

at no charge, will contain the following information, on a per iShare basis, for each Index Fund: (a) the prior business day's NAV and Bid/Ask Price, and a calculation of the premium or discount of such Bid/Ask Price against such NAV; and (b) data in chart format displaying the frequency distribution of discounts and premiums of the daily Bid/Ask Price against the NAV, within appropriate ranges, for each of the four previous calendar quarters. In addition, the Product Description for each Index Fund will state that the website(s) for the Companies has information about the premiums and discounts at which the Index Fund's iShares have traded.

7. The Prospectus and annual report for each Index Fund will also include: (a) the information listed in condition 6(b), (i) in the case of the Prospectus, for the most recently completed year (and the most recently completed quarter or quarters, as applicable) and (ii) in the case of the annual report, for the immediately preceding five years, as applicable; and (b) the following data, calculated on a per iShare basis for one, five and ten year periods (or life of the Index Fund), (i) the cumulative total return and the average annual total return based on NAV and Bid/Ask Price, and (ii) the cumulative total return of the relevant Benchmark Index.

#### *Fixed Income Index Funds*

The applicants agree that the order granting the requested relief with respect to the Index Funds proposed in the Fixed Income Application will be subject to the following condition:

8. Before an Index Fund may rely on the order, the Commission will have approved, pursuant to rule 19b-4 under the Exchange Act, an Exchange rule requiring Exchange members and member organizations effecting transactions in iShares of such Index Fund to deliver a Product Description to purchasers of iShares.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-46001; File No. 4-429]

### **Joint Industry Plan; Order Granting Approval of Joint Amendments Nos. 2 and 3 to the Options Intermarket Linkage Plan Relating to Satisfaction of Trade-Throughs, the Procedures for Handling Multiple Principal Orders, Restrictions on Withdrawal, and an Implementation Timetable**

May 30, 2002.

On November 20, 2001, November 21, 2001, December 10, 2001, December 10, 2001, and December 26, 2001, the Philadelphia Stock Exchange, Inc. ("Phlx"), International Stock Exchange LLC ("ISE"), Chicago Board Options Exchange, Inc. ("CBOE"), Pacific Exchange, Inc. ("PCX"), and American Stock Exchange LLC ("AMEX") (collectively, the "Participants"), respectively, filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 11A(a)(3) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 11Aa3-2 thereunder,<sup>2</sup> an amendment ("Joint Amendment No. 2") to the Options Intermarket Linkage Plan.<sup>3</sup> In addition, on April 5, 2002, April 9, 2002, April 15, 2002, April 15, 2002 and April 16, 2002, CBOE, ISE, Phlx, PCX, and Amex, respectively, filed with the Commission an additional amendment ("Joint Amendment No. 3") to the Linkage Plan.

The proposed amendments to the Linkage Plan were published for comment in the **Federal Register** on April 30, 2002.<sup>4</sup> No comments were received on the proposal. This order approves the proposed amendments to the Linkage Plan.

#### **I. Description of the Proposed Amendments**

##### *A. Proposed Joint Amendment No. 2*

In Proposed Joint Amendment No. 2, the Participants propose changes to two provisions of the Linkage Plan to

modify: (1) The manner in which a Participant displaying the best published quote may be compensated when its quote represents a customer order and another Participant executes an order for a listed option at a price inferior to the best-published quote displayed on that exchange ("intermarket trade-through"); and (2) the procedures for monitoring restrictions on how often orders for the account of market makers ("Principal Orders") may be sent through the Linkage.

##### *1. Satisfaction of Trade-Throughs*

One of the main goals of the Linkage Plan is to limit the incidence of intermarket trade-throughs. As part of achieving this goal, the Linkage Plan provides that if a customer order is the best-published quote and a trade is executed at a worse price, the exchange representing that customer order may request compensation from the exchange that executed the trade-through.

Currently, the Linkage Plan requires that, to be compensated by another Participant, a Participant generally must lodge a complaint with that Participant within three minutes of the time that the transaction report was disseminated. The Linkage Plan requires that the complaint specify the number of customer contracts at the disseminated quotation that were traded-through. The Participant that traded through is then required to respond to the complaint, either by claiming an exception to liability<sup>5</sup> or by taking corrective action. If no exception to liability applies, the Participant initiating the trade-through may either: (1) Send a Satisfaction Order<sup>6</sup> to the Participant that sent the complaint; or (2) adjust the price of the trade to a price at which a trade-through would not have occurred.

The proposed amendment would simplify this procedure by combining the complaint and satisfaction process. Specifically, if a Participant identifies a trade-through by another exchange, that Participant would send a Satisfaction Order to the exchange that traded-through for the number of customer

<sup>1</sup> 15 U.S.C. 78k-1(a)(3).

<sup>2</sup> 17 CFR 240.11Aa3-2.

<sup>3</sup> On July 28, 2000, the Commission approved a national market system plan ("Linkage Plan") for the purpose of creating and operating an intermarket options market linkage ("Linkage") proposed by Amex, CBOE, and ISE. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000). Subsequently, Phlx and PCX joined the Linkage Plan. See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70850 (November 28, 2000) and 43574 (November 16, 2000), 65 FR 70851 (November 28, 2000). On June 27, 2001, the Commission approved an amendment to the Linkage Plan. See Securities Exchange Act Release No. 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001).

<sup>5</sup> The exceptions to liability are set forth in § 8(c)(iii) of the Linkage Plan.

<sup>6</sup> A Satisfaction Order is currently defined in the Linkage Plan as an order for the principal account of a member who initiated a trade-through, sent through the linkage to satisfy the liability arising from that trade-through. section 2(16)(c) of the Linkage Plan. In Joint Proposed Amendment No. 2, the Participants propose to define a Satisfaction Order as an order sent through the linkage to notify a Participant of a trade-through and to seek satisfaction of liability arising from that trade-through. See Proposed amendments to § 2(16)(c) of the Linkage Plan.

contracts at the disseminated quotation. The exchange receiving the Satisfaction Order can: (1) Fill the order; (2) claim an exemption from liability; or (3) take other action currently permitted under the Linkage Plan (such as correcting the price of the transaction to a price that would not be a trade-through). Due to the uncertainty as to whether a Participant will receive an execution of the Satisfaction Order, the proposed amendment would permit the Participant that sent the Satisfaction Order to reject any execution it receives if the customer order(s) underlying the Satisfaction Order had been executed or canceled while the Satisfaction Order was pending.<sup>7</sup>

## 2. Sending Principal Orders Through the Linkage

Currently, the Linkage Plan provides that a market maker may send a Principal Order for automatic execution to another exchange for up to 10 contracts. If a market maker of a Participant sends such a Principal Order for automatic execution to another Participant, there are limits and prohibitions on any market maker from that Participant sending additional Principal Orders to the same exchange in the same options class. Specifically, subject to certain exceptions, a Participant cannot send another Principal Order for automatic execution for 15 seconds, and for the following 45 seconds it can only send Principal Orders larger than the automatic execution size.

The Participants propose to place the responsibility for monitoring compliance with these limitations on the receiving, not the sending, Participant. Specifically, proposed amended Section 7(a)(ii)(C) of the Linkage Plan states that if a Participant received a second Principal Order for automatic execution from a Participant within 15 seconds, it could reject such order. Similarly, for the next 45 seconds, the receiving Participant could deny automatic execution to any Principal Orders it receives from the same Participant. The same exceptions to these provisions contained in the current Linkage Plan would continue to apply.<sup>8</sup>

<sup>7</sup> See Proposed amendments to the definitions of "Satisfaction Order" and "Reference Price," and § 8(c) of the Linkage Plan.

<sup>8</sup> If there is a change of price in the receiving Participant's disseminated offer (bid) and such price continues to be at the NBBO, the receiving Participant may not reject a second order received from the same Participant within 15 seconds of the initial order; if there is a change of price in the receiving Participant's disseminated offer (bid), the receiving Participant may not reject a second order received from the same Participant after 15 seconds

## B. Proposed Joint Amendment No. 3

Proposed Joint Amendment No. 3 would substantively modify the Linkage Plan by: (1) Restricting Participants' withdrawal from the Linkage Plan; (2) incorporating a timetable for implementing the linkage; and (3) requiring each Participant to submit to the Commission a project plan for implementation and monthly status reports.<sup>9</sup>

### 1. Withdrawal from the Linkage Plan

Currently, a Participant is required to provide only 30 days written notice to the other Participants and the facilities manager to withdraw from the Linkage Plan. The proposed amendment would delete this provision and require, instead, that a Participant wishing to withdraw from the Linkage Plan effect an amendment to the Linkage Plan, which would be subject to Commission approval. The Participant would be required to state how it plans to accomplish, by alternate means, the goals of the Linkage Plan regarding limiting trade-throughs of prices on other exchanges trading the same options classes. A Participant would be permitted to propose such an amendment unilaterally, and approval of the other Participants would not be required.<sup>10</sup>

### 2. Implementation Timetable

The proposed amendment would incorporate into the Linkage Plan a specific implementation timetable. The Participants propose to implement the linkage in two phases: the first phase would be limited to those aspects of the Linkage Plan providing for automatic execution, and the second phase would implement all other linkage functionality. The proposal would require the Participants to begin full intermarket testing of phase 1 no later than December 1, 2002, and testing of phase 2 no later than March 1, 2003. The Participants would be required to implement phase 1 and phase 2 as soon as practical after successful testing, and no later than February 1, 2003 and April 30, 2003, respectively.<sup>11</sup>

and within one minute of the initial order. See section 7(a)(ii)(C) of the Linkage Plan.

<sup>9</sup> Proposed Joint Amendment No. 3 also would conform two Linkage Plan provisions to Joint Amendment No. 2 by replacing references to trade-through complaints with references to Satisfaction Orders. See proposed Amendments to § 8(c) of the Linkage Plan.

<sup>10</sup> See Proposed section 4(d) of the Linkage Plan.

<sup>11</sup> See Proposed section 12(a) of the Linkage Plan.

## 3. Project Plan and Monthly Status Reports

Finally, proposed Joint Amendment No. 3 would require each Participant to provide the Commission with a detailed project plan and monthly status reports regarding implementation of such project plan.<sup>12</sup>

## II. Discussion

After careful consideration, the Commission finds that the proposed Joint Amendments to the Linkage Plan are consistent with the requirements of the Act and the rules and regulations thereunder. Specifically, the Commission finds that the proposed Joint Amendments are consistent with section 11A of the Act,<sup>13</sup> and Rule 11Aa3-2 thereunder,<sup>14</sup> in that it is 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.

The Commission believes that the proposed streamlined procedures for achieving satisfaction of trade-throughs set forth in proposed Joint Amendment No. 2 should enable each Participant to more easily seek compensation on behalf of customer orders represented in the quote in circumstances in which it believes that a trade-through of that quote has occurred. In addition, the proposal to place the responsibility for monitoring the handling of multiple principal orders on the receiving, rather than the sending, Participant should address the Participants' technical concerns regarding implementation of this provision, without modifying the substance or intent of the provision.

The Commission further believes that the proposed restrictions on withdrawal from the Linkage Plan, proposed in Joint Amendment No. 3, will ensure that each of the Participants remains subject to the requirements of the Linkage Plan to avoid trading through better prices displayed on the other options markets, unless the Participant can demonstrate to the Commission's satisfaction that it can accomplish the same goal by an alternate means. Because each Participant would be required to obtain Commission approval before it could withdraw from the Linkage Plan, the Commission is assured of an opportunity to carefully consider the full implications of any such proposed withdrawal from the Linkage Plan.

Moreover, the proposed implementation timetable provides

<sup>12</sup> See Proposed section 12(b) of the Linkage Plan.

<sup>13</sup> 15 U.S.C. 78k-1.

<sup>14</sup> 17 CFR 240.11Aa3-2.

certainly regarding the dates by which an intermarket linkage in the options market will be available. Finally, the submission by the exchanges to the Commission of detailed project plans and monthly status reports will enhance the Commission's ability to continue monitoring the Participants' progress in achieving full implementation of the Linkage Plan within the established timetables.

Accordingly, *It is ordered*, pursuant to section 11A of the Act,<sup>15</sup> and Rule 11Aa3-2 thereunder,<sup>16</sup> that the proposed Joint Amendments No. 2 and 3 to the Options Intermarket Linkage Plan are approved.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46003; File No. S7-17-00]

### Order Granting Temporary Exemption for Broker-Dealers from the Trade-Through Disclosure Rule

May 30, 2002.

In July 2000, the Commission approved an intermarket linkage plan, in which all five options exchanges<sup>1</sup> are currently participants ("Linkage Plan").<sup>2</sup> Also in July 2000, the Commission proposed, and in November 2000 adopted, Rule 11Ac1-7 ("Trade-Through Disclosure Rule") under the Securities Exchange Act of 1934 ("Exchange Act").<sup>3</sup>

The Trade-Through Disclosure Rule requires a broker-dealer to disclose to a customer when the customer's order for a listed option is executed at a price

inferior to the best-published quote ("intermarket trade-through"), and to disclose the better published quote available at that time. However, a broker-dealer is not required to disclose to its customer an intermarket trade-through if the broker-dealer effects the transaction on an exchange that participates in an approved linkage plan that includes provisions reasonably designed to limit customers' orders from being executed at prices that trade through a better published price. In addition, broker-dealers are not required to provide the disclosure required by the rule if the customer's order is executed as part of a block trade. Once implemented, the Linkage Plan would reasonably limit intermarket trade-throughs on each of the options markets,<sup>4</sup> provided that the Options Exchanges remain participants in the Linkage Plan.<sup>5</sup> Under these circumstances, broker-dealers effecting transactions on options exchanges that participate in the Linkage Plan would be excepted from the disclosure requirements of the Trade-Through Disclosure Rule.

To date, the options exchanges have taken steps to implement the Linkage Plan. Specifically, the options exchanges have selected The Options Clearing Corporation ("OCC") to be the linkage provider and have worked closely with OCC to develop the technical requirements related to the linkage's central core or "hub" to and from which all linkage orders would be routed. The Options Exchanges have informed the Commission that they are completing the process of evaluating their internal systems to determine the extent of modification necessary to integrate their systems into the central hub and beginning to modify those systems.

The Commission has twice extended the compliance date of the Trade-Through Disclosure Rule for broker-dealers, most recently until April 1, 2002, because of its reluctance to

impose on broker-dealers the costs of complying with the disclosure requirements of the rule while the Options Exchanges are working to implement the Linkage Plan, which would render such disclosures unnecessary.<sup>6</sup>

In addition, on March 27, 2002, the Commission issued an Order temporarily exempting for 90 days broker-dealers from compliance with the Trade-Through Disclosure Rule.<sup>7</sup> At that time, the Commission stated that it would consider a further extension of the 90-day temporary exemption at the time it considered a proposal to repeal the Trade-Through Disclosure Rule, which it directed the staff to develop.<sup>8</sup> Today, the Commission has separately proposed a repeal of the Trade-Through Disclosure Rule.<sup>9</sup>

Today, the Commission also approved amendments to the Linkage Plan, proposed by the Options Exchanges on April 15, 2002, that permit an exchange to withdraw from participation in the Linkage Plan only if it can satisfy the Commission that it can accomplish, by alternative means, the same goals as the Linkage Plan of limiting intermarket trade-throughs of prices on other markets.<sup>10</sup> The amendment also requires the Options Exchanges to implement the linkage in two phases by specified dates.<sup>11</sup> As a result of the Commission's approval of the amendments to the Linkage Plan, the principal purpose of the Trade-Through Disclosure Rule "to require customers' orders to be executed on exchanges that participate in a linkage that limits intermarket trade-throughs or, in the alternative, to provide customers with additional information about the execution of their orders" has been accomplished.

The Commission, therefore, believes it is appropriate in the public interest and consistent with the protection of investors at this time to temporarily

<sup>15</sup> 15 U.S.C. 78k-1.

<sup>16</sup> [16]: 17 CFR 240.11Aa3-2.

<sup>1</sup> The exchanges currently trading options are the American Stock Exchange ("Amex"), the Chicago Board Options Exchange ("CBOE"), the International Securities Exchange ("ISE"), the Pacific Exchange ("PCX"), and the Philadelphia Stock Exchange ("Phlx") (collectively, "Options Exchanges").

<sup>2</sup> See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000). The Linkage Plan approved by the Commission in July 2000 is the plan filed by the Amex, CBOE, and ISE. Subsequently, the PCX and Phlx joined the Linkage Plan. See Securities Exchange Act Release Nos. 43310 (September 20, 2000), 65 FR 58583 (September 29, 2000) (approving an amendment to the Linkage Plan adding the PCX as a participant); and 43311 (September 20, 2000), 65 FR 58584 (September 29, 2000) (approving an amendment to the Linkage Plan adding the Phlx as a participant).

<sup>3</sup> 17 CFR 240.11Ac1-7. See also Securities Exchange Act Release Nos. 43591 (November 17, 2000), 65 FR 75439 (December 1, 2000); and 43085 (July 28, 2000), 65 FR 47918 (August 4, 2000).

<sup>4</sup> The Commission approved an amendment to the previously-approved Linkage Plan that would permit broker-dealers executing orders on participating exchanges to satisfy the exception to the disclosure requirements of the Trade-Through Disclosure Rule. Securities Exchange Act Release No. 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001).

<sup>5</sup> The Commission today is approving an amendment to the Linkage Plan proposed by the options exchanges that deletes the provision that permits any participant to withdraw after 30 days written notice and requires, instead, that a participant wishing to withdraw from the Linkage Plan must first satisfy the Commission that it can accomplish, by alternative means, the same goals as the Linkage Plan of limiting trade-throughs of prices on other markets. Securities Exchange Act Release No. 46001 (May 30, 2002).

<sup>6</sup> See Securities Exchange Act Release Nos. 44078 (March 15, 2001), 66 FR 15792 (March 21, 2001); and 44852 (September 26, 2001), 66 FR 50103 (October 2, 2001).

<sup>7</sup> Securities Exchange Act Release No. 45654 (March 27, 2002), 67 FR 15637 (April 2, 2002).

<sup>8</sup> *Id.*

<sup>9</sup> Securities Exchange Act Release No. 46002 (May 30, 2002).

<sup>10</sup> Securities Exchange Act Release No. 46001 (May 30, 2002).

<sup>11</sup> *Id.* The first phase will comprise those elements of the linkage that are necessary to send and receive orders required under the Linkage Plan to be automatically executed by the exchange receiving the order. The Options Exchanges will begin full intermarket testing of the first phase by December 1, 2002, and will implement this phase no later than February 1, 2003. The second phase will comprise the remaining elements of the linkage. The exchanges will begin testing of this second phase by March 1, 2003, and will implement this phase no later than April 30, 2003.