

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 the filing also will be available for inspection and copying at the principal offices of the NASD. 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 Number SR-NASD-2005-132 and should be submitted on or before January 10, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Jonathan G. Katz,

Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52954; File No. SR-NYSE-2005-87]

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 Thereto Relating to the Pilot to Put Into Operation Phase 1 of the NYSE HYBRID MARKETSM

December 14, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 9, 2005, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in

Items I and II below, which Items have been prepared by the Exchange. On December 13, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice and order to solicit comments on the proposed rule change, as amended, from interested persons and to approve the proposed rule change, as amended, on an accelerated basis.

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

The Exchange is proposing a pilot to put into operation Phase 1 of the NYSE HYBRID MARKETSM ("Hybrid Market") initiative, as proposed in SR-NYSE-2004-05 and amendments thereto ("Hybrid Market filings") with respect to a group of securities trading on the Exchange ("Pilot").⁴ In addition, the Pilot will implement certain system changes discussed in SR-NYSE-2005-57.⁵ This filing sets forth amended rules (previously described in the Hybrid Market filings) which would be operational during the Phase 1 pilot as well as certain new proposals, discussed herein. The text of the proposed rule change is available on NYSE's Web site (<http://www.nyse.co>), at the principal office of the Exchange, and at the Commission's Public Reference Room.

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 the proposed rule change and discussed any comments it received on the proposed rule change. The text of these

³ See Partial Amendment dated December 13, 2005 ("Amendment No. 1"). In Amendment No. 1, the Exchange submitted Exhibit 3 to the proposed rule change, which identified the securities that would be included in the Pilot, and corrected a typographical error.

⁴ See Securities Exchange Act Release No. 50173 (August 10, 2004), 69 FR 50407 (August 16, 2004) (Amendment No. 1 to SR-NYSE-2004-05); Securities Exchange Act Release No. 50667 (November 15, 2004), 69 FR 67980 (November 22, 2004) (Amendment Nos. 2 and 3 to SR-NYSE-2004-05) (The Exchange withdrew Amendment No. 4 and replaced it with Amendment No. 5); Securities Exchange Act Release No. 51906 (June 22, 2005), 70 FR 37463 (June 29, 2005) (Amendment No. 5 to SR-NYSE-2004-05). See also Amendment No. 6 to SR-NYSE-2004-05 (September 16, 2005) and Amendment No. 7 to SR-NYSE-2004-05 (October 10, 2005).

⁵ See Securities Exchange Act Release No. 52362 (August 30, 2005), 70 FR 53701 (September 9, 2005) (SR-NYSE-2005-57). While submitted as effective upon filing, the Exchange intended to implement these changes upon approval of the Hybrid Market filings by the Commission, if such approval is granted.

statements may be examined at the places specified in Item III 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

The Exchange proposes a Pilot to put into operation Phase 1 of the Hybrid Market initiative with respect to a group of securities, known as Phase 1⁶ Pilot securities ("Pilot securities"). The Pilot would commence following Commission approval of the Pilot, during the week of December 12, 2005 and would terminate the earlier of: (1) 90 calendar days from the date of Commission approval, if granted, or (2) Commission approval of the Exchange's Hybrid Market proposal, if granted.

Approximately 200 securities out of the 3,600 securities listed on the Exchange (approximately 5%) have been identified as Pilot securities and are listed on Exhibit 3 of the filing.⁷ In addition, the list of Pilot securities will be posted on the Exchange's Web site.

The Pilot will allow the Exchange to conduct real-time system and user testing of certain features of the Hybrid Market filings in order to be in a position to comply with the implementation of Regulation NMS.⁸

The Exchange believes the Pilot will prove beneficial from both a technology and a training perspective. It will give the Exchange the opportunity to identify and address any system problems and to identify and incorporate beneficial system changes that become apparent as a result of usage in real time and under real market conditions. The ability to have such real time user interface will be invaluable, as it is impossible to accurately anticipate behavioral changes in a development or mock-trading

⁶ See Securities Exchange Act Release No. 51906 (June 22, 2005), 70 FR 37463 (June 29, 2005) (Amendment No. 5 to SR-NYSE-2004-05).

⁷ The NYSE selected the Pilot securities based on the following criteria: (1) Trading location so as to include in the Pilot securities from each room and post on the floor; (2) crowd participation so as to include securities that generally have crowd participation; (3) trading characteristics so as to include securities whose trading characteristics are typically less volatile to minimize the likelihood of disruptions during the systems testing; and (4) specialist firm so as to include each of the equity specialist firms on the floor. The Pilot securities represent approximately 10% of the average daily NYSE trading volume. Telephone call between Nancy Reich Jenkins, NYSE and Kelly Riley, SEC on December 14, 2005.

⁸ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

environment. In addition, the Pilot will allow users to gain essential practical experience with the new systems and processes in a well-modulated way.

The Exchange anticipates that the Pilot will operate with minimal problems given the amount and degree of testing and training that has occurred to date. In addition, the Exchange plans to phase-in the Pilot, if approved, to allow for a controlled and moderated roll out of the new systems and capabilities.⁹

There has been extensive testing of the approximately 15 Exchange systems impacted by the Pilot, individually and collectively, both in development and production environments. This testing occurred at all levels, including development testing, automation testing, SIAC testing, NYSE testing, integrated system testing and code reviews, production environment testing, fall-back and recovery testing, and regression and new functionality testing.

In addition, there has been comprehensive training for both Floor brokers and specialists, individually and together in a mock trading environment. Training was conducted by the Exchange and was supplemented in most cases by firm-specific training conducted by member organizations for their employees. In addition, the Exchange training environment was made available to proprietary system vendors for their training sessions.

Moreover, the Exchange intends to have available at all times during the Pilot two versions of the operating software—the new version that would be operational and the original, pre-Pilot version. If a problem develops during the Pilot, the Exchange will be able to revert to the pre-Pilot software within an average time of two minutes or less.

Accordingly, the Exchange believes that the extensiveness of the testing and training, the phase-in approach and the fall-back capabilities provide significant assurances that the Pilot will operate as expected. However, in the event systems or other problems arise with the Pilot that adversely impact investors or impede the Exchange's ability to maintain a fair and orderly market, the Exchange will immediately terminate the Pilot in whole or in part, as appropriate, and return trading to

⁹The NYSE intends to phase in the Pilot gradually, beginning with a single security on the first day of the Pilot and expanding gradually over the course of four weeks. The timing of the phase-in will be adjusted depending on the extent and significance of any technical or user interface problems that might arise. Telephone call between Nancy Reich Jenkins, NYSE and Kelly Riley, SEC on December 14, 2005.

current operations under current NYSE rules.

Phase 1 Pilot

During the Pilot, the following rules and provisions of the Hybrid Market initiative as outlined in the Hybrid Market filings will be operational. To eliminate possible confusion as to what rule provisions apply to Pilot securities, the Exchange has identified those new or amended rules which will be operational during the Pilot with a "P." Where part of a provision of a proposed Hybrid Market rule will be operational during the Pilot, but another part of the proposed rule will not, the Exchange has noted this in the attached rule text with the designation that the section is "intentionally omitted." In addition, during the Pilot, all other Exchange rules apply to Pilot securities as they do today.

NYSE Direct+® (Exchange Rules 1000–1005)

During the Pilot, NYSE Direct+® ("Direct+") will continue to operate as it does today under current Exchange Rules 1000–1005 and subject to the same availability, restrictions and conditions, as outlined in those rules.

NYSE Floor Broker Agency Interest Files® (Exchange Rule 70.20(a)–(l)(P))

During the Pilot, the Exchange is proposing to activate the Floor broker agency file to permit brokers to enter their interest at or outside the best bid and offer in Pilot securities (also referred to as "e-Quoting"). The following sections of proposed Exchange Rule 70.20, described in the Hybrid Market filings, would apply during the Pilot:

- 70.20(a)(i)(ii)
- 70.20(b)
- 70.20(c)(i)–(iv): Floor brokers will

be able to populate the reserve file but it will be *visible* to the specialist in this phase

- 70.20(e)
- 70.20(f)
- 70.20(i)–(l)
- 70.30

During the Pilot, the following sections of proposed Rule 70.20 would *not* apply:

- Rule 70.20(d)(i)–(ii): Sweep functionality
- Rule 70.20(g)–(h): Feature permitting brokers to exclude their interest from the aggregate information available to the specialist

The above sections that are not applicable during the Pilot are intentionally omitted from the proposed rule text.

In the event that a proprietary vendor system has not been activated or vender

systems or Exchange systems that have been activated otherwise become unavailable, a Floor broker who is unable to enter his or her own Floor broker agency interest has the following options:

(i) Request a specialist to enter the agency interest on behalf of the Floor broker who is unable to enter it for himself or herself;

(ii) Send an order through SuperDot;¹⁰

(iii) Send a CAP–DI order¹¹ to the specialist;

(iv) Trade manually in the Crowd, as is done today;

(v) Ask another Floor broker to represent the order through his or her agency interest file; or

(vi) Send an order for Direct+ execution.

Rule 70.20(f)(P)

The Hybrid Market filings described proposed rule 70.20(f) which requires cancellation of agency interest files when the broker leaves the Crowd. In connection with the Pilot, the Exchange proposes to amend this provision to clarify that a Floor broker may leave the Crowd without canceling his or her agency interest files in order to recharge his or her handheld device. *See* proposed Exchange Rule 70.20(f)(P).

NYSE Specialist Interest FilesSM (Exchange Rule 104(c)(P))

During the Pilot, specialists will be able to manually layer their interest at and outside the best bid and offer, which will give specialists' bids and offers persistent standing (also referred to as s-Quotes). *See* Exchange Rule 104(c)(P). This means that if the specialist bids/offers at a price that is not the best bid/offer, but layers its interest below/above such best bid/offer, the specialist's interest will remain in the specialist interest file and be available to be displayed as the best bid/offer should better bids/offers be exhausted. The Hybrid Market filings discuss the specialists' ability to do this systemically via algorithmically generated messages sent via the NYSE Specialist APISM ("API"). During the Pilot, however, specialists will not be

¹⁰ SuperDot® is an electronic order-routing system used by NYSE member firms to send market and limit orders to the NYSE.

¹¹ *See* Exchange Rule 123A.30. The CAP–DI order guides the specialist to represent the order to ensure that the elected or converted portion goes along with the market, by not initiating a significant price change or lagging behind the market. CAP–DI orders are subject to a number of restrictions intended to minimize the specialist's discretion in handling such orders. Elected and converted CAP–DI orders that are not executed revert to CAP–DI status.

able to use systems employing algorithms to generate messages to bid, offer, or trade via the API. Accordingly, for the purposes of the Pilot, the Exchange is proposing a new rule to provide specialists with the ability to manually layer interest at and outside the Exchange best bid and offer. See proposed Exchange Rule 104(c)(P).

During the Pilot, specialists will not be able to disseminate NYSE Specialist FilesSM via NYSE OPENBOOK[®] or other Exchange data distribution channels.

During the Pilot, specialists will not be able to have systems using algorithms to send messages via the API to layer their interest or to otherwise trade or quote, nor will the specialist's reserve capability be operational. Therefore, proposed Exchange Rules 104(b)-(h) will not be in effect.

Priority, Parity, and Yielding: Exchange Rules 70.20(b)(P), 72(c)-(g)(P), 104.10(6)(i)(C)(P), 108(a)(P)

During the Pilot, the systemic programming of priority, parity and yielding, as proposed by the Hybrid Market filings, other than the yielding requirements for additional specialist interest, will be operational. As a result, the following rules will apply during the Pilot: 70.20(b)(P), 72(c)-(g)(P), 104.10(6)(i)(C)(P), and 108(a)(P).

The most substantive change that will apply to trading in Pilot securities will be that Floor brokers will lose their current ability to object to the specialist trading on parity with their orders unless the specialist is manually trading with them in the Crowd. However, a Floor broker's use of an e-Quote implicitly suggests his or her agreement that the specialist can be on parity with his or her orders. A Floor broker who does not want to permit the specialist to trade on parity with his or her orders may send the order through SuperDot,[®] enter a Direct+ order, or hit a bid/take an offer.

A Floor broker who is manually bidding or offering (*i.e.*, not through his or her agency interest file) will not be able to participate in an execution involving e-Quotes and/or s-Quotes or, as today, in Direct+ executions.

Other Exchange Rules

During the Pilot, the following rules, as amended in the Hybrid Market filings would apply to Pilot securities: Exchange Rules 60(e)(P), 117P, 122P, 123(e)(P), and 132B(a)(D)(P).

Pilot Trading Example

The Exchange quotation is 20.05 bid, offered at 20.07, 3,000 x 300. The bid consists of: 1,000 shares of book

interest, which arrived first and has priority; 1,000 shares of broker agency interest comprised of two brokers' bids for 500 shares each at 20.07, and 1,000 shares of specialist interest. A market order to sell 3,000 shares arrives and trades with the 20.05 bid, as follows: 3,000 shares trade and this is reported by the specialist via the Smart Report Template and the system assigns the contra-parties as follows: 1,000 shares of book interest trade first (priority), and the remaining 2,000 shares are split equally (1,000 shares each) between the floor broker agency interest files and specialist interest file, as they are on parity.

Automatic Execution of CAP-DI Orders and Stop Orders

Currently, when a trade occurs, the Exchange's system notifies the specialist if any CAP-DI or stop orders have been elected by such trade. The specialist has to then determine if there is any liquidity against which the elected orders (or portions thereof) can trade. If so, the specialist manually executes and reports trades involving the elected volume.

The Commission recently published an Exchange filing that provides that elected stop and CAP-DI volume will be automatically executed¹² to the extent that contra-side interest is available to trade with the elected orders.¹³ These executions will be automatically reported, including the relevant information regarding participants to the execution (*See* Exchange Rule 123A.30, discussed below). Elected CAP-DI volume unable to trade will automatically revert to CAP-DI status, and elected stop limit orders unable to trade will become a limit order on the Display Book. Elected stop orders will be executed in the same manner as any market order. The rules regarding the election and execution of CAP-DI and stop orders remain the same. The implementation of this process will commence with the Pilot.

In connection with the Pilot, the Exchange is proposing changes to Rule 76 to clarify that elected stop and stop limit orders are exempt from the requirement that a member expose the order for possible price improvement before crossing it.

In addition, the Exchange is proposing amendments to Rule 13 with respect to stop and stop limit orders. Certain of these changes were proposed in the Hybrid Market filings. With

respect to the Pilot, the Exchange is proposing additional changes to Rule 13 to add language that provides for the possibility of manual representation of stop and stop limit orders in the Crowd.

Converted CAP-DI Orders and Direct+

In addition, commencing with the Pilot, converted CAP-DI orders will be systemically represented to enable them to participate in NYSE Direct+[®] executions under current Rules 1000-1005.¹⁴

Automation of Parity Between Specialist and Elected CAP-DI Orders

Exchange Rule 123A.30 provides that a Floor broker may permit a specialist to trade on parity with CAP-DI orders. The rule currently provides that if a specialist is on parity with one or more CAP-DI orders, at no time may the specialist participate for its own account in an amount in excess of that which each CAP-DI order would receive, except that the specialist may participate for its own account to an extent greater than any particular CAP-DI order where the size specified on such order has been satisfied. A specialist trading on parity with a CAP-DI order remains subject to the limitations in Exchange Rule 104.10 as to transactions for his or her own account effected on destabilizing ticks.

Commencing with the Pilot, the Exchange will systemically ensure that the specialist's participation when trading along with CAP-DI orders is in accordance with the parity requirements of Rule 123A.30. The system will assign the proper number of shares to the specialist and CAP-DI orders. The Exchange filed¹⁵ this change for immediate effectiveness pursuant to Section 19(b)(3)(A) of the Act¹⁶ and Rule 19b-4(f)(5)¹⁷ thereunder.

Automatic Conversions of CAP-DI Orders

Current Exchange Rule 123A.30 also provides that specialists have the ability, subject to certain restrictions noted in the rule, to convert CAP-DI orders to participate in transactions or to bid or offer, without an electing trade.

Proposed Exchange Rule 123A.30(a)(P)¹⁸ provides in part that the elected or converted portion of a "percentage order that is convertible on a destabilizing tick and designated

¹⁴ See *id.*

¹⁵ See *id.*

¹⁶ 15 U.S.C. 78s(b)(3)(A).

¹⁷ 17 CFR 240.19b-4(f)(5).

¹⁸ This rule is parallel to amendments made to Rule 123A.30. See Securities Exchange Act Release No. 51906 (June 22, 2005), 70 FR 37463 (June 29, 2005) (Amendment No. 5 to SR-NYSE-2004-05).

¹² This automatic execution will not be done through NYSE Direct+, but rather a different system. Therefore, such execution is not subject to the volume limitations of the Direct+ rules.

¹³ See *supra* note 5.

immediate execution or cancel election" ("CAP-DI order") may be automatically executed. An elected or converted CAP-DI order on the same side of the market as an automatically executed electing order may participate in a transaction at the bid (offer) price if there is volume associated with the bid (offer) remaining after the electing order is filled in its entirety. An elected or converted CAP-DI order on the contra-side of the market as an automatically executed electing order may participate in a transaction at the bid (offer) price if there is volume remaining in the electing order.

In addition, the Exchange is proposing to add new section (iv)(P) to proposed Exchange Rule 123A.30(a)(P) to provide that when a specialist is bidding or offering and an automatic execution occurs with such bid/offer, marketable CAP-DI orders on the Display Book[®] on the same side as the specialist's interest will be automatically actively converted to participate in this execution, with the system assigning the proper number of shares to the specialist and CAP-DI orders, as discussed above. This will allow CAP-DI orders to better participate in executions.

However, in certain instances, an automatic conversion of marketable CAP-DI orders will not occur even though the specialist is trading for its own account. This will occur where the execution that included automatically converted CAP-DI orders elects a contra-side stop or stop limit order. In this situation, pursuant to current Exchange Rule 123A.40, the specialist, as party to the election of the stop order, owes such elected stop order an execution at the same price as the specialist traded. The execution of such stop orders, in which the specialist is the contra-party, may be manual¹⁹ or automatic,²⁰ depending upon whether any specialist interest remains at the execution price. In either situation, marketable CAP-DI interest at that price will not be automatically converted to participate along with the specialist. However, the specialist will be alerted to the fact there are CAP-DI orders on the Display Book[®] capable of trading so

¹⁹If there is no specialist interest remaining in the bid/offer, and the specialist must guarantee an execution to the stop order at the electing price pursuant to Rule 123A.40, the specialist must do a manual transaction to guarantee that the stop order receives the same price as the specialist.

²⁰If there is specialist interest remaining in the bid/offer and the specialist must guarantee an execution to the stop order at the electing price pursuant to Rule 123A.40, the Display Book system will automatically execute the remaining specialist interest against the elected stop order at the same price the specialist traded.

that he or she can take appropriate action.

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act²¹ in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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, is also designed to support the principles of Section 11A(a)(1) of the Act²² in that it seeks to assure economically efficient execution of securities transactions, make it practicable for brokers to execute investors' orders in the best market and provide an opportunity for investors' orders to be executed without the participation of a dealer.

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

See the SEC's Web site (<http://www.sec.gov>) for the comment letters received on the Hybrid Market initiative and a copy of the Exchange's response to the letters.

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

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. Please include File Number SR-NYSE-2005-87 on the subject line.

²¹ 15 U.S.C. 78f(b)(5).

²² 15 U.S.C. 78k-1(a)(1).

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 Number SR-NYSE-2005-87. This file number should be included on the subject line 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 also will be available for inspection and copying at the principal office of the Exchange. 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 Number SR-NYSE-2005-87 and should be submitted on or before January 10, 2006.

IV. Commission's Finding and Order Granting Accelerated Approval of the Proposed Rule Change

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.²³ Specifically, the Commission finds that approval of the proposed rule change is consistent with Section 6(b)(5) of the Act because the proposal 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.

With this proposed rule change, the Exchange has requested temporary

²³ 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).

approval by the Commission of certain features of its Hybrid Market, so that it may begin live systems testing in a limited group of stocks. According to the Exchange, this Pilot is necessary so that the Exchange can maintain its planned implementation schedule for the Hybrid Market and meet the Regulation NMS compliance dates.²⁴ The Commission recognizes that certain of the processes that NYSE has proposed to begin testing have generated comment in the Hybrid Market filings. The Commission wishes to emphasize that it continues to review the larger Hybrid Market filings, including the processes included in this Pilot.²⁵ The Commission is considering all of the comments submitted in response to the Hybrid Market filings and has not reached a decision on whether they should be approved or disapproved. The Commission, however, believes that due to the limited nature of the Pilot and its short duration, that it is consistent with the Act to allow NYSE to begin testing its new systems with this Pilot.

The NYSE explained in its filing that it has tested these functions extensively but that it needs to test them in an actual trading environment to ensure that they operate as intended. Accordingly, NYSE represented that it does not anticipate any significant problems arising from the Pilot. However, NYSE will immediately terminate the Pilot, in whole or in part, as appropriate, should any systems or other problems arise that adversely impact the protection of investors or impede its ability to maintain a fair and orderly market, and return trading to its current operations under current NYSE rules.²⁶

The Commission finds good cause, pursuant to Section 19(b)(2) of the

²⁴ NYSE has represented that it has proposed the Hybrid Market with the intent that it will entitle NYSE quotations to protection under Rule 611 as well as to comply with its obligations under this rule. The compliance date for certain rules adopted under Regulation NMS is June 29, 2006. 17 CFR 242.611.

²⁵ The Commission notes that the scope of the Pilot is extremely limited. This Pilot is intended to enable NYSE to technologically test certain features of its Hybrid Market proposal. Other significant features of the Hybrid Market proposal, such as the expansion of Direct+ and the ability of specialists to electronically interact with the Display Book, are not included in this Pilot. The NYSE represented that it expects to be able to use the results of the systems testing in evaluating and addressing any technology issues related to its Hybrid Market proposal that become apparent.

²⁶ The Exchange stated that it would be able to revert back to pre-Pilot operations within an average of two minutes or less. The Exchange will notify the public via its Web site if the Pilot is terminated in whole or in part. In addition, the Exchange will notify floor members at the post if the Pilot is terminated in whole or in part.

Act,²⁷ for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice in the **Federal Register**. The Pilot, which as discussed above is limited in scope and duration, will allow the NYSE to conduct real-time system and user testing of certain features of the proposed Hybrid Market. According to NYSE, such testing should be beneficial from both a technology and a training perspective. Although preliminary steps have been taken—the NYSE has provided training for both Floor brokers and specialists, many member organizations also provided firm-specific training for their employees, and proprietary system vendors were able to utilize the NYSE trading environment for their training sessions—the Pilot should give the Exchange the opportunity, in advance of the compliance date of Regulation NMS, to identify and address any system problems with these particular rules under the proposed Hybrid Market. Further, the Pilot should allow users to gain essential practical experience with the new systems and processes. Therefore, the Commission finds that immediate implementation of the Pilot, which is limited in both scope and duration, should permit NYSE to remain on schedule to implement the Hybrid Market filings, if approved by the Commission so that it may meet the Regulation NMS compliance dates.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NYSE-2005-87), as amended, is hereby approved on an accelerated basis until March 14, 2006 or the Commission otherwise acts on the Hybrid Market filings.

By the Commission.

Jonathan G. Katz,

Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52951; File No. SR-NYSE-2004-39]

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving a Proposed Rule Change and Partial Amendment No. 1 To Amend Exchange Rule 431 (Margin Requirements)

December 14, 2005.

I. Introduction

On July 12, 2004, the New York Stock Exchange, Inc. (the “Exchange” or “NYSE”) filed with the Securities and Exchange Commission (“SEC” or the “Commission”) a proposed rule change to amend specified provision of Exchange Rule 431 (margin requirements) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”)² and Rule 19b-4 thereunder.³ On September 29, 2005, the Exchange filed a partial amendment to its proposed rule change.⁴ The proposed rule change, as amended, was published for comment in the **Federal Register** on November 10, 2005.⁵ The Commission received no comments on the proposal.

II. Description

The Exchange has proposed amendments to Rule 431 (margin requirements) that will recognize specific additional complex option spread strategies and set margin requirements commensurate with the risk of such spread strategies. These complex spread strategies are a combination of two or more basic option spreads that are already covered under Exchange Rule 431. In addition, the Exchange has proposed the elimination of the two-dollar standard exercise price interval limitation for listed options and certain terminology with respect to “permitted offsets,” as defined in its Rule. The proposed amendments described below have been developed in conjunction with the Chicago Board Options Exchange (“CBOE”).

A. Complex Option Spreads

As noted, the Exchange has proposed amendments to Rule 431 to recognize

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78a et seq.

³ 17 CFR 240.19b-4.

⁴ SR-NYSE-2004-39: Amendment No. 1. The NYSE, in coordination with the Chicago Board Options Exchange, Incorporated (“CBOE”), filed the partial amendment to conform the complex options spreads strategies to which its rule amendments apply to those of the CBOE.

⁵ See Securities Exchange Act Release No. 52738 (Nov. 4, 2005); 70 FR 68501 (Nov. 10, 2005).

²⁷ 15 U.S.C. 78s(b)(2).