section 12(f) requirement, see November 1995 Extension Order, *infra* note 16.

¹⁴ Currently, the Plan defines "eligible securities" as any Nasdaq/NM security as to which UTP have been granted to a national securities exchange pursuant to Section 12(f) of the Act or that is listed on a national securities exchange. The Participants propose to amend the definition of "eligible security" in this amendment to include SmallCap securities.

¹⁵ See Securities Exchange Act Release No. 28146, 55 FR 27917 (July 6, 1990) ("1990 Plan Approval Order").

¹⁶ See Securities Exchange Act Release Nos 34371 (July 13, 1994), 59 FR 37103 (July 20, 1994); 35221 (January 11, 1995), 60 FR 3886 (January 19, 1995); 36102 (August 14, 1995), 60 FR 43626 (August 22, 1995); 36226 (September 13, 1995), 60 FR 49029 (September 21, 1995); 36368 (October 13, 1995), 60 FR 54091 (October 19, 1995); 36481 (November 13, 1995), 60 FR 58119 (November 24, 1995) ("November 1995 Extension Order"); 36589

exchange participant or Nasdaq market participant changes its bid and/or offer, it will be treated as a new quote for purposes of time priority. However, a change to only bid size and/or ask size will not change the time priority of the quote. Section VI also addresses how Participant quotes will be carried over from one trading day to the next, including the use of previous day's quotes in the calculation of the consolidated best bid and best offer ("BBO").

Seventh, Section VI.C.1. specifies procedures for the Processor to follow when the BBO results in a locked or crossed market and states that the Processor shall normally cease calculation of the BBO at 6:30 p.m. Eastern Time ("ET"). It also contains a "phase-in" schedule for the addition of Nasdaq securities that will be eligible for trading pursuant to UTP by the Participants if the Commission extends UTP to all Nasdaq/NM securities and SmallCap securities. The Participants proposed the phase-in to minimize the threat to available Processor capacity that may arise as Participants trade additional Eligible Securities pursuant to UTP. The Committee believes that the phase-in period will allow the Processor to monitor the effects, if any, that the increased quote traffic and trading have upon Processor capacity. The phase-in schedule does not apply to Nasdaq, Nasdaq market participants acting in their capacity as Nasdaq market participants, or to any Participant that does not engage in auto-quoting.²²

Eighth, the 12th Amendment limits the practice of auto-quoting if the Processor has made a determination that it is necessary to maintain adequate capacity and provides 30 days notice to Participants. If a Participant thereafter exceeds the auto-quoting limitations, the Processor may initiate proceedings, before the entire Committee, that will put the Participant on notice of the violation and afford ample time and procedures to rectify the situation.²³ The auto-quoting limitation ends once the Operating Committee selects a new Processor. The auto-quoting limitation includes a "grandfather clause" exempting a Participant from the auto-quoting limitations and the phase-in schedule for the number of securities that the Participant quoted, pursuant to the Plan, as of May 1, 2001.²⁴

Ninth, the section on Operational Issues establishes Participant responsibilities with respect to the collection, validation, and transmission of data to the Processor. It also establishes operational procedures that the Processor must follow in collection data from Participants, such as performing gross validation processing for quotes and last sale messages and consolidating and disseminating trade and quote information from each Participant.

Finally, the 12th Amendment to the Plan amends Exhibit 1 to the Plan to eliminate the "minimum-maximum" payment formula and replace it with a formula for determining Participants' total trades, total share volume, operating expenses, and operating income for the purposes of distribution of gross operating revenue to the Participants, as well as a provision for reimbursing the Processor in the event that operating expenses exceed operating revenues.²⁵

In addition, Exhibit 1 includes criteria and schedules for determining Participant eligibility for receiving distributions of gross operating revenue. Exhibit 1 also establishes procedures and cost allocations for retaining an independent auditor for the purpose of auditing the Processor's costs or other calculations used in the determination of operating expenses, operating revenues, and distribution shares, among other calculations.²⁶

Thus, the Plan, as amended, will govern the collection, consolidation, and dissemination of quotation information and transaction reports in Nasdaq/NM securities and SmallCap securities.

IV. Summary of Comments

The Commission received four comment letters on Amendment No. 12.²⁷ Instinet raised several concerns about the Amendment. First, Instinet believes Amendment No. 12 does not fulfill the conditions the Commission set forth with respect to the Plan in the SuperMontage Order. Specifically, Amendment No. 12 does not provide a timeframe within which a new processor will be selected and does not require that Nasdaq step down as the processor. Second, Instinet notes that

Amendment No. 12 does not provide for participation in decision-making by non-self-regulatory organizations. Instinet believes that this will inhibit its ability to compete. Instinet also asserts that Section 11A of the Act requires the Commission to provide automated trading systems ("ATs") with the opportunity to directly participate in the Plan. Third, Instinet objects to the provision in the Plan that prohibits ECNs and ATs in their role as Nasdaq market participants from imposing any access or execution fee or charge with respect to transactions with Participants and their members effected through the telephone. Instinet believes this provision is not consistent with the Act. Instinet also objects to a provision in Section IX of the Plan that states that an exchange Participant may charge for access, other than telephone access, to its floor or facilities. Fourth, Instinet argues that the provision in Section IX regarding what constitutes access is not clear.²⁸ Finally, Instinet favors extension of UTP to all Nasdaq/NM securities and SmallCap securities.

Island objects to the methodology and formula used to calculate costs submitted by Nasdaq in operating the Processor. Island also objects to some of the costs of the Processor that are subtracted from gross revenue before disbursements are made to the Participants. With respect to the Commission's request for comment on extending UTP to all Nasdaq/NM as well as SmallCap securities, Island urges the Commission to expand the number of securities that can be traded from 1,000 Nasdaq/NM securities to all Nasdaq/NM securities and also to expand UTP to SmallCap securities.

Knight objects to the concept of exchanges trading over-the-counter ("OTC") securities because Knight believes that the rules that exchange members must comply with are not as demanding as the NASD's rules and therefore, the playing field is not level between exchanges and Nasdaq market makers trading the same securities. Knight specifically claims that exchanges do not have to comply with the NASD's firm quote rule.²⁹ Knight also raises concerns about the NASD's Trade or Move rule³⁰ and asserts that the Commission should not approve the 12th Amendment until either exchange participants are subject to the NASD's rules or they adopt comparable rules. Knight also argues that the Commission should not extend UTP to additional securities until the Commission has had

²⁵ The Commission put Exhibit 1 into effect summarily on October 2, 2001 on a temporary basis not to exceed 120 days. See note 5 *supra*.

²⁶ The 12th Amendment also contains numerous "house-keeping" corrections, such as changing the term "NASDAQ" to "Nasdaq," officially removing the Chicago Board Options Exchange, and ensuring that references to amended sections are consistent with the amendments discussed above.

²⁷ See note 6 *supra*.

²⁸ See Instinet at p. 8.

²⁹ NASD Rule 4613(b)(1).

³⁰ NASD Rule 4613(b)(2).

²² See Section VI.C.2(a)(v) and Section VI.C.2(b).

²³ The Participants proposed a notice and cure period in which a Participant may rectify the situation on its own accord, as well as providing for formal proceedings to be held before the Committee before any remedial action may be taken against a violating Participant. See Section VI.C.2(e).

²⁴ See Section VI.C.2(f).

a chance to review the impact of trading in a decimals environment on Nasdaq/NM and SmallCap securities.

Knight also raises concern that, under the 12th Amendment, UTP exchanges will be able to charge non-members access fees for interacting with their quotes that are included in the NASD's montage. Finally, Knight believes that the Commission should not grant an extension of the exemption from Rule 11Ac1-2 under the Act³¹ regarding calculation of the BBO. Knight opposes continuation of the exemption from calculating the BBO based on price, size, time priority. Currently, Nasdaq uses price, time, size to calculate the BBO. According to Knight, using the calculation required by Rule 11Ac1-2 under the Act³² will encourage depth in the market.

Amex's main concern is with the ability of the Processor to determine that there is a capacity concern. Once the Processor makes this determination, the autoquoting restrictions are activated. Some Participants are grandfathered out of the limitation on autoquoting. Amex believes that these provisions are unfair and anticompetitive. Because Amex was not yet a Participant, it did not vote on the 12th Amendment.

In addition, the Commission received four comment letters in response to its request for comments regarding raising the number of Nasdaq/NM securities that can be traded pursuant to UTP consistent with Section 12(f) of the Act.³³ Two of the commenters (Phillips and Kamensky) supported extension of the UTP to all Nasdaq/NM securities. They both stated that extending UTP would add liquidity to the market for these securities and enhance competition. Kamensky stated that the earlier increases in the number of Nasdaq/NM securities that could be traded pursuant to UTP had increased the liquidity of the markets for these securities and enhanced competition. A third commenter, Knight, objected to the extension of the UTP to all Nasdaq/NM securities because of the level playing field argument raised in its comment on the 12th Amendment. Knight also stated that PCX had not demonstrated how the expansion of the number of securities that could be traded pursuant to UTP would help maintain fair and orderly markets and further the National Market System ("NMS") goals. According to Knight, problems appeared in the market for Nasdaq/NM securities after the Commission raised the number of

securities that could be traded pursuant to UTP from 500 to 1,000 in 1999.

Nasdaq stated that it did not object to the Commission raising the number of Nasdaq/NM securities that could be traded pursuant to UTP; however, it raised concerns about the capacity of the Nasdaq SIP to handle quote and trade reporting of all Nasdaq/NM securities given the potential new entrants to the Plan and the advent of decimal trading. Nasdaq also stated that the Commission should wait until Nasdaq and other interested market participants had resolved the issue of the exclusive SIP before granting PCX's request.

V. Discussion

The Commission has determined to approve the 12th Amendment, including Exhibit 1 to the Plan, on a pilot basis until August 19, 2001, to grant UTP to the Participants to trade all Nasdaq/NM securities as well as Small Cap securities pursuant to Section 12(f) of the Act,³⁴ and to continue the exemption from Rule 11Ac1-2³⁵ regarding the calculation of the BBO.³⁶

The Commission notes that the 12th Amendment to the Plan has been vigorously debated by the Participants and represents the result of good faith negotiations among the Participants. The Plan, as amended, is regarded by the Participants and the Commission as an interim plan. The Participants are currently negotiating a further amendment to the Plan to address the remaining outstanding items outlined in the Commission's SuperMontage order. In particular, the Commission notes that the Participants approved a proposed request for proposal ("RFP") to select a new SIP. The Commission understands that the RFP has been issued. The Commission therefore believes that the Participants will continue to make progress in amending the Plan and responding to the concerns that the Commission noted in the SuperMontage Order.

Instinet argued that Section 11A of the Act requires the participation of ATSS in the Plan, and noted that the 12th Amendment does not contain provisions to permit the participation of non-self-regulatory organizations. As the Commission stated in the SuperMontage Order, the Commission believes that

ATSS and ECNs should be given a role in the governance of the Plan; however, the Commission does not believe that Section 11A requires that the role of ECNs and ATSS be the same as the role of the SROs. While at this time the Plan does not contain a specific provision for receiving input from non-participants, the Commission notes that a number of ECNs have been represented at meeting of the Operating Committee over the past year, and the Commission expects that the Participants will address this issue in the next amendment to the Plan.³⁷

Instinet also raised objections to Section IX of the Plan that prohibits Participants from charging any access or execution fee with respect to transactions with Participants and their members effected by telephone. The Commission notes that the Plan sets forth the terms of free telephone access to quotes of all market participants, including the ECNs, market makers, and specialists. The Commission therefore believes that the Plan establishes consistent standards for access to quotes displayed on any Participant by the members of other Participants.³⁸ Instinet also objects to a specific provision in Section IX of the Plan that permits exchange participants to charge for access, other than telephone access. Instinet believes that the Plan should jump Nasdaq participant to charge for such access. As the Plan is silent on this matter, the Commission believes that, this provision is not meant to change the way that ECNs currently operate.

Island objected to the methodology and formula used to calculate the costs of the Processor. In general, Island believes that some of the costs included are more properly associated with the costs of operating the Nasdaq market as opposed to the costs of operating the SIP. However, the Participants unanimously agreed to the cost for which the Processor will be reimbursed. Moreover, the Commission believes that the ambiguities related to the dual roles of Nasdaq supporting both the Process and the Nasdaq market will be resolved by the next amendment to the Plan and the selection of a new Processor.

Knight objects to exchanges being able to trade Nasdaq securities without either being subject to the NASD's rules or having comparable rules. The

³⁴ 15 U.S.C. 781(f).

³⁵ 17 CFR 250.11Ac1-2.

³⁶ With this order, SmallCap securities will now be securities reported pursuant to a transaction reporting plan approved by the Commission. Accordingly, SmallCap securities will now be subject to all Commission rules that cover securities reported pursuant to a Commission approved transaction reporting plan.

³⁷ The Commission notes that the Participants are working on an amendment to add the NASD as a new Participant once Nasdaq's exchange registration is approved. Nasdaq will continue as a Participant.

³⁸ The Commission notes that, since its inception, the Plan approved by the Commission prohibited fees for telephone access to market makers. *See also* 17 CFR 242.301(b)(4).

³¹ 17 CFR 240.11Ac1-2.

³² *Id.*

³³ 15 U.S.C. 781(f). *See note 12, supra. See also* Instinet at 4.

Commission notes that all exchange participants, as well as the NASD's market participants, are subject to the Commission's Firm Quote Rule.³⁹ All exchange participants must comply with the Firm Quote Rule unless the exchange participant qualifies for one of the two exceptions in the Rule. In addition, Knight is concerned about not being able to open the market or trade because of a locking or crossing quote. The Commission notes that it recently approved an NASD proposal on a temporary basis, which provides, among other things, that SuperSOES may trade through the superior quote of a UTP exchange that does not participate voluntarily in SuperSOES.⁴⁰ The Commission believes that this rule deals with the substance of Knight's objection.

Knight also raises concerns about the effects of decimal trading with minimum price increments on trading in the Nasdaq market and cautions the Commission not to approve the 12th Amendment or extent UTP until the Commission has reviewed the implications of decimalization. While the Commission is aware that decimalization has had a significant effect on the markets for securities, the Commission is not aware of any particular effect specific to UTP trading of Nasdaq/NM securities. The Commission will continue to monitor the impact of decimal trading on the securities markets. Knight also objects to the Commission extending the temporary exemption from Rule 11Ac1-2⁴¹ regarding the BBO calculation. Since the inception of this Plan, Nasdaq has calculated the BBO based on price, time, size priority. The Participants are currently discussing a change to the calculation to make it consistent with the requirement in Rule 11Ac1-2. The Commission expects the issue to be resolved in connection with the next amendment to the Plan.

Finally, while the Commission understands Amex's concern with respect to the Processor (which is both an exclusive SIP and a competitor of the Amex's) making determinations regarding capacity, as an exclusive SIP, the Processor is subject to the provisions of Section 11A of the Act. Furthermore, the auto-quoting restrictions and the grandfather clause do not come into play until the Processor determines that there is a capacity concern. If the Processor determines that a capacity concern exists, it must provide Participants with 30 calendar days

notice and the basis for the determination. After 30 days, the Processor can invoke the auto-quoting limitation. The Commission believes that the Plan contains adequate procedural safeguards surrounding the Processor's determination that a capacity concern exists. The Commission expects the Participants to move quickly to select a processor, consistent with the discussion in the SuperMontage Order.

Extension of UTP

Knight objected to the extension of UTP for two reasons. First, it stated that PCX had not made a case that extending UTP to all Nasdaq/NM securities would further the goals of NMS. The Commission notes that since 1993 there has been UTP trading of Nasdaq/NM securities and the Commission is not aware of any negative effects from having extending UTP to Nasdaq/NM securities. Indeed, two of the commenters stated that UTP for Nasdaq/NM securities had had a positive effect on the liquidity in the market and had provided additional competition. Second, Knight raised the issue that UTP exchanges do not have to comply with NASD rules. This argument is addressed above.

Nasdaq, the only other commenter to voice concerns, raised concerns about capacity of the SIP and the effects of the implementation of trading in decimals on Nasdaq/NM securities. It urged the Commission not to extend trading to all Nasdaq/NM securities until these issues had been addressed. Nasdaq also wanted the Commission to wait until a new SIP was in place. The Commission believes that the Participants to the Plan, including Nasdaq itself, addressed these concerns adequately in the 12th Amendment.

VI. Commission Findings and Conclusion

Plan Amendment

For the reasons discussed above, the Commission finds that the 12th Amendment, including Exhibit 1, to the Plan is consistent with the requirements of the Act and the rules and regulations thereunder and, in particular, Section 11A(a)(1) and Rules 11Aa3-1 and 11Aa3-2. The Commission finds that the 12th Amendment to the Plan is necessary and appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments, to, and perfect the mechanisms of, a national market system.

Extension of UTP

The Commission finds that extending UTP to all Nasdaq/NM securities and SmallCap securities is consistent with Section 12(f) of the Act. Specifically, extending UTP to these securities is consistent with the maintenance of fair and orderly markets, the protection of investors and the public interest, and otherwise in furtherance of the purposes of the Act. The Commission has taken into account the public trading activity in these securities, the character of the trading, the impact of the extension on existing markets for the securities, and the desirability of removing impediments to, and the progress that has been made toward, the development of a national market system.

Exemptive Relief

For the reasons discussed above, the Commission has determined to grant an exemption for Nasdaq/NM and SmallCap securities from the requirement in Rule 11Ac1-2 under the Act regarding calculation of the BBO. The Commission has determined that granting exemptive relief for the duration of the 12th Amendment is consistent with the public interest and the protection of investors. The Commission notes that the Participants have undertaken to address this issue in the next amendment to the Plan and the Commission urges that Participants to act quickly to implement the amendment.

It is therefore ordered, pursuant to Section 11A of the Act and paragraph (c)(2) of Rule 11Aa3-2, thereunder, that the 12th Amendment to the Plan described above be, and hereby is, approved on a pilot basis until August 19, 2002. Further, the Commission hereby extends UTP pursuant to Section 12(f) of the Act to all Nasdaq/NM securities and SmallCap securities. Finally, the Commission hereby grants a temporary exemption from the requirement in Rule 11Ac1-2 that the BBO be calculated based on price, size, time priority for the duration of the 12th Amendment.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴²

Margaret H. McFarland,

Deputy Secretary.

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³⁹ 17 CFR 240.11Ac1-1.

⁴⁰ See Securities Exchange Act Release No. 45047 (November 8, 2001).

⁴¹ 17 CFR 240.11Ac1-2.

⁴² 17 CFR 200.30-3(a)(27); 17 CFR 200.30-3(a)(2); 17 CFR 200.30-3(a)(36).