

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45331; File No. SR-NYSE-2001-50]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc. Extending the Pilot Program for NYSE Direct+ until December 23, 2002

January 24, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 17, 2001, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed a proposed rule change with the Securities and Exchange Commission ("SEC" or "Commission"). The proposed rule change is described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange filed the proposed rule change pursuant to section 19(b)(3)(A) of the Act,³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposed rule change effective upon filing with the Commission. 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

The Exchange is proposing to extend the pilot program period for NYSE Direct+, and all pertinent interpretations, for an additional year, or until December 23, 2002. No changes to previously approved rule language are being proposed.

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 Exchange 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. The Exchange 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 December 22, 2000, the Commission approved a proposed rule change implementing NYSE Direct+, an automatic execution facility for certain limit orders of 1099 shares or less, on a one year pilot basis ending on December 21, 2001.⁵ The Exchange has filed this proposed rule change to extend the NYSE Direct+ pilot program for another year, or until December 23, 2002.

The purpose of the original proposed rule change was to provide for the automatic execution of limit orders of 1099 shares or less ("auto ex" orders) against trading interest reflected in the Exchange's published quotation. Under NYSE Direct+, it is not mandatory that all limit orders of 1099 shares be entered as auto ex orders; rather, the member organization entering the order or its customer if enabled by the member organization can choose to enter an auto ex order when such member organization (or customer) believes that the speed and certainty of an execution at the Exchange's published bid or offer price is in its customer's best interest. In such a case, the member organization enters an auto ex order priced at or above the Exchange's published offer price (in the case of an auto ex order to buy), or an auto ex order priced at or below the Exchange's published bid price (in the case of an auto ex order to sell). The auto ex order then receives an automatic execution without being exposed to the auction market, provided the bid or offer is still available. In any instance where, as specified in Rule 1000 below, the automatic execution feature is not available, the auto ex order will be entered for execution in the Exchange's auction market. Auto ex transactions are identified on the Consolidated Tape with a unique identifier. The Exchange's published bid or offer is automatically decremented to the extent of the size of the auto ex order to reflect the automatic execution. The contra side of the auto ex order execution is the trading interest reflected in the Exchange's bid or offer, with such interest participating in the execution in accordance with the Exchange's auction market principles of priority and parity as codified in NYSE

Rule 72. Any member organization or a customer if enabled by the member organization that believed in any particular case that the customer's interests would be best served by affording the customer's order the opportunity for price improvement may enter a limit or market order by means of the SuperDOT system for representation in the auction market, rather than an auto ex order.

The Exchange's proposal was implemented in a new series of rules, Rules 1000 through 1005 and a proposed amendment to Rule 13. The pilot program is currently available for all stocks.⁶ A description of all existing Exchange rules affected by NYSE Direct+, as well as the new series of Rules implementing NYSE Direct+ follows:

Rule 13

Rule 13 was amended to define an auto ex order type. An auto ex order now includes a limit order of 1099 shares or less priced at or above the Exchange's published offer (in the case of an order to buy) or at or below the Exchange's published bid (in the case of an order to sell) which shall receive an automatic execution against the interest reflected in the published quotation, provided the size of the published quotation is greater than 100 shares. An auto ex order or any portion thereof that cannot be immediately executed shall be displayed as a limit order in the Exchange's auction market.

The new rules provide as follows:

Rule 1000

Rule 1000 states the basic operative principles providing for automatic execution of limit orders of 1099 shares or less against the Exchange's published quotation. The Rule lists six instances in which the automatic feature would not be available due to market situations, lack of depth in the published quotation, or inappropriate pricing of the auto ex order, as follows:

(i) The NYSE's published quotation is non-firm (pursuant to NYSE Rule 60);

(ii) The NYSE's published quotation has been gapped (pursuant to the Exchange's usual procedures for such situations) for a brief period because of an influx of orders on one side of the market, and the Exchange's published quotation size is 100 shares at the bid and/or offer;

⁶ When initially approved, NYSE Direct+ was only implemented for a limited number of stocks prior to being made available for all stocks. See Securities Exchange Act Release No. 43767 (December 22, 2001), 66 FR 834 (January 4, 2001) (SR-NYSE-00-18).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6). The Exchange filed the pre-filing notice required by Rule 19b-4(f)(6) by filing a written description of the proposed rule change and the text of the proposed rule change on November 28, 2001.

⁵ Securities Exchange Act Release No. 43767 (December 22, 2000), 66 FR 834 (January 4, 2001) (SR-NYSE-00-18).

(iii) A better price exists in another ITS participating market center for a single-sided auto ex order;

(iv) The NYSE's published bid or offer is 100 shares (see Rule 1002(c));

(v) A transaction outside the Exchange's published quotation pursuant to NYSE Rule 127 is in the process of being completed, in which case the specialist should publish a 100-share bid and/or offer; or

(vi) Trading in the subject security has been halted.

Rule 1000 provides that an auto ex order that cannot be immediately executed for any of the above reasons shall be automatically entered for execution in the Exchange's auction market. Once it is entered in the auction market, it will be treated the same as any other limit order entered onto the Exchange. The Exchange also notes that the provisions of proposed Rule 1000(ii) and (v) are, in effect, examples of proposed Rule 1000(iv) in that each relate to situations where the Exchange's published bid or offer will be 100 shares.

Rule 1000(ii) provides that auto-ex orders will not be executed when the Exchange's published quotation has been gapped for a brief period. The procedure to "gap" a quotation involves setting the bid and asked prices at a spread wider than normal in a stock in order to alert market participants that a special situation exists. This may occur if a member proposes to effect a block transaction at a significant premium or discount from the prevailing market and the specialist is aware of interest on the contra side. In such situations, the size of the quotation is set at 100 shares by 100 shares.

Rule 1000(v) provides that auto-ex orders will not be executed when an auction market execution under Exchange Rule 127 is being completed. Rule 127 establishes procedures for executions outside the NYSE's published bid or offer. During the process for completing such transactions, the specialist should publish a bid and/or offer that is 100 shares.

Rule 1001

Rule 1001(a) provides that the contra side of an auto ex execution shall be trading interest reflected in the Exchange's published quotation, consistent with the principles of priority and parity as codified in Exchange Rule 72.

Rule 1001(a) also provides that it shall be the specialist's responsibility, after receiving a report that an auto ex order has been executed, to assign the appropriate number of shares to each

bidder or offeror, consistent with the principles of Exchange Rule 72, with a universal contra being reported as the contra to each auto ex execution. Rule 1001(a) also provides that the specialist shall take the contra side of an auto ex execution where the interest in the published quotation against which the auto ex order was executed is no longer available.

Rule 1001(b) provides that if the published bid or offer is not of sufficient depth to fill an auto ex order in its entirety, the unfilled balance of the order shall be displayed in the auction market.

Rule 1001(c) provides that if executions of auto ex orders have traded with all trading interest reflected in the Exchange's published bid or offer, the Exchange shall disseminate a bid or offer at that price of 100 shares until the specialist requotes that market. Auto ex orders will not receive an automatic execution against any 100 share bid or offer, whether a default bid or offer or otherwise, but rather will be displayed in the auction market. Rule 1001(c) provides that the specialist shall be the contra party to any auction market interest seeking to trade against the 100-share default bid or offer.

Rule 1001(d) provides that the concept of precedence based on size, which is codified in Rule 72, shall not apply with respect to the contra side of an auto ex execution, with such contra side interest being assigned, as noted above, in accordance with the principles of priority and parity in Rule 72.

Rule 1002

Rule 1002 provides that auto ex orders may be entered on any day in a particular stock from the time the Exchange has published a bid or offer in that stock until 3:59 p.m., at which time the specialist is preparing the closing transaction in the security. If orders designated as auto ex are entered before a quote is published or after 3:59 p.m., the orders will be treated as limit orders in the auction market.

Rule 1003

Rule 1003 provides that if a transaction is being completed in the auction market, and an execution involving auto ex orders is reported at a different price before the auction market transaction is reported, any tick test applicable to the auction market transaction shall be based on the last reported trade prior to the execution of the auto ex order.

For example, assume the Exchange's published quotation is 20 bid for 5000 shares, with 5000 shares offered at 20.20. The last reported sale is 20.10,

which is a plus tick. A broker in the crowd bids 20.10 for 5000 shares, and another broker, representing a short sale order, agrees to trade at the 20.10 bid price. Before the trade at 20.10 is reported, an auto ex order to buy is automatically executed at the 20.20 published offer price, making the trade at 20.10 a minus tick, which would preclude execution of the order to sell short. Rule 1003 provides that, in this instance, the short sale tick test would be based on the last reported sale of 20.10, a plus tick, at the time the crowd brokers agreed to trade.⁷

Rule 1004

Rule 1004 provides that executions of auto ex orders shall elect stop orders and percentage orders electable at the price of such executions. The rule also provides that stop orders so elected shall be executed pursuant to the Exchange's auction market procedures, and shall not be guaranteed executions at the prices of subsequent auto ex executions.

Rule 1005

Rule 1005 in part provides that auto ex orders for the same customer may be entered at time intervals of no less than 30 seconds between entry of each such order, on a per stock basis.

Addition to Rule 476A Summary Fine List. The Exchange also obtained in the original pilot approval to add to the List of Rules subject to imposition of fines under Rule 476A procedures the failure by members or member organizations to comply with the provisions of Rules 1000–1005, which implement the Exchange's NYSE Direct+[®] facility. Rule 476A provides that the Exchange may impose a fine, not to exceed \$5,000, on any member, member organization, allied member, approved person, or registered or non-registered employee of a member or member organization for a minor violation of certain specified Exchange rules.

⁷ Rule 1003 is not consistent with the strict application of last reported "tick" tests in Rule 10a-1 under the Act or Exchange Rule 440B, and, in conjunction with its initial filing of the rule, the Exchange sought an exemption from Rule 10a-1 for the limited purpose of recognizing that transactions in compliance with tick tests when effected would not be deemed to be violative if reported after an auto ex execution changed the tick. The Commission granted a limited exemption from Rule 10a-1 to permit floor brokers to effect short sales in accordance with Rule 1003 during the NYSE Direct+ pilot subject to certain conditions. See Letter from James E. Buck, Secretary and Senior Vice President, Exchange, to Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, dated December 21, 2000 ("Exemption Request") and response by Larry E. Bergmann to James E. Buck, dated December 22, 2000 ("Rule 10a-1 Exemption Letter").

The purpose for the proposed rule change to Rule 476A was to facilitate the Exchange's ability to induce compliance with all aspects of the above-cited rules. The Exchange believed that failure to comply with the requirements of these rules and procedures should be addressed with an appropriate sanction and sought Commission approval to add violations of these requirements to the Rule 476A List so as to have a broad range of regulatory responses available. The Exchange continues to believe that this would more effectively encourage compliance by enabling a prompt, meaningful and heightened regulatory response (e.g., the issuance of a fine rather than a cautionary letter) to a minor violation of these rules.

The Exchange again wishes to emphasize the importance it places upon compliance with the above-named rules. While the Exchange, upon investigation, may determine that a violation of any of these rules is a minor violation of the type which is properly addressed by the procedures adopted under Rule 476A, in those instances where investigation reveals a more serious violation of the above-described rules, the Exchange will provide an appropriate regulatory response. This includes the full disciplinary procedures available under Rule 476.

Interpretive Issues

The Exchange has previously submitted for Commission approval the following interpretations of several NYSE rules, as well as a no action or interpretive position which the Exchange requested the Commission to adopt under its short sale rule, Rule 10a-1.⁸ The Exchange requests that these exemptions and interpretations be extended for an additional one year concurrent with the extension of the NYSE Direct+ pilot until December 22, 2002.⁹

These matters concern situations pursuant to proposed Rule 1001(a)(iv) where the specialist may be required to take the contra side of an auto ex execution against the published quotation, even though the specialist's interest was not part of such quotation. For example, the published quotation may reflect the interest of a broker in the Crowd whose interest is then executed in an auction market transaction; but before the published quotation can be updated, an auto ex order is executed against such quotation. In such instance, the specialist would be required to take

the contra side of the auto ex execution. In other instances, the Crowd broker might cancel his or her interest as reflected in the published quotation, but an auto ex order might be executed against such quotation before it can be updated. Again, in such instance, the specialist would be required to take the contra side of the auto ex execution.

- *Rule 104.* Rule 104 contains the specialist's affirmative and negative obligations, and restricts the specialists' ability to purchase stock on direct plus ticks, or sell stock on direct minus ticks. The Exchange is proposing that any instance in which the specialist is effecting such a direct tick transaction only because he or she has been required to assume the contra side of an auto ex execution as described above shall be deemed to be a "neutral" transaction for purposes of Rule 104, and shall be deemed not to be in violation of the rule. The Exchange believed that this interpretation is appropriate because the specialist is not setting the price, but is simply being required to trade at a price set by other market participants.

- *Rule 10a-1.* Rule 10a-1 under the Act and Exchange Rule 440B do not permit the execution of short sales on minus or zero minus ticks. The Exchange believes that exemptive relief from Rule 10a-1 should continue to apply to a specialist whenever he or she is required to take the contra side of an auto ex execution on a minus or zero minus tick because of Exchange Rule 1001(a)(iv), and has an existing short position, or would be creating a short position by virtue of such execution. In particular, the Exchange believes that the situation where a specialist sells short on a minus or zero minus tick because he or she is required to become the contra-party to an executed auto ex trade in the limited circumstances where the interest reflected in the published quotation against which the auto ex order was executed is no longer available does not implicate the policy concerns of Rule 10a-1.

Further, the Exchange believes that exemptive relief from Rule 10a-1 should continue to apply to allow a floor broker to report a short sale that is on a minus or zero-minus tick relative to the last reported auto ex transaction on the NYSE at the time of the floor broker's report, if at the time the floor broker agreed to sell short, the short sale was not on a minus or zero-minus tick relative to the last reported sale. As with all other trades, floor brokers seeking to rely on Rule 1003 with respect to short sales in auction market transactions subject to Rule 10a-1 and Exchange Rule 440B must report such auction

market transactions immediately upon agreement to the trade.¹⁰

- *Rule 123A.40.* The specialist shall not be required to fill any stop orders elected by an auto ex execution at the price of the electing sale in any instance where the specialist was required by Rule 1001(a)(iv) to take the contra side of an auto ex execution.

- *Rule 91.* As the specialist does not accept an auto ex order for execution or act as agent for such order, the transaction confirmation requirements of Rule 91 shall not be applicable in any instance where the specialist is the contra party to an auto ex execution.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b)(5) of the Act¹¹ which requires that an Exchange have rules that are designed 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. The proposed rule change also is designed to support the principles of section 11A(a)(1) of the Act¹² in that it seeks to assure economically efficient execution of securities transactions, make it practicable for brokers to execute investors' orders in the best market and provide an opportunity for investors' orders to be executed without the participation of a dealer.

With respect to the addition to the summary fine list under Rule 476A, the proposed rule change also advances the objectives of section 6(b)(6) of the Act¹³ because it provides a procedure whereby member organizations can be "appropriately disciplined" in those instances when a rule violation is minor in nature, but a sanction more serious than a warning or cautionary letter is appropriate. The proposed rule change provides a fair procedure for imposing such sanctions, in accordance with the

¹⁰ See Exemption Request and Rule 10a-1 Exemption Letter. In order to verify compliance with Rule 10a-1, where an auto ex transaction takes place while the auction market transaction is being completed and the auto ex price would cause the auction market trade to be reported on a minus or zero-minus tick, the Floor broker effecting the short sale must obtain NYSE Floor Official approval that the transaction was agreed upon at a price in compliance with Rule 10a-1 and Rule 440B. Each such short sale must be reported as a "sold sale." Further, Floor brokers will not be allowed to sell short at a price lower than the best bid displayed in the auction market at the time the transaction is reported.

¹¹ 15 U.S.C. 78f(b)(5).

¹² 15 U.S.C. 78k-1(a)(1).

¹³ 15 U.S.C. 78f(b)(6).

⁸ See Exemption Request and Rule 10a-1 Exemption Letter.

⁹ *Id.*

requirements of sections 6(b)(7) and 6(d)(1) of the Act.¹⁴

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange has neither solicited nor received written comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective upon filing pursuant to section 19(b)(3)(A)(iii) of the Act¹⁵ and Rule 19b-4(f)(6)¹⁶ thereunder because the proposed rule change does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which the proposed rule change was filed, or such shorter time as the Commission may designate. At any time within 60 days of the filing of a rule change pursuant to section 19(b)(3)(A) of the Act, the Commission may summarily abrogate the rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

The Commission finds that it is appropriate to accelerate the operative date of the proposed rule change and to permit the proposed rule change to become immediately operative because the proposal simply extends a previously approved pilot program until December 22, 2002.¹⁷ No changes to NYSE Direct+ are being proposed at this time and the Commission has not received any comments on the pilot program. In addition, the Exchange appropriately filed a pre-filing notice as required by Rule 19b-4(f)(6).¹⁸

¹⁴ 15 U.S.C. 78f(b)(6) and 78f(d)(1).

¹⁵ 15 U.S.C. 78s(b)(3)(A).

¹⁶ 17 CFR 240.19b-4(f)(6).

¹⁷ The Commission confirms that the Rule 10a-1 Exemption Letter remains in effect for the duration of the pilot.

¹⁸ 17 CFR 240.19b-4(f)(6). For purpose only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule 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, NW., Washington, DC 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-NYSE-2001-50 and should be submitted by February 22, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45343; File No. SR-Phlx-2001-120]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the Philadelphia Stock Exchange, Inc. to Amend Phlx Rule 237, "The eVWAP Morning Session"

January 28, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4² thereunder, notice is hereby given that on December 26, 2001, the Philadelphia Stock Exchange, Inc. ("Phlx" 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. On January 25, 2002, the Phlx amended

¹⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

the proposal.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend Phlx Rule 237, "The eVWAP Morning Session," to: (1) Allow Exchange-Traded Fund Shares⁴ to be executed on the eVWAP System ("System");⁵ (2) codify order increment size requirements; and (3) make minor technical amendments to Phlx Rule 237.

Background

The System is a daily, pre-opening order matching session for the execution of large-sized stock orders at the volume weighted average price ("VWAP"). The matched and executed orders are assigned a VWAP after the close of regular trading. The System operates as a facility of the Phlx under Section 3(a)(2) of the Act and is governed by Phlx Rule 237.⁶

Currently, the securities eligible for execution in the System pursuant to Phlx Rule 237(b) are exchange listed component issues of the Standard & Poor's 500 index and any exchange listed issue that has been designated by the compiler of the index for inclusion in such index and any of 300 New York Stock Exchange ("NYSE") issues selected according to a prescribed selection process.⁷

Pursuant to Phlx Rule 237, access to the System is limited to "Committers,"⁸ who enter "commitments" and "Users,"

³ See January 24, 2002 letter from Cynthia K. Hoekstra, Counsel, Phlx, to Joseph P. Morra, Special Counsel, Division of Market Regulation, Commission ("Amendment No. 1"). In Amendment No. 1, the Phlx made minor, technical changes to the proposed rule language.

⁴ Exchange-Traded Fund Shares include exchange listed securities representing interests in open-end unit investment trusts or open-end management investment companies that hold securities based on an index or a portfolio of securities. See Phlx Rule 1000(b)(42).

⁵ The System was developed by Universal Trading Technologies Corporation, Inc. ("UTTC"). UTTC is a subsidiary of the Ashton Technology Group, Inc.

⁶ See Securities Exchange Act Release No. 41210 (March 24, 1999), 64 FR 15857 (April 1, 1999) (SR-Phlx-96-14).

⁷ The 300 NYSE issues are selected as follows: The top 400 NYSE issues with the highest market capitalization excluding the 100 issues that have the lowest average daily dollar trading volume over 20 days preceding the eligibility determination. Eligibility is determined at least semi-annually. See Phlx Rule 237(b).

⁸ "Committers" are Exchange members that are: (i) Phlx Floor traders (i.e., a Phlx Specialist or Phlx Alternate Specialist in the eligible stock that is the subject of the Commitment); or (ii) Phlx Off-Floor Liquidity Providers (members that commit to provide contra-side liquidity). See Phlx Rule 237(d).