

APs who worked at Disciplined Firms for less than 60 days more than ten years ago to avoid triggering the Requirements. In fact, only two firms would have triggered the Requirements under the former method but were not so classified because of the 2003 modification, and neither has been subject of any regulatory action. In its latest review of the Requirements, NFA revisited the question of whether further modifications can be prudently made to decrease the potential burden on NFA's membership and the Waiver Committee. NFA studied data to examine the effect of keeping the less than sixty days at a Disciplined Firm requirement while reducing the time away from Disciplined Firms from ten to five years.

NFA's analysis showed that reducing the required period from 10 years to five years while maintaining the less 60 days cumulative tenure at Disciplined Firms requirement yielded a population that is of no more cause for concern than the present system. Approximately 1,280 individuals are exempted from being counted under the current system. Reducing the required length of time away from a Disciplined Firm to five years would add approximately 275 APs who would not have to be counted in determining if a firm triggered the Requirements. As was the case with the group that has been exempted under the current ten-year test, the number of additional APs who would be exempted under the proposed modification who have been subject to any kind of regulatory action is small.<sup>7</sup>

Based upon this data, NFA believes that the triggering criteria as currently set out in the Notice can be further refined to reduce the burden on the membership while still imposing supervisory enhancements on firms that pose a concern given the background of their APs and principals at Disciplined Firms. Not including APs and principals who served less than sixty cumulative days with Disciplined Firms more than five years ago in calculating whether a Member is subject to enhanced supervision would also serve the efficiency and fairness of the Waiver Committee's function by removing a few

<sup>7</sup> Ten individuals who have been subject to actions by NFA or the CFTC are exempted from being included in the calculation of whether a Member has become a Telemarketing Firm under the Notice's current 10-year provision. The proposed modification to reduce the required time away from a Disciplined Firm to more than five years would exempt six additional individuals who have been subject to actions by NFA or the CFTC. All charges against those individuals have been resolved. None of the individuals has been permanently barred from the industry and none of them are currently registered.

non-problematic firms from the waiver process.

## 2. Statutory Basis

The rule change is authorized by, and consistent with, Section 15A(k) of the Exchange Act.<sup>8</sup>

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

The rule change will not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act and the Commodity Exchange Act.<sup>9</sup>

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

NFA discussed the proposed rule change with its Special Committee to Study Customer Protection Issues, which voted to recommend the proposed rule change. NFA did not publish the proposed rule change to the membership for comment. NFA did not receive comment letters concerning the proposed rule change.

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

The proposed rule change is not effective because the CFTC has not approved the proposed rule change. Within 60 days of the date of effectiveness of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of Section 19(b)(1) of the Exchange Act.<sup>10</sup>

## IV. Solicitation of Comments

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-NFA-2005-01 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-9303.

All submissions should refer to File No. SR-NFA-2005-01. This file number should be included on the subject line

<sup>8</sup> 15 U.S.C. 78o-3(k).

<sup>9</sup> 7 U.S.C. 1.

<sup>10</sup> 15 U.S.C. 78s(b)(1).

if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 such filing will also be available for inspection and copying at the principal office of the NFA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-NFA-2005-01 and should be submitted on or before December 19, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52807; File No. SR-NSX-2005-06]

### Self-Regulatory Organizations; National Stock Exchange; Order Approving Proposed Rule Change, and Amendment Nos. 1 and 2 Thereto, To Amend the Exchange's Customer Priority Rule To Require Designated Dealers To Implement and Maintain Automated Compliance Systems

November 18, 2005.

## I. Introduction

On July 19, 2005, the National Stock Exchange<sup>SM</sup> ("NSX" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule

<sup>11</sup> 17 CFR 200.30-3(a)(75).

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

19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the text of NSX Rule 12.6 (“NSX’s Customer Priority Rule”) to require the Exchange’s Designated Dealers<sup>3</sup> to implement and maintain automated systems reasonably designed to ensure compliance with the NSX Customer Priority Rule.<sup>4</sup> On October 5, 2005, the Exchange filed Amendment No. 1 to the proposed rule change. On October 7, 2005, the Exchange filed Amendment No. 2 to the proposed rule change. Notice of the proposed rule change, as amended, was published for comment in the **Federal Register** on October 18, 2005.<sup>5</sup> No comments were received regarding the proposal. This order approves the proposed rule change, as amended.

## II. Description of the Proposed Rule Change

The NSX Customer Priority Rule, currently provides, in part, that no member of the Exchange shall: (i) Personally buy or initiate the purchase of any security traded on the Exchange for its own account or for any account in which it or any associated person of the member is directly or indirectly interested while such member holds or has knowledge that any person associated with it holds an unexecuted market or limit price order to buy such security in the unit of trading for a customer, or (ii) sell or initiate the sale of any such security for any such account while it personally holds or has knowledge that any person associated with it holds an unexecuted market or limit price order to sell such security in the unit of trading for a customer.<sup>6</sup>

NSX proposes to amend the text of the NSX Customer Priority Rule to require

the Exchange’s Designated Dealers to implement and maintain automated systems reasonably designed to ensure compliance with the NSX Customer Priority Rule.<sup>7</sup> The proposed rule change would also prohibit Designated Dealers from disabling or disengaging their automated systems, except under limited circumstances.<sup>8</sup> Furthermore, the proposed rule would make clear that, if a Designated Dealer holds for execution on the Exchange a customer buy order and a customer sell order that can be crossed, the Designated Dealer’s automated system shall systemically cross them.<sup>9</sup>

NSX also proposes to provide that, for purposes of Rule 12.6, a member or any associated person of a member responsible for entering orders for its own account or any account in which it is directly or indirectly interested shall be presumed to have knowledge of a particular customer order.<sup>10</sup> The proposed interpretation would also provide that such presumption can be rebutted by adequate evidence that effectively demonstrates, to the Exchange’s satisfaction, that the member has implemented a reasonable system of internal policies and procedures and has an adequate system of internal controls to prevent the misuse of information about customer orders by those responsible for entering such proprietary orders.<sup>11</sup>

## III. Discussion and Commission Findings

The Commission has reviewed the proposed rule change, as amended, and finds that it is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>12</sup> Specifically, the Commission finds that the proposed rule change, as amended, furthers the objectives of Section 6(b)(1)<sup>13</sup> of the Act, which requires the Exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members, with the Act and the rules of the Exchange. In addition, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the

Act,<sup>14</sup> which requires, among other things, that the rules of a national securities exchange be 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.

Currently, NSX Rule 12.6 prohibits an NSX member from trading ahead of its customers’ orders. Customer order protection ensures that members consider the orders of their customers when executing their own orders and thus prevents the isolation of customer orders that might otherwise occur if a member were freely able to trade ahead of its customers’ orders. The Commission believes that the proposed rule change should enhance investor confidence by helping to improve the quality of executions for customers. By ensuring a customer order’s priority over the member’s proprietary trading, more trade volume should be available to be matched with the customer’s order, resulting in quicker and more frequent executions for customers. Specifically, the Commission believes that proposed NSX Rule 12.6(e) and Interpretations and Policies .01 to NSX Rule 12.6 should enhance the customer protections already provided by NSX Rule 12.6 by requiring NSX specialists to implement and maintain automated systems reasonably designed to ensure compliance with NSX Rule 12.6 and requiring that if an NSX specialist is able to cross two customer orders, such specialist’s automated system shall systemically cross such order without the specialist interposing itself as a dealer.

Proposed Interpretations and Policies .03 to NSX Rule 12.6 would define what constitutes knowledge for purposes of NSX Rule 12.6 to provide that a member or any associated person of a member responsible for entering orders for its own account or any account in which it is directly or indirectly interested shall be presumed to have knowledge of a particular unexecuted customer order and would provide that such knowledge can be rebutted by adequate evidence that the member has implemented a reasonable system of internal policies and procedures and has an adequate system of internal controls to prevent misuse of information about customer orders by those responsible for entering such proprietary orders. The Commission believes that the proposed interpretation is substantially similar to a rule of the New York Stock Exchange, Inc. interpreting its trading ahead

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

<sup>3</sup> NSX Rule 5.5(a) defines “Designated Dealer” as a specialist.

<sup>4</sup> The Exchange filed this proposed rule change, in part, pursuant to the provisions of the Commission’s Order Instituting Administrative and Cease-And-Desist Proceedings Pursuant to Sections 19(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Sanctions entered May 19, 2005. See *In the Matter of National Stock Exchange and David Colker*, Securities Exchange Act Release No. 51715 (May 19, 2005) (“Administrative Order”). In Section III.F.6. of the Administrative Order, NSX undertook to file proposed rule changes to require its designated dealers to implement system enhancements, to the extent practicable, such that when a dealer is in the process of executing a proprietary trade while in possession of a customer order that could trade in place of some or all of the dealer’s side of the trade, the designated dealer’s system will systemically allocate the execution to the customer’s order unless the trade meets a specified exemption in NSX’s rules. Pursuant to the undertaking, the proposed rule changes must also require that the required system enhancements cannot be disabled by NSX’s designated dealers.

<sup>5</sup> See Securities Exchange Act Release No. 52576 (October 7, 2005), 70 FR 60594 (“Notice”).

<sup>6</sup> See NSX Rule 12.6(a).

<sup>7</sup> See Proposed NSX Rule 12.6(e).

<sup>8</sup> *Id.*

<sup>9</sup> See Proposed Interpretations and Policies .01 to NSX Rule 12.6.

<sup>10</sup> See Proposed Interpretations and Policies .03 to NSX Rule 12.6.

<sup>11</sup> *Id.*

<sup>12</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78f(b)(1).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

rules,<sup>15</sup> and that such proposed interpretation raises no new issues or regulatory concerns.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (File No. SR-NSX-2005-06) and Amendment Nos. 1 and 2, thereto be, and hereby are, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Jonathan G. Katz,**

*Secretary.*

[FR Doc. E5-6562 Filed 11-25-05; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52780; File No. SR-NYSE-2004-64]

### Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendments Nos. 1 and 2 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 to the Proposed Rule Change Relating to Exchange Rule 342 (“Offices—Approval, Supervision and Control”)

November 16, 2005.

#### I. Introduction

On November 2, 2004, the New York Stock Exchange, Inc. (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change amending NYSE Rule 342.30 (“Annual Reports”) primarily to require each member organization (“Member Organization”) and each member not associated with a member organization (“Member”) to file with the Exchange annual reports and to file a yearly statement confirming the adequacy of their compliance processes and procedures. On July 11, 2005, the NYSE filed Amendment No. 1 to the proposed

rule change (“Amendment No. 1”).<sup>3</sup> On August 12, 2005, the NYSE filed Amendment No. 2 to the proposed rule change (“Amendment No. 2”).<sup>4</sup> The proposed rule change was published for comment in the **Federal Register** on August 22, 2005.<sup>5</sup> The Commission received two comments on the proposal, as amended.<sup>6</sup> On October 31, 2005, the Exchange filed a response to the comment letters,<sup>7</sup> and on the same day the Exchange filed Amendment No. 3 to the proposed rule change (“Amendment No. 3”).<sup>8</sup> This order approves the proposed rule change, as amended by Amendments Nos. 1 and 2, grants accelerated approval to Amendment No. 3 to the proposed rule change, and solicits comments from interested persons on Amendment No. 3.

#### II. Description of the Proposed Rule Change

##### A. Description of the Proposal

##### 1. Background

NYSE Rule 342 requires supervision of the offices, departments and business activities of Members and Member Organizations. NYSE Rule 342.30, which was adopted on May 27, 1988, requires Members and Member Organizations to prepare an Annual Report addressing specified compliance issues by April 1 of each year. Currently, Member Organizations are required to submit this report only to their Chief Executive Officer (“CEO”) or managing partner and Members are required only to prepare, but are not required to submit, the report.

<sup>3</sup> In Amendment No. 1, which supplemented the original filing, the Exchange added its proposed Interpretive Handbook Interpretations 342.30(d)/01 and 342.30(e)/01 for purposes of clarifying issues related to the designation of a Chief Compliance Officer and the Annual Certification, respectively. The text of interpretations 342.30(d)/01 and 342.30(e)/01 is available on the NYSE’s Web site (<http://www.NYSE.com>), at the NYSE’s principal office, and at the Commission’s Public Reference Room.

<sup>4</sup> In Amendment No. 2, which supplemented the original filing, the Exchange modified proposed interpretation 342.30(e)/01 in order to clarify the obligations of Members and Member Organizations in the preparation of annual certifications.

<sup>5</sup> See Exchange Act Release No. 52259 (Aug. 15, 2005), 70 FR 48997 (Aug. 22, 2005) (the “Notice”).

<sup>6</sup> See letter from Scott C. Kursman, Senior Vice President & Chief Counsel for Global Compliance, Lehman Brothers, Inc. (“Lehman Letter”), dated September 14, 2005, and letter from John Polanin, Jr., Chairman, SIA Self-Regulation and Supervisory Practices Committee, dated Sept. 14, 2005 (“SIA Letter”).

<sup>7</sup> See letter from Mary Yeager, Assistant Secretary, NYSE, to Catherine McGuire, Chief Counsel, Division of Market Regulation, Commission, dated October 31, 2005.

<sup>8</sup> In Amendment No. 3, which supplemented the original filing, the Exchange amended the proposed rule text to respond to certain of the commenters’ concerns.

##### 2. Provisions of the Proposed Rule Change

The proposed rule change makes the following changes relating to the Annual Reports:

- The Annual Reports must be filed with the Exchange by April 1 of each year.
- The anti-money laundering compliance programs required by Exchange Rule 445<sup>9</sup> have been added to the list of specific areas of compliance that must be discussed in the Annual Reports.
- Member Organizations must designate a principal officer or general partner as Chief Compliance Officer (“CCO”).<sup>10</sup>
- Each Member, and the CEO (or equivalent officer) of each Member Organization, must submit a certification attesting to the adequacy of their organization’s compliance policies and procedures.<sup>11</sup>

##### 3. Regulatory Purpose of Proposed Rule Change’s Provisions

(a) Submission of Annual Reports to the Exchange.

Filing the Annual Reports with the Exchange will provide timely information about the compliance efforts of Members and Member Organizations, thereby strengthening and making more efficient the Exchange’s regulatory oversight, and facilitating the required annual certifications (see below).

Because submission of the Annual Reports to the Exchange was previously not required, the reports were typically provided to the Exchange at the time of, or in connection with, examinations of Member Organizations and Members.<sup>12</sup> Consequently, the Exchange did not always receive important information in a timely, efficient manner. Providing the reports to Exchange staff at annual intervals will afford the Exchange a timely picture of the Members’ and Member Organizations’ compliance issues from the preceding year, a tool for planning surveillance and examinations, and more comprehensive information for evaluation of

<sup>9</sup> NYSE Rule 445 requires Members and Member Organizations to develop and implement written anti-money laundering programs consistent with the Bank Secrecy Act (31 U.S.C. 5311, *et seq.* and 31 CFR 103.120 thereunder).

<sup>10</sup> The Commission recently approved a similar requirement in NASD’s Rule 3013. Securities Exchange Act Release No. 50347 (September 10, 2004), 69 FR 56107 (September 17, 2004) (SR-NASD-2003-176).

<sup>11</sup> The Commission recently approved a similar requirement in NASD’s new Rule 3013. *See id.*

<sup>12</sup> Some Member Organizations already submit the Annual Reports to the Exchange and/or make them available to Exchange examiners.

<sup>15</sup> See Securities Exchange Act Release No. 44139 (March 30, 2001), 66 FR 18339 (April 6, 2001) (approving proposed rule change SR-NYSE-94-34, including Supplementary Material .10 of NYSE Rule 92).

<sup>16</sup> 15 U.S.C. 78s(b)(2).

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

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

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