

specialist in such security) presenting any order for the account of a member on the exchange clearly announces or otherwise indicates to the specialist and to other members then present that he is presenting an order for the account of a member.

Without these requirements, it would not be possible for the Commission to monitor its mandate under the Exchange Act to promote fair and orderly markets and ensure that exchange members have, as the principle purpose of their exchange memberships, the conduct of a public securities business.

There are approximately 1,000 respondents that require an aggregate total of 333 hours to comply with this rule. Each of these approximately 1,000 respondents makes an estimated 20 annual responses, for an aggregate of 20,000 responses per year. Each response takes approximately 1 minute to complete. Thus, the total compliance burden per year is 333 hours (20,000 minutes/60 minutes per hour = 333 hours). The approximate cost per hour is \$100, resulting in a total cost of compliance for the respondents of \$33,333 (333 hours @ \$100).

Compliance with Rule 11a-1(T) is necessary for exchange members to make transactions for their own accounts under a specific exemption from the general prohibition of such transactions under section 11(a) of the Exchange Act. Compliance with Rule 11a-1(T) does not involve the collection of confidential information. Rule 11a-1(T) does not have a record retention requirement per se. However, responses made pursuant to Rule 11a-1(T) are subject to the recordkeeping requirements of Rules 17a-3 and 17a-4. Please note that an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Written comments regarding the above information should be directed to the following persons: (i) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, DC 20503; and (ii) Kenneth A. Fogash, Action Associate Executive Director for the Office of Information Technology, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Comments must be submitted to OMB within 30 days of this notice.

Dated: December 20, 2002.

**Margaret H. McFarland.**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47105; File No. SR-Amex-2002-99]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the American Stock Exchange LLC Relating to a Six-Month Extension of the Exchange's Pilot Program for Automatic Execution of Orders for Exchange Traded Funds

December 30, 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 December 4, 2002, the American Stock Exchange LLC ("Amex" 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 Exchange. The proposed rule change has been filed by the Amex as a "non-controversial" rule change under Rule 19b-4(f)(6) under the Act.<sup>3</sup> 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 Amex seeks a six-month extension of Amex Rule 128A to continue its pilot program for the automatic execution of orders for Exchange Traded Funds ("ETFs"), with certain modifications as described below. Proposed changes to the text of Rule 128A are set forth below.<sup>4</sup> New text is in italics. Deleted text is in brackets.

##### *Automatic Execution for Exchange Traded Funds*

*Rule 128A.* The Exchange shall determine the size and other parameters of orders eligible for execution by its Automatic Execution System (Auto-Ex). An Auto-Ex eligible order for any account in which the same person is directly or indirectly interested may

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

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

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

<sup>4</sup> The Commentary to Rule 128A, providing details of the pilot program that are summarized in Section II of this notice, will remain unchanged.

only be entered at intervals of no less than 10 [30] seconds between entry of each such order *on the same side of the market* in a security. Members and member organizations are responsible for establishing procedures to prevent orders in a security *on the same side of the market* for any account in which the same person is directly or indirectly interested from being entered at intervals of less than 10 [30] seconds.

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#### 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. 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 parts of such statements.

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

###### 1. Purpose

On June 19, 2001, the Commission approved the Exchange's proposal, adopted as Amex Rule 128A, to permit the automatic execution of orders for ETFs on a six-month pilot program basis.<sup>5</sup> Since that time, the Exchange has extended the pilot program twice, in December 2001 and June 2002, each time for six months.<sup>6</sup> The Exchange now seeks to extend the pilot program, with certain modifications, for an additional six months.

Since 1986, the Exchange has had an automatic order execution feature ("Auto-Ex") for eligible orders in listed options. The Chicago Board Options Exchange, Philadelphia Stock Exchange, and Pacific Exchange established similar automatic option order execution features at about the same time as the Amex, and the newest options exchange, the International Securities Exchange, also features automatic order execution. Auto-Ex,

<sup>5</sup> See Securities Exchange Act Release No. 44449 (June 19, 2001), 66 FR 33724 (June 25, 2001) ("June 2001 Release") (approving File No. SR-Amex-2001-29).

<sup>6</sup> See Securities Exchange Act Release Nos. 45176 (December 20, 2001), 66 FR 67582 (December 31, 2001) and 46085 (June 17, 2002) 67 FR 42836 (June 25, 2002) (notices of filing and immediate effectiveness of File Nos. SR-Amex-2001-105 and SR-Amex-2002-42, respectively).

accordingly, has been a standard feature of the options markets for a number of years.

In 1993, the Amex commenced trading Standard and Poor's Depository Receipts® ("SPDRs®"), the first ETF to be listed and traded on the Exchange. ETFs are individual securities that represent a fractional, undivided interest in a portfolio of securities. Currently, more than 100 ETFs are listed on the Amex. Like an option, an ETF is a derivative security, and, according to the Amex, its price is a function of the value of the portfolio of securities underlying the ETF. Thus, as is the case with options, the Exchange asserts that it is not the price discovery market for ETFs, and that the price discovery market is the market or markets where the underlying securities trade.

The Exchange is now proposing to extend its current Auto-Ex technology for an additional six months to ETFs listed under Amex Rules 1002, 1002A, and 1202. The Amex represents that this will provide investors that send eligible orders to the Exchange with faster executions than they otherwise would receive. The Exchange believes that many investors desire rapid executions in trading securities that are priced derivatively since the value of the underlying instruments may fluctuate during order processing. The Amex, moreover, will continue under the pilot extension to incorporate a price improvement algorithm into Auto-Ex for ETFs, thus to provide investors with better execution prices on their orders. The price improvement algorithm works in the following manner:

When the Amex establishes the National Best Bid or Offer ("NBBO"),<sup>7</sup> Auto-Ex is programmed to execute eligible incoming ETF orders at the APQ plus a programmable number of trading increments with respect to the Amex bid, and less a programmable number of trading increments in the case of the Amex offer. For example, if the APQ were 90.10 to 90.20, and the APQ

constituted the NBBO, incoming sell orders might be automatically executed at 90.12 (the Amex bid plus two ticks) and incoming buy orders might be executed at 90.18 (the Amex offer less two ticks). If the Amex does not establish the NBBO, Auto-Ex is programmed to execute eligible incoming ETF orders at or better than the NBBO up to a specified number of trading increments relative to the APQ.<sup>8</sup> Auto-Ex executes an eligible order at the improved price relative to the APQ unless such execution would result in a trade-through with respect to the price of an away market that is a participant in the Intermarket Trading System ("ITS"). If a trade through would result, the order is routed to the specialist for electronic processing through the Amex electronic order book.<sup>9</sup>

For example, assume that Auto-Ex is programmed to execute the order at the Amex bid plus two ticks. If the Amex bid were 90, and an away ITS market were bidding 90.01, an incoming sell order would be automatically executed on the Amex at 90.02. Continuing with this example, if the away market were bidding 90.02, an incoming sell order would be automatically executed on the Amex at 90.02 (matching the away market). If the away market were bidding 90.03, the incoming sell order would not be automatically executed. Instead, it would be routed to the specialist for electronic processing through the Amex electronic order book.

The amount of price improvement that the system provides, both when the Amex establishes the NBBO and when it does not, is determined by the Auto-Ex Enhancements Committee ("Committee") upon the request of a specialist and may differ among ETFs. The Committee consists of the Exchange's four Floor Governors and the Chairmen (or their designees) of the Specialists Association, Options Market Makers Association, and the Floor Brokers Association, respectively. The Exchange anticipates that the amount of

price improvement will vary among securities based upon such factors as the width of the spread, the volatility of the basket of securities underlying the ETF, and liquidity of available hedging vehicles. The amount of price improvement may be adjusted intra-day by the Committee.

As detailed in Amex Rule 128A, Auto-Ex for ETFs with price improvement is unavailable when the spread is at a specified minimum and maximum variation, which may be adjusted security to security. The Committee will determine, upon the request of a specialist, the minimum and maximum spreads at which Auto-Ex is unavailable. As further provided in the rule, Auto-Ex is also unavailable with respect to incoming sell orders when the Amex bid is for 100 shares, and similarly unavailable with respect to incoming buy orders when the Amex offer is for 100 shares.

Orders that are otherwise Auto-Ex eligible orders are also routed to the specialist, and not automatically executed, in situations where the specialist in conjunction with a Floor Governor or two Floor Officials determine that quotes are not reliable and the Exchange is experiencing communications or systems problems, "fast markets," or delays in the dissemination of quotes. Members and member organizations are notified when the Exchange has determined that quotes are not reliable prior to disengaging Auto-Ex.

Specialists and Registered Options Traders ("ROTs") that sign onto the system are automatically allocated the contra side of Auto-Ex trades for ETFs. Due to the automatic price improvement feature, the specialist and ROTs that sign onto Auto-Ex for ETFs are deemed to be on parity for purposes of allocating the contra side of ETF Auto-Ex trades. Amex Rule 128A incorporates the following methodology for the allocation of the contra side to Auto-Ex ETF trades.

Number of ROTs signed on to auto-ex in a crowd	Approximate number of trades allocated to the specialist throughout the day ("target ratio") (percent)	Approximate number of trades allocated ROTs signed on to auto-ex throughout the day ("target ratio") (percent)
1 .....	60	40
2-4 .....	40	60

<sup>7</sup> The term "establish" as used in this context of Amex Rule 128A means that the Amex Published Quote ("APQ") is currently at the NBBO, regardless of whether or not the Amex was the first exchange to be at that price. See June 2001 Release, *supra* note.

<sup>8</sup> The number of trading increments designated for price improvement when the Amex establishes

the NBBO may be different than the number of increments designated for price improvement when the Amex does not establish the NBBO. *Id.*

<sup>9</sup> Once an order that is Auto-Ex eligible is sent to the Exchange, the person that initiated the order has no control over its execution. This is the case regardless of whether the order is executed by Auto-Ex or is executed by the specialist because Auto-

Ex is unavailable. If the order is routed to the specialist for handling because Auto-Ex is unavailable, the specialist does not know if the order is for the account of a broker-dealer or for the account of a customer. This information is in the Exchange's order processing systems and is unavailable to the specialist.

Number of ROTs signed on to auto-ex in a crowd	Approximate number of trades allocated to the specialist throughout the day ("target ratio") (percent)	Approximate number of trades allocated ROTs signed on to auto-ex throughout the day ("target ratio") (percent)
5-7 .....	30	70
8-15 .....	25	75
16 or more .....	20	80

At the start of each trading day, the sequence in which trades are to be allocated to the specialist and ROTs signed onto Auto-Ex is randomly determined. Auto-Ex trades then are automatically allocated in sequence on a rotating basis to the specialist and to the ROTs that have signed onto the system so that the specialist and the crowd achieve their "target ratios" over the course of a trading session. If an Auto-Ex eligible order is greater than 100 shares, Auto-Ex divides the trade into lots of 100 shares each. Each lot is considered a separate trade for purposes of determining target ratios and allocating trades within Auto-Ex.

Round lot orders delivered to the post electronically for 2,000 shares or less are eligible for Auto-Ex for ETFs. Orders from an account in which a market maker in ETFs registered as such on another market has an interest are ineligible for Auto-Ex for ETFs. If orders for such market makers were eligible for Auto-Ex with price improvement, the Exchange represents, Amex specialists and ROTs would be unable to make markets with the proposed liquidity for other investors. (Orders for Amex Registered Traders are ineligible for Auto-Ex for ETFs pursuant to Commentaries .04 and .05 to Rule 111 and Amex Rule 950(c).)

The Exchange proposes that Amex Rule 128A now stipulate that Auto-Ex eligible orders for any account in which the same person is directly or indirectly interested may be entered only at intervals of 10 seconds or more between the entry of each such order in an ETF.<sup>10</sup> The Exchange states that Amex specialists and ROTs are willing to provide Auto-Ex with price improvement for orders of a certain size. If persons were allowed to enter more than one Auto-Ex eligible order from an account in which they had a direct or indirect interest at intervals of less than 10 seconds, according to the Exchange, Amex specialists and ROTs would be unable to make markets with the proposed liquidity for all investors. Under Amex Rule 128A, members and member organizations are responsible

for establishing procedures to prevent orders for any account in which the same person is directly or indirectly interested from being entered at intervals of less than 10 seconds with respect to an ETF.

The specialist may request the Exchange to increase the maximum size of Auto-Ex eligible orders. Under Amex Rule 128A, such requests are reviewed by the Committee, which approves, disapproves, or conditionally approves such requests. The rule directs the Committee to balance the interests of investors, the specialist, ROTs in the crowd, and the Exchange in determining whether to grant a request to increase the size of Auto-Ex eligible orders. The Committee also may consider requests from the specialist or ROTs to reduce the size of Auto-Ex eligible orders, balancing the same interests that it would consider in reviewing a request to increase the size of Auto-Ex eligible orders. The Committee is not permitted, however, to reduce the size of Auto-Ex eligible orders below 2,000 shares.

In addition, under Amex Rule 128A, the Committee may delegate its authority to one or more Floor Governors. The rule provides, however, that the Committee must meet promptly to review a Floor Official's decision in the event that a Floor Governor acts pursuant to delegated authority.

Amex Rule 128A further provides that in the event of system problems or unusual market conditions, a Floor Governor is permitted to reduce the size of Auto-Ex eligible orders below 2,000 shares or increase the size of Auto-Ex eligible orders up to 5,000 shares. Any such change is temporary and lasts only until the end of the unusual market condition or the correction of the system problem. Members and member organizations will be notified when the size of Auto-Ex eligible orders is adjusted due to system problems or unusual market conditions.

Amex Rule 128A also provides that the Chairman and Vice Chairman of the Exchange, acting jointly, will determine which ETFs are Auto-Ex eligible.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with

Section 6(b) of the Act<sup>11</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>12</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities, 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 is not designed to permit unfair discrimination between customers, issuers, brokers and dealers.

The proposed rule change will allow the Auto-Ex for ETFs pilot program to continue for an additional six months. The proposal also facilitates the comparison and settlement of trades since Auto-Ex transactions result in "locked-in" trades. Auto-Ex for ETFs, moreover, automatically provides investors with price improvement on their orders.

### *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 not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes the proposal, in fact, will enhance competition among markets and market makers and thereby benefit investors by allowing the Exchange to continue to provide Auto-Ex for ETFs with price improvement.

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

A member firm submitted a comment letter to the Commission dated September 4, 2002, on SR-Amex-2002-42 (the previous extension of the Auto-Ex for ETFs Pilot). In this correspondence, the member organization objected to the 30-second "speed bump" in Rule 128A and sought

<sup>10</sup> The proposed rule change reduces the interval from 30 seconds to 10 seconds, as discussed in Section I.I.C. below.

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

<sup>12</sup> 15 U.S.C. 78f(b)(5).

clarification that the 30-second window applied only to electronic orders on the same side of the market in a security. On November 20, 2002, the Amex Board authorized revisions to Rule 128A to reduce the speed bump to 10 seconds (less than the 15 second window that is standard at options exchanges) and to clarify that the new, 10 second, window only applies to orders on the same side of the market in a security. The Exchange believes that it has addressed the concerns articulated by the member organization.

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

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 until 30 days from the date on which it was filed, or such shorter time as the Commission may designate. The proposed rule change has therefore become effective pursuant to Section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup>

The Amex has requested that the Commission waive the usual five-day notice and 30-day pre-operative waiting periods. The Commission believes that it is consistent with the protection of investors and the public interest to accelerate the operative date and to waive the five-day notice period so that the pilot can continue without the 30-day delay. Thus, the Commission waives the five-day notice period and designates that the proposal become operative immediately.<sup>15</sup> The pilot extension will expire June 19, 2003.

At any time within 60 days of the filing of this 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.<sup>16</sup>

## 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 in the Commission's Public Reference Section. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-2002-99 and should be submitted by January 27, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 03-182 Filed 1-3-03; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47103; File No. SR-NASD-2002-180]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding the Prohibition Against Guarantees and Sharing in Customer Accounts

December 30, 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 December 18, 2002, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

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

<sup>27</sup> 17 CFR 240.19b-4.

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

NASD is proposing to amend Rule 2330(e) to clarify that members and their associated persons are prohibited from guaranteeing any customer against loss in connection with any securities transaction or in any securities account of such customer. In addition, NASD is proposing that associated persons obtain written authorization from their employing member firm and the customer prior to sharing in a customer's account under Rule 2330(f). The proposed rule change to Rule 2330(f) also deletes the requirement that members and associated persons obtain the written authorization of the member carrying the account prior to sharing in a customer's account. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

### A. 2330. Customers' Securities or Funds

(a) Through (d) No Change.

### (e) Prohibition Against Guarantees

No member or person associated with a member shall guarantee a customer against loss in *connection with* any securities [account] *transaction or in any securities account* of such customer [carried by the member or in any securities transaction effected by the member with or for such customer].

### (f) Sharing in Accounts: Extent Permissible

(1)(A) Except as provided in paragraph (f)(2) no member or person associated with a member shall share directly or indirectly in the profits or losses in any account of a customer carried by the member or any other member; provided, however, that a member or person associated with a member may share in the profits or losses in such an account if (i) such [member or] person associated with a member obtains prior written authorization from the member [carrying the account] *employing the associated person*; (ii) *such member or person associated with a member obtains prior written authorization from the customer*; and (iii) [the] *such member or person associated with a member [shall] shares in the profits or losses in any account of such customer only in direct proportion to the financial contributions made to such account by either the member or person associated with a member.*

(B) Exempt from the direct proportionate share limitation of

<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 17 CFR 240.19b-4(f)(6).

<sup>15</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>16</sup> 17 CFR 240.19b-4(f)(6).