

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The purpose of the proposed rule change is add a new Rule 30 to NSCC's Rules and Procedures ("Rules") in order to create a new CBRS that will facilitate the automated exchange of cost basis information related to a customer account transfer.

NSCC has developed a cost basis reporting service to augment its current Automated Customer Account Transfer Service ("ACATS") processing. Cost basis reporting is useful to customers for tax reporting purposes. Cost basis information is currently captured and entered into many firm's portfolio systems manually. NSCC was requested to centralize and standardize the transmission of cost basis information.

CBRS will be available to NSCC members and qualified securities depositories acting on behalf of their participants and will permit them to transmit between themselves on an automated basis cost basis information with respect to accounts that have previously been transferred via ACATS. Participants may send cost basis data to NSCC multiple times during the day up to a predetermined cutoff.

NSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act³ and the rules and regulations thereunder because it will facilitate the prompt and accurate clearance and settlement of securities transactions.

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

NSCC does not believe that the proposed rule change will have an impact on or impose a burden on competition.

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

No written comments relating to the proposed rule change have been solicited or received. NSCC has notified its member of the terms of the proposed service by an Important Notice on November 4, 2002. NSCC will notify the Commission of any written comments it receives.

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

The Commission finds that NSCC's proposed rule change is consistent with the requirements of the Act and the

rules and regulations thereunder and particularly with the requirements of Section 17A(b)(3)(F)⁴ of the Act. Section 17A(b)(3)(F) requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions. Providing an automated and standardized method of transmitting cost basis information related to securities accounts that are transferred from one broker-dealer to another through ACATS should reduce NSCC's members' administrative burdens and as such should promote the prompt and accurate clearance and settlement of securities transactions.

NSCC 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 of filing. The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing because such approval will allow NSCC to implement this new service in time for it to provide benefits for brokers, dealers, and investors for the current tax filing period and will also enable NSCC to implement CBRS in accordance with its systems implementation schedule.

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 5th Street NW., Washington, DC 20549-0069. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-NSCC-2003-02. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the rule filing that are filed with the Commission, and all written communications relating to the rule filing between the Commission and any person, other than those that may be withheld from the public in accordance with provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room in Washington, DC. Copies of

such filing will also be available for inspection and copying at NSCC's principal office. All submissions should refer to File No. SR-NSCC-2003-02 and should be submitted by April 29, 2003.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NSCC-2003-02) be, and hereby is, approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁵

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47614; File No. SR-NYSE-2002-55]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the New York Stock Exchange, Inc. Regarding the Dissemination of Liquidity Quotations

April 2, 2003.

I. Introduction

On October 28, 2002, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")¹ and rule 19b-4 thereunder,² a proposed rule change to amend its rules to permit the display and use of quotations in stocks traded on the NYSE to show additional depth in the market for those stocks ("Liquidity Quote Proposal"). On December 20, 2002, NYSE filed Amendment No. 1 to the proposed rule change.³ The proposed rule change, as amended, was published for public comment in the **Federal Register** on January 2, 2003.⁴ On March 20, 2003, NYSE filed Amendment No. 2 to the

⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated December 19, 2002 ("Amendment No. 1"). Amendment No. 1 replaces the filing in its entirety and provides, in the proposed rule text and the purpose section of the filing, further details on the display of additional quotations in stocks to show market depth.

⁴ Securities Exchange Act Release No. 47091 (December 23, 2002), 68 FR 133.

³ 15 U.S.C. 78q-1.

⁴ 15 U.S.C. 78q-1(b)(3)(F).

proposed rule change.⁵ The Commission has received 12 substantive comment letters on the proposed rule change, including the NYSE's response addressing the commenters' concerns.⁶ The Commission has substantial concern that the proposed rule change is not consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NYSE. As an alternative to instituting proceedings to determine whether the proposed rule change should be disapproved, 15 U.S.C. 78s(b)(2)(B), this order approves the proposed rule change, as amended, conditional on the delayed effectiveness of the proposal as described below.

⁵ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 20, 2003 ("Amendment No. 2"). In Amendment No. 2, the NYSE removes paragraph (c) of NYSE Rule 1001, which currently provides that if executions of auto ex orders have traded with all trading interest reflected in the Exchange's published bid or offer, the Exchange will disseminate a bid or offer at that price of 100 shares until the specialist requites the market. The NYSE's proposed autoquoting feature in NYSE Rule 1000, which will systematically update a published quotation immediately reflecting the next best bid or offer on the specialist's book, will have the effect of superceding this provision. This was a technical amendment and is not subject to notice and comment.

⁶ See letters from Thomas F. Secunda, Bloomberg, dated December 16, 2002 ("Bloomberg Letter I"); W. Hardy Callcott, Senior Vice President and General Counsel, Charles Schwab & Co., Inc., dated January 22, 2003 ("Schwab Letter"); Craig S. Tyle, General Counsel, Investment Company Institute, dated January 23, 2003 ("ICI letter"); Thomas F. Secunda, Bloomberg, dated January 23, 2003 ("Bloomberg Letter II"); Jeffrey T. Brown, Senior Vice President, Secretary and General Counsel, Cincinnati Stock Exchange, Inc., dated January 24, 2003 ("CSE Letter"); Meyer S. Frucher, Chairman and Chief Executive Officer, Philadelphia Stock Exchange, Inc., dated February 27, 2003 ("Phlx Letter"); Kevin M. Foley, Bloomberg, dated February 26, 2003 ("Bloomberg Letter III"); and Paul Merolla, Executive Vice President and General Counsel, Instinet Corp., dated March 14, 2003 ("Instinet Letter"), to Jonathan G. Katz, Secretary, Commission. See also letters from Richard P. Bernard, Executive Vice President and General Counsel, NYSE, to Annette Nazareth, Director, Division, Commission, dated February 7, 2003 ("NYSE Letter"); Richard A. Grasso, Chairman and Chief Executive Officer, NYSE, to William H. Donaldson, Chairman, Commission, dated March 11, 2003 ("Grasso Letter I") and March 20, 2003 ("Grasso Letter II"); and Greg Babyak, Counsel to Bloomberg, to William H. Donaldson, Chairman, Commission, dated March 26, 2003 ("Bloomberg Letter IV"). See also emails from Richard Bernard, Executive Vice President and General Counsel, NYSE, to Annette Nazareth, Director, Division, Commission, *et al.*, dated February 11, 2003, February 12, 2003, February 14, 2003, and March 4, 2003. Luis de la Torre, Counsel to Commissioner Goldschmid, Brian A. Stern and Mary S. Head, Counsels to Commissioner Glassman, wrote memoranda to the official file documenting several meetings.

II. Description of the Liquidity Quote Proposal

A. Exchange Rules Affecting Dissemination of Liquidity Quote

The Exchange is required by Rule 11Ac1-1 under the Act⁷ to disseminate the highest bid and lowest offer in its market (*i.e.*, the "best quote" available for dissemination). The Exchange believes that decimal trading has resulted in many more price intervals that can be the best quote, with the result that the highest bid and lowest offer may not reflect the true depth of the market at prices reasonably related to the last sale.

The Exchange is proposing to address this issue by providing for the dissemination, in selected securities as appropriate, of a "liquidity bid" and a "liquidity offer," which would reflect aggregated Exchange trading interest at a specific price interval below the best bid (in the case of a liquidity bid) or at a specific price interval above the best offer (in the case of a liquidity offer).

The specific price interval above or below the best bid and offer, as well as the minimum size of the liquidity bid or offer, would be established by the specialist in the subject security. Liquidity bids and offers would include orders on the specialist's book, trading interest of brokers in the trading crowd, and the specialist's dealer interest, at prices ranging from the best bid (offer) down to the liquidity bid (up to the liquidity offer).

According to the Exchange, it would not be mandatory to disseminate a separate liquidity bid and/or offer. In certain instances, depending on the depth of the market, the Exchange represents that the best bid (offer) and the liquidity bid (offer) may converge. In such case, the Exchange would make available the same price and size both as the best bid (offer) over the Consolidated Quotation System ("CQS") and as the liquidity bid (offer) via the Exchange's Common Access Point ("CAP"). In any event, all disseminated bids and offers (best and liquidity) would be deemed to be "firm quotations" that are available for interaction with trading interest.

Orders seeking to trade against the best and liquidity bids/offers would be executed in accordance with NYSE auction procedures and NYSE XPress orders.⁸ Proposed NYSE rule 60

⁷ 17 CFR 240.11Ac1-1.

⁸ An XPress order is an order of a specified minimum size that is to be executed against a displayed XPress quote, or at an improved price, if obtainable. In order to be indicated as an XPress quote, a published bid or offer must be for no less

includes details on how market and limit orders, as well as XPress orders, would be executed against best and liquidity bids and offers.

First, with respect to market orders, NYSE proposes that when a liquidity bid is published in addition to a best bid, a market order to sell of a size greater than the size of the best bid will be executed to the extent possible against the best bid⁹ with the balance of the sell order being executed at the higher price of the liquidity bid or at the price of other orders on the book below the best bid, but above the liquidity bid.¹⁰

NYSE is proposing that similar procedures would be used for the execution of limit orders when there are liquidity bids and offers as well as best bids and offers. In that regard, when a liquidity bid is published in addition to a best bid, a limit order to sell of a size greater than the size of the best bid, but which is limited to a price executable at or above the liquidity bid price, would be executed first against the best bid (or crossed as explained above), with the balance of the order being executed within its limit price at a price at which orders on the book will not be traded through.¹¹

than the minimum share size, currently 15,000 shares, at the same price for no less than 15 seconds.

⁹ The order will be crossed by the specialist when he or she is acting as agent for the order using the auction market procedures in NYSE Rule 76, which calls for the member to publicly bid and offer on behalf of the orders before making a transaction with him- or herself.

¹⁰ For example, assume the best bid is \$20.10 for 200 shares, while the liquidity bid is \$20.05 for 10,000 shares, with no other bids in between the best and liquidity bids. If a market order to sell 1000 shares is received by the specialist, 200 shares would trade at the best bid price of \$20.10, and 800 shares would trade at \$20.05, the liquidity bid price, unless the specialist in crossing the order obtains price improvement for it. If there were other bids on the book between the best and liquidity bids, the sell market order could receive executions at those prices. For example, if, in addition to the best and liquidity bids of \$20.10 and \$20.05 in the previous example, there were also a bid of \$20.07 for 300 shares, the market order to sell would be executed as follows—200 shares at the best bid of \$20.10, 300 shares at \$20.07 and 500 shares at the liquidity bid of \$20.05, unless the specialist in crossing the order obtains price improvement for it. Market orders to buy would follow the same principles using the best and liquidity offers.

¹¹ For example, assume there is a best bid for 200 shares of \$20.10 and a liquidity bid of \$20.05 for 10,000 shares. In addition, there is a bid for 500 shares at \$20.07. If a limit order to sell 1,000 shares at \$20.05 is received by the specialist, it would be executed as follows—200 shares at \$20.10, 500 shares at \$20.07 and 300 shares at the liquidity bid of \$20.05. In all these examples, however, as with market orders, the specialist would follow NYSE auction market crossing procedures in an effort to obtain price improvement for the order. Limit orders to buy would follow the same principles.

Third, regarding the execution of XPress Orders,¹² the Exchange proposes to amend Supplementary Material .40 of NYSE rule 13 (“Definitions of Orders”) to provide that a liquidity bid or offer, regardless of size, will be XPress eligible if it has been published for at least 15 seconds. The Exchange expects that the size of Liquidity Quote bids and offers will be of a size that represents significant interest for a stock and will, in many stocks, be greater than 15,000 shares. However, where the share size of the liquidity bid or offer does not equal 15,000 shares, the Exchange believes that institutional interest in trading at the liquidity price may still be present, and that utilizing the XPress trading protocol will be an appropriate way for this interest to access such displayed greater liquidity. Liquidity Quote will still be required to be at the same liquidity price for at least 15 seconds to be eligible as a quotation against which an XPress order may be executed.

Further, the Exchange proposes to amend NYSE rule 60 to provide that an XPress order may be priced at either the best bid or offer price if XPress eligible (*i.e.*, for at least 15,000 shares for at least 15 seconds), or priced at the liquidity bid or offer price, if, again, XPress eligible. An XPress order to buy priced at the liquidity offer price will be either executed at that price, or a price that will allow an XPress order to be filled without trading through orders on the book. The Exchange represents that specialists will seek price improvement for XPress orders in accordance with the Exchange’s procedures for the execution of XPress orders.¹³

B. Automated Dissemination of Quotations

In conjunction with the dissemination of dual quotations, the Exchange proposes to provide for the automated dissemination of the NYSE best bid and offer as SuperDOT limit orders are received systemically. This is a change to the Exchange’s current practice whereby specialists are responsible for disseminating bids and offers. Proposed NYSE rule 60 would provide that the Exchange will “autoquote” the NYSE’s

highest bid or lowest offer whenever a limit order is transmitted to the specialist’s book at a price higher (lower) than the previously disseminated highest (lowest) bid (offer). When the NYSE’s highest bid or lowest offer has been traded with in its entirety, the Exchange would then autoquote a new bid or offer reflecting the total size of orders on the specialist’s book at the next highest (in the case of a bid) or lowest (in the case of an offer) price.¹⁴

In any instance where the specialist disseminates a proprietary bid (offer) of 100 shares or more on one side of the market, the bid or offer on that side of the market shall not be autoquoted. In such an instance, any better-priced limit orders received by the specialist shall be manually displayed, unless they are executed at a better price in a transaction being put together in the auction market at the time that the order is received.

In conjunction with autoquoting of bids and offers, NYSE Rule 1000 (“Automatic Execution of Limit Orders Against Orders Reflected in NYSE Published Quotation”) would be amended to provide that a NYSE Direct+® (“NYSE Direct+”) order¹⁵ equal to or greater than the size of the published bid/offer will exhaust the entire bid/offer, rather than decrease it to 100 shares as is the case today.¹⁶ The purpose of this change is to facilitate the autoquoting of the next highest bid/lowest offer. The unfilled balance of the NYSE Direct+ order would be displayed in the auction market as a SuperDOT limit order.

The Exchange believes that the proposed automated dissemination of the best bid and offer also suggests a need to amend Supplementary Material .30 to NYSE rule 123A (“Miscellaneous Requirements”) to enable specialists to trade percentage orders against incoming SuperDOT orders.¹⁷ With the

automating of SuperDOT bids and offers, specialists would not be permitted to interact with such orders on behalf of percentage orders as they do today because they cannot “reach across the market” to effect smaller size trades. Thus, the Exchange is proposing to amend NYSE rule 123A.30 to permit specialists to “reach across the market” with percentage orders to effect trades of less than 10,000 shares or a quantity of stock having a market value of less than \$500,000.¹⁸

C. NYSE Liquidity Quote Service Agreements

Liquidity Quote would be part of the NYSE OpenBook data feed service.¹⁹ Recipients of the Liquidity Quote data would be subject to the terms of the existing NYSE “vendor” agreement, and end-users that receive the Liquidity Quote data from vendors or broker-dealers would continue to be subject to the existing “subscriber” agreement. The vendor agreement generally authorizes a data feed recipient to provide a display of the Liquidity Quote data for retransmission, or to distribute the Liquidity Quote data internally.²⁰ The vendor agreement prohibits data feed recipients from enhancing, integrating, or consolidating its market data with data from other market centers for retransmission.²¹ In addition, NYSE has imposed a “window requirement” as part of its service agreements, which requires that the Liquidity Quote data be displayed in a separate window, or with a line drawn between its data and other markets’ data.²²

trade against such bid or offer. The specialist may not “reach across the market” to trade a percentage order against a bid or offer in a “destabilizing” transaction (bid above the last sale or sell below the last sale) unless the trade is for at least 10,000 shares or a quantity of stock with a market value of at least \$500,000.

¹⁸ According to the Exchange, specialists could not “reach across the market” more than \$0.10 from the last sale to effect these smaller size trades if the trade would be destabilizing. This \$0.10 limitation is the same as the current limitation on making destabilizing bids or offers against which incoming orders may trade.

¹⁹ For further details on the NYSE OpenBook service, see Securities Exchange Act Release No. 45138 (December 7, 2001), 66 FR 66491 (December 14, 2001) (SR-NYSE-2001-42).

²⁰ For further details on the vendor and subscriber agreements, see *id.* (“Order Approving a Proposed Rule Change by NYSE Establishing the Fees for NYSE OpenBook”).

²¹ See NYSE Letter, at 3 (stating in FN2, “[o]ur vendor contacts provide: ‘[Vendor] shall not cause * * * the displays of [NYSE Depth] Information that [Vendor] provides to [end-users] to be integrated with other market information that any source other than NYSE makes available [For example, Vendor] shall not permit the displays * * * to be consolidated with limit orders [of] any other market * * *”).

²² *Id.*, at FN2 (“* * * Vendor [may display] one or more other entities’ limit orders side-by-side

¹² See *supra* note .

¹³ The Exchange proposes that if a specialist receives two XPress orders within a nearly simultaneous time frame, one priced at the best bid (offer), and the other priced at the liquidity bid (offer), both orders will be executed in accordance with the Exchange’s procedures for the execution of XPress orders. Both orders will also be exposed to the trading crowd for price improvement. Those portions of the orders that do not receive price improvement will be executed against the XPress bids (offers), which may not then be traded against by other members pursuant to the Exchange’s procedures for the execution of XPress orders.

¹⁴ NYSE Rule 60 would also be amended to provide that autoquoting will include: (i) adding size to the best and liquidity bids/offers as additional limit orders are received; and (ii) reducing the size of the best and liquidity bids/offers as limit orders on the book are executed or cancelled. However, the Exchange notes that *de minimis* increases or decreases in the size of limit orders on the book, as determined by the specialist, will not result in automated augmenting or decrementing of the size of the liquidity bid or offer where such bid or offer continues to reflect the actual size of limit orders on the book.

¹⁵ NYSE Direct+ provides for the automatic execution of limit orders of 1099 shares or less against the Exchange’s disseminated bid or offer. See NYSE Rules 1000–1005.

¹⁶ See Amendment No. 2, *supra* note 5.

¹⁷ Currently, specialists may bid or offer (within \$0.10 of the last sale) on behalf of a percentage order, and an incoming SuperDOT order may then

III. Summary of Comments

The Commission received 12 comment letters on the proposal.²³ All of the commenters generally supported the idea of NYSE's Liquidity Quote proposal. The commenters believed that with the advent of decimalization, the highest bid and lowest offer no longer reflects the true depth of the market. However, there were several issues raised by the commenters regarding the form and use of Liquidity Quote data.

First, four commenters believed that the Commission should require the NYSE to submit for public comment the vendor and subscriber agreements for the Liquidity Quote service or, at minimum, a description of the relevant terms of the agreements for Commission review.²⁴ Three commenters believed that the contracts constituted SRO rules and, as such, the contracts should be filed as a proposed rule change for Commission approval, pursuant to section 19(b)(2) of the Act.²⁵

Second, three commenters also believed that the restrictions of the vendor agreements are inconsistent with sections 6 and 11A of the Exchange Act.²⁶ Specifically, the commenters opposed NYSE's contractual restrictions on the integration, display, and redistribution of Liquidity Quote data, and stated that the restrictions were inconsistent with the standards of a national market system set forth in section 11A of the Exchange Act because access to this "critical" data should be offered on a reasonable and nondiscriminatory basis.

Third, three commenters said that the downstream restrictions of NYSE's vendor agreements would create a bifurcated market for data and transparency. These commenters believe that large broker-dealers would have the internal ability to reformat the NYSE data feed and take full advantage of the Liquidity Quote data. Conversely, small- and medium-sized broker-dealers that lack the internal resources to reformat the Liquidity Quote data feed would have to rely on market data vendors. The commenters concluded that the downstream restrictions of NYSE's vendor agreements impose unfair access restrictions on small- and medium-sized market participants that are financially unable to purchase a data feed directly from the NYSE and thus rely on vendors

to provide this market information for a reasonable fee.²⁷

Fourth, one commenter asserted that the downstream restrictions prevent market data vendors from providing value-added services to their customers, in contravention of the Display Rule.²⁸ This commenter believed that enhancing the format of the Liquidity Quote data and integrating it with data from other markets, or with analytics that use the data, would create a more useful product available for redistribution to its customers.²⁹ The commenter also believed that the vendor restrictions on integration are anticompetitive in contravention of section 6(b)(8) of the Exchange Act,³⁰ in that they impair other market centers from viewing Liquidity Quotes in tandem with the consolidated quote display, and inhibit competition with the NYSE for order flow in NYSE-listed securities.³¹

In response to the commenters' concerns about the Liquidity Quote data restrictions, NYSE stated that it intends to compete in the market for finished data products by producing and disseminating a distinguishable product identified to the NYSE. Therefore, to preserve NYSE's branding goal of an independent display of depth data, the NYSE's vendor agreements restrict the integration of Liquidity Quote data with other markets' data and preclude a vendor from displaying rows or columns of other markets' data intermingled with Liquidity Quote data.

In response to commenters' concerns regarding vendors' ability to provide value-added services to its customers, NYSE argued that the Commission should not prohibit NYSE from restricting the way in which vendors can package Liquidity Quote data. NYSE asserted that such restrictions allow the NYSE to compete with vendors in the market for finished data products, as well as compete with the other market centers for sizeable order flow. In addition, NYSE stated that the integration of Liquidity Quote data with other markets' quotation information would be misleading, in that its firm and executable liquidity bid or offer would be commingled with "fleeting" 100-share best bids and offers of its competitors.

IV. Discussion

Section 19(b) of the Act³² requires the Commission to approve the proposed rule change filed by the NYSE if the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder. After careful review, the Commission finds, for the reasons discussed below, that NYSE's proposal is consistent with the requirements of the Act, and the rules and regulations thereunder applicable to a national securities exchange, but only if the NYSE does not apply the restrictions on data integration currently contained in the vendor agreements.³³

Specifically, the Commission finds that the Liquidity Quote proposal, when viewed apart from the vendor agreements, is consistent with sections 6(b)(5)³⁴ and 6(b)(8)³⁵ of the Act. Section 6(b)(5) of the Act³⁶ requires, among other things, that the rules of NYSE be 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; and are not designed to permit unfair discrimination between customers, issuers, brokers or dealers. Section 6(b)(8) of the Act³⁷ requires, among other things, that the Exchange's rules do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The Commission believes that the Liquidity Quote proposal, when viewed apart from the NYSE vendor agreements, will substantially increase the amount of information available to the public and market participants with respect to quotations for, and transactions in, certain specified securities listed on the Exchange, consistent with sections 6(b)(5) and 6(b)(8) of the Act. In a decimal market environment, the highest bid and lowest offer of an exchange may not reflect where the actual market is, particularly for sizeable orders, because the increase in the number of price increments causes less depth to be available at each price point. Accordingly, the dissemination, in selected securities, of a liquidity bid or offer reflecting NYSE aggregate trading interest, including limit orders, trading crowd interest, and

with, or on the same page as, displays of OpenBook Information.").

²³ See *supra* note 6.

²⁴ See Schwab Letter; Bloomberg Letter II; CSE Letter; and Bloomberg Letter III.

²⁵ 15 U.S.C. 78s(b). See Bloomberg Letter I, II, III; CSE Letter; and Schwab Letter.

²⁶ Schwab Letter; Bloomberg Letter II; and CSE Letter.

²⁷ *Id.* The Schwab and Bloomberg II Letters also noted that the fees charged to retail investors for liquidity quote data are unduly excessive, discriminatory, and anticompetitive. See Schwab Letter and Bloomberg Letter II.

²⁸ 17 CFR 240.11Ac1-2. See Bloomberg Letter II.

²⁹ Bloomberg Letter II.

³⁰ 15 U.S.C. 78f(b)(8).

³¹ Bloomberg Letter II.

³² 15 U.S.C. 78s(b).

³³ In approving this rule, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³⁴ 15 U.S.C. 78f(b)(5).

³⁵ 15 U.S.C. 78f(b)(8).

³⁶ 15 U.S.C. 78f(b)(5).

³⁷ 15 U.S.C. 78f(b)(8).

specialist proprietary interest, at a price interval below the best bid (in the case of a liquidity bid), or above the best offer (in the case of a liquidity offer), is consistent with the protection of investors and the public, when viewed apart from the NYSE vendor agreements.³⁸

However, nine commenters criticized the provisions of the NYSE's vendor and subscriber agreements for Liquidity Quote that preclude data feed recipients from enhancing, integrating, or consolidating its market data with data from other market centers for retransmission. While these agreements have not been filed with the Commission under section 19(b)(2) of the Act,³⁹ because these comments directly relate to the manner in which the Liquidity Quote proposal will operate, the Commission believes that it can and must consider these comments in determining whether, or on what terms, to approve or institute disapproval proceedings with respect to the Liquidity Quote proposal. In other words, in assessing whether the Liquidity Quote is consistent with the requirements of section 6, we must measure against the standards of section 6, not only the literal terms of the Liquidity Quote proposal, but also the operation of Liquidity Quote as governed by the provisions of the vendor agreements.

Section 6(b), in pertinent part, requires that the Liquidity Quote proposal, viewed in the context of the restrictions contained in the vendor agreements, (1) "foster cooperation and coordination with persons engaged in * * * processing information with respect to, and facilitating transactions

³⁸ The NYSE has represented that in some cases, depending on the depth of market, the NYSE best bid or offer and the liquidity bid or offer may converge, in which case, the NYSE will make available the same price and size both as the best bid (offer) over CQS, and the liquidity bid (offer) over the Exchange's CAP line. The Commission notes that liquidity bids and offers will be deemed firm quotations, subject to the firm quoting obligations of Rule 11Ac1-1(c) under the Act. 17 CFR 240.11Ac1-1(c). In addition, the Commission notes that orders seeking to trade against liquidity bids (offers) will be executed in accordance with NYSE's current auction market procedures, in particular, with respect to the handling of market orders, limit orders, and XPress orders.

³⁹ 15 U.S.C. 78s(b)(2). Because of the manner in which the Commission is disposing of this matter, the Commission need not decide whether the NYSE agreements at issue here or similar such agreements should be filed under section 19(b)(2) of the Act. In this connection, we note, however, that commenters have not been precluded from commenting on these agreements in the absence of such a filing and the Commission is able to, and indeed required to, take these comments into account to the extent that they relate to the manner in which the proposal that has been filed with the Commission will operate.

in securities;"⁴⁰ (2) "remove impediments to and perfect the mechanism of a free and open market and a national market system;"⁴¹ (3) not be "designed to permit unfair discrimination between customers; * * *"⁴² and (4) "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title."⁴³ With respect to the first two considerations, we look for guidance to section 11A.

Section 11A of the Act⁴⁴ provides the Commission with broad powers over exclusive processors of market information⁴⁵ and thus the Commission is responsible for assuring that exclusive processors function in a manner that is neutral with respect to all market centers, all market makers, and all private firms.⁴⁶ In particular, section 11A(a)(1)(C)(ii) and (iii) of the Act⁴⁷ direct the Commission, in the interest of the public, for the protection of investors and maintenance of fair and orderly markets, to assure: (1) the availability to brokers, dealers and investors of information with respect to quotations for and transactions in securities; and (2) fair competition among brokers and dealers, among exchange markets, and between exchange and other markets.⁴⁸ The

⁴⁰ 15 U.S.C. 78f(b)(5).

⁴¹ *Id.*

⁴² *Id.*

⁴³ See also 15 U.S.C. 78f(b)(8).

⁴⁴ 15 U.S.C. 78k-1.

⁴⁵ The Commission notes that the NYSE would be operating the Liquidity Quote service as an "exclusive processor." An "exclusive processor" is defined in section 3(a)(22)(B) of the Act as "any SIP or SRO that, directly or indirectly, engages on an exclusive basis, in collecting, processing, or distributing the market information of an SRO." 15 U.S.C. 78c(a)(22)(B). A Securities Information Processor ("SIP") is defined in section 3(a)(22)(A) of the Act as "any person engaged in the business of (i) collecting, processing, or preparing for distribution or publication, or assisting, participating in, or coordinating the distribution or publication of, information with respect to transactions in or quotations for any security (other than an exempted security) or (ii) distributing or publishing * * * on a current and continuing basis, information with respect to such transactions or quotations * * * ." 15 U.S.C. 78c(a)(22)(A).

⁴⁶ There is no indication in section 11A and its legislative history that self-regulatory organizations ("SROs") acting as SIPs should be treated differently under the section because of the Commission's separate statutory authority under section 19(b). Therefore, section 19(b) review does not limit the Commission's authority under section 11A.

⁴⁷ 15 U.S.C. 78k-1(a)(1)(C)(ii) and (iii).

⁴⁸ In enacting the Securities Acts Amendments of 1975 ("1975 Act Amendments"), Congress specifically recognized that the securities markets are dynamic and change over time and, therefore, specifically rejected mandating the specific components of the national market system. Instead, Congress granted the Commission broad authority to oversee its implementation. See S. Rep. No. 75, 94th Cong., 1st Sess. (1975) ("Senate Report"). The

NYSE proposes to disseminate its Liquidity Quote data on a voluntary basis; however, even absent a Commission rule requiring dissemination, if the NYSE chooses to disseminate Liquidity Quote data, it must do so on terms that are fair and not unreasonably discriminatory, and in accordance with the objectives of a national market system, as provided by section 11A of the Act.⁴⁹

In this context, the Commission is concerned that the restrictions in the vendor agreements that preclude vendors from providing an enhanced, integrated, or consolidated data product to customers raise such significant fair and reasonable access issues under section 11A of the Act for data recipients, as to preclude the NYSE from disseminating Liquidity Quote data in a manner consistent with the statute.

Specifically, the Commission is concerned that the restrictions in the vendor agreements on the use and form of Liquidity Quote data are not fair to market data vendors because they will be prevented from integrating or commingling Liquidity Quote data with data from other markets. This restriction may be particularly unfair and unreasonably discriminatory to customers of vendors whose businesses

1975 Act Amendments added section 11A "to bring under the SEC's direct jurisdiction all organizations engaged in the business of collecting, processing, or publishing information relating to quotations for, indications of interest to purchase and sell, and transactions in securities." *Id.*, at 9-10. As a result, the 1975 Act Amendments greatly expanded the Commission's authority to regulate the national market system and matters related to the dissemination of market information.

The goals of this new authority were "to insure the availability of prompt and accurate trading information, to assure that these communications networks are not controlled or dominated by any particular market center, to guarantee fair access to such systems by all brokers, dealers and investors, and to prevent any competitive restriction on their operation not justified by the purposes of the Act." *Id.* The Commission's broad authority "includes all powers necessary to ensure the regulation of the securities information processing activities of [the] exchanges and associations in the same manner and to the same extent as the Commission may regulate securities information processors registered and regulated under new section 11A(b)." *Id.*, at 10.

Moreover, Congress noted that the Commission's authority under section 11A of the Exchange Act includes the authority to regulate "what and how information is displayed and qualifications for the securities to be included on any tape or within any quotation system." *Id.*, at 11. Legislative history for section 11A states that "it is critical for those who trade to have access to up-to-the-second information as to the prices at which transactions in particular securities are taking place (*i.e.*, last sale reports) and the prices at which other traders have expressed their willingness to buy or sell (*i.e.*, quotations)." *Id.*, at 9.

⁴⁹ See *e.g.*, Securities Exchange Act Release No. 20874 (April 17, 1984), 49 FR 17640 (April 24, 1984).

primarily consist of packaging quotation information from all reporting market centers on a consolidated basis for sale to customers. Such customers seek to avoid the costs of desktop integration, and the NYSE restrictions would impose integration costs that smaller users of market data may be unable to bear.⁵⁰

In addition, the Commission believes that restrictions on integration of data such as Liquidity Quote are likely to be more troublesome than restrictions on integration for products such as NYSE OpenBook.⁵¹ OpenBook contains only a display of orders left with the specialist, while Liquidity Quote reflects orders in the book, interest in the crowd, and the specialist's own interest at a price and size usually different than the NYSE's best bid or offer. In other words, Liquidity Quote differs from OpenBook in that it: (1) Represents the NYSE's market-wide price for a specific size, not just a subset of orders on the NYSE; and (2) immediately may be executed against. The Commission believes that preventing vendors from integrating quotations of this type with quotations from other markets is a more substantial restriction on the ability of vendors to provide useful market data than posed by OpenBook and would, unlike OpenBook, impose on users integration costs with respect to immediately executable, market-wide quotations in a manner that would: (1) Be inconsistent with fostering "cooperation and coordination with persons engaged in processing information with respect to * * * securities;" (2) "be "designed to permit unfair discrimination between customers;" and (3) impede, rather than remove impediments to, a "free and open market and a national market system."⁵²

⁵⁰ Desktop integration requires certain infrastructure, such as data storage and application installation and maintenance, that many small users currently do not directly bear. Such smaller users often take advantage of the economies of scale offered by data vendors that provide integration at a central location.

⁵¹ For further details on the NYSE OpenBook service, see Securities Exchange Act Release No. 45138 (December 18, 2001), 66 FR 66491 (December 26, 2001). In its order approving the NYSE's OpenBook service, the Commission stated that "NYSE's * * * restrictions on vendor dissemination of OpenBook data, including the prohibition on providing the full data feed and providing enhanced, integrated, or consolidated data found in these agreements are on their face discriminatory, and may raise fair access issues under the Act."

⁵² See section 6(b)(5) of the Act, 15 U.S.C. 78f(b)(5). In the context of the Liquidity Quote proposal, we have received comment from a more diverse array of commenters and have received more information about the potential negative transparency and competitive effects, and effects on smaller market data users, than we received in response to publication of the OpenBook proposal.

The Commission also believes that the restrictions on integrating Liquidity Quote data and only permitting the data to be displayed in a separate window raise substantial concerns about burdens on competition, which may be inconsistent with section 6(b)(8) of the Act. In particular, the Commission believes that in the case of other market centers, the restrictions likely could inhibit competition with the NYSE for order flow in NYSE-listed securities because Liquidity Quote data is precluded from being viewed in tandem with the consolidated quote display. In addition, the Commission is concerned that the restrictions may be anticompetitive as to small- and medium-sized market participants that are unable to choose useful formats to view the Liquidity Quote data.

The NYSE argues that these restrictions are designed to maintain the integrity of its data so that it is uniquely identified to the NYSE. We are not persuaded by this argument. We believe that a less restrictive labelling requirement, such as one that simply would require the clear identification of the data as the NYSE Liquidity Quote, might well achieve the stated objective. The Commission believes that whatever ownership interests the NYSE may have in these data cannot be asserted in a manner inconsistent with the requirements of sections 6(b)(5) and 6(b)(8). The Commission believes that there is a substantial question as to whether, to be consistent with these standards, Liquidity Quote should be provided in a way that allows data feed recipients to be able to enhance, integrate or consolidate Liquidity Quote data in a reasonable format.⁵³

We also have had the advantage of experience with the operations of the restrictions on the dissemination of the OpenBook product, which shows that our expectation, as expressed in our cautionary statement in the OpenBook order, see note 51, *supra*, that the market would challenge these types of vendor agreement restrictions, has not been fulfilled. The Commission has a statutory responsibility to balance the statutory goals of facilitating the provision of more quotation information to the market with the goals of ensuring that quotations information is provided in a fair way and in a way that does not unreasonably burden competition. In conducting this balance, as we have done here with respect to the Liquidity Quote proposal, we must take into account all the information provided to us by commenters and by market experience. The additional experience we have with respect to the failure of market forces to act to address the anti-competitive nature of the vendor contracts in the context of the OpenBook proposal further informs and reinforces our decision here.

⁵³ The Commission believes that it would be reasonable and consistent with the statute for the NYSE to require that data feed recipients who choose to provide a value-added liquidity quote data package to: (i) Give the NYSE attribution next to any integrated quote that includes NYSE data;

While it is arguable that an SRO may restrict the integration of some information that is not required by current SEC rules to be disseminated in a consolidated format, the Commission believes it is also arguable that, at a minimum, where a market chooses to disseminate quotation data that is immediately executable and represents a market's entire interest at a particular price such market data should be consolidatable.⁵⁴ The NYSE argues that as owner of this data, it has the legal right to "brand" this data and, in order to preserve its brand, it must be able to restrict integration of this data with other data. The Commission preliminarily believes that the better view of section 11A is that these statutory provisions preclude the NYSE, once it makes the decision to disseminate this data, from asserting whatever property rights it may have to this data in a way that unfairly and unreasonably limits vendor and investors access and use of this data and has a negative effect on intermarket competition in NYSE listed securities.

The Commission, therefore, is approving this proposal on the condition that the proposed rule change is not effective until the NYSE accepts the condition to remove from its contracts the prohibition on the ability of data feed recipients, including vendors, to integrate the data with the display of other markets' data, and demonstrates its acceptance of the condition to the Commission. If the NYSE accepts the condition, it must do so by the close of business on April 9, 2003. If the NYSE accepts the condition, it may not implement the Liquidity Quote Proposal until the prohibition is removed from its vendor contracts.

If by the close of business on April 9, 2003, the NYSE has not demonstrated

and (ii) make available to customers NYSE's liquidity quote product as a separate branded package.

⁵⁴ The NYSE believes that the Commission is "extend[ing] the consolidated Display Rule to NYLQ [or Liquidity Quote]." See Grasso (NYSE) Letter, at 2. The NYSE argues, in referencing the "Report of the Advisory Committee on Market Information: A Blueprint for Responsible Change," September 14, 2001 ("Seligman Report"), that the Seligman Report concluded that such data should be free from "mandatory consolidation requirements." See *id.* (citing, the Seligman Report). The Commission is not mandating that the NYSE consolidate its Liquidity Quote data with that of other markets. The Commission does believe, however, that the Liquidity Quote data should be disseminated in a consolidatable format—*i.e.*, vendors and investors should not be precluded from opting to consolidate the Liquidity Quote data. Contrary to the NYSE's views, the Seligman Report did not recommend that markets be able to make their own market data non-consolidatable; the Seligman Report recommended that markets no longer be required to centrally consolidate their data.

its acceptance of the condition to the Commission, the Commission will issue an order beginning proceedings to disapprove the proposed rule change, pursuant to section 19(b)(2)(B) of the Act.⁵⁵

V. Conclusion

It is ordered, pursuant to section 19(b)(2) of the Act,⁵⁶ that the proposed rule change (SR-NYSE-2002-55), as amended, is approved, on the condition that the proposed rule change will not be effective unless the NYSE demonstrates to the Commission by April 9, 2003 that it has accepted the condition that it remove from its vendor agreements the prohibition on data feed recipients, including vendors, from integrating Liquidity Quote data with other markets' data or with the display of other markets' data, provided however that the NYSE may require that vendors provide the NYSE attribution in any display that includes Liquidity Quote and also may require vendors that purchase the Liquidity Quote product to make Liquidity Quote available to their customers as a separate branded package.

It is further ordered that the Liquidity Quote Proposal may not be implemented until the prohibition is removed from the NYSE's vendor agreements.

By the Commission.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47610; File No. SR-PCX-2003-12]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Regarding Firm Quotation Size

April 1, 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 21, 2003, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in items I, II and III below, which items have been

prepared by the self-regulatory organization. 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 PCX proposes to amend its rules governing firm quotations in order to provide that all PCX quotations will be firm for all incoming customer and broker-dealer orders for their full disseminated size pursuant to PCX rule 6.86(b)(2). The text of the proposed rule change is available at the Office of the Secretary, PCX and 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 PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in item IV below. The Exchange has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this proposed rule change is to provide that all PCX quotations will be firm for all incoming customer and broker-dealer orders for their full disseminated size pursuant to PCX rule 6.86(b)(2). This will allow the Exchange to provide customers and broker-dealers an opportunity to receive executions up to the full disseminated size beyond the one contract minimum that the Exchange's current rule provides for broker-dealer orders. As proposed, absent unusual market conditions as set forth in PCX rule 6.86(d), each Responsible Broker or Dealer³ is obligated to be firm for all incoming orders in a listed option series in an amount up to the full disseminated size.

³ The term "Responsible Broker or Dealer" means that, with respect to any bid or offer for any listed option made available by the Exchange to quotation vendors, the Lead Market Maker and any registered Market Makers constituting the trading crowd in such option series will collectively be the "Responsible Broker or Dealer" to the extent of the aggregate quotation size specified. See PCX Rule 6.86(a)(2).

2. Basis

The Exchange believes that the proposed rule change is consistent with section 6(b)⁴ of the Act, in general, and further the objectives of section 6(b)(5),⁵ in particular, because it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments and perfect the mechanisms of a free and open market and to protect investors and the public interest.

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

Written comments on the proposed rule change were neither solicited nor received.

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

The foregoing rule change has been filed by the Exchange as a "non-controversial" rule change pursuant to section 19(b)(3)(A)(i) of the Act⁶ and subparagraph (f)(6) of rule 19b-4 thereunder.⁷ Consequently, because the foregoing 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) does not become operative for thirty days from the date on which it was filed or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, and the Exchange provided the Commission with written notice of its intent to file the proposed rule change at least five days prior to the filing date, it has become effective pursuant to section 19(b)(3)(A) of the Act and rule 19b-4 thereunder.

A proposed rule change filed under rule 19b-4(f)(6)⁸ normally does not become operative prior to thirty days after the date of filing. However, pursuant to rule 19b-4(f)(6)(iii), the Commission may designate a shorter

⁴ 15 U.S.C. 78f(b).

⁵ 15 U.S.C. 78f(b)(5).

⁶ 15 U.S.C. 78s(b)(3)(A)(i).

⁷ 15 CFR 240.19b-4(f)(6).

⁸ 17 CFR 240.19b-4(f)(6).

⁵⁵ 15 U.S.C. 78s(b)(2)(B).

⁵⁶ 15 U.S.C. 78s(b)(2).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.