

between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-2001-33 and should be submitted by January 22, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45182; File No. SR-PHLX-2000-20]

### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 Thereo Relating to the Trading of Nasdaq Securities on the Floor of the Exchange

December 20, 2001.

#### I. Introduction

On November 16, 2000, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and rule 19b-4 thereunder,<sup>2</sup> a proposed rule change regarding the trading of Nasdaq securities on the floor of the Exchange, pursuant to unlisted trading privileges ("UTP"). Notice of the proposed rule change was published in the **Federal Register** on December 14, 2000.<sup>3</sup> On May 14, 2001, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>4</sup> Amendment No. 1 was published in the **Federal Register** on July 16, 2001.<sup>5</sup> On June 22, 2001, the Exchange submitted Amendment No. 2 to the proposed rule change.<sup>6</sup> The

Commission received two comment letters on the proposed rule change and a response from Phlx.<sup>7</sup> This order approves the proposed rule change, as amended.

#### II. Description of the Proposal

The Phlx proposes to reinstate trading in certain over-the-counter ("OTC") securities, *i.e.*, Nasdaq National Market Securities ("Nasdaq/NM Securities"), on the floor of the Exchange, pursuant to UTP under section 12(f) of the Act.<sup>8</sup> Therefore, Phlx seeks reinstatement of the pilot program and accompanying rules to permit the trading of Nasdaq/NM Securities on the Exchange pursuant to UTP ("Phlx OTC/UTP Pilot Program" or "Pilot").<sup>9</sup> Generally, the Exchange proposes to make only minor changes to the Phlx rules that specifically govern trading of Nasdaq/NM Securities, such as to revise the term "Nasdaq/NM Securities." The Phlx has, however, proposed a new allocation procedure for Nasdaq/NM Securities. The Phlx has proposed to reinstate its Pilot to trade Nasdaq/NM Securities on a six-month pilot basis.

#### III. Summary of Comments

The Commission received two comments on the proposed rule change and a response from Phlx.<sup>10</sup> One commenter, Knight, opposed the proposal. In its letter, Knight argued that the proposal should not be approved because: (1) Phlx has failed to demonstrate how permitting Phlx specialists to trade certain Nasdaq/NM Securities pursuant to the Pilot will maintain fair and orderly markets (as

required by section 12(f)(1)(E)(i) of the Act<sup>11</sup>) (of particular concern to Knight is the fact that members of regional UTP exchanges will be held to the less stringent rules of regional exchanges than NASD market maker members); (2) members of regional UTP exchanges trading Nasdaq/NM Securities currently act in a manner inconsistent with the SEC Rule 11Ac1-1<sup>12</sup> (the "Firm Quote Rule"), by failing to execute transactions at prices that were displayed in the Nasdaq Montage; and (3) members of regional UTP exchanges trading Nasdaq/NM Securities currently act in a manner inconsistent with NASD's Locked/Crossed Market Rule<sup>13</sup> and Trade-or-Move Rule.<sup>14</sup>

The Phlx responded to the Knight Letter. In its response letter, the Phlx countered each of Knight's arguments by contending that: (1) The SEC has already determined that permitting regional exchanges and their specialists and dealers to trade Nasdaq/NM Securities pursuant to the OTC/UTP Plan<sup>15</sup> is consistent with fair and orderly markets; (2) the Knight Letter offers no evidence that members of regional UTP exchanges routinely violate the Firm Quote Rule; and (3) even through regional exchange specialists are not bound by the NASD's Locked/Crossed Market and Trade-or-Move Rules, regional specialists on a voluntary basis routinely comply with Trade-or-Move messages received by them pre-opening. Moreover, the Phlx noted that it does not intend to trade or quote during the pre-opening session.

The other commenter, Ashton, supported the proposal. Ashton operates the eVWAP trading system ("eVWAP") as a facility of the Phlx through its Universal Trading Technologies Corporation subsidiary. eVWAP is a pre-opening order matching session for the electronic execution of large-sized stock orders at a standardized volume weighted average price. Ashton noted that the Phlx soon will be filing amendments to Phlx Rule 237 (The eVWAP Morning Session) to expand eligibility of certain Nasdaq/NM

Division of Market Regulation, SEC, dated June 21, 2001 ("Amendment No. 2"). In Amendment No. 2, the Exchange corrected a citation to SEC "Rule 11Ac1-1" on page 22 of the amended Form 19b-4, deleted a reference to subsection "(ii)" on page 25 of the amended Form 19b-4, and changed all references to "issue" and "issues" in the proposed Rule 516 to read "security" and "securities," respectively.

<sup>7</sup> See letters to Jonathan G. Katz, Secretary, SEC, from Michael T. Dorsey, Senior Vice President and General Counsel, Knight Trading Group, Inc., dated December 19, 2000 ("Knight Letter"); William W. Uchimoto, Executive Vice President and General Counsel, Ashton Technology Group, Inc., dated February 23, 2001 ("Ashton Letter"); and Edith Hallahan, Deputy General Counsel, Phlx, dated April 2, 2001 ("Phlx Letter").

<sup>8</sup> 15 U.S.C. 781(f).

<sup>9</sup> The Commission notes that the Phlx began trading Nasdaq/NM Securities pursuant to the Pilot in February 1993. See Securities Exchange Act Release No. 31672 (Dec. 30, 1992), 58 FR 3054 (Jan. 7, 1993). The effectiveness of the Pilot was extended four times before the Phlx decided to cease trading such securities pending reorganization of its OTC/UTP Pilot Program as a whole. See Securities Exchange Act Release No. 36087 (Aug. 10, 1995), 60 FR 42637, 42638 (Aug. 16, 1995). The Phlx OTC/UTP Pilot Program expired on February 12, 1996. *Id.*

<sup>10</sup> See note 7 *supra*.

<sup>11</sup> 15 U.S.C. 781(f)(1)(E)(i).

<sup>12</sup> 17 CFR 240.11Ac1-1.

<sup>13</sup> NASD Rule 4613(e).

<sup>14</sup> NASD Rule 4613(b)(2).

<sup>15</sup> The OTC/UTP Plan refers to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis. The participants of the OTC/UTP Plan are the American Stock Exchange LLC, the Chicago Stock Exchange, Inc., the Cincinnati Stock Exchange, Inc., the National Association of Securities Dealers, Inc., the Pacific Exchange, Inc., and the Philadelphia Stock Exchange, Inc.

<sup>7</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> Securities Exchange Act Release No. 43692 (Dec. 8, 2000), 65 FR 78240.

<sup>4</sup> See Form 19b-4 dated May 14, 2001 ("Amendment No. 1").

<sup>5</sup> Securities Exchange Act Release No. 44533 (July 10, 2001), 66 FR 37083.

<sup>6</sup> See letter from Diana Tenenbaum, Phlx, to Nancy J. Sanow, Senior Special Counsel [sic],

Securities to eVWAP. Ashton stated that many eVWAP participants have requested the addition of Nasdaq issues for eVWAP matching.

Ashton also responded to the Knight Letter. In the Ashton Letter, Ashton counters two of Knight's arguments by contending that: (1) The SEC has already determined that UTP trading of Nasdaq/NM securities is in furtherance of fair and orderly markets; and (2) the federal statutory and regulatory scheme dictates that self-regulatory organizations' rules govern their own members (Ashton questions whether Knight is requesting a complete overhaul of the Act to impose a single self-regulatory, NASDR, over all market participants trading Nasdaq/NM Securities).

#### IV. Discussion

The Commission finds that the proposed rule change, as needed, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and in particular, with the requirements of section 6(b)(5) of the Act.<sup>16</sup> The Commission believes that Phlx has proposed rules that should ensure that trading in Nasdaq/NM Securities on its floor occurs in an orderly fashion,<sup>17</sup> consistent with the requirements of the Act. The Commission, therefore, believes that the proposal should remove impediments to and perfect the mechanism of a free and open market in a manner that is consistent with the protection of investors and the public interest.<sup>18</sup> The Commission also notes that Phlx's response to the comments raised in the Knight Letter were sufficient.<sup>19</sup>

<sup>16</sup> 15 U.S.C. 78f(b)(5).

<sup>17</sup> The Commission notes that trading in Nasdaq/NM Securities will occur on the Phlx's equity floor, which is separate from the Phlx's options floor. Therefore, Phlx's proposal does not raise any side-by-side trading concerns. In addition, Phlx Rule 1014, which prohibits Registered Options Traders ("ROTs") from executing proprietary options transactions in Phlx-listed options on OTC securities, if, during the preceding hour, the ROT was physically at the trading post where such OTC security trades, will apply during the Pilot.

<sup>18</sup> In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>19</sup> The Commission notes that the Phlx's rules regarding short sales do not require an exemption from the Commission's short sale rule, Rule 10a-1, since Nasdaq securities currently are excluded from the Rule. See CFR 240.10a-1(a)(ii). However, Nasdaq has applied to become a national securities exchange. See Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001). If Nasdaq becomes a registered exchange, Nasdaq securities will be exchange-listed and the exemption in subparagraph (ii) of Rule 10a-1 will no longer be available. Accordingly, trading in Nasdaq securities would be subject to Rule 10a-1 unless Phlx obtains an exemption from the Rule.

Furthermore, the proposed rule change is consistent with section 12(f)(2) of the Act,<sup>20</sup> which grants the Commission explicit authority to approve UTP in OTC securities. Section 12(f)(2) of the Act requires the Commission, before approving UTP, to determine that the granting of UTP is consistent with the maintenance of fair and orderly markets and the protection of investors. The Commission believes that the proposed rule change is consistent with these goals and thus, the Commission is approving the proposed rule change, subject to the Phlx complying with the requirements of the OTC/UTP Plan.

#### V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>21</sup> that the proposed rule change (SR-Phlx-2000-20), as amended, is approved on a pilot basis effective for a six month period beginning on the date trading begins.<sup>22</sup>

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45178; File No. SR-PHLX-00-68]

#### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment Nos. 1, 2, and 3 by the Philadelphia Stock Exchange, Inc. Related to Generic Listing Standards Applicable to Trust Shares Pursuant to Rule 19-4(e) Under the Securities Exchange Act of 1934

December 20, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 7, 2000, the Philadelphia Stock Exchange, Inc. ("PHLX" or "Exchange") filed with the Securities and Exchange Commission

The Commission notes that Nasdaq has requested an exemption from Rule 10a-1.

<sup>20</sup> 15 U.S.C. 781(f)(2).

<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</sup> Phlx has advised the Commission that it expects to begin trading in January 2002.

<sup>23</sup> 17 CFR 200.30-3(a)(12).

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

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

("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the PHLX. The PHLX filed Amendment Nos. 1, 2, and 3 to the proposal on September 7, 2000,<sup>3</sup> September 12, 2001,<sup>4</sup> and December 18, 2001,<sup>5</sup> respectively. The Commission is

<sup>3</sup> See letter from Carla Behnfeldt, Director, Legal Department New Product Development Group, PHLX, to Nancy Sanow, Division of Market Regulation ("Division"), Commission, dated September 26, 2000 ("Amendment No. 1"). In Amendment No. 1, the PHLX indicated that in the event the PHLX proposes to list and trade a series of Trust Shares that do not satisfy the generic criteria provided in the proposal, the PHLX will submit to the Commission a proposed rule change pursuant to Rule 19b-4 with respect to the series.

<sup>4</sup> See letter from Carla Behnfeldt, Director, Legal Department New Product Development Group, PHLX, to Yvonne Fraticelli, Special Counsel, Division, Commission, dated September 12, 2001 ("Amendment No. 2"). Amendment No. 2 indicates that: (1) The PHLX currently does not list any Trust Shares, although it trades shares of the Nasdaq 100 Trust pursuant to unlisted trading privileges ("UTP"); (2) the PHLX is amending PHLX Rule 803(i)(11)(e) to indicate that the minimum trading increment for a series of Trust Shares will be \$0.01; (3) the PHLX will issue a circular to members for each Trust Shares series listed pursuant to Rule 19b-4(e) under the Act, which will describe the unique characteristics and risks of Trust Shares, and inform members of any obligation to deliver a written product description or prospectus, as applicable to purchasers of Trust Shares, and inform members of their responsibilities under PHLX Rules 746, "Diligence as to Accounts," and 747, "Approval of Accounts," in connection with customer transactions in Trust Shares; (4) Trust Shares are subject to, among others, the PHLX's general agency-auction rules, trading rules, clearance and settlement rules, equity margin rules, priority, parity, and precedence rules, rules governing the responsibilities of specialists, trading halt rules and procedures, and account opening requirements; (5) any series of Trust Shares traded pursuant to the standards in PHLX Rule 803(i)(11) must meet the eligibility criteria in PHLX Rule 803(i)(11) as of the date of the initial deposit of securities and cash into the trust; (6) the initial deposit of a specified portfolio of securities in connection with the issuance of shares of a series of Trust Shares must be made before the start of trading on the PHLX; (7) unless the PHLX maintains an index, the current index value will be disseminated every 15 seconds over the Consolidated Tape Association's ("CTA") Network B by or through the primary exchange or an entity working with that exchange; and (8) Trust Shares are subject to PHLX Rules 133, "Trading Halts Due to Extraordinary Market Volatility," and 136, "Trading Halts in Certain Exchange Traded Funds."

<sup>5</sup> See letter from Carla Behnfeldt, Director, Legal Department New Product Development Group, PHLX, to Yvonne Fraticelli, Special Counsel, Division, Commission, dated December 17, 2001 ("Amendment No. 3"). In Amendment No. 3, the PHLX revised the text of PHLX Rule 803(i)(11) to indicate: (1) that the provisions of PHLX Rule 803(i)(11) apply to Trust Shares listed or traded pursuant to UTP; and (2) that the minimum trading increment for Trust Shares will be \$0.01. In addition, in Amendment No. 3 the PHLX represented that it will use its existing surveillance procedures for Trust Shares to monitor trading in Trust Shares traded pursuant to Rule 19b-4(e). Amendment No. 3 also stated that the PHLX will issue a circular to members for each Trust Shares series listed or traded on a UTP basis pursuant to Rule 19b-4(e) under the Act, and reiterated the