

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46599; File No. SR-CSE-2002-04]

### Self-Regulatory Organizations; Notice of Filing of Amendment Nos. 1 and 2 to a Proposed Rule Change by the Cincinnati Stock Exchange, Inc. Relating to the Introduction of Order Delivery and Automated Response

October 4, 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 22, 2002, the Cincinnati Stock Exchange, Inc. ("CSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change. The proposed rule change was published for comment in the **Federal Register** on May 10, 2002.<sup>3</sup> On September 13, 2002, the CSE filed Amendment No. 1 to the proposed rule change<sup>4</sup> and on September 17, 2002, filed Amendment No. 2 to the proposed rule change.<sup>5</sup> Amendment Nos. 1 and 2 are described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on Amendment Nos. 1 and 2 to the proposed rule change from interested persons.

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

As discussed in the Initial Notice, the Exchange proposed to amend CSE Rule 11.9, National Securities Trading System ("NSTS" or "System"), to modify CSE's execution functionality from a process of automatically matching and executing like-priced

displayed orders and quotes to an optional process of delivering orders to quoting CSE members and requiring automated responses from such members back to the CSE System.<sup>6</sup> The Exchange filed Amendment No. 1 to delete proposed rule language in Paragraph 11.9(i)(2)(a) regarding price/time and agency/principal priorities, which was inadvertently included in the original proposal. The Exchange filed Amendment No. 2 to expand the proposed order delivery and automated response alternative to all securities traded through the Exchange's NSTS, rather than simply Nasdaq National Market Securities. In addition, Amendment No. 2 made certain non-substantive grammatical changes. The text of the proposed rule change, incorporating Amendment Nos. 1 and 2, is set forth below in its entirety. Proposed new language is in italics; proposed deletions are in brackets.

\* \* \* \* \*

#### Chapter XI

##### Trading Rules

##### Rule 11.9(i)

The System [shall automatically match and execute like-priced orders, bids and offers in accordance with the price-time and agency/principal priorities set forth in Rule 11.9(l) and (m).] *offers two modes of order interaction selected by members:*

(1) *If automatic execution is selected, the System shall match and execute like-priced orders, bids and offers on an order by order basis only at the specific instruction of Users, including Designated Dealers.*

(2) *If order delivery and automated response is selected, the System will deliver contra-side orders against displayed orders and quotations on an order by order basis and only at the specific instruction of Users, including Designated Dealers. To be eligible for order delivery service, Users must*

<sup>6</sup> In the Initial Notice, reference was made to a defined term, the CSE Over-the-Counter Unlisted Trading Privileges System ("CSE OTC-UTP System"). This reference created ambiguity, because the term CSE OTC-UTP System is defined in and ostensibly created by a pending CSE rule filing (File No. SR-CSE-2001-04) that has been published in the **Federal Register** for comment, but has not been approved by the Commission. See Securities Exchange Act Release No. 45405 (February 6, 2002), 67 FR 6558 (February 12, 2002). Because of this ambiguity and because of the lack of need for such a defined term in the instant proposal, the Exchange requested that the Commission remove the defined term, CSE OTC-UTP System, from the purpose section of the instant proposal. Telephone discussion between Jeffrey, T. Brown, Vice President, Regulation and General Counsel, CSE, and Katherine England, Assistant Director, and Christopher B. Stone, Attorney Advisor, Division, Commission (October 3, 2002).

*demonstrate to Exchange examiners that the User's system can automatically process the inbound order and respond appropriately within 1 second.*

\* \* \* \* \*

#### 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, as amended. 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

As discussed in the Initial Notice and Amendment Nos. 1 and 2, the purpose of the proposed rule change is to increase the flexibility of CSE execution systems to accommodate member needs. Specifically, CSE proposes to modify CSE's execution functionality within the CSE System from a process of automatically matching and executing like-priced displayed orders and quotes to an optional process of delivering orders to quoting CSE members and requiring automated responses from such members back to the CSE System. CSE is proposing this modification to facilitate a diverse membership base while promoting a fair and orderly market. CSE members that operate as electronic communications networks ("ECNs")<sup>7</sup> or alternative trading systems ("ATSs") subject to SEC Regulation ATS,<sup>8</sup> as well as members that act as Designated Dealers or specialists on CSE will have the option of selecting the type of centralized execution system that best fits their business model.

In an order delivery and automated response system, a member's quotation or displayed order will be held in the CSE System, and when a contra-side order is received in the CSE System, CSE will immediately forward the order

<sup>7</sup> ECNs are defined in SEC Rule 11Ac1-1(a)(8), 17 CFR 240.11Ac1-1(a)(8), as any electronic system that widely disseminates to third parties orders entered therein by an exchange market maker or OTC market maker, and permits such orders to be executed against in whole or in part.

<sup>8</sup> 17 CFR 242.300-303.

<sup>14</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 45873 (May 3, 2002), 67 FR 31856 ("Initial Notice"). No comments have been received on the proposal.

<sup>4</sup> See letter from Jennifer M. Lamie, CSE, to Katherine England, Assistant Director, Division of Market Regulation ("Division"), Commission (September 12, 2002) ("Amendment No. 1").

<sup>5</sup> See letter from Jennifer M. Lamie, CSE, to Katherine England, Assistant Director, Division, Commission (September 16, 2002) ("Amendment No. 2").

message to the quoting member, who will be obligated by rule to respond instantaneously to the order message. Moreover, the quoting member must have a demonstrated capability to respond instantaneously to the order message. On receipt of the order message delivered by CSE, the quoting member will automatically determine whether its quote is still active. If so, the member will automatically deliver to the CSE System matched orders representing its quote and the contra-side for execution. If the member's quote is in the process of changing due to a prior internal match at the displayed price, consistent with the Firm Quote Rule,<sup>9</sup> the member will reject the inbound order and send it back to the CSE System. The CSE System will then automatically send a cancellation message to the member submitting the order. The entire duration of the order delivery and automated response process likely will be less than one second.

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with the provisions of Section 6(b) of the Act,<sup>10</sup> in general, and Section 6(b)(5) of the Act,<sup>11</sup> in particular, which requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Further, the Exchange believes that the proposal, as amended, is consistent with Section 6(b)(8) of the Act<sup>12</sup> in that it is not designed to impose any burden on competition not necessary or appropriate in furtherance of the Act.

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

The Exchange does not believe that the proposed rule change, as amended by Amendment Nos. 1 and 2, will impose 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, including Amendment Nos. 1 and 2.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, as amended, or

(B) Institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1 and 2, including whether the amendments are 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-CSE-2002-04 and should be submitted by November 1, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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<sup>13</sup> 17 CFR 200.30-3(a)(12).

## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-46594; File No. SR-NASD-2002-109]

### **Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Fees for Nasdaq's InterMarket**

October 3, 2002.

On August 8, 2002, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), 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: (i) Modify the execution fees for Nasdaq InterMarket trades executed through the Intermarket Trading System ("ITS") and Nasdaq's Computer Assisted Execution System ("CAES"); and (ii) establish a credit for the liquidity provider for executions via ITS and CAES.<sup>3</sup> The proposed rule change was published in the **Federal Register** on September 3, 2002.<sup>4</sup> The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.<sup>5</sup> Specifically, the Commission believes that the proposal is consistent with Section 15A(b)(5) of the Act,<sup>6</sup> which requires that the rules of the association provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which the association operates or controls, and Section 15A(b)(6) of the Act,<sup>7</sup> which requires, among other things, that the rules of an association promote just and equitable

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

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

<sup>3</sup> On June 13, 2002, the NASD, through its subsidiary, Nasdaq, filed a similar proposed rule change that was effective upon filing pursuant to Section 19(b)(3)(A) of the Act. 15 U.S.C. 78s(b)(3)(A). See Securities Exchange Act Release No. 46153 (July 1, 2002), 67 FR 45164 (July 8, 2002) (SR-NASD-2002-68). The proposal was summarily abrogated by Commission order on July 2, 2002. See Securities Exchange Act Release No. 46159, 67 FR 45775 (July 10, 2002).

<sup>4</sup> See Securities Exchange Act Release No. 46419 (August 27, 2002), 67 FR 56333.

<sup>5</sup> In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78o-3(b)(5).

<sup>7</sup> 15 U.S.C. 78o-3(b)(6).

<sup>9</sup> 17 CFR 240.11Ac1-1.

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

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> 15 U.S.C. 78f(b)(8).