

VI. Conclusion

The Commission believes that the proposal, as amended, should significantly assist the NYSE's efforts in fulfilling its regulatory responsibilities. The Commission further believes that the proposed rules meet the minimum requirements for an order audit trail system imposed by the Commission in the SEC Order, which required a time-sequenced record of orders and market-wide synchronization of all member firms' business clocks. In addition, OTS should provide a useful surveillance tool that will allow earlier detection of fraudulent activity for the benefit of investors and the public. Therefore, the Commission believes the approval of the proposed OTS, as amended, is appropriate and consistent with the requirements of the Act applicable to a national securities exchange, and in particular, with the requirements of section 6(b)(5) of the Act,²⁹ and the rules and regulations thereunder.

It is therefore Ordered, pursuant to section 19(b)(2) of the Act,³⁰ that the proposed rule change, as amended, (NYSE-99-51) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³¹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47690; File No. SR-NYSE-2003-07]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc. To Extend the Pilot Program Relating to the Allocation Policy for Trading of Exchange-Traded Funds on an Unlisted Trading Privileges Basis

April 17, 2003.

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 March 31, 2003, 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, II, and III below, which Items have been prepared by the self-

regulatory organization. The proposed rule change has been filed by the NYSE as a "non-controversial" rule change under Rule 19b-4(f)(6) of the Act.³ 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 NYSE seeks to extend the pilot program relating to the allocation policy for trading certain Exchange-Traded Funds ("ETFs"), for an additional year. The current pilot program is set to expire on May 8, 2003. For purposes of the allocation policy, ETFs include both Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual) and Trust Issued Receipts (as defined in Rule 1200), which trade on an Unlisted Trading Privileges ("UTP") basis. The text of the proposed rule change is available at the Office of the Secretary, NYSE and at the Commission.

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 self-regulatory organization 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 NYSE 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

This proposed rule change was originally filed as a one-year pilot in SR-NYSE-2001-07⁴ and Amendment No. 1 thereto, and subsequently amended by SR-NYSE-2001-10⁵ and SR-NYSE-2002-07.⁶ The pilot was subsequently extended for another year and is due to expire on May 8, 2003.⁷

³ 17 CFR 240.19b-4(f)(6).

⁴ See Securities Exchange Act Release No. 44272 (May 7, 2001), 66 FR 26898 (May 15, 2001) (SR-NYSE-2001-07).

⁵ See Securities Exchange Act Release No. 44306 (May 15, 2001), 66 FR 28008 (May 21, 2001) (SR-NYSE-2001-10).

⁶ See Securities Exchange Act Release No. 45729 (April 10, 2002), 67 FR 18970 (April 17, 2002) (SR-NYSE-2002-07).

⁷ See Securities Exchange Act Release No. 45884 (May 6, 2002), 67 FR 32073 (May 13, 2002) (SR-NYSE-2002-17).

Therefore, the Exchange seeks to extend the pilot relating to the allocation policy for trading certain Exchange-Traded Funds, for an additional year.

Since the inception of the Allocation Policy, the Exchange states that 36 different ETFs have been allocated. This includes 17 Merrill Lynch Holding Company Depository Receipts (HOLDERS), a type of Trust Issued Receipt, 9 different types of Select Sector SPDRs, 1 MidCap SPDR, 5 different types of iShares, 1 VIPER, the Nasdaq-100 Index Tracking Stock (symbol QQQ), the Standard & Poor's Depository Receipts (symbol SPY), and The Dow Industrials DIAMONDS (symbol DIA).

Allocation Policy for ETFs Trading Under UTP

The Exchange states that the intent of the Exchange's Allocation Policy and Procedures (the "Policy") is: (1) To ensure that the allocation process is based on fairness and consistency and that all specialist units have a fair opportunity for allocations based on established criteria and procedures; (2) to provide an incentive for ongoing enhancement of performance by specialist units; (3) to provide the best possible match between specialist unit and security; and (4) to contribute to the strength of the specialist system.

The Allocation Committee has sole responsibility for the allocation of securities to specialist units under this policy pursuant to authority delegated by the Board of Directors and is overseen by the Quality of Markets Committee of the Board ("QOMC"). The Allocation Committee renders decisions based on the allocation criteria specified in this policy.⁸

The Exchange believes that it would be appropriate to extend the pilot that modifies the conventional allocation process to provide that ETFs traded on a UTP basis be allocated by a special committee, consisting of the Chairman of the Allocation Committee, the three most senior Floor broker members of the Allocation Committee, and four members of the Exchange's senior management as designated by the Chairman of the Exchange. This will permit Exchange management, acting with key members of the Allocation Committee, to oversee directly the introduction of the UTP concept to the NYSE. For purposes of the Allocation Policy, ETFs collectively include Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual) and Trust Issued

⁸ See Securities Exchange Act Release No. 42746 (May 2, 2000), 65 FR 30171 (May 10, 2000) (SR-NYSE-99-34).

²⁹ 15 U.S.C. 78f(b)(5).

³⁰ 15 U.S.C. 78s(b)(2).

³¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Receipts (as defined in Exchange Rule 1200).

Allocation applications would be solicited by the Exchange, and this special committee would review the same performance and disciplinary material as is reviewed by the Allocation Committee.⁹ In addition, specialist unit applicants would be required to demonstrate:

- (a) An understanding of the trading characteristics of ETFs;
- (b) expertise in the trading of derivatively-priced instruments;
- (c) ability and willingness to engage in hedging activity as appropriate;
- (d) knowledge of other markets in which the ETF which is to be allocated trades; and
- (e) willingness to provide financial and other support to relevant Exchange publicity and educational initiatives.

The special committee would review specialist unit applications and reach its allocation decision by majority vote. Any tie vote would be decided by the Chairman of the Exchange. The Exchange has determined that due to the unique aspects of certain ETF products, it may be helpful for the special committee to meet with and interview specialist units before making an allocation decision.

A specialist organization cannot be both the specialist in the ETF and the specialist in any security which is a component of the ETF. This restriction is necessary to avoid the possibility of "wash sales" in a situation where the specialist in the ETF needs to hedge by buying or selling component stocks of the ETF, and could inadvertently be trading with a proprietary bid or offer made by a specialist in the same member organization who is making a market in the component security.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act,¹⁰ in general, and furthers the objectives of section 6(b)(5),¹¹ in particular, 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.

⁹ See Section IV ("Allocation Criteria") of the Allocation Policy and Procedures approved in Securities Exchange Act Release No. 42746 (May 2, 2000), 65 FR 30171 (May 10, 2000) (SR-NYSE-99-34) for details of the performance and disciplinary material available to the Allocation Committee.

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

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

The Exchange does not believe that the proposed rule change 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.

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

The proposed rule change has been filed by the Exchange as a "non-controversial" rule change pursuant to section 19(b)(3)(A) of the Act¹² and Rule 19b-4(f)(6) thereunder.¹³ Because the foregoing proposed rule change: (1) Does not significantly affect the protection of investors or the public interest, (2) does not impose any significant burden on competition, and (3) by its terms does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as the Commission may designate, it has become effective pursuant to section 19(b)(3)(A) of the Act¹⁴ and Rule 19b-4(f)(6)¹⁵ thereunder.

The Exchange has requested that the Commission waive the five-day pre-notice requirement and the 30-day operative delay requirement, to permit the Exchange to implement the proposal immediately. Under Rule 19b-4(f)(6)(iii), a proposed "non-controversial" rule change does not become operative for 30 days after the date of filing, unless the Commission designates a shorter time.

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Acceleration of the operative date will allow for the continued operation of the

Exchange's Allocation Policy for ETFs trading on a UTP basis as a pilot program without interruption.¹⁶ The Commission notes that it has not received any comments on previous proposed rule changes filed by the NYSE for this pilot. For this reason, the Commission designates the proposed rule change to be effective and operative upon its filing with the Commission. The Commission also waives the five-business day pre-filing requirement. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such 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.

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 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 Exchange.

All submissions should refer to the File No. SR-NYSE-2003-07 and should be submitted by May 15, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,
Deputy Secretary.

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¹⁶ For the purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rules impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁷ 17 CFR 200.30-3(a)(12).

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6).

¹⁴ 15 U.S.C. 78s(b)(3)(A).

¹⁵ 17 CFR 240.19b-4(f)(6).