

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54549; File No. SR-NYSEArca-2006-59]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change and Amendment No. 1 Thereto Relating To Adoption of Regulation NMS

September 29, 2006.

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 September 14, 2006, NYSE Arca, Inc., through its wholly owned subsidiary NYSE Arca Equities, Inc. (“NYSE Arca” or the “Exchange”), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) and Rule 19b-4 thereunder,<sup>3</sup> a proposed rule change to amend its rules to conform them to the requirements of Regulation NMS under the Act (“Regulation NMS”).<sup>4</sup> On September 29, 2006, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>5</sup> The proposed rule change, as amended, is described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is approving the proposal on an accelerated basis.

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

NYSE Arca proposes to amend its rules to conform them to the requirements of the Commission’s Regulation NMS,<sup>7</sup> including Rule 611 of Regulation NMS and Rule 610 of Regulation NMS. In addition, the Exchange proposes the adoption of other Regulation NMS order types, to utilize Regulation NMS terms, for example, “Protected Bid,” “Protected Offer” and “Protected Quotation,” and to add an additional term, “Protected Best Bid and Offer” (“PBBO”), which mirrors the concept of the NBBO for Protected Quotes. Finally, the Exchange proposes that this rule filing shall

become effective on February 5, 2007, the Trading Phase Date under Regulation NMS.<sup>8</sup> The text of the proposed rule change is available at the Commission’s Public Reference Room, at the Exchange, and on the Exchange’s Web site at <http://www.nysearca.com>.

#### II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NYSE Arca included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item III below. NYSE Arca 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

NYSE Arca is submitting this rule change to bring its rules into conformity with Regulation NMS.<sup>9</sup> NYSE Arca proposes revisions to and the adoption of certain definitions to conform its rules to Regulation NMS. In addition, Rule 611 of Regulation NMS requires the Exchange to adopt certain order types that the Exchange proposes to begin utilizing upon the Trading Phase Date.

###### a. Trading Features of NYSE Arca and Rule 611 of Regulation NMS

NYSE Arca proposes to adopt certain trading features to conform to

<sup>8</sup> The date the Commission has set for automated trading centers to be in compliance with Rule 611 of Regulation NMS is February 5, 2007 (“Trading Phase Date”). See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038 (May 24, 2006).

<sup>9</sup> On June 9, 2005, the Commission issued its Regulation NMS Release. See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37495 (June 29, 2005). Regulation NMS adopted, among other things, the Order Protection Rule, requiring trading centers to establish, maintain and enforce written policies and procedures reasonably designed to prevent the execution of trades at prices inferior to protected quotations displayed by automated trading centers, subject to applicable exceptions. Regulation NMS also adopted an Access Rule, which: requires fair and non-discriminatory access to quotations; establishes a limit on access fees to harmonize the pricing of quotations across different trading centers; and requires NYSE Arca to adopt, maintain and enforce written rules that prohibit its members from engaging in a pattern or practice of displaying any quotations that lock or cross protected quotations disseminated pursuant to an effective National Market System Plan (“NMS Plan”).

Regulation NMS requirements, including:

###### i. Quotations and Other Regulation NMS Definitions

The Exchange proposes to adopt certain Regulation NMS definitions for quotations such as “Protected Bid,” “Protected Offer,” “Best Protected Bid,” “Best Protected Offer,” and “Protected Quotation.”<sup>10</sup> The Exchange also proposes to add the definition of “Protected Best Bid and Offer” (“PBBO”) to distinguish Protected NBBO quotes in order to satisfy Rule 611 of Regulation NMS. The terms “Protected Bid,” “Protected Offer”<sup>12</sup> and “Protected Quotation”<sup>14</sup> refer to automated quotations in NMS securities<sup>15</sup> that are displayed by “Trading Centers,” disseminated pursuant to an effective national market system plan, and which are the best bid, offer or both bid and offer, respectively, of a national securities exchange or a national securities association.<sup>16</sup> The terms “Best Protected Bid,” “Best Protected Offer” will replace the references to the national best bid and national best offer for all automated quotations, and “Protected Best Bid and Offer” (“PBBO”) will replace the references to the NBBO for all automated quotations.

The Exchange will also utilize the terms “Automated Trading Center,”<sup>18</sup> “Automated Quotation,”<sup>19</sup> and “Manual Quotation”<sup>20</sup> as defined by Regulation NMS.<sup>21</sup> A “Trading Center” includes not only Exchange and SRO trading facilities, but also Automated Trading Systems, exchange and OTC Market Makers and any other broker/dealer that internalizes or crosses orders.<sup>22</sup>

The Exchange also proposes other Regulation NMS terms including “Effective National Market System Plan,” and “Regular Trading Hours,”<sup>23</sup> both of which terms shall have the meanings set forth in Rule 600(b) of Regulation NMS, and “Trade-Through,”<sup>24</sup> which shall mean the

<sup>10</sup> See proposed NYSE Arca Rule 1.1(dd).

<sup>11</sup> See proposed NYSE Arca Rule 1.1(eee).

<sup>12</sup> 17 CFR 242.600(b)(57).

<sup>13</sup> 17 CFR 242.600(b)(57).

<sup>14</sup> 17 CFR 242.600(b)(58).

<sup>15</sup> As defined in Rule 600(b)(3) of Regulation NMS. 17 CFR 242.600(b)(3).

<sup>16</sup> See proposed NYSE Arca Rule 1.1(eee).

<sup>17</sup> See proposed NYSE Arca Rule 1.1(dd).

<sup>18</sup> 17 CFR 242.600(b)(4).

<sup>19</sup> 17 CFR 242.600(b)(3).

<sup>20</sup> 17 CFR 242.600(b)(37).

<sup>21</sup> See proposed NYSE Arca Rule 1.1(eee).

<sup>22</sup> See proposed NYSE Arca Rule 1.1(ggg).

<sup>23</sup> See proposed NYSE Arca Rule 1.1(hhh).

<sup>24</sup> See proposed NYSE Arca Rule 1.1(fff).

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(1).

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

<sup>5</sup> 17 CFR 242.600 *et seq.*

<sup>6</sup> See Form 19b-4 dated September 28, 2006 (“Amendment No. 1”). Amendment No. 1 replaces and supersedes the original filing in its entirety.

<sup>7</sup> 17 CFR 242.600, *et seq.*

purchase or sale of an NMS stock during regular trading hours, either as principal or agent, at a price that is lower than a Protected Bid or higher than a Protected Offer.

#### ii. Order Routing

Consistent with the adoption of the Order Protection Rule, NYSE Arca proposes to clarify how certain of its existing order types will function in the Regulation NMS environment, including the Limit, Inside Limit, Market, Cross, and Q Orders, as explained further below. The Exchange also proposes additional clarity on how Auction functions will work within the Regulation NMS environment. For Inside Limit, Pegged and Market orders, the rules will continue to provide that they shall not be executed outside of the NBBO.<sup>25</sup>

#### Limit Orders

Limit Orders, Reserve Limit Orders, and Discretion Limit Orders, will be routed to Protected Quotations, but not to Manual Quotations. These limit orders may lock, cross, and trade-through a Manual Quotation without a requirement to route away.<sup>26</sup>

Post No Preference (“PNP”) Orders and PNP Directed Orders will never route away and will be posted in the NYSE Arca book if partially executed on the Exchange. PNP Orders may lock, cross or trade-through a Manual Quotation without a requirement to route.<sup>27</sup>

Immediate or Cancel (“IOC”) Orders will never route away. IOC Orders will be permitted to trade-through a Manual Quotation.<sup>28</sup>

NOW Orders if routed away will be routed to Protected Quotations.<sup>29</sup> When eligible, Pegged Limit Orders will be routed to Protected Quotations and Manual Quotations representing (and pegged off of) the NBBO.<sup>30</sup>

Intermarket Sweep Orders with an Immediate-or-Cancel designation (“ISO IOC”) and ISO Post no Preference (“ISO PNP”) Limit Orders will never be routed to either an Automated or Manual Quotation and may lock, cross and trade-through both Manual Quotations and Protected Quotations without routing if the User has complied with proposed NYSE Arca Rule

7.37(e)(3)(C).<sup>31</sup> These orders will require specific tape indicators if executed under the exemptions provided in Rule 611(b) of Regulation NMS.

#### Inside Limit Orders

Inside Limit and Pegged Orders will be routed to Protected Quotations representing the NBBO.<sup>32</sup> PNP Inside Limit and IOC Inside Limit Orders will never be routed to either Automated or Manual Quotations. PNP Inside Limit Orders, however, cannot lock or cross Manual Quotations.<sup>33</sup> NOW Inside Limit Orders will be routed to Protected Quotations.<sup>34</sup>

#### Market Orders

When eligible, Market Orders will be routed to both Automated and Manual Quotations.<sup>35</sup>

#### Cross Orders

Cross Orders, including Cross and Post Orders, will be routed to a Protected Quotation if needed,<sup>36</sup> but each will be identified as an ISO IOC sent to the Protected Quotation market.<sup>37</sup> A Cross Order may trade-through a Manual Quotation without routing.<sup>38</sup> A Cross and Post Order may lock and cross Manual Quotations, and may trade-through Manual Quotations.<sup>39</sup> Unless marked ISO, however, the Cross Order and the Cross and Post Orders may not trade-through Protected Quotations.<sup>40</sup> PNP and IOC Crosses may trade-through Manual Quotations.<sup>41</sup>

#### Q Orders

All Q Orders will never be routed, but each may lock, cross and trade-through Manual Quotations.<sup>42</sup>

#### iii. New Limit Order Types

The Exchange proposes to add new order types that will be consistent with Regulation NMS. The new order types are “Intermarket Sweep Orders” or (“ISO”),<sup>43</sup> which is a limit order for an NMS stock that meets the requirements of Rule 600(b)(30) of Regulation NMS,<sup>44</sup> an “ISO IOC Order,” which contains the

attributes of the ISO order, but which will provide that any remaining balance in the order not executed would be automatically cancelled,<sup>45</sup> an “ISO Order designated as PNP,” which will provide for limit orders that are to be executed in whole or in part at the Exchange, but which may lock and cross and trade-through Manual and Protected Quotations but only if the User has complied with proposed NYSE Arca Rule 7.37(e)(3)(C),<sup>46</sup> “ISO IOC Cross” orders, which may trade-through Protected Quotations,<sup>47</sup> and “ISO PNP Cross and Post” orders, which may trade-through Protected Quotations, and may lock and cross any quotes, but only if the User has complied with proposed NYSE Arca Rule 7.37(e)(3)(C).<sup>48</sup>

#### iv. Auctions

NYSE Arca Rule 7.35 provides for certain Auction sessions, including the Opening, Market Order, Halt and Closing Auctions. For purposes of Regulation NMS, the Exchange will not route orders designated for these Auctions to any away markets. In addition, orders designated for these Auctions may trade-through any away market pursuant to the exemptions in Rule 611 of Regulation NMS,<sup>49</sup> if the transaction that constituted the trade-through was a single-priced opening, reopening, or closing transaction by the trading center. Any trade-through execution will be designated with the appropriate trade modifier as defined by the transaction reporting plans.

#### b. Exceptions to Locking/Crossing and Trade-Throughs

The Exchange proposes specific trade-through restrictions, including how orders are handled at NYSE Arca or transmitted to another Trading Center based upon the Order Protection Rule. The Exchange’s systems will prevent the execution of all or a part of an inbound order if the execution of all or a part of the order would violate the Rule 611 of Regulation NMS. NYSE Arca proposes the following exceptions:

(1) The “Locking Quotation” or “Crossing Quotation”<sup>50</sup> was displayed at a time when the Trading Center displaying the locked or crossed quotation was experiencing a failure, material delay, or malfunction of its systems or equipment.<sup>51</sup> This is known as the “self-help exception,” discussed further below. The term “Crossing

<sup>31</sup> See proposed NYSE Arca Rule 7.37(g)(2) and Proposed NYSE Arca Rule 7.31(w).

<sup>32</sup> See proposed NYSE Arca Rule 7.37(d)(2)(A).

<sup>33</sup> See proposed NYSE Arca Rule 7.31(w).

<sup>34</sup> See proposed NYSE Arca Rule 7.31(v).

<sup>35</sup> See proposed NYSE Arca Rule 7.37(d)(2)(A).

<sup>36</sup> See proposed NYSE Arca Rule 7.31(s)(2).

<sup>37</sup> See proposed NYSE Arca Rule 7.31(s)(6).

<sup>38</sup> See proposed NYSE Arca Rule 7.31(s).

<sup>39</sup> See proposed NYSE Arca Rule 7.31(s)(3).

<sup>40</sup> See proposed NYSE Arca Rule 7.31(s)(3) and (4).

<sup>41</sup> See proposed NYSE Arca Rule 7.31(s)(4).

<sup>42</sup> See proposed NYSE Arca Rule 7.31(k).

<sup>43</sup> See proposed NYSE Arca Rule 7.31(jj).

<sup>44</sup> 17 CFR 242.600(b)(3).

<sup>45</sup> See proposed NYSE Arca Rule 7.37(g)(2).

<sup>46</sup> See proposed NYSE Arca Rule 7.31(w).

<sup>47</sup> See proposed NYSE Arca Rule 7.31(s)(5)(A).

<sup>48</sup> See proposed NYSE Arca Rule 7.31(s)(5)(B).

<sup>49</sup> See proposed NYSE Arca Rule 7.35(h).

<sup>50</sup> See proposed NYSE Arca Rule 7.37(e).

<sup>51</sup> See proposed NYSE Arca Rule 7.37(e)(3)(A).

<sup>25</sup> See NYSE Arca Rules 7.31(a), (d) and (cc).

<sup>26</sup> See proposed NYSE Arca Rule 7.31(b)(1); proposed NYSE Arca Rule 7.31(h)(3)(C); and proposed NYSE Arca Rule 7.31(h)(2)(B).

<sup>27</sup> See proposed NYSE Arca Rule 7.31(w).

<sup>28</sup> See proposed NYSE Arca Rule 7.31(e)(3).

<sup>29</sup> See proposed NYSE Arca Rule 7.31(v).

<sup>30</sup> See proposed NYSE Arca Rule 7.37.

Quotation”<sup>52</sup> will be defined as the display of a bid for an NMS stock during regular trading hours at a price that is higher than the displayed offer for such NMS stock previously disseminated pursuant to an effective national market system plan, or the display of an offer for an NMS stock during regular trading hours at a price that is lower than the displayed price of a bid for such NMS stock previously disseminated pursuant to an effective national market system plan. The term “Locking Quotation”<sup>53</sup> will be defined as the display of a bid for an NMS stock during regular trading hours at a price that equals the displayed price of an offer for such NMS stock previously disseminated pursuant to an effective national market system plan, or the display of an offer for an NMS stock during regular trading hours at a price that equals the displayed price of a bid for such NMS stock previously disseminated pursuant to an effective national market system plan.

(2) The Crossing Quotation was displayed at a time when a Protected Bid was higher than a Protected Offer in the NMS stock.<sup>54</sup>

(3) The Locking or Crossing Quotation was an Automated Quotation, and the User of the Exchange displaying such Automated Quotation simultaneously routed an ISO to execute against the full displayed size of any locked or crossed Protected Quotation.<sup>55</sup>

NYSE Arca believes that its disseminated quotations would constitute Automated Quotations under the definition set out in Rule 600(b)(3) of Regulation NMS,<sup>56</sup> and for that reason has not submitted rules regarding Manual Quotations of its participants.

<sup>52</sup> See proposed NYSE Arca Rule 7.37(e)(1)(A).

<sup>53</sup> See proposed NYSE Arca Rule 7.37(e)(1)(B).

<sup>54</sup> See proposed NYSE Arca Rule 7.37(e)(3)(B).

<sup>55</sup> See proposed NYSE Arca Rule 7.37(e)(3)(C).

<sup>56</sup> The definition of automated trading center in Rule 600(b)(4) of Regulation NMS, 17 CFR 242.600(b)(4), requires, among other things, that a trading center (1) implement such systems, procedures and rules as are necessary to render it capable of meeting the requirements for automated quotations, as defined in Rule 600(b)(3) of Regulation NMS, 17 CFR 242.600(b)(3); and (2) immediately identify its quotations as manual whenever it has reason to believe it is not capable of displaying automated quotations. The definition of automated quotation requires, among other things, that a trading center provide an immediate response to incoming IOC orders and immediately update its quotations. NYSE Arca is designed to accept IOC orders, to immediately and automatically execute an IOC order against the displayed BBO up to its full size; to immediately and automatically cancel any unexecuted portion of the IOC order without routing the order elsewhere; to immediately and automatically transmit a response to the order-sending participant indicating the action taken on the order; and to immediately and automatically update the BBO to reflect any change that occurred as a result of the execution.

#### i. Additional Exceptions Self Help

The Exchange proposes to utilize the “self-help” exception to any trade-through of a Protected Quotation displayed by a Trading Center that is experiencing a failure, material delay, or malfunction of its systems or equipment.<sup>57</sup> The Exchange will be able to ignore another Trading Center’s bid and offer if the other Trading Center has repeatedly failed to respond within one second to an incoming IOC order after adjusting for order transmission time. In these instances, Protected Quotations may be bypassed by: (a) notifying the non-responding Trading Center immediately after (or at the same time as) electing self-help;<sup>58</sup> (b) assessing whether the cause of the problem lies with the Exchange’s own systems and, if so, taking immediate steps to resolve the problem; and (c) developing objective parameters for monitoring and utilizing this exception.

For purposes of utilizing self-help when effecting a trade-through of a Protected Quotation displayed by a Trading Center, NYSE Arca proposes to use mechanisms such as e-mail or other mechanisms that may be determined between Trading Centers. Generally, the NYSE Arca Systems procedures will allow for the disregard of Protected Quotations of a market against which the Exchange has elected self-help, and all trades executed under this exception will be marked with the appropriate identifier specified by the relevant NMS Plan.

Should NYSE Arca determine that the problem lies within its own system or with its connection to the other Trading Center, NYSE Arca shall no longer rely on the self-help exception and shall notify the other Trading Center that the Exchange is no longer claiming the exception.<sup>59</sup>

#### Intermarket Sweep Order Exception

The Exchange proposes to add new a new rule to provide that ISOs may, by their definition, trade-through Protected Quotations when the Exchange has simultaneously routed an ISO to execute against the full displayed size of that Protected Quotation.<sup>60</sup> NYSE Arca will accept ISO orders to be executed against orders at the Exchange’s Protected Quotation without regard to whether the execution will trade-through another market’s Protected Quotation under the assumption that the ISO being routed

<sup>57</sup> See proposed NYSE Arca Rule 7.37(f)(1).

<sup>58</sup> See proposed NYSE Arca Rule 7.37(f)(1)(A).

<sup>59</sup> See proposed NYSE Arca Rule 7.37(f)(1)(B).

<sup>60</sup> See proposed NYSE Arca Rule 7.37(g)(1).

has already satisfied the Protected Quotations of other Trading Centers. The NYSE Arca System may also lock or cross an away Protected Quotation if the System has first routed an order to that quotation and all better priced quotations for their full displayed size.

The Exchange proposes to add a new rule to provide that if an ISO is marked as “immediate or cancel,” any remaining balance in the order will be automatically cancelled.<sup>61</sup> If an ISO is not marked as “immediate or cancel,” any remaining balance in the order would be displayed by the Exchange without regard to whether that display would lock or cross another market center, only if the participant routing the order has already sent an order to satisfy the quotations of other markets so that the display of the order would not lock or cross those markets.

#### Single-Price Openings, Reopenings, and Closing Transactions

The Exchange proposes to add a new rule to provide that a transaction that constituted the trade-through is excepted from the Order Protection Rule if it was a single-priced opening, reopening, or closing transaction by the Exchange.<sup>62</sup> NYSE Arca will conduct a formalized and transparent process for executing orders during reopening after a trading halt that involves the queuing and ultimate execution of multiple orders at a single equilibrium price.<sup>63</sup>

#### Benchmark Trades

The Exchange proposes to add a new rule to provide for the execution of volume-weighted average price (“VWAP”) orders, as well as other types of orders that are not priced with reference to the quoted price of the NMS stock at the time of execution and for which the material terms were not reasonably available at the time the commitment to execute the order was made. Benchmark Trades will not be allowed to trade-through the NYSE Arca Book.<sup>64</sup>

#### Stopped Orders

The Exchange proposes to add a new rule to provide that an exception for stopped orders will apply when the price of the execution of the stopped order was lower (for a buy order) than the best Protected Bid at the time of execution, or was higher (for a sell order) than the best Protected Offer at the time of execution. This exception is contingent upon the User having agreed

<sup>61</sup> See proposed NYSE Arca Rule 7.37(g)(2).

<sup>62</sup> See proposed NYSE Arca Rule 7.37(g)(3).

<sup>63</sup> See proposed NYSE Arca Rule 7.35(f).

<sup>64</sup> See proposed NYSE Arca Rule 7.37(g)(4).

to the stop price for each order. Stopped Orders will not be allowed to trade-through the NYSE Arca Book.<sup>65</sup>

#### Transactions Other Than “Regular-Way” Contracts

The Exchange proposes to add a new rule to provide that transactions that are executed other than pursuant to standardized terms and conditions, such as transactions that have extended settlement terms, also are excepted from the Order Protection Rule.<sup>66</sup>

#### ii. Exemptions from 611(d) of Regulation NMS

The Commission exempted from the provisions of Rule 611 of Regulation NMS trade-throughs<sup>67</sup> caused by the execution of an order involving one or more NMS stocks that are components of a qualified contingent trade.<sup>68</sup> The Exchange therefore proposes to adopt that same exemption as a part of its Rules.

#### c. Locked/Crossed Markets

In order to satisfy NMS restrictions on locked and crossed markets, NYSE Arca has proposed additional rules regarding Crossing Quotations and Locking Quotations. The Exchange addresses intentional locks/crosses by requiring that all locks/crosses of Protected Quotations be reasonably avoided, and prohibiting a pattern or practice of displaying any quotations that lock or cross a Protected Quotation pursuant to an effective national market system plan. There is no restriction on the display of automated quotations that lock or cross Manual Quotations. Inevitably, unintentional locks/crosses will continue to occur even after adoption of the Rule, often because of rapid updating of quotations in active stocks.

#### 2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act,<sup>69</sup> in general, and furthers the objectives of Section 6(b)(5)<sup>70</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the

mechanisms of a free and open market and a national market system.

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

The Exchange does not believe that the proposed rule change 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

Written comments on the proposed rule change were neither solicited nor received.

#### III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the proposed rule change, as amended, 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](mailto:rule-comments@sec.gov). Please include File Number SR–NYSEArca–2006–59 on the subject line.

##### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSEArca–2006–59. 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 the filing also will be available for inspection and copying at

the principal office of NYSE Arca. 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–NYSEArca–2006–59 and should be submitted on or before October 27, 2006.

#### IV. Discussion of Commission Findings and Order Granting Accelerated Approval of Proposed Rule Change

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 and, in particular, the requirements of Section 6 of the Act<sup>71</sup> and the rules and regulations thereunder applicable to a national securities exchange.<sup>72</sup> The Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act<sup>73</sup> in that it is designed to prevent fraudulent and manipulative acts and practices, 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.

Pursuant to Section 19(b)(2) of the Act,<sup>74</sup> the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing. As set forth below, the Commission finds good cause for approving the proposed rule change prior to the thirtieth day after publishing notice thereof in the **Federal Register** pursuant to Section 19(b)(2) of the Act.<sup>75</sup> The proposed amendments to NYSE Arca’s rules are substantially similar to rules of other exchanges that were designed to comply with Regulation NMS and have been published for comment and approved by the Commission.<sup>76</sup> In this regard, as

<sup>71</sup> 15 U.S.C. 78f.

<sup>72</sup> In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>73</sup> 15 U.S.C. 78f(b)(5).

<sup>74</sup> 15 U.S.C. 78s(b)(2).

<sup>75</sup> *Id.*

<sup>76</sup> See Securities Exchange Act Release No. 54391 (August 31, 2006), 71 FR 52836 (September 7, 2006) (SR–NSX–2006–08); Securities Exchange Act Release No. 54155 (July 14, 2006), 71 FR 41291 (July 20, 2006) (SR–NASDAQ–2006–01); and

<sup>65</sup> See proposed NYSE Arca Rule 7.37(g)(5).

<sup>66</sup> See proposed NYSE Arca Rule 7.37(g)(6).

<sup>67</sup> 17 CFR 242.611(d).

<sup>68</sup> See Securities Exchange Act Release No. 34–54389 (August 31, 2006).

<sup>69</sup> 15 U.S.C. 78f(b).

<sup>70</sup> 15 U.S.C. 78f(b)(5).

discussed more fully below, the Commission believes that accelerating approval of these rules is appropriate because the proposed rule changes do not raise any new or novel issues and that such action is necessary for the maintenance of fair and orderly markets and the protection of investors, in that it will help ensure timely compliance with Regulation NMS.

#### A. Order Types, Routing and Execution

NYSE Arca has proposed to revise its rules governing order types and modifiers, order routing and order execution<sup>77</sup> to comply with the requirements of Regulation NMS, and specifically, to prevent trade-throughs in accordance with the Rule 611 of Regulation NMS<sup>78</sup> and to avoid locked and crossed markets. In addition, NYSE Arca's rules assume that its disseminated quotations will constitute automated quotations under Rule 600(b)(3) of Regulation NMS.<sup>79</sup>

NYSE Arca has proposed to implement routing options that it believes are consistent with Rules 610 and 611 of Regulation NMS.<sup>80</sup> Specifically, the Commission notes that NYSE Arca represents that its systems will prevent the execution of all or part of an inbound order if the execution of all or part of the order would violate Rule 611 of Regulation NMS.<sup>81</sup> The Commission notes that the proposed NYSE Arca rules would provide exceptions to the general prohibition on trade-throughs consistent with Rule 611(b) of Regulation NMS. For example, these proposed amendments would include permitting users to designate orders meeting the requirement of Rule 600(b)(30) of Regulation NMS<sup>82</sup> as intermarket sweep orders and accepting intermarket sweep orders, which would allow orders so designated to be automatically matched and executed without reference to protected quotations at other trading centers.<sup>83</sup> In

addition, the Commission notes that the proposed NYSE Arca rules would permit use of the "self help" exception under Rule 611(b)(1) of Regulation NMS<sup>84</sup> when another trading center is experiencing a failure, material delay, or malfunction of its systems or equipment.<sup>85</sup> The proposed rules include policies and procedures for communicating to other trading centers about such a situation.<sup>86</sup> The Commission notes that these proposed exceptions to Rule 611 of Regulation NMS comply with the requirements of Regulation NMS.<sup>87</sup> The Commission further notes that, pursuant to the proposed changes to NYSE Arca Rule 7.40, any executions in the NYSE Arca Marketplace that occur through a protected quotation shall be marked with the appropriate designation as defined by the transaction reporting plans.<sup>88</sup> Finally, the Commission notes that the proposed rules are designed to prohibit locked and crossed markets.<sup>89</sup>

The Commission finds that these proposed changes are consistent with the Act. The Commission also finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the **Federal Register**. The Commission believes that the proposed amendments to NYSE Arca's rules governing order types, routing and execution are designed to comply with Regulation NMS and are substantially similar to rules of other exchanges that were designed to comply with Regulation NMS and that have been published for comment and approved by the Commission.<sup>90</sup> The Commission believes, therefore, that the proposed rule changes do not raise new regulatory issues.

#### B. Definitions and Technical Changes

NYSE Arca proposes to amend certain of its defined terms to make them consistent with Regulation NMS and to add other defined terms consistent with Regulation NMS.<sup>91</sup> In particular, the Commission notes that NYSE Arca proposes to adopt definitions for NMS Stock, Protected Bid, Protected Offer, Protected Quotation, Trade-Through, Trading Center, Effective National

Market System Plan and Regular Trading Hours that are intended to be consistent with Regulation NMS and necessary for NYSE Arca's other proposed rule changes that are designed to enable the Exchange to comply with Regulation NMS.<sup>92</sup> Further, NYSE Arca proposes to make other technical, non-substantive changes, such as renumbering its rule sections, that are consistent with the other changes proposed in this filing. The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the **Federal Register**. The Commission believes that these rules are appropriate and consistent with the Act, and that accelerating approval of these rules is appropriate because they do not raise any new regulatory issues.

#### C. Compliance Dates and Effectiveness of Proposed Rules

The Exchange represents that the purpose of this proposed rule change is to bring its rules into conformity with Regulation NMS.<sup>93</sup> The Commission notes that February 5, 2007 is the Trading Phase Date and the final date for full operation of Regulation NMS-compliance trading systems of all automated trading centers, including SRO trading facilities that intend to qualify their quotations for trade-through protection under Rule 611 of Regulation NMS during the Pilot Stock Phase and All Stock Phase.<sup>94</sup> The Commission also notes that the Exchange proposes to implement these proposed rules on the Trading Phase Date.<sup>95</sup> The Commission further finds good cause to accelerate approval of these proposed rule changes prior to the thirtieth day after publication in the **Federal Register**, because the Commission believes that doing so should help to ensure that the appropriate NYSE Arca rules are in place at the time that Regulation NMS compliance is required.

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and finds that good cause exists to accelerate approval of the proposed rule change, pursuant to Section 19(b)(2) of the Act.<sup>96</sup>

Securities Exchange Act Release No. 54528 (September 28, 2006) (SR-ISE-2006-48).

<sup>77</sup> See proposed changes to NYSE Arca Rules 7.31 and 7.37.

<sup>78</sup> 17 CFR 242.611.

<sup>79</sup> 17 CFR 242.600(b)(3). See note 56, *infra*, and accompanying text.

<sup>80</sup> See proposed changes to NYSE Arca Rules 7.31, 7.35 and 7.37. For NYSE Arca's proposed exceptions see proposed NYSE Arca Rules 7.35(f), 7.37(e)(3), 7.37(f)(1), 7.37(g) and 7.37(h).

<sup>81</sup> See Section II.A.1.b., *infra*. The Commission notes that, in general, proposed NYSE Arca Rule 7.37 will require that, for an execution to occur on NYSE Arca the price must be equal to or better than (1) the PBBO, in the case of a Limit Order or a Q Order or (2) the NBBO, in the case of an Inside Limit Order, a Pegged Order, or a Market Order.

<sup>82</sup> 17 CFR 242.600(b)(30).

<sup>83</sup> See proposed NYSE Arca Rule 7.37(g). See also proposed NYSE Arca Rules 7.37(b)(2)(B)(iii) and 7.31(gg).

<sup>84</sup> 17 CFR 242.611(b).

<sup>85</sup> See proposed NYSE Arca Rule 7.37(f) and Section II.A.1.i.(Self Help), *infra*.

<sup>86</sup> See proposed NYSE Arca Rule 7.37(f)(1)(A)-(B). See also Section II.A.1.b.1., *infra*, for a discussion of the policies and procedures that NYSE Arca will utilize.

<sup>87</sup> See 17 CFR 242.611. See also Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006).

<sup>88</sup> See proposed NYSE Arca Rule 7.40.

<sup>89</sup> See proposed NYSE Arca Rule 7.37(e).

<sup>90</sup> See note 76, *infra*, and accompanying text.

<sup>91</sup> See proposed changes to NYSE Arca Rule 1.1.

<sup>92</sup> See note 9, *infra*.

<sup>93</sup> See Sections I and II.A.1., *infra*.

<sup>94</sup> Securities Exchange Act Release No. 58329 (May 18, 2006), 71 FR 30038 (May 24, 2006). See *supra* note 8.

<sup>95</sup> See Section I, *infra*.

<sup>96</sup> 15 U.S.C. 78s(b)(1).

## VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>97</sup> that the proposed rule change (File No. SR-NYSEArca-2006-59), as amended by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,<sup>98</sup>

Nancy M. Morris,  
Secretary.

[FR Doc. E6-16582 Filed 10-5-06; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54538; File No. SR-Phlx-2006-43]

### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving a Proposed Rule Change and Amendment Nos. 1 and 2 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 Thereto Relating to the Exchange's New Equity Trading System, XLE

September 28, 2006.

#### I. Introduction

On July 13, 2006, the Philadelphia Stock Exchange, Inc. ("Phlx" 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 to amend its rules to implement a new trading model for equity securities that provides the opportunity for automated executions to occur within a central matching system accessible by Exchange members and member organizations and their Sponsored Participants, as defined below. On August 14, 2006, the Exchange filed Amendment No. 1 to the proposed rule change. On August 16, 2006, the Exchange filed Amendment No. 2 to the proposed rule change. The proposed rule change, as amended, was published for comment in the **Federal Register** on August 25, 2006.<sup>3</sup> The Commission received two comment letters on the proposal, as amended.<sup>4</sup> On

September 22, 2006, the Exchange filed Amendment No. 3 to the proposed rule change.<sup>5</sup>

This order approves the proposed rule change as amended by Amendment Nos. 1 and 2. Simultaneously, the Commission is providing notice of filing of Amendment No. 3 and is granting accelerated approval of Amendment No. 3.

#### II. Description

The Exchange proposes to amend its rules to implement a new market structure and trading model for equity securities. Specifically, the Exchange proposes to adopt a fully-automated equities trading system, referred to as "XLE," through which automated executions will occur within a central matching system. With the introduction of this new automated, order-driven system, the Exchange no longer will continue to operate a physical equities trading floor, nor will it operate its automated Philadelphia Stock Exchange Automated Communication and Execution ("PACE") System through which Phlx member organizations currently can send orders to the Exchange electronically.<sup>6</sup>

dated September 5, 2006; and Letter from Joseph D. Carapico, PennMont Securities to C. Robert Paul, Chief Counsel, Phlx, dated September 13, 2006 ("Second PennMont Letter"). See also Letter from C. Robert Paul, Executive Vice President and General Counsel, Phlx, to Nancy M. Morris, Secretary, Commission, dated September 20, 2006 (responding to the two comment letters) ("Phlx Response Letter").

<sup>5</sup> The text of Amendment No. 3 is available on Phlx's Web site (<http://www.phlx.com>), at the principal office of Phlx, and at the Commission's Public Reference Room. In Amendment No. 3, the Exchange made several technical, non-substantive changes to the proposed rule text. In addition, the Exchange added text to proposed Phlx Rule 188 regarding trade identifiers; relocated the self-help provision from proposed Phlx Rule 1(cc) to proposed Phlx Rule 185(h); added text to proposed Phlx Rule 185(b)(3) to clarify the operation of Pegged Orders; and amended the terminology in proposed Phlx Rule 163 from "Exchange Official" to "Equity Exchange Official." Further, the Exchange proposes to allow floor members and member organizations who become XLE participants to remain in their current space on the Exchange's floor, paying the applicable space rental fees, for a short time while they transition to XLE. The Exchange also announced its intent to request relief from the applicable provisions of the ITS Plan to allow the Exchange to implement ISO Orders and IOC Cross Orders marked ISO, as well as orders marked "Benchmark," before the February 5, 2007 "Trading Phase Date" for Regulation NMS (*i.e.*, the operative date for Regulation NMS-compliant systems that intend to qualify their quotations for trade-through protection under Rule 611 of Regulation NMS during the Pilot Stocks Phase and All Stocks Phase).

<sup>6</sup> Since the Exchange proposes to operate XLE in lieu of trading on its physical equities trading floor, in addition to proposing new and amended rules to implement XLE, the Exchange also proposes to modify or delete several Phlx By-laws and various Phlx Rules that relate to floor trading. The Exchange

XLE will accept orders in NMS Stocks<sup>7</sup> that are traded on the Exchange (which, as proposed, will include Nasdaq-listed securities)<sup>8</sup> from Exchange members and member organizations, and their Sponsored Participants and their Participant Authorized Users (collectively, "XLE Participants") and will display, route, and execute those orders automatically pursuant to non-discretionary algorithms codified in the proposed Phlx Rules. Orders will be ranked on XLE in price-time priority regardless of the identity of the entering XLE Participant, and executions will occur automatically and immediately upon order entry if trading interest is available on the system. The Exchange also will provide an optional routing service for those orders eligible for routing for which trading interest is not present on XLE.<sup>9</sup>

With its new equities trading platform, the Exchange no longer will accommodate equity specialists. However, the Exchange proposes to allow its member organizations to register as Market Makers<sup>10</sup> on XLE, and those Market Makers could then choose to register in one or more securities that are traded on XLE. Since Market Maker registration will be optional, an NMS Stock may trade on XLE without a Market Maker. Once registered in a particular security, a Market Maker will be required to maintain continuous Limit Orders on both sides of the market in that security during the Core Session

also proposes to delete various outdated Phlx Rules that relate, for example, to the delivery and settlement of securities. The Commission notes that upon approval, unless otherwise specified, the proposed rule changes will be effective, but not operative, until the Exchange discontinues its physical equities trading floor and commences operation of XLE, as described in Section II.

<sup>7</sup> See proposed Phlx Rule 1(t). See also 17 CFR 242.600(b)(47). The term "NMS Stock" means any NMS security other than an option. "NMS security" is defined in Rule 600(b)(46) of Regulation NMS under the Act to mean any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan. See 17 CFR 242.600(b)(46).

<sup>8</sup> Unlike its current equities floor, where Phlx does not trade Nasdaq-listed securities, the Exchange proposes to allow XLE to trade Nasdaq-listed securities, in addition to securities listed on other national securities exchanges, pursuant to unlisted trading privileges.

<sup>9</sup> The Routing Agreement will allow the routing broker-dealer to act for the XLE Participant if the XLE Participant or its Sponsored Participant enters an order-type that is routable. As proposed, no XLE Participant will be able to enter a Limit Order or Reserve Order without "Do Not Route" instructions, or a Single Sweep Order, unless the XLE Participant or the XLE Participant's Sponsoring Member Organization has entered into a Routing Agreement. See proposed Phlx Rule 181.

<sup>10</sup> See proposed Phlx Rule 1(l).

<sup>97</sup> *Id.*

<sup>98</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.

<sup>3</sup> See Securities Exchange Act Release No. 54329 (August 17, 2006), 71 FR 50482 (August 25, 2006) ("Notice").

<sup>4</sup> See Letter from Joseph D. Carapico, PennMont Securities to C. Robert Paul, Chief Counsel, Phlx,