

security. The circular also will note the Exchange members' prospectus delivery requirements, and highlight the characteristics of purchases in TIRs. The circular also will inform members of Exchange policies regarding trading halts in TIRs.

#### *Trading TIRs Pursuant to Rule 19b-4(e)*

The Commission further believes that adopting generic listing standards for these securities pursuant to Rule 19b-4(e) under the Act should fulfill the intended objective of the rule by giving the NYSE the ability to potentially reduce the time frame for bringing these securities to the market, or for permitting the trading of these securities pursuant to UTP, and thus enhances investors' opportunities. The Commission notes that it maintains regulatory oversight over any products listed under the generic standards through regular inspection oversight.

The Commission finds that the NYSE's proposal contains adequate rules and procedures to govern the listing and trading of TIRs pursuant to Rule 19b-4(e) on the NYSE, or pursuant to UTP. All TIR products listed under the generic standards will be subject to the full panoply of NYSE rules and procedures that now govern both the trading of TIRs and the trading of equity securities.

As described above, the Commission has previously approved similar Amex, CHX, and PCX rules that permit the generic listing and trading of individual TIRs. In approving these securities for trading, the Commission considered their structure, their usefulness to investors and the markets, and the Exchanges' rules and surveillance programs that govern their trading. The Commission concluded then, as it does now, that securities approved for listing under those rules would allow investors to: (1) Respond quickly to changes in the overall securities markets generally and for the industry represented by a particular trust; (2) trade, at a price disseminated on a continuous basis, a single security representing a portfolio of securities that the investor owns beneficially; (3) engage in hedging strategies similar to those used by institutional investors; (4) reduce transactions costs for trading a portfolio of securities; and (5) retain beneficial ownership of the securities underlying the TIRs.

The Commission notes that the NYSE's proposed generic listing standards are substantially similar to the Amex, CHX and PCX. The Commission therefore believes that TIRs that satisfy the NYSE's proposed generic listing

standards should produce the same benefits to the NYSE and to investors.

The NYSE has requested that the Commission find good cause for approving the proposed rule change, and Amendments Nos. 1 and 2 prior to the thirtieth day after the date of publication of notice in the **Federal Register**. The Commission believes that the Exchange's proposal to trade TIRs, pursuant to UTP, will provide investors with a convenient and less expensive way of participating in the securities markets. The Commission believes that the proposed rule change, as amended, could produce added benefits to investors through the increased competition between other market centers trading the product. Specifically, the Commission believes that by increasing the availability of TIRs as an investment tool, the NYSE's proposal should help provide investors with increased flexibility in satisfying their investment needs, by allowing them to purchase and sell a single security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day.

As noted above, the Commission has approved the listing and trading of TIRs at the Amex, under rules that are substantially similar to the NYSE rules.<sup>27</sup> The trading requirements of TIRs at the NYSE will be substantially similar to the trading requirements of TIRs at the Amex. The Commission published those rules in the **Federal Register** for the full notice and comment period. No comments were received on the proposed rules, and the Commission found them consistent with the Act.<sup>28</sup> The Commission does not believe that trading of this product raises novel regulatory issues that were not addressed in the previous filing. Accordingly, the Commission finds good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice in the **Federal Register**.

#### **V. Conclusion**

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>29</sup> that the proposed rule change, as amended, (SR-NYSE-2002-07) is hereby approved on an accelerated basis.

<sup>27</sup> See note 6, *supra*.

<sup>28</sup> *Id.*

<sup>29</sup> 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>30</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-9309 Filed 4-16-02; 8:45 am]

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-45729; File No. SR-NYSE-2002-15]

### **Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change by the New York Stock Exchange, Inc. Relating to the Trading of Certain Holding Company Depositary Receipts**

April 10, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 10, 2002, 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 and II 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, and to approve the proposed rule change on an accelerated basis.

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

The Exchange proposes to adopt standards for the trading pursuant to unlisted trading privileges ("UTP"), of certain Trust Issued Receipts ("TIRs"), known as Holding Company Depositary Receipts ("HOLDERS").<sup>3</sup> The text of the proposed rule change is available at the Office of the Secretary, NYSE, and at the Commission.

<sup>30</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> On April 9, 2002, the Commission approved the Exchange's listing standards for the listing and trading, or the trading pursuant to UTP, of TIRs under NYSE Rules 1200 through 1202, and Paragraph 703.20 of the NYSE's Listed Company Manual. The Commission also approved amendments to the Exchange's Rules 13, 36, 98, 104, 105(1), 460, the Allocation Policy and pre-opening and MOC/LOC policies to incorporate therein referenced to TIRs. Finally, the Commission approved the Exchange's generic listing standards that permit the listing and trading, or trading pursuant to UTP of TIRs, pursuant to Rule 19b-4(e) of the Act. See Securities Exchange Act Release No. 45719 (April 9, 2002).

## 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. The text of these statements may be examined at the places specified in Item III 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

The Exchange proposes to trade pursuant to UTP the following HOLDRs: (1) Broadband; (2) B2B Internet, (3) Europe 2001, (4) Internet Infrastructure, (5) Market 2000, (6) Wireless, and (7) Telecom (each a "HOLDR" and collectively, the "HOLDRs"). The HOLDRs currently are listed and traded on the Amex and trade on other securities exchanges, and in the over-the-counter market. The following paragraphs contain information applicable to all the HOLDRs generally.<sup>4</sup>

#### Trust Issued Receipts Generally

HOLDRs, a type of TIRs, are negotiable receipts that are issued by a trust representing securities of issuers that have been deposited and are held on behalf of the holders of the TIRs. TIRs are designed to allow investors to hold interests in a variety of companies throughout a particular industry in a single, exchange-listed and traded instrument that represents beneficial ownership in the deposited securities. Holders may cancel their TIRs at any time to receive the deposited securities.

Beneficial owners of TIRs will have the same rights, privileges and obligations as they would have if they beneficially owned the deposited securities outside of the TIR program. Holders of TIRs have the right to instruct the trustee to vote the deposited securities evidenced by the receipts. They will receive reports, proxies, and other information distributed by the issuers of the deposited securities to their security holders and will receive dividends and other distributions

<sup>4</sup> The Exchange notes that this information is based upon descriptions included in the various TIRs prospectuses and depository trust agreements, the American Stock Exchange LLC ("Amex") submissions relating to its TIR listing proposal, and the Commission's order approving the Amex proposal.

declared and paid by the issuers of the deposited securities to the trustee.

TIRs are not leveraged instruments, and therefore do not possess any of the attributes of stock index options. The Exchange believes that the level of risk involved in the purchase and sale of TIRs is almost identical to the risk involved in the purchase or sale of the common stocks represented by the receipt.

TIRs will be issued by a trust created pursuant to a depository trust agreement. After the initial offering, the trust may issue additional receipts on a continuous basis when an investor deposits the requisite securities with the trust. An investor in TIRs will be permitted to withdraw his or her deposited securities upon delivery to the trustee of one or more round-lots of 100 TIRs. Orders for other than a round lot (or round lot multiples) will not be allowed. Conversely, an investor may deposit the necessary securities and receive the TIRs in return.

#### Exchange Rules Applicable to the Trading of HOLDRs

TIRs, including the HOLDRs, are considered "securities" pursuant to NYSE Rule 3 and are subject to all applicable trading rules. The HOLDRs will be deemed "eligible securities" for purposes of the Intermarket Trading System ("ITS") Plan and therefore will be subject to the trade-through provisions of NYSE Rule 15A. The HOLDRs, as TIRs, are also subject to NYSE rules and policies governing, among other things, equity margin, priority, parity and precedence of orders, market volatility related trading halts, and responsibilities of member firms.<sup>5</sup>

The Exchange's surveillance procedures for HOLDRs will be similar to those used for investment company units and will incorporate and rely upon existing NYSE surveillance procedures governing equities.

Prior to the commencement of trading in HOLDRs, the Exchange will distribute a circular to the membership

<sup>5</sup> The Exchange notes that rules relating to odd lot executions will not apply, because TIRs are traded only in round lots or round lot multiples. Additionally, the Exchange understands that the Commission has provided an exemption from the short sale rule, Rule 10a-1 under the Act, 17 CFR 240.10a-1, for transactions in securities issued under the HOLDRs program. See Letter from James A. Brigagliano, Assistant Director, Division of Market Regulation ("Division"), Commission, to Claire P. McGrath, Vice President and Special Counsel Derivative Securities, Amex, dated (November 3, 1999), 1999 WL 692411 (SEC No-Action Letter). Thus, the NYSE will issue a notice to its members detailing the terms of the exemption, and confirming that applicable NYSE rules relating to short sales do not apply.

highlighting the characteristics of HOLDRs, including that HOLDRs are not individually redeemable. In addition, the circular will advise members of the Exchange about policies relating to trading halts in HOLDRs. Specifically, the circular will note that the Exchange may consider factors such as the extent to which trading is not occurring in the underlying security(s); whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the applicable current portfolio value; and whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

#### Disclosure to Customers

The Exchange will require its members to provide all purchasers of newly issued TIRs with a prospectus for that series of HOLDRs.

#### Trading Issues for TIRs (including HOLDRs)

A round lot of any of the above TIRs represents a holder's individual and undivided beneficial ownership interest in the whole number of securities represented by the receipt. The amount of deposited securities for each round lot of 100 TIRs will be determined at the beginning of the marketing period and will be disclosed in the prospectus to investors. Because TIRs may be acquired, held or transferred only in round lots of 100 receipts or round lot multiples, orders for other than a round lot (or round lot multiples) will not be allowed.

The Exchange believes that HOLDRs will not trade at a material discount or premium to the assets held by the issuing trust, because the arbitrage process should promote correlative pricing between the HOLDRs and the deposited securities. If the price of the HOLDR deviates enough from the portfolio of deposited securities to create a material discount or premium, an arbitrage opportunity would be created, allowing the arbitrageur to either: (1) Buy the HOLDRs at a discount, exchanging them for shares of the underlying securities and selling those shares at a profit; or (2) sell the HOLDRs short at a premium, buying the securities underlying the HOLDRs, depositing them in exchange for the HOLDRs, and delivering against the short position. In both instances, the arbitrageur locks in a profit and the markets move back into line.

The Exchange represents that its rules and policies currently applicable to investment company units will also

apply to the HOLDERS. These include the Exchange's policies regarding mandatory dissemination of pre-opening price indications (other than ITS pre-opening notifications) in the case of significant order imbalances, and the Exchange's MOC and LOC procedures (which do not apply to investment company units and will also not apply to the HOLDERS). Other such rules and policies include those relating to specialist allocation, capital and net liquid assets requirements for specialist member organizations, market making activity by a specialist, and control relationships involving a specialist.

#### Maintenance of the HOLDERS Portfolio

Except when a reconstitution event occurs, as described below, the securities represented by a HOLDER will not change. According to the prospectus of TIRs, under no circumstances will a new company be added to the group of issuers of the underlying securities, and weightings of component securities will not be adjusted after they are initially set.<sup>6</sup>

#### Reconstitution Events of HOLDERS

Trust agreements will provide for, and prospectuses for HOLDERS will describe, the automatic distribution of specified deposited securities in the trust's portfolio to the beneficial owners of HOLDERS in the circumstances referred to in such trust agreements and prospectuses as "reconstitution events." The reconstitution events occur under the following circumstances:

(1) If the issuer of the underlying securities no longer has a class of common stock registered under Section 12 of the Act, then its securities will no longer be an underlying security and the trustee will distribute the securities of that company to the owners of the HOLDERS;

(2) If the Commission finds that an issuer of underlying securities should be registered as an investment company under the Investment Company Act of 1940, and the trustee has actual knowledge of the Commission's finding, then the trustee will distribute the shares of that company to the owners of the HOLDERS;

(3) If the underlying securities of an issuer cease to be outstanding as a result of a merger, consolidation or other corporate combination, the trustee will

<sup>6</sup> The Exchange represents that the number of each security represented in a receipt may change due to certain corporate events such as stock splits or reverse stock splits on the deposited securities, and the relative weightings among the deposited securities may change based on the current market price of the deposited securities. See NYSE Rule 1202, Supplementary Material .20.

distribute the consideration paid by and received from the acquiring company to the beneficial owners of the HOLDERS, unless the acquiring company's securities are already included in the HOLDERS as deposited securities, in which case such additional securities will be deposited into the trust; and

(4) If an issuer's underlying securities are delisted from trading on a national securities exchange or Nasdaq and are not listed for trading on another national securities exchange or through Nasdaq within five business days from the date the deposited securities are delisted.

As described in the prospectus, if a reconstitution event occurs, the trustee will deliver the deposited security to the investor as promptly as practicable after the date that the trustee has knowledge of the occurrence of a reconstitution event.

#### Issuance and Cancellation of HOLDERS

The trust will issue and cancel—and an investor may obtain, hold, trade or surrender—HOLDERS only in round lots of 100 or in round lot multiples. Orders for other than a round lot or round lot multiples will not be allowed. While investors will be able to acquire, hold, transfer and surrender a round lot of 100 HOLDERS, the bid and asked prices will be quoted on a per receipt basis. The trust will issue additional receipts on a continuous basis when an investor deposits the required securities with the trust.

An investor may obtain HOLDERS by either purchasing them on an exchange or by delivering to the trustee the underlying securities evidencing a round lot of HOLDERS. The trustee will charge an issuance and cancellation fee of up to \$10.00 per 100 HOLDERS. Lower charges may be assigned for bulk issuances and cancellations. An investor may cancel HOLDERS and withdraw the deposited securities by delivering a round lot or round lot multiple of the TIRs to the trustee, during normal business hours. According to the prospectus, the trustee expects that, in most cases, it will deliver the deposited securities within one business day of the withdrawal request.

#### Termination of HOLDERS

The trust shall terminate upon the earlier of: (1) The removal of the HOLDERS from listing on a national securities exchange or Nasdaq if they are not listed for trading on another national securities exchange or Nasdaq within five business days from the date the receipts are delisted; (2) the trustee resigns and no successor trustee is appointed within 60 days from the date

the trustee provides notice to the initial depositor of its intent to resign; (3) 75% of the beneficial owners of outstanding HOLDERS (other than Merrill Lynch, Pierce, Fenner & Smith Incorporated) vote to dissolve and liquidate the trust; or (4) December 31, 2039. If a termination event occurs, the trustee will distribute the underlying securities to the beneficial owners as promptly as practicable after the termination event.

#### Criteria for Continued Listing

Except as otherwise noted below, and in *Exhibit A* of NYSE 2002-15, the Exchange believes that the HOLDERS satisfy the Exchange's continued listing criteria in NYSE Rule 1202, which is generally consistent with the continued listing criteria currently used by the Amex, the Chicago Stock Exchange (the "CHX"), the Chicago Board Options Exchange, Inc. (the "CBOE") and the Boston Stock Exchange (the "BSE").<sup>7</sup>

When listing TIRs under Rule 1202, the Exchange will establish a minimum number of receipts that must be outstanding at the time trading commences on the Exchange, and such minimum number will be included in any required submission to the Commission. In connection with continued listing, the Exchange will consider the suspension of trading in, or removal from listing of, a series of TIRs when any of the following circumstances arise: (1) The trust has more than 60 days remaining until termination and there have been fewer than 50 record and/or beneficial holders of the TIRs for 30 or more consecutive trading days; (2) the trust has fewer than 50,000 receipts issued and outstanding; (3) the market value of all receipts issued and outstanding is less than \$1 million; or (4) such other event occurs or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable. These flexible criteria will allow the Exchange to avoid delisting the TIRs (and possibly terminating the trust) due

<sup>7</sup> See Securities Exchange Act Release No. 41892 (September 21, 1999) 64 FR 52559 (September 29, 1999) (approving listing and trading of Trust Issued Receipts and Internet HOLDERS on the Amex); Securities Exchange Act Release No. 42056 (October 22, 1999), 64 FR 58870 (November 1, 1999) (approving listing and trading of Trust Issued Receipts and Internet HOLDERS on the CHX pursuant to UTP); Securities Exchange Act Release No. 42347 (January 18, 2000), 65 FR 4451 (January 27, 2000) (approving listing and trading of Trust Issued Receipts and Internet HOLDERS on the BSE pursuant to UTP); Securities Exchange Act Release No. 43134 (August 10, 2000), 65 FR 50255 (August 17, 2000) (approving listing standards for Trust Issued Receipts on the CBOE) and Securities Exchange Act Release No. 44908 (October 4, 2001), 66 FR 52161 (October 12, 2001) (approving listing and trading of Trust Issued Receipts and HOLDERS on the CBOE).

to relatively brief fluctuations in market conditions that may cause the number of holders to vary. However, these delisting criteria will not be applied for the initial 12-month period following formation of a trust and commencement of trading on the Exchange.

In addition, if the number of component securities drops to fewer than nine, and each time the number of component securities is reduced thereafter, the Exchange will consult with the staff of the Division of Market Regulation to confirm the appropriateness of continued listing of the TIRs.

NYSE Rule 1202 also contains specific "generic" listing criteria under which the Exchange may commence trading pursuant to Rule 19b-4(e). Those criteria are substantially similar to the criteria that have been applied to the initial listing of HOLDERS on the Amex. Specifically, each of the companies represented by the securities in the portfolios underlying the HOLDERS trusts (each of such companies referred to herein as a "component security") were required to meet the following minimum criteria when they were selected: (1) Each component security common stock was registered under Section 12 of the Exchange Act; (2) the minimum public float of each component security was at least \$150 million; (3) each component security was either listed on a national securities exchange or traded on Nasdaq and was a reported national market system security; (4) the average daily trading volume for each component security was at least 100,000 shares during the preceding sixty-day trading period; and (5) the average daily dollar value of the component security traded during the preceding sixty-day trading period was at least \$1 million. The initial weighting of each component security in the portfolio was based on its market capitalization; however, if on the date such weighting was determined, a component security represented more than 20% of the overall value of the receipt, then the amount of such component security was to be reduced to no more than 20% of the receipt value.

Based on the fact that each of the HOLDERS was initially listed on the Amex, the Exchange assumes that each component security met the criteria described above. Presently, however, the Exchange represents that each of the HOLDERS that the Exchange proposes to trade on a UTP basis has one or more component securities that fail to meet the minimum criteria set forth above. As a result, while the HOLDERS are substantially in compliance with the

forementioned minimum standards, the HOLDERS do not satisfy the Exchange's generic standards for listing and trading TIRs pursuant to Rule 19b-4(e). Specifically, one or more component securities of each HOLDER do not meet the minimum public float requirement in clause (2) above and/or the average daily dollar value requirement in clause (5) above, as more specifically described in *Exhibit A* attached to NYSE 2002-15.<sup>8</sup>

Notwithstanding that fact, the Exchange believes that its proposal to trade the HOLDERS on a UTP basis is appropriate, and thus should be approved. The HOLDERS continue to be substantially in compliance with the minimum initial listing criteria listed above, and thus, are substantially similar to products previously approved by the Commission. These HOLDERS also continue to be traded on the Amex, on several regional exchanges and in the over-the-counter market. Permitting the Exchange to trade these HOLDERS on a UTP basis will afford investors the advantage of an additional market on which to trade the HOLDERS, and avoid the unfair discrimination against the Exchange that would otherwise result from precluding the Exchange from trading these securities while the aforementioned markets continue to do so.

## 2. Statutory Basis

The Exchange believes that the basis under the Act for this proposed rule change is the requirement under section 6(b)(5) of the Act,<sup>9</sup> which provides that an exchange have rules that are 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, in general, to protect investors and the public interest.

## III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth

<sup>8</sup>The following component securities are at issue: (1) Broadband: CMTN and NXTV; (2) B2B Internet: IMGX, PPRO, SCNT, SOST, VERT, and NXPS; (3) Europe 2001: AUTN, BKHM, JAZZ, KQIP, and SNRA; (4) Internet Infrastructure: INAP, NAVI, and VITR; (5) Market 2000: OOM; (6) Wireless: NTRQ; and (7) Telecom: MCLDQ. For further details of each component security, see SR-NYSE-2002-15, *Exhibit A*.

<sup>9</sup>15 U.S.C. 78f(b)(5).

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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR-NYSE-2002-15 and should be submitted by May 8, 2002.

## IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of section 6(b)(5) of the Act<sup>10</sup> and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that this proposal, which establishes standards for trading the HOLDERS, pursuant to UTP, will provide investors with a convenient and less expensive way of participating in the securities markets. The Exchange's proposal should advance the public interest by providing investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell a single security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day. Accordingly, the Commission finds that the Exchange's proposal will facilitate transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.<sup>11</sup>

As noted in the Amex approval order, the Commission believes that HOLDERS will provide investors with an alternative to trading a broad range of securities on an individual basis, and will give investors the ability to trade the HOLDERS representing a portfolio of securities continuously throughout the business day in secondary market

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> In approving this rule, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

transactions at negotiated prices. The HOLDRs will allow investors to: (1) Respond quickly to changes in the overall securities markets generally and for the industry represented by a particular trust; (2) trade, at a price disseminated on a continuous basis, a single security representing a portfolio of securities that the investor owns beneficially; (3) engage in hedging strategies similar to those used by institutional investors; (4) reduce transaction costs for trading a portfolio of securities; and (5) retain beneficial ownership of the securities underlying the HOLDRs.

Although the HOLDRs are not leveraged instruments, and therefore do not possess any of the attributes of stock index options, their prices will be derived and based upon the securities held in their respective trusts. Accordingly, the level of risk involved in the purchase or sale of TIRs is similar to the risk involved in the purchase or sale of traditional common stock, with the exception that the pricing mechanism for TIRs is based on a basket of securities.<sup>12</sup>

#### Trading of the HOLDRs pursuant to UTP

The Commission finds that the NYSE's proposal contains adequate rules and procedures to govern the trading of the HOLDRs pursuant to UTP. The HOLDRs are equity securities that will be subject to the full panoply of NYSE rules governing the trading of equity securities on the NYSE,<sup>13</sup> including, among others, rules governing the priority, parity and precedence of orders, responsibilities of the specialist, account opening and customer suitability requirements, and the election of a stop or limit order.<sup>14</sup> TIRs, including these HOLDRs, trade in the expanded blue room, shared only by exchange traded funds ("ETFs").<sup>15</sup>

<sup>12</sup> The Commission has concerns about continued trading of TIRs whether listed or pursuant to UTP, if the number of component securities fails to reflect a cross section of the selected industry. Accordingly, the NYSE has represented that it would consult the Commission concerning continued trading, once the trust has fewer than nine component securities, and for each subsequent loss of a security thereafter.

<sup>13</sup> The Commission notes that the amendments to NYSE trading rules are substantially similar to changes approved for the trading of exchange-traded funds. See Securities Exchange Act Release No. 44616 (July 30, 2001), 66 FR 40761 (August 3, 2001).

<sup>14</sup> Trading rules pertaining to the availability of odd-lot trading do not apply because the Holders only can be traded in round-lots or round-lot multiples.

<sup>15</sup> Telephone conversation between James F. Duffy, Senior Vice President and Associate General Counsel, Office of the General Counsel, NYSE, and Florence E. Harmon, Senior Special Counsel, Division, Commission (April 10, 2002). If TIRs and

In addition, the NYSE has developed specific listing and delisting criteria for the HOLDRs that will help to ensure that a minimum level of liquidity will exist for the HOLDRs to allow for the maintenance of fair and orderly markets. The delisting criteria also allow the NYSE to consider the suspension of trading and the delisting of a HOLDR if an event occurred that made further dealings in such securities inadvisable. This will give the NYSE flexibility to delist the HOLDRs if circumstances warrant such action. The NYSE's proposal also provides procedures to halt trading in the HOLDRs in certain enumerated circumstances.

Moreover, in approving this proposal, the Commission notes the Exchange's belief that the HOLDRs will not trade at a material discount or premium in relation to the overall value of the trusts' assets because of potential arbitrage opportunities. The Exchange also represents that the potential for arbitrage should keep the market price of a HOLDR comparable to the overall value of the deposited securities.

Furthermore, the Commission believes that the Exchange's proposal to trade the HOLDRs should enhance market liquidity, and should promote more accurate pricing, tighter quotations, and reduced price fluctuations. The Commission also believes that such trading should allow customers to receive the best possible execution of their transactions in the HOLDRs.

Finally, the NYSE will apply surveillance procedures for the HOLDRs that will be similar to the procedures used for investment company units and will incorporate and rely upon existing NYSE surveillance procedures governing equities. The Commission believes that these surveillance procedures are adequate to address concerns associated with the trading of the HOLDRs pursuant to UTP, including any concerns associated with purchasing and redeeming round-lots of 100 receipts. Accordingly, the Commission believes that the rules governing the trading of the HOLDRs provide adequate safeguards to prevent manipulative acts and practices and to protect investors and the public interest.

#### Disclosure and Dissemination of Information

The Commission believes that the Exchange's proposal will ensure that

ETFs were to trade on a floor that was not physically separated from the trading of the underlying component securities, the Commission notes that the NYSE would have to file a proposed rule change pursuant to Section 19(b) of the Act. 15 U.S.C. 78s(b).

investors have information that will allow them to be adequately apprised of the terms, characteristics, and risks of trading the HOLDRs. The prospectus will address the special characteristics of a particular HOLDR basket, including a statement regarding its redeemability and method of creation. The Commission notes that all investors in the HOLDRs who purchase in the initial offering will receive a prospectus. In addition, anyone purchasing a HOLDR directly from the trust (by delivering the underlying securities to the trust) will also receive a prospectus. Finally, all NYSE member firms that purchase the HOLDRs from the trust for resale to customers must deliver a prospectus to such customers.

The Commission also notes that prior to the commencement of trading the HOLDRs, the Exchange will issue a circular to its members explaining the unique characteristics and risks of this type of security. The circular also will note the Exchange members' prospectus delivery requirements, and highlight the characteristics of purchases in HOLDRs, including that the HOLDRs are not individually redeemable. The circular also will inform members of Exchange policies regarding trading halts in HOLDRs.

As described above, the Commission has previously approved similar Amex, CHX, and Pacific Exchange, Inc. rules that permit the listing and trading of individual TIRs, including the trading of TIRs pursuant to UTP. In approving these securities for trading, the Commission considered their structure, their usefulness to investors and the markets, and the Exchanges' rules and surveillance programs that govern their trading.

The Commission notes that the HOLDRs that NYSE proposes to trade pursuant to UTP currently trade on other securities exchanges. The Commission therefore believes that it is appropriate to approve these HOLDRs for trading pursuant to UTP on the NYSE, as their trading should produce the same benefits to the NYSE and to investors.

The NYSE has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice in the **Federal Register**. The Commission believes that the Exchange's proposal to trade the HOLDRs pursuant to UTP will provide investors with a convenient and less expensive way of participating in the securities markets. The Commission believes that the proposed rule change, as amended, could produce added benefits to investors through the

increased competition between other market centers trading the product. Specifically, the Commission believes that by increasing the availability of the HOLDRs as an investment tool, the NSYE's proposal should help provide investors with increased flexibility in satisfying their investment needs, by allowing them to purchase and sell a single security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day.

As noted above, the Commission has approved the listing and trading of HOLDRs at other securities exchanges, under rules that are substantially similar to the NYSE rules.<sup>16</sup> The Commission published those rules in the **Federal Register** for the full notice and comment period. No comments were received on the proposed rules, and the Commission found them consistent with the Act.<sup>17</sup> The HOLDRs at issue are currently trading on other securities exchanges pursuant to UTP. The Commission does not believe that trading of this product raises novel regulatory issues that were not addressed in the previous filings. Accordingly, the Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice in the **Federal Register**.

## V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-NYSE-2002-15) is hereby approved on an accelerated basis.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-9314 Filed 4-16-02; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45737; File No. SR-PCX-00-45]

### Self Regulatory Organizations; Pacific Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to the Proposed Rule Change Relating to the Expansion of the Equity Hedge Exemption From Position and Exercise Limits

April 11, 2002.

#### I. Introduction

On December 11, 2000, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to expand the current equity hedge exemption to eliminate position and exercise limits for certain qualified hedge strategies. The proposed rule change was published for comment in the **Federal Register** on August 17, 2001.<sup>3</sup> The Commission received no comments on the proposal. On April 9, 2002, the PCX submitted Amendment No. 1 to the proposal.<sup>4</sup>

#### II. Description of the Proposal

The Exchange is proposing to eliminate position and exercise limits when certain qualified strategies are employed to establish a hedged equity option position and to establish a position and exercise limit of five times the standard limit for those strategies that include an OTC option contract. Accordingly, the PCX proposes to amend Commentary .07 of Exchange Rule 6.8(a) to expand the definition of a "qualified" hedged position. The proposed qualified hedged strategies are as follows:

1. Where each option contract is "hedged" by the number of shares underlying the option contract or securities convertible into the underlying security or, in the case of an adjusted option, the same number of shares represented by the adjusted contract: (a) Long call and short stock;

(b) short call and long stock; (c) long put and long stock; or (d) short put and short stock.

2. Reverse Conversions—A long call position accompanied by a short put position, where the long call expires with the short put and the strike price of the long call and short put is the same, and where each long call and short put contract is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.<sup>5</sup>

3. Conversions—A short call position accompanied by a long put position, where the short call expires with the long put and the strike price of the short call and long put is the same, and where each short call and long put contract is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.<sup>6</sup>

4. Collars—A short call position accompanied by a long put position, where the short call expires at the same time as the long put and the strike price of the short call equals or exceeds the strike price of the long put position and where each short call and long put position, is hedged with 100 shares of the underlying security (or other adjusted number of shares).<sup>7</sup> Neither side of the short call/long put position can be in-the-money at the time the position is established.

5. Box Spreads—A long call position accompanied by a short put position, where both the long call and short put have the same strike price, and a short call position accompanied by a long put position, where the short call and long put have the same strike price as each other, but a different strike price than the long call/short put position.

6. Back-to-Back Options—A listed option position hedged on a one-for-one basis with an over-the-counter ("OTC") option position on the same underlying security.<sup>8</sup> The strike price of the listed

<sup>5</sup>For these strategies one of the option components can be an OTC option guaranteed or endorsed by the firm maintaining the proprietary position or carrying the customer account. Hedge transactions and positions established pursuant to these strategies and using an OTC option contract as part of the hedge are subject to a position limit equal to five times the standards limit established under Commentary .05 to PCX Rule 6.8(a). For purposes of this rule filing, an OTC option contract is defined as an option that is not listed on a National Securities Exchange or cleared at the Options Clearing Corporation.

<sup>6</sup>*Id.*

<sup>7</sup>*Id.*

<sup>8</sup>Hedge transactions and positions established pursuant to this strategy are subject to a position limit equal to five times the standards limit established under Commentary .05 to PCX Rule 6.8(a).

<sup>16</sup> See note 7, *supra*.

<sup>17</sup> *Id.*

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

<sup>19</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 Securities Exchange Act Release No. 44680 (August 10, 2001), 66 FR 43283.

<sup>4</sup> See Letter from Cindy Sink, Senior Attorney, Regulatory Policy, PCX, to John Riedel, Attorney, Division of Market Regulation, Commission, dated April 9, 2002 ("Amendment No. 1"). In Amendment No. 1, the PCX established a position and exercise limit equal to no greater than five times the standard limit for those hedge strategies that include an OTC option component.