

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 procedures governing the execution of XPress orders.⁸ Proposed NYSE rule 60

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.

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