

Information Memo



New York
Stock Exchange, Inc.

Market Surveillance

11 Wall Street
New York, NY 10005

Number 01-4
February 27, 2001

TO: ALL MEMBERS AND MEMBER ORGANIZATIONS

SUBJECT: NYSE DIRECT+

The New York Stock Exchange began trading through its new NYSE DIRECT+™ facility on a pilot basis on December 21, 2000 with a limited number of stocks. The rollout of DIRECT+ will now be completed over a seven week period beginning on February 28. This Information Memorandum will provide details on the rules and procedures adopted in connection with trading through NYSE DIRECT+.

NYSE DIRECT+™

NYSE DIRECT+™ will provide electronic execution of limit orders up to 1,099 shares. It is designed to allow member organizations to offer speed of execution to their customers by entering orders for immediate execution against the published NYSE quote.

Orders for NYSE DIRECT+™ execution are entered through SuperDot with the indicator NX added. An order placed in NYSE DIRECT+™ is executed when the limit price is equal to or better than the published bid or offer. The transaction report is returned through SuperDot to the member organization which entered it. If an order placed in NYSE DIRECT+™ is not executed, it is placed on the specialist's book for representation in the market at its limit price.

Rollout Schedule

Twenty two issues are currently eligible for the NYSE Direct+ pilot. The remaining issues will be phased in over a seven week period beginning on February 28. Implementation will proceed in alphabetical order by symbol as detailed below:

<u>DATE</u>	<u>SYMBOL</u>
February 28	A
March 7	B-C
March 14	D-F
March 21	G-J
March 28	K-M
April 4	N-P
April 11	Q-Z

New Rules, Rule Amendments and Interpretive Matters

The Securities and Exchange Commission has approved proposed new Exchange Rules 1000 through 1005 governing NYSE Direct+™, which will provide automatic execution of limit orders of 1099 shares or less. The Commission has also approved an amendment to Rule 13 to define an “auto ex” order and an amendment to the list of rules subject to summary fine procedures under Exchange Rule 476A.

Rule 13

A definition of an auto ex order is being added to Rule 13. An auto ex order is a limit order of 1099 shares or less priced at or above the Exchange’s published offer (in the case of an order to buy) or at or below the Exchange’s published bid (in the case of an order to sell) which will receive an automatic execution against the interest reflected in the published quotation, provided the size of the published quotation is greater than 100 shares. An auto ex order or any portion thereof that cannot be immediately executed will be entered as a limit order in the Exchange’s auction market.

The new rules adopted for NYSE Direct+™ provide as follows:

Rule 1000

Rule 1000 states the basic operative principles providing for automatic execution of limit orders of 1099 shares or less against the Exchange’s published quotation. The Rule lists six instances in which the automatic feature would not be available due to market situations, lack of depth in the published quotation, or inappropriate pricing of the auto ex order, as follows:

- the NYSE’s published quotation is non-firm (pursuant to Rule 60);
- the NYSE’s published quotation has been gapped (pursuant to the Exchange’s usual procedures for such situations) for a brief period because of an influx of orders on one side of the market, and the Exchange’s published quotation size is 100 shares at the bid and/or offer;
- a better price exists in another ITS participating market center;
- the NYSE’s published bid or offer is 100 shares (see Rule 1001(c));
- a transaction outside the Exchange’s published quotation pursuant to NYSE Rule 127 is in the process of being completed, in which case the specialist should publish a 100-share bid and/or offer; or
- trading in the subject security has been halted.

Rule 1000 provides that an auto ex order that cannot be immediately executed for any of the above reasons will be automatically entered for execution in the Exchange’s auction market via the SuperDOT system. Once it is entered in the auction market, it will be treated the same as any other limit order entered onto the Exchange.

Rule 1000(ii) provides that auto-ex orders will not be executed when the Exchange's published quotation has been gapped for a brief period. The procedure to "gap" a quotation involves setting the bid and asked prices at a spread wider than normal in a stock in order to alert market participants that a special situation exists. This may occur if a member proposes to effect a block transaction at a significant premium or discount from the prevailing market and the specialist is aware of interest on the contra side. In such situations, the size of the quotation may be set at 100 shares by 100 shares.

Rule 1000(v) provides that auto-ex orders will not be executed when an auction market execution under Exchange Rule 127 is being completed. Rule 127 establishes procedures for executions outside the NYSE's published bid or offer. During the process for completing such transactions, the specialist should publish a bid and/or offer that is 100 shares.

Rule 1001

Rule 1001 (a) provides that the contra side of an auto ex execution will be trading interest reflected in the Exchange's published quotation, consistent with the principles of priority and parity as codified in Exchange Rule 72. Under Rule 1001(a), it will be the specialist's responsibility, after receiving a report that an auto ex order has been executed, to assign the appropriate number of shares to each bidder or offeror, consistent with the principles of Rule 72, with a universal contra being reported as the contra to each auto ex execution. Where the interest in the published quotation against which the auto ex order was executed is no longer available, Rule 1001(a) also provides that the specialist will take the contra side of an auto ex execution.

Rule 1001(b) provides that if the published bid or offer is not of sufficient depth to fill an auto ex order in its entirety, the unfilled balance of the order will be displayed in the auction market.

Rule 1001(c) 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 requotes that market. Auto ex orders will not receive an automatic execution against any 100 share bid or offer, whether a default bid or offer or otherwise, but rather will be displayed in the auction market. Rule 1001(c) provides that the specialist will be the contra party to any auction market interest seeking to trade against the 100-share default bid or offer.

Rule 1001(d) provides that the concept of precedence based on size codified in Rule 72, will not apply with respect to the contra side of an auto ex execution, with such contra side interest being assigned, as noted above, in accordance with the principles of priority and parity in Rule 72.

Rule 1002

Rule 1002 provides that auto ex orders may be entered on any day in a particular stock from the time the Exchange has published a bid or offer in that stock until 3:59 p.m., at which time

the specialist is preparing the closing transaction in the security. If orders designated as auto ex are entered before a quote is published or after 3:59 p.m., the orders will be treated as limit orders in the auction market.

Rule 1003

Rule 1003 provides that if a transaction has been agreed upon in the auction market, and an execution involving auto ex orders is reported at a different price before the auction market transaction is reported, any tick test applicable to the auction market transaction will be based on the last reported trade prior to the execution of the auto ex order.

For example, assume the Exchange's published quotation is 20 bid for 5,000 shares, with 5,000 shares offered at 20.20. The last reported sale is 20.10, which is a plus tick. A broker in the Crowd bids 20.10 for 5,000 shares, and another broker, representing a short sale order, agrees to trade at the 20.10 bid price. Before the trade at 20.10 is reported, however, an auto ex order to buy is automatically executed at the 20.20 published offer price, making the trade at 20.10 a minus tick, which would preclude execution of the order to sell short. Rule 1003 provides that, in this instance for purposes of NYSE Rule 440B and Rule 10a-1 under the Securities Exchange Act of 1934 ("Rule 10a-1"), the short sale tick test would be based on the last reported sale of 20.10, a plus tick, at the time the Crowd brokers were completing their trade.

As with all other trades, Floor brokers seeking to rely on Rule 1003 with respect to short sales in auction market transactions subject to Rule 10a-1 and NYSE Rule 440B must report such auction market transactions immediately upon agreement to the trade. In order to verify compliance with Rule 10a-1, where an auto ex transaction takes place while the auction market transaction is being completed and the auto ex price would cause the auction market trade to be reported on a minus or zero-minus tick, the Floor broker effecting the short sale must obtain NYSE Floor Official approval that the transaction was agreed upon at a price in compliance with Rule 10a-1 and Rule 440B. Each such short sale must be reported as a "sold sale". Further, Floor brokers will not be allowed to sell short at a price lower than the best bid displayed in the auction market at the time the transaction is reported.

Rule 1004

Rule 1004 provides that executions of auto ex orders will elect stop limit orders as well as stop orders and percentage orders electable at the price of such executions. The rule also provides that stop orders so elected will be executed pursuant to the Exchange's auction market procedures, and will not be guaranteed executions at the prices of subsequent auto ex executions.

Rule 1005

Rule 1005 provides that auto ex orders for the same customer may be entered at time intervals of no less than 30 seconds between entry of each such order. This will apply on a per stock basis.

Interpretive Issues

The Exchange has received Commission approval on interpretations of several NYSE rules, as well as an interpretive position from the Commission under the short sale rule, Rule 10a-1 under the Securities Exchange Act of 1934. These matters concern situations pursuant to proposed Rule 1001(a)(iv) where the specialist may be required to take the contra side of an auto ex execution against the published quotation, even though the specialist's interest was not part of such quotation. For example, the published quotation may reflect the interest of a broker in the Crowd, whose interest is then executed in an auction market transaction, but before the published quotation can be updated, an auto ex order is executed against such quotation. In such instance, the specialist would be required to take the contra side of the auto ex execution. In other instances, the Crowd broker might cancel his or her interest as reflected in the published quotation, but an auto ex order might be executed against such quotation before it can be updated. Again, in such instance, the specialist would be required to take the contra side of the auto ex execution.

Rule 104. Rule 104 contains the specialist's affirmative and negative obligations, and restricts the specialist's ability to purchase stock on direct plus ticks, or sell stock on direct minus ticks. Any instance in which the specialist is effecting such a direct tick transaction only because he or she has been required to assume the contra side of an auto ex execution as described above will be deemed to be a "neutral" transaction for purposes of Rule 104, and will be deemed not to be in violation of the rule. The Exchange believes that this interpretive position approved by the Commission is appropriate because the specialist is not setting the price, but is simply being required to trade at a price set by other market participants.

Rule 123A.40. The specialist will not be required to fill any stop orders elected by an auto ex execution at the price of the electing sale in any instance where the specialist was required by Rule 1001(a)(iv) to take the contra side of an auto ex execution.

Rule 91. As the specialist does not accept an auto ex order for execution or act as agent for such order, the transaction confirmation requirements of Rule 91 will not be applicable in any instance where the specialist is the contra party to an auto ex execution.

Rule 10a-1. Similarly, the specialist will be deemed not to be in violation of Rule 10a-1 under the Securities Exchange Act of 1934 or Rule 440B whenever he or she would be required to take the contra side of an auto ex execution on a minus or zero minus tick, and has an existing short position, or would be creating a short position by virtue of such execution. In such instance, the specialist would not be deemed to be engaging in manipulative behavior to

influence the price of the subject security because the specialist is simply being required to trade at a price set by other market participants.

Addition to Rule 476A Summary Fine List

The List of Exchange Rule violations under Rule 476A has been amended to include the failure by members or member organizations to comply with the provisions of Rules 1000-1005, which implement the Exchange's NYSE Direct+™ facility. Rule 476A provides that the Exchange may impose a fine, not to exceed \$5,000, on any member organization, or not to exceed \$2,500 on any member, allied member, approved person, or registered or non-registered employee of a member or member organization for a minor violation of certain specified Exchange rules.

The Exchange wishes to emphasize the importance it places upon compliance with the above-named rules. While the Exchange, upon investigation, may determine that a violation of any of these rules is a minor violation of the type which is properly addressed by the procedures adopted under Rule 476A, in those instances where investigation reveals a more serious violation of the above-described rules, the Exchange will provide an appropriate regulatory response. This includes the full disciplinary procedures available under Rule 476.

The texts of the rules as adopted or amended are attached. Questions concerning these changes may be addressed to Brian McNamara at (212) 656-7086 or Donald Siemer at (212) 656-6940.

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Attachments