

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44427; File No. SR-NYSE-99-25]

### Self-Regulatory Organizations; Notice of Filing of Amendment No. 2 to Proposed Rule Change by the New York Stock Exchange, Inc. To Amend Rule 134, Governing Error Accounts, and Rule 411, Governing Erroneous Reports; and To Adopt New Rule 407A

July 14, 2001.

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 January 8, 2001, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") Amendment No. 2 to the proposed rule change submitted as File No. SR-NYSE-99-25.<sup>3</sup> Amendment No. 2 is described in Items I, II and III below, which Items have been prepared by the NYSE. The Commission is publishing this notice to solicit comments on Amendment No. 2 from interested persons.

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

Amendment No. 2 proposes an amendment to NYSE Rule 411; an additional amendment to NYSE Rule 134 with regard to error accounts; and an amendment to proposed NYSE Rule 407A regarding notification by members of accounts in which they have an interest.

#### 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 Amendment No. 2 to the proposed rule change and discussed any comments it received on the amendment. 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

In the initial filing of proposed rule change SR-NYSE-99-25, the Exchange proposed initiatives to strengthen the regulation of activities of members on the Floor. The initiatives consisted of amendments to NYSE Rule 134, regarding error accounts, and a new rule, NYSE Rule 407A, regarding Floor member account disclosure. Amendment No. 1 to the filing provided more detail as to the application of Rule 134 and proposed amendments to Rule 134 by adding specific language with respect to the Rule's requirements. Amendment No. 2 now proposes an amendment to another Exchange rule, NYSE Rule 411, and additional amendments to NYSE Rules 134 and 407A.

##### Amendment of Rule 411

NYSE Rule 411(a), "Erroneous Reports," provides that the price and size of the actual auction market trade are binding, notwithstanding the fact that the customer has received an erroneous report with respect to the terms of the trade. In today's markets, however, some customers may not want to take corrected reports, due to processing costs or other difficulties with respect to other trading strategies effectuated by the customer in reliance on the erroneous report. This has the potential for creating problems in clearing and settling trades, because Rule 411(a) does not currently provide a means whereby a Floor broker can treat an erroneous report as though it were an erroneous trade.

The Exchange is proposing to amend Rule 411(a) to provide two alternative approaches in cases where an order has been executed, but the wrong price and/or size has been reported to the customer:

*Alternative One:* The first alternative is simply the current rule. The actual execution price and size are binding, and the trade clears and settles in accordance with the terms of the auction market trade. The member and the customer resolve any monetary issues between themselves. This alternative must be represented to the customer and rejected by a person authorized to accept or reject the erroneous report for the customer before a member can rely on new Alternative Two.

*Alternative Two.* Under this alternative, which is proposed to be added to Rule 411(a), a non-member

may treat the terms of the execution report as though they were the terms of the actual auction market trade, provided that:

(i) The price and size of the erroneous report are within the range of prices and sizes reported on the Consolidated Tape; (ii) the member reports the nature of the error to the non-member, and whether it results in a favorable adjustment to the non-member; (iii) the member documents, on a trade-by-trade basis, the name of the individual authorized to accept or reject the erroneous report for the non-member, where such documentation includes the amount of the error, and whether it was in the non-member's or member's favor; (iv) the member treats the erroneous report as though it were an erroneous trade, and, in the member's error account, the member takes the opposite side of the report and the opposite side of the actual auction market trade; (v) the member absorbs any loss as a result of taking the trade into the member's error account and any profit is paid to the New York Stock Exchange Foundation; and (vi) a specialist may accommodate the member by taking the error into the specialist's error account. In the latter case, the member would be required to absorb any loss, while any profit would go to the New York Stock Exchange Foundation; the member would be required to document the specialist's accommodation and non-member understandings as per (ii) above; and the specialist would be required to document taking in the error to accommodate the member.

The NYSE is also proposing to amend NYSE Rule 411 to make clear that a member may not rely on Alternative Two in situations where a member has issued a report but has not actually executed the order.

The Exchange believes this approach provides a reasonable means for handling erroneous reports as between members and non-members, and provides sufficient safeguards to prevent abusive practices.

##### Other Amendments

The Exchange also proposes to amend NYSE Rule 134 to provide that no non-error trading may take place in a member's error account, and to amend NYSE Rule 407A, "Disclosure of All Members Accounts," to provide that a member must inform the Exchange when any securities account in which the member has an interest is closed. The amendment to Rule 134 will assist in surveilling members' error account activities by limiting transactions to those that are related to errors. The amendment to Rule 407A will help the

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

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

<sup>3</sup> The proposed rule change, as amended by Amendment No. 1, was published for comment in the *Federal Register* on February 10, 2000. See Securities Exchange Act Release No. 42381 (February 3, 2000), 65 FR 6673.

Exchange know whether members have active securities accounts.

## 2. Statutory Basis

The Exchange believes the proposed rule change, as amended, is consistent with Section 6(b)(5)<sup>4</sup> of the Act, which requires 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. The Exchange believes that the proposed rule change, as amended, will help accomplish these ends by strengthening the Exchange's ability to surveil the Floor activities of members.

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

The Exchange does not believe that the proposed rule change, as amended, 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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 2 to the proposed rule change is consistent with the Act. Persons making written submission 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 Room. Copies of the filing will also be available for inspection and copying at the principal offices of the NYSE. All submissions should refer to File No. SR-NYSE-99-25 and should be submitted by July 6, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44434; File No. SR-OCC-2001-05]

### Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Clearing Security Futures

June 15, 2001.

On March 21, 2001, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") and on April 16, 2001, amended a proposed rule change (File No. SR-OCC-2001-05) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the **Federal Register** on April 30, 2001.<sup>2</sup> Three comment letters were received.<sup>3</sup> For the reasons discussed below, the Commission is granting approval of the proposed rule change.

#### I. Description

The Commodity Futures Modernization Act ("CFMA"), which

became law on December 21, 2000, eliminated the preexisting ban on trading in futures contracts on individual securities and narrow-based stock indices. Such "security futures" will be permitted to be traded on a principal to principal basis between "eligible contract participants" on August 21, 2001, and by other classes of customers on December 21, 2001. The purpose of OCC's proposed rule change is to make an initial identification of the kinds of markets for whom OCC will clear transactions in security futures.

OCC proposed to amend its By-Laws to provide that OCC may clear transactions in security futures effected on any national securities exchange or association registered under Section 6(a) or 15A(a) of the Act, as amended, or any "designated contract market" (as that term is used in the Commodity Exchange Act ("CEA")) that is registered as a national securities exchange under Section 6(g) of the Act.

OCC anticipates that some or all of OCC's five participant exchanges will trade security futures, either on the participant exchange itself or on an affiliated futures exchange. OCC expects that it will therefore enter into the business of clearing security futures. However, the types of entities that can provide a marketplace for security futures include markets in addition to the options exchanges that are OCC's participant exchanges. These include other national securities exchanges and national securities associations as well as any "board of trade" that has been designated as a "contract market" under the CEA. An SEC-regulated market that wishes to trade security futures is required to obtain a limited-purpose registration as a designated contract market in security futures products under the CEA through a notice filing with the Commodity Futures Trading Commission ("CFTC"). A CFTC-regulated market trading security futures is required to obtain a limited-purpose registration with the Commission as a national securities exchange under a similar procedure. Each market will be regulated primarily by the agency (*i.e.*, the Commission or the CFTC) with which it is fully registered.

OCC believes that it is well-positioned to clear security futures for any of these types of markets. OCC's role as the common clearinghouse for equity options offers opportunities for margin offsets and other efficiencies that would not be as readily available if positions in security futures were carried with other clearinghouses. OCC's settlement interface with the National Securities Clearing Corporation gives OCC the

<sup>5</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> Securities Exchange Act Release No. 44212, (April 23, 2001), 66 FR 21425.

<sup>3</sup> Letters to Jonathan Katz, Secretary, SEC, from Chris Concannon, Vice President, The Island ECN, Inc. (May 21, 2001) ("Island letter"); William H. Navin, Executive Vice President and General Counsel, OCC (June 1, 2001) ("OCC letter"); and Fulbright & Jaworski, L.L.P., on behalf of The Philadelphia Stock Exchange, (June 7, 2001) ("PHLX letter").

<sup>4</sup> 15 U.S.C. 78f(b)(5).