

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

1. Purpose

NYSE Rule 123(e) provides that all orders in any security traded on the Exchange be entered into an electronic database (front end systemic capture, or "FESC") before they can be represented in the Exchange's auction market.

On December 20, 2001, the Exchange filed a proposed rule change (a one-year pilot) to amend Rule 123(e) to provide that orders in ETFs must be entered into FESC within 90 seconds of execution.⁵ The pilot was subsequently extended for an additional year and is set to expire on January 5, 2004.⁶ The NYSE submitted the proposed rule change to make the pilot effective on the premise that ETF products are derivatively priced, and trade very rapidly in response to changes in the underlying value of fund components and prices of options and futures contracts on the funds. In addition, the proposed rule change was in response to market participants who thought that the FESC requirement might possibly be a disincentive to sending order flow to the Exchange as it may have been perceived as unduly slowing down the trading process and interfering with trading strategies dependent upon speed of execution. Market participants noted that the Exchange is competing for order flow with other market centers that do not have any FESC-type requirements. In the Exchange's experience, however, that rule change did not have a material impact on the Exchange's market share in ETF products. Thus, the Exchange is proposing to remove the exception from NYSE Rule 123(e) at this time.⁷ In addition, removal of the exception will aid in the Exchange's ability to surveil for on-Floor trading in ETF products if the Commission approves the Exchange's proposal to allow portable phones on the Floor.⁸

The Exchange believes that requiring orders in ETFs to be first entered into FESC before execution or representation on the Floor will place them on an equal footing with orders in other securities with respect to order entry and recording procedures. The Exchange notes that the same surveillance procedures applicable to trading in all other equities will also apply to ETFs.

By requiring orders to be first entered into FESC before execution or representation on the Floor, the Exchange can track more accurately, via systemic records, the time an order is received on the Floor. Therefore, the Exchange's ability to surveil for anomalous trading situations—such as on-Floor trading and the creation of inaccurate records, frontrunning of orders and improper execution of customers' orders—would be enhanced.

2. Statutory Basis

The basis under the Exchange Act for this proposed rule change is the requirement under section 6(b)(5)⁹ that an Exchange have rules that are designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

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

The Exchange believes that the proposed rule change would not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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

The Exchange has not solicited, and does not intend to solicit, comments regarding the proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

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

Because the foregoing proposed rule: (1) Does not significantly affect the

restraints to block the use of portable phones in the Expanded Blue Room, where ETFs trade. However, due to an inability to develop technical restraints to prevent the use of portable phones where ETFs currently trade, the Exchange amended the filing, in Amendment No. 2 to NYSE-2002-11, to allow the use of portable phones for orders in ETFs in conjunction with this proposal to eliminate the NYSE Rule 123 ETF FESC entry exception.

⁹ 15 U.S.C. 78f(b)(5).

protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days 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, the proposed rule change has become effective pursuant to section 19(b)(3)(A) of the Act,¹⁰ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹¹ At any time within 60 days of the filing of the proposed rule change the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

The Exchange requests that the Commission waive the 30-day delayed operative date of Rule 19b-4(f)(6)(iii). Waiver of this period will allow the Exchange to discontinue the exception to FESC under NYSE Rule 123(e) for ETFs. The Exchange believes this will enhance its ability to surveil for anomalous trading situations such as on-Floor trading and the creation of inaccurate records, frontrunning of orders and improper execution of customers' orders. In addition, this will aid the Exchange's ability to surveil the market if the Commission approves the Exchange's proposal to allow Exchange-provided and authorized portable phones on the Floor. The Exchange believes that this is in the public interest.

The Commission believes that it is consistent with the protection of investors and the public interest to waive the 30-day operative delay and make this proposed rule change immediately effective as of April 9, 2003.¹² The Commission believes that the elimination of the ETF FESC entry exception to NYSE Rule 123 will enhance the Exchange's ability to meet its surveillance obligations under the Exchange Act and the SEC Order relating to NYSE's floor broker regulatory program.¹³ The waiver of the

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

¹² For purposes of only 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).

¹³ See In the Matter of New York Stock Exchange, Inc., SEC Release No. 34-41574, June 29, 1999;

⁵ See note 3, *supra*.

⁶ See note 4, *supra*.

⁷ Telephone conversation between Don Siemer, Director, Market Surveillance, NYSE, and Marc McKayle, Special Counsel, Division of Market Regulation, Commission, on April 9, 2003.

⁸ See File No. SR-NYSE-2002-11. In NYSE-2002-11 the Exchange proposes to authorize the use of and provide portable phones on the Exchange Floor on a six-month pilot basis. Originally under the proposed rule change, the Exchange proposed not to permit portable communications at the point of sale for orders in Investment Company Units (as defined in Section 703.16 of the Listed Company Manual), also known as ETFs, since under an exception to NYSE Rule 123(e) orders in ETFs can first be executed and then entered into an electronic data base (FESC). To implement this facet of the proposal, the Exchange proposed creating technical