SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49745; File No. SR–NYSE–2003–37]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. To Amend Exchange Rule 124 To Change the Way Odd-Lot Orders Are Priced and Executed Systemically

May 20, 2004.

I. Introduction

On November 18, 2003, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] to amend Exchange Rule 124 to change the way odd-lot orders are priced and executed systemically. On March 31, 2004, the Exchange amended the proposed rule change.[3] The proposed rule change, as amended by Amendment No. 1, was published for comment in the **Federal Register** on April 14, 2004.[4] The Commission received no comments on the proposed rule change, as amended. This order approves the proposed rule change, as amended.

II. Description

The Exchange is proposing to change the way odd-lot orders are priced and executed systemically. Currently, odd-lot orders do not enter the Exchange's auction market, but are executed systemically, with the specialist being assigned as the contra-party in all cases. Currently, odd-lot market orders to buy (sell) are generally executed at the price of the adjusted ITS round-lot offer (bid)[5] at the time the Exchange's system receives the order, and odd-lot limit orders are generally executed at the price of the first round-lot transaction, subsequent to the receipt of the order by the system, that is at or better than the limit price on the order.

Under the proposal, odd-lot orders would be priced and executed at the price of subsequent round-lot transactions, and in proportion to round-lot volume, as follows:

a. *Market Orders.* Odd-lot market orders would be executed in time priority at the price of the next round-lot transaction. Buy and sell orders would, in essence, be netted against one another and executed (the specialist is technically the contra party to the buy orders and to the sell orders, but since the specialist is buying the same amount that he or she is selling, there is no economic consequence to the specialist in this type of pairing-off of orders). Any imbalance of buy or sell orders would be executed against the specialist, but only up to the size of the round-lot transaction. Any market orders that do not receive an execution because of the volume limitation would be executed, in time priority order, at the price of the next round-lot transaction, subject to the volume limitation. There would be a ''timer'' provision in the rule to provide that an order not executed within 30 seconds would be executed at the price of the adjusted ITS best round-lot bid (in the case of a sell order) or offer (in the case of a buy order).

b. *Limit Orders.* Odd-lot limit orders would be executed at the price of the first round-lot transaction that is at or better than the limit price of the order, subject to the volume limitation of the round-lot transaction. Odd-lot limit orders also would be aggregated with odd-lot market orders for purposes of the volume limitation. Limit orders eligible for execution would be intermingled with market orders for purposes of determining time priority, and buy and sell orders would be netted against each other in the same fashion as market orders. As with odd-lot market orders, odd-lot limit orders which would otherwise receive a partial execution would be executed in full. There would be no ''timer'' for odd-lot limit orders.

c. *Short Sale Orders.* A short sale market odd-lot order would be eligible for execution at the price of the next sale in the round-lot market on the Exchange which is higher than the last different round-lot transaction. Short sale limit odd-lot orders would be eligible for execution at the price of the first round-lot transaction on the Exchange which is at or above the specified limit of the order, and which is also higher than the last different round-lot transaction.

d. *Stop Orders.* Stop orders in odd-lots would be handled as they are today.

III. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[6] In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,[7] in that it is 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.

In the Notice, the NYSE noted that certain legitimate trading strategies may result in specialists having to assume large positions of aggregated odd-lot orders at prices that are not necessarily reflective of the prices such orders would have received had they been executed pursuant to the supply and demand dynamics of the round-lot auction market.[8] The Commission believes that the proposal is a reasonable response to this unintended use and consequence of NYSE's current odd-lot process. Under the proposed rule change, as amended, the NYSE should continue to accommodate traditional odd-lot orders in a manner that is based on the prevailing market, while limiting a specialist's financial exposure. The Commission believes that the proposed rule change, as amended, represents a reasonable method of pricing odd-lot orders because the pricing of odd-lot orders at the execution would reflect actual round-lot market price and activity at the time of execution.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[9] that the proposed rule change (SR–NYSE–2003–37) and Amendment No. 1 are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[10]

Margaret H. McFarland,

Deputy Secretary.

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letter, from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated March 30, 2004 and accompanying Form 19b–4 (''Amendment No. 1'').

[4] *See* Securities Exchange Act Release No. 49536 (April 7, 2004), 69 FR 19890 (''Notice'').

[5] ''Adjusted ITS bid'' and ''adjusted ITS offer'' are defined in NYSE Rule 124.60.

[6] In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[7] 15 U.S.C. 78f(b)(5).

[8] *See* note 4, *supra.*

[9] 15 U.S.C. 78s(b)(2).

[10] 17 CFR 200.30–3(a)(12).