

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-58184; File No. SR-NYSE-2008-46]

Self-Regulatory Organizations; New York Stock Exchange, LLC; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, To Create a New NYSE Market Model, With Certain Components To Operate as a One-Year Pilot That Will Provide Market Participants With Additional Abilities To Post Hidden Liquidity, Phase Out Specialists by Creating a Designated Market Maker, and Enhance the Speed of Execution Through Technological Enhancements

July 17, 2008.

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 June 12, 2008, the New York Stock Exchange, LLC (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On July 15, 2008, the Exchange filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to establish a new market model (“New Model”) to: (i) Provide market participants with additional abilities to post hidden liquidity on Exchange systems; (ii) create a Designated Market Maker (“DMM”), and phase out the NYSE specialist; and (iii) enhance the speed of execution through technological enhancements and a reduction in message traffic between Exchange systems and its DMMs.

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 included statements concerning the purpose of, and basis for, the proposed rule change. The text of these statements may be examined at the places specified in Item IV 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

With this rule filing, the Exchange is proposing to transform its market structure and create the premier venue for price discovery, liquidity, competitive quotes and price improvement. The instant proposal is the core filing of a series of rule amendments³ submitted by the Exchange designed to move its market structure forward in a very dynamic and competitive marketplace. For example, in April 2008, the Exchange expanded to all market participants the ability to enter both displayed and non-displayed (reserve) trading interest in NYSE’s Display Book® (“Display Book”). Another important aspect of the New Model will be enhancements to technology that will greatly increase the speed of execution. The key elements of this filing are: (1) The Redefinition of the Role of the Specialist and (2) Priority and Parity.

Historically, the specialist was responsible for execution of all orders coming into the Exchange, conducting auctions on the Floor, and for maintaining an orderly market in assigned securities. To assist in this function, the specialist had an order-by-order advance “look” at activity in the Display Book. When the Exchange implemented its NYSE HYBRID MARKETSM (“Hybrid Market”),⁴ Exchange systems assumed the function of matching and executing orders entered electronically, although the specialist retained a first “look” at incoming orders. The proposed rules redesign the role of the specialist to reflect more accurately the market making function in the Hybrid Market environment by creating a new category of market participant, DMM, and to eliminate the “specialist” category.

In the New Model, DMMs will no longer function (as the specialist did) as the “broker-dealer of record” for every order. The DMM will not “hold” orders. Like specialists today, DMMs will be

³ See SR-NYSE-2008-45, filed with the Commission on June 11, 2008 (proposal to amend NYSE Rule 98 to redefine Specialist Operations at the NYSE); see also e-mail from Deanna G.W. Logan, Associate General Counsel, NYSE to David Liu, Assistant Director, Division of Trading and Markets (“Division”), Commission, dated July 17, 2008 (making clarifying edits) (“July 17th e-mail”).

⁴ See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006) (SR-NYSE-2004-05).

able to generate orders through a DMM algorithm that interacts directly with the Display Book. However, in the New Model, DMMs will be able to commit additional liquidity in advance to fill incoming orders (“Capital Commitment Schedule” or “CCS”). The CCS will create a liquidity schedule at various price points where the DMM is willing to interact with interest and provide price improvement to orders in the Exchange’s system.

The DMM will have affirmative responsibilities to the Exchange’s marketplace (including an obligation to provide quotes at the National Best Bid and Offer (“NBBO”). Balancing that equation of increased market-making capabilities against affirmative responsibilities, the DMM will be given more freedom to manage trading risks associated with their responsibilities to the NYSE market.

As part of the redesign of its market, the NYSE proposes to amend the logic related to share distribution among market participants having trading interest at a price point upon execution of incoming orders to create a model that rewards displayed orders that establish the NYSE’s best bid or Exchange best offer (collectively “Exchange BBO”⁵). In the proposed New Model, orders or portions thereof that establish priority, as more fully described below, will retain that priority until the portion of the order that established priority is exhausted. Where no one order has established priority, shares will be distributed among all market participants on parity.

In this filing, the Exchange first describes the market model as it currently exists and then describes the rules which implement the New Model and any other required conforming rule amendments.

The NYSE intends to implement these changes in a phased approach during third and fourth quarters of 2008.

Current Exchange Market

(a) Overview and Background

On March 22, 2006, the Commission approved amendments to Exchange rules to establish the Hybrid Market. The Hybrid Market integrates in one marketplace the best of both auction market and electronic trading. The goal of the Hybrid Market was to combine the benefits of specialist and Floor broker expertise with the speed,

⁵ The term “Exchange BBO” refers to the best bid or the best offer on the NYSE. It should not be confused with the defined terms “national best bid” and “national best offer” as defined in Rule 600(b)(42) of Regulation NMS Rule 242.600(b)(42) under the Act.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

certainty, and anonymity of electronic execution. It was designed to offer maximum choice to customers in how to execute orders, while preserving traditional trading procedures that historically served to provide stable, liquid, and less volatile markets.

The Exchange continually reviews the operation of its market, changes in the behavior of market participants and the general environment of the securities markets in order to find ways to improve the quality and competitiveness of its market. As a result of this review, the Exchange introduced a number of enhancements to its Hybrid Market aimed at improving the trading experience for market participants.⁶

Today on the Exchange, customers who want execution speed and certainty, with anonymity, can enter a variety of order types into Exchange systems that will result in immediate and automatic executions and/or price improvement for some or all of the order. Alternatively, customers who value Floor broker expertise in the

handling of their orders can submit orders for execution in the traditional auction process and/or participate electronically in automatic executions through Floor broker agency interest files ("e-Quotes"). Specialists on the Floor, meanwhile, have been given tools with which to offer additional opportunities for price improvement; these tools include various targeted quoting or trading messages based on the state of the specialist's book and the market, including the ability to match better prices of away market centers. In this way, a customer sending his or her order to the Exchange today benefits from an expanded experience of execution opportunities.

(b) Exchange Systems

All orders entered into Exchange systems are maintained in the Display Book. Autoquote is a part of the Display Book that immediately displays customer limit orders received on the Exchange.⁷ Autoquote immediately updates the Exchange BBO when a new order improves the Exchange quote.⁸ In addition, Autoquote updates the Exchange BBO when an execution occurs to reflect a new Exchange BBO based on the orders contained in the Display Book. Pursuant to Exchange Rule 60, Autoquote is suspended when: (1) The specialist manually reports a block size transaction that involves orders in the Display Book system; (2) the specialist gaps the quote;⁹ or (3) when a Liquidity Replenishment Point ("LRP") is reached.¹⁰ When Autoquote is suspended due to a manual report of a block trade that involves orders in the

Display Book,¹¹ Autoquote resumes when the manual reporting is concluded.¹² When Autoquote is suspended following a gap quote, Autoquote resumes upon the report of a manual transaction or the publication of a non-gapped quotation.¹³ When Autoquote is suspended because an LRP has been reached, it resumes in no more than five seconds after the LRP is reached.¹⁴ If the order that triggers the LRP is capable of trading at a price beyond the LRP price, and would not create a locked or crossed market if quoted, then Autoquote resumes upon the report of a manual transaction or the publication of a new quote by the specialist, but in any event in no more than ten seconds.¹⁵ Finally, if the order is capable of trading at a price beyond the LRP price but would create a locked or crossed market if quoted, then Autoquote would resume upon a manual transaction or the publication of a new quote by the specialist.¹⁶

During the brief moment it takes a specialist to manually report a transaction in a security, Autoquoting of the highest bid/lowest offer is suspended in that stock.¹⁷ In addition, during that same period of time, automatic executions against the interest that is published in the NYSE quote at the Exchange BBO ("displayed") are not available.¹⁸ After the specialist has completed the report of the transaction, Autoquote will resume immediately,¹⁹ and the NYSE quotation will similarly again be available for automatic executions.²⁰

Currently all orders, except orders entered in securities that the Exchange has designated as manually traded securities, entered into Exchange systems²¹ are eligible for automatic and immediate execution. The maximum order size eligible for automatic execution is one million shares.

The Display Book is the Exchange's order execution system for round lot orders²² entered on the Exchange by

⁶ See generally Securities Exchange Act Release Nos. 56599 (October 2, 2007), 72 FR 57622 (October 10, 2007) (SR-NYSE-2007-93) (amending NYSE Rules 70 and 104 to reduce the requirement that a Floor broker and specialist post 1,000 shares of displayed liquidity at the Exchange best bid or offer in order to use the reserve function); 56711 (October 26, 2007), 72 FR 62504 (November 5, 2007) (SR-NYSE-2007-83) (amendment to NYSE Rule 104.10 to extend the duration of the pilot program applicable to Conditional Transactions as defined in Rule 104.10 to March 31, 2008 and to remove the active securities limitation on Conditional Transactions); 56551 (September 27, 2007), 72 FR 56415 (October 3, 2007) (SR-NYSE-2007-82) (amendments to NYSE Rule 124 to change the way in which the Exchange prices and executes odd-lot order); 56370 (September 6, 2007), 72 FR 52188 (September 12, 2007) (SR-NYSE-2007-81) (amendment to NYSE Rule 104 to remove required price parameters for a specialist to provide price improvement to an incoming order); 56209 (August 6, 2007), 72 FR 45290 (August 13, 2007) (SR-NYSE-2007-65) (amendment to NYSE Rule 79A.30 to remove the requirement to obtain Floor Official approval before trading more than one or two dollars away from the last sale); 56088 (July 18, 2007), 72 FR 40351 (SR-NYSE-2007-63) (July 24, 2007) (amendment to NYSE Rule 92 to permit specialists to trade between the hours of 6 p.m. and 9:15 a.m. in any security in which the specialist is registered, notwithstanding any open customer orders on the Display Book); 55908 (June 14, 2007), 72 FR 34056 (June 20, 2007) (SR-NYSE-2007-54) (amendments to NYSE Rules 54 and 70 to allow member organizations to operate booth premises on the Exchange Floor similar to Upstairs offices); 54820 (November 27, 2006), 71 FR 70824 (December 6, 2006) (SR-NYSE-2006-65) (amendment to clarify certain definitions and systematic processing of certain orders in the HybridMarket); and 54086 (June 30, 2006), 71 FR 38953 (July 10, 2006) (SR-NYSE-2006-24) (amendment to NYSE Rule 104(d)(i) to conform the minimum display requirements for reserve interest for specialists and Floor brokers such that specialists, like Floor brokers, only be required to provide at least 1,000 shares displayed interest at the bid and offer in order to have reserve interest on that side of the quote).

⁷ This system was developed to facilitate specialists' compliance with the Commission's Limit Order Display Rule. See 17 CFR 242.604.

⁸ See NYSE Rule 60(e).

⁹ A specialist could cause a non-auto-executable quote by gapping the quotation due to an order imbalance in accordance with the policies and procedures of the Exchange. Gap quotes are used to signal an imbalance so as to attract contra-side liquidity in an attempt to mitigate volatility. The size of an imbalance suitable for gapped quoting is at least 10,000 shares or a quantity of stock having a value of \$200,000 or more, although depending on the trading characteristics of the security, the appropriate conditions for gapped quoting could be higher. See NYSE Information Memo 04-27 (June 9, 2004). When the quotation is gapped, automatic executions and Autoquote would be suspended, and the NYSE quote would be identified as non-firm. Incoming orders and cancellations update the Book electronically. Once a trade occurs or a non-gapped quote is published, Autoquote and automatic execution resume.

¹⁰ LRPs are pre-determined price points that function as "speed bumps" to moderate volatility in a particular security, improve price continuity, and foster market quality by temporarily converting the electronic market to an auction market and permitting new orders, the Crowd, and the specialist, to add liquidity. See also NYSE Rules 60(e)(i) and 1000(a)(iv).

¹¹ See NYSE Rule 1000(a)(v).

¹² See NYSE Rule 60(e)(ii)(B).

¹³ See NYSE Rule 60(e)(ii)(A).

¹⁴ See NYSE Rule 60(e)(ii)(C).

¹⁵ See *id.*

¹⁶ See *id.*

¹⁷ See NYSE Rule 60(e)(i)(B).

¹⁸ See NYSE Rule 1000(a)(v).

¹⁹ See NYSE Rule 60(e)(ii)(B).

²⁰ See NYSE Rule 1000(b).

²¹ There still remain certain securities traded on the Exchange that are not designated to participate in automatic execution pursuant to NYSE Rule.

²² Currently, odd-lot orders do not enter the Exchange's auction market but are executed systemically by Exchange systems designated solely for odd-lot orders (the "odd-lot System"). The odd-lot System executes all odd-lot orders against the specialist as the contra party. See NYSE Rule 124.

participants. Display Book maintains a separate volume category for Floor broker's interest, Off-Floor participant's ("Off-Floor") interest and specialist's interest.

Incoming marketable limit orders and market orders automatically execute to the extent possible at the NBBO and then, if there is insufficient liquidity available at the bid or offer, the remainder of the order will execute automatically against available liquidity at each price point (*i.e.*, below the bid in the case of an order to sell or above the offer in the case of an order to buy) in one continuous transaction ("sweep"). The sweep ends when the order has reached its total cumulative quantity, its limit price or when it hits an intervening LRP. Posted liquidity, reserve liquidity, convert and parity ("CAP") liquidity, and specialist liquidity at each price point are all liquidity available to execute against an order during a sweep.

(c) Market Participants

(1) Specialists

A NYSE specialist is a market professional who manages the two-way auction market trading in the specific securities he or she has been assigned. He or she works for a specialist unit, which is an independent company in the business of trading listed securities. The specialist serves as the "responsible broker or dealer" on the Exchange as that term is defined in Rule 600 of Regulation National Market System ("Reg. NMS").²³ Pursuant to section (a)(2) of Rule 602,²⁴ when NYSE Rule 60 was adopted, the specialist responsible for each security available for quotation on the Exchange was designated as the

²³ See 17 CFR 242.600(a)(65)(i), which states that responsible broker or dealer means, "when used with respect to bid or offers communicated on a national securities exchange, any member on such national securities exchange who communicates to another member on such national securities exchange, at the location (or locations) or through the facility or facilities designated by such national securities exchange for trading in an NMS security a bid or offer for such NMS security, as either principal or agent; provided, however, that, in the event two or more members of a national securities exchange have communicated on or through such national securities exchange bid or offers for an NMS security at the same price, each such member shall be considered a responsible broker or dealer for that bid or offer, subject to the rules of priority and precedence then in effect on that national securities exchange; and further provided, that for a bid or offer which is transmitted from one member of a national securities exchange to another member who undertakes to represent such bid or offer on such national securities exchange as agent, only the last member who undertakes to represent such bid or offer as agent shall be considered the responsible broker or dealer for that bid or offer. * * * See also NYSE Rule 60.

²⁴ See 17 CFR 242.602(a)(2).

responsible broker or dealer.²⁵ The specialist as designated responsible broker or dealer is responsible, with respect to each reported security, to collect all bids and offers, determine the highest bid and lowest offer and quote and otherwise communicate to the quotation vendors the same along with the quotation size for each security.²⁶

In addition to being the responsible broker dealer, NYSE Rule 104 governs specialist dealings in the market. Specialists' transactions for their own account are subject to specific expectations of performance. These include a specialist's affirmative and negative obligations. Pursuant to these obligations, specialists have a duty to ensure that their principal transactions are designed to contribute to the maintenance of price continuity with reasonable depth.

The affirmative obligation requires a registered specialist to maintain adequate minimum capital based on his or her registered securities and use said capital to engage in a course of dealings for his or her own account to assist in the maintenance, so far as practicable, of a fair and orderly market.²⁷ Thus pursuant to the affirmative obligations, registered dealers on primary exchanges are required to commit the dealer's capital in their registered securities in order to maintain a fair and orderly market.

The negative obligation, which is part of NYSE Rule 104, requires that specialists allow public orders to be executed against each other without undue dealer intervention and that specialists not deal in a manner that is inconsistent with the overall objective of maintaining a fair and orderly market. Specifically, NYSE Rule 104(a) provides:

No specialist shall effect on the Exchange purchases or sales of any security in which such specialist is registered, for any account in which he, his member organization or any other member, allied member, or approved person, (unless an exemption with respect to such approved person is in effect pursuant to Rule 98) in such organization or officer or employee thereof is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly

²⁵ See NYSE Rule 60(a)(2), which provides that the "term 'responsible broker or dealer' shall mean, with respect to any bid or offer for any reported security made available by the Exchange to quotation vendors, the specialist in such reported security, who shall be the responsible broker or dealer to the extent of the quotation size he specifies."

²⁶ See NYSE Rule 60(c) and 17 CFR 242.602(b)(1). Today, these functions are done by the Exchange Autoquote system.

²⁷ See 17 CFR 240.11b-1.

market, or to act as an odd-lot dealer in such security.

To assist specialists in meeting their obligations, they have the ability to manually and systematically place in a separate file ("specialist interest file" or "s-Quotes") within the Display Book system their dealer interest at prices at or outside the Exchange BBO.²⁸ Specialists further have the ability to maintain reserve interest on behalf of their dealer accounts at the Exchange BBO, provided that they display at least one round lot at that price on the same side of the market as the reserve.²⁹ After an execution against a specialist's displayed bid (offer), if the specialist has reserve interest remaining at that bid (offer), the amount of displayed interest is automatically replenished from the specialist's reserve interest, if any, so that at least one round lot of specialist interest is displayed.³⁰ Specialist interest at the Exchange BBO is included in the Exchange quote; displayable specialist interest away from the Exchange BBO is currently included in NYSE OpenBook[®] ("OpenBook").³¹

Further, in their capacity as dealer for their assigned securities, specialists maintain systems that use proprietary algorithms, based on predetermined parameters, to electronically participate in the Exchange electronic market ("Specialist Algorithm"). The Specialist Algorithm communicates with the Display Book system via an Exchange-owned external application programming interface ("API"). The Specialist Algorithm is intended to replicate electronically some of the activities specialists are permitted to engage in on the Floor in the auction market, and to facilitate specialists' ability to fulfill their obligations to maintain a fair and orderly market.

The Specialist Algorithm receives information via the API, including information about orders entering NYSE systems, before that information is

²⁸ See NYSE Rules 104(b)(i) and 104(c)(viii).

²⁹ See NYSE Rule 104(d)(j). When discussed herein, the term "displayable" shall mean that portion of non-marketable interest that would be published as, or as part of, the Exchange BBO. The term "displayed interest" includes that part of an order that is published as, or as part of, the Exchange BBO.

³⁰ See NYSE Rule 104(d)(ii).

³¹ OpenBook is a compilation of limit order data for all NYSE traded securities that the Exchange provides to market data vendors, broker-dealers, private network providers, and other entities through a data feed. See Securities Exchange Act Release No. 44138 (December 7, 2001), 66 FR 64895 (December 14, 2001) (SR-NYSE-2001-42). See also July 17th e-mail, *supra* note 3.

available to other market participants.³² NYSE systems enforce the proper sequencing of incoming orders and algorithmically-generated messages.³³ The Specialist Algorithm and the specialists on the Floor do not have the ability to affect the arrival of orders at the Display Book system, or the sequence in which orders and algorithmically-generated messages are processed by the Display Book system.³⁴ The Specialist Algorithm, however, is able to generate certain specified quoting and trading messages based on the information it receives through the API. Once an algorithmic message has been generated, it cannot be stopped, changed, or cancelled on its way to the Display Book system.

The Display Book system does not accept algorithmically-generated messages from the Specialist Algorithm when automatic executions are unavailable, except in certain specified situations.³⁵ Specifically, when automatic executions are suspended, but Autoquote is active, the Display Book system accepts algorithmically-generated messages from the Specialist Algorithm to generate a bid or offer that improves the Exchange BBO or supplements the size of the existing BBO.³⁶

In addition, when Autoquote and automatic executions are suspended, the Display Book system: (1) Processes algorithmically-generated messages to layer specialist interest outside the published Exchange quotation; and (2) permits specialists to manually layer specialist interest at prices within a previously established locking or crossing quotation.³⁷

Display Book does not process algorithmically-generated messages from the Specialist Algorithm during the time a block size transaction involving orders in the Display Book system is being manually reported.³⁸

³² *The Specialist Algorithm has access to the following information:* (1) Specialist dealer position; (2) quotes; (3) information about orders in the Display Book system such as limit orders, percentage orders ("state of the book"); (4) any publicly available information the specialist firm chooses to supply to the algorithm, such as the Consolidated Quote stream; and (5) incoming orders as they are entering NYSE systems. *The Specialist Algorithm does not have access to:* (1) Information identifying the firms entering orders, customer information, or an order's clearing broker; (2) floor broker agency interest files or aggregate floor broker agency interest available at each price; or (3) order cancellations, except for cancel and replace orders. See NYSE Rule 104(c)(ii).

³³ See NYSE Rule 104(b)(iii)(A).

³⁴ See NYSE Rule 104(b)(iii)(B).

³⁵ See NYSE Rule 104(c)(vi).

³⁶ See NYSE Rule 104(c)(vi)(i).

³⁷ See NYSE Rule 104(c)(vi)(ii).

³⁸ See NYSE Rule 104(c)(v).

Algorithmically-generated messages are systemically blocked from creating a locked or crossed market³⁹ and would have to comply with all Commission and NYSE rules, policies and procedures governing specialist proprietary trading.⁴⁰

In general, specialists can generate two categories of messages: quoting messages and trading messages. *Quoting messages allow the Specialist Algorithm to:* (1) Supplement the size of the existing Exchange BBO; (2) place within the Display Book system specialist reserve interest at the Exchange BBO;⁴¹ (3) layer within the Display Book system specialist interest at varying prices outside the Exchange BBO; (4) establish the Exchange BBO; and (5) withdraw previously established specialist interest at the Exchange BBO.⁴² Quoting messages do not interact with the order that preceded it. In addition, specialists are systemically blocked from generating a quoting message that moves their quote away from the inside market only until after the order it is reacting to is processed.

Trading messages allow the specialist to: (1) Provide "additional specialist volume" to partially or completely fill an order at the Exchange BBO or at a sweep price; (2) match better bids and offers published by other market centers where automatic executions are immediately available; (3) provide price improvement to an order, subject to the conditions outlined below; and (4) trade with the Exchange published quotation—that is, "hit bids" or "take offers."⁴³ Trading messages generated in response to an incoming order do not guarantee that the specialist interacts with that order or that the specialist has priority in trading with that order.⁴⁴ Specialist interest may not trade with the order identified by the algorithmic message because the specialist's message did not arrive at the Display Book in time or the specialist has to yield to off-Floor orders in Display Book which cancels the specialist interest.⁴⁵ Moreover, even when the specialist sets the NBBO and no off-Floor interest is present, a specialist may still not receive priority because of an intervening Floor clearing event which causes the specialist to lose priority.⁴⁶

The Specialist Algorithm further allows the specialists, on behalf of their

dealer accounts, to electronically provide price improvement to all or part of a marketable incoming order provided the specialist is represented in a "meaningful amount"⁴⁷ in the bid with respect to price improvement provided to an incoming sell order, or in the offer with respect to price improvement provided to an incoming buy order. Price improvement by the specialist benefits the incoming order and CAP-DI orders⁴⁸ entered on the Exchange because marketable CAP-DI orders are systemically converted to allow these orders to participate on parity with the specialist when the specialist is price improving an incoming order.⁴⁹

Specialists' messages to trade with the Exchange published quote must include information that indicates the quote has been publicly disseminated.⁵⁰ In addition, to ensure that a specialist's algorithmic message to trade with the Exchange published quotation does not possess any speed advantage in reaching the Display Book system, Exchange systems process such messages in a manner that gives specialists and other market participants a similar opportunity to trade with the Exchange's published quotation, by delaying the processing of this type of trading message from the Specialist Algorithm.⁵¹

In addition to systemic restraints on the specialist's ability to trade with the published bid and offer, the specialist is required pursuant to NYSE Rule 104 to re-enter liquidity on the opposite side of the market when he or she effects a transaction for their own account to

⁴⁷ See NYSE Rule 104(e)(ii) which provides that "meaningful amount" shall constitute at least ten round-lots for the 100 most active securities on the Exchange, based on average daily volume, and at least five round-lots for all other securities on the Exchange. A list of the 100 most active securities on the Exchange is disseminated quarterly, or more frequently, as determined by the Exchange. Specialists cannot provide price improvement to an incoming order that is not marketable (*i.e.*, those orders that would establish a new best bid or best offer), and the specialist cannot trade with such an order until the new bid or offer is publicly disseminated.

⁴⁸ This type of CAP order provides that the elected or converted portion of the percentage order that is convertible on a destabilizing tick and designated immediate execution or cancel election. See NYSE Rules 13 and 123A.30(a).

⁴⁹ See NYSE Rule 123A.30(a)(iii).

⁵⁰ See NYSE Rule 104(c)(i)(A).

⁵¹ See NYSE Rule 104(b)(iii)(B). Based upon the average transit time from the Common Message Switch ("CMS") system to the Display Book system, the Exchange determines the appropriate amount of time to delay the processing of algorithmic messages to trade with the Exchange published quotation. The delay parameter is adjusted periodically to account for changes to the average transit time resulting from capacity and other upgrades to Exchange systems.

³⁹ See NYSE Rule 104(c)(iv).

⁴⁰ See NYSE Rule 104(c)(iii).

⁴¹ See NYSE Rule 104(d).

⁴² See NYSE Rule 104(b)(i)(A)–(E).

⁴³ See NYSE Rule 104(b)(i)(F)–(I).

⁴⁴ See NYSE Rule 104(c)(i)(C).

⁴⁵ See NYSE Rule 104(c)(i)(D).

⁴⁶ A Floor clearing event is any intervening transaction or an update of the NYSE quote.

establish or increase a position and reaches across the market to trade as the contra-side to the Exchange published bid or offer (“Conditional Transaction”).

Conditional Transactions may have additional re-entry obligations pursuant to the rule. Specifically, pursuant to NYSE Rule 104.10(6)(iii), “appropriate” re-entry means “re-entry on the opposite side of the market at or before the price participation point or the ‘PPP.’”⁵² Depending on the type of Conditional Transaction, a specialist’s obligation to re-enter may be immediate or subject to the same re-entry conditions of Non-Conditional Transactions.⁵³

Pursuant to current NYSE Rule 104.10(6)(iv) Conditional Transactions that involve:

(a) A specialist’s purchase from the Exchange published offer that is priced above the last differently-priced trade on the Exchange or above the last differently-priced published offer on the Exchange; and

(b) A specialist’s sale to the Exchange published bid that is priced below the last differently-priced trade on the Exchange or below the last differently-priced published bid on the Exchange.

(c) Re-entry obligations following transactions defined in subparagraphs (6)(iv)(a) and (6)(iv)(b) above are the same as for Non-Conditional Transactions pursuant to subparagraph (5)(i)(a)(II)(c) above.

NYSE Rule 104.10 (5)(i)(a)(II)(c) provides:

Re-entry Obligation Following Non-Conditional Transactions—The specialist’s obligation to maintain a fair and orderly market may require re-entry on the opposite side of the market trend after effecting one or more Non-Conditional Transactions. Such re-entry

⁵² NSYE Rule 104.10(6)(iii)(a) provides that the PPP identifies the price at or before which a specialist is expected to re-enter the market after effecting a Conditional Transaction. PPPs are only minimum guidelines and compliance with them does not guarantee that a specialist is meeting its obligations.

⁵³ NYSE Rule 104.10(6)(iii)(c) requires immediate re-entry following a Conditional Transaction that is:

(I) A purchase that (1) reaches across the market to trade with an Exchange published offer that is above the last differently priced trade on the Exchange and above the last differently priced published offer on the Exchange, (2) is 10,000 shares or more or has a market value of \$200,000 or more, and (3) exceeds 50% of the published offer size.

(II) A sale that (1) reaches across the market to trade with an Exchange published bid that is below the last differently priced trade on the Exchange and below the last differently priced published bid on the Exchange, (2) is 10,000 shares or more or has a market value of \$200,000 or more, and (3) exceeds 50% of the published bid size.

(III) Each trade at a separate price in a Sweep is viewed as a transaction with the published bid or offer for the purpose of subparagraphs (6)(iii)(c)(I) and (6)(iii)(c)(II) above.

transactions should be commensurate with the size of the Non-Conditional Transactions and the immediate and anticipated needs of the market.

(2) Floor Brokers

Floor brokers are individuals that execute orders to buy or sell securities on behalf of a customer pursuant to instructions provided by the customer. Sometimes a Floor broker may represent his or her firm’s proprietary account.⁵⁴

(A) Floor Broker Interest

Floor brokers are permitted to represent electronically the orders they hold by including these orders in a separate file (“Floor broker agency interest file,” also referred to as “e-QuotesSM”) within the Display Book system at multiple price points on either side of the market.⁵⁵ e-Quotes enable Floor brokers’ customer interest to participate in automatic executions at the Exchange BBO and in sweeps. Floor brokers are permitted to place liquidity electronically at or outside the Exchange BBO. Floor brokers are not permitted to enter in the Floor broker agency interest files any interest that restricts the specialist’s ability to trade on parity with the Floor broker agency interest file.⁵⁶

Floor broker agency interest placed in the Display Book becomes part of the quotation when the price point is at or becomes the Exchange BBO. All floor broker agency interest files in the Display Book system at the same price and on the same side of the market are on parity. However, an e-Quote that establishes the Exchange BBO is entitled to priority.⁵⁷ No Floor broker agency

⁵⁴ NYSE Rule 112, entitled “Orders initiated ‘Off the Floor’” is one of the Exchange rules codifying the provisions of Section 11(a) of the Act and Commission Rule 11a-1 promulgated thereunder. In substance, these rules provide that no member or member organization, while on “the Floor” of the Exchange, may initiate a transaction in any security admitted to trading on the Exchange for an account in which they have a beneficial interest or over which they are entitled to exercise discretion, unless subject to an exception. The purpose of this rule and the securities laws upon which it is based is to eliminate the advantage at the point of sale that member organizations traditionally have been deemed to have possessed by virtue of their presence on the trading floor and adjacent surroundings. See also Exchange Rules 90 and 108.

⁵⁵ See NYSE Rule 70.20(a)(i).

⁵⁶ See NYSE Rule 70.20(a)(i) and NYSE Rule 108(a). Parity describes an equal allotment, so far as practicable, of shares among the participants eligible to participate in an execution.

⁵⁷ See NYSE Rule 70.20(b). Priority describes the entitlement to receive an allotment of shares before other executable interest at the price point for one trade because the bid (offer) established the Exchange BBO. A specialist bid or offer entitled to priority must yield to Off-Floor participant limit orders on the Display Book at the same price. In manual executions, an order may also be entitled

interest placed within files in the Display Book system is entitled to precedence based on size.⁵⁸ Floor broker agency interest within the Display Book can be automatically executed pursuant to Exchange Rules 1000–1004.⁵⁹

Floor brokers also maintain non-displayed interest (reserve) at the Exchange BBO provided that a minimum of one round lot⁶⁰ of the Floor broker’s agency interest is displayed at that price.⁶¹ If an execution at the Exchange BBO does not completely execute the Floor broker’s interest at that price, the displayed interest is automatically replenished from the Floor broker’s reserve interest, if any, so that at least one round lot is displayed.⁶² The Floor broker reserve interest is not included in the NYSE quote. Floor broker agency interest away from the BBO is not displayed in Open Book or other Exchange data distribution channels. In order for Floor brokers’ reserve interest not to be visible to the specialists, a Floor broker must designate his or her reserve interest as “Do Not Display” (“DND”) interest.

An incoming automatically-executing order will trade first with the displayed bid (offer). Where there is insufficient displayed volume to fill the order, it will trade next with a Reserve Order and Floor broker reserve interest, if any, and then any specialist reserve interest as more fully discussed below.⁶³

Floor broker agency interest participates in the opening and closing trades subject to Exchange rules.⁶⁴ Specialists are able to see the aggregate number of shares of all Floor broker agency interest files at each price.⁶⁵ A Floor broker may exclude all of his or her Floor broker agency interest from the aggregate information available to the specialist.⁶⁶

Floor broker agency interest excluded from the aggregated Floor broker agency interest information available to the specialist participates in automatic and manual executions.⁶⁷ Exchange systems

to receive an allotment of shares when that order is for a number of shares greater than all other interest eligible to be executed at the price. In those instances, the order has precedence and may be executed before other executable interest at the price point. See NYSE Rule 72(d).

⁵⁸ *Id.*

⁵⁹ See NYSE Rule 70.20(c)(i).

⁶⁰ Generally, one round lot is 100 shares; however, there are securities on the Exchange that have units of trading of less than 100 shares.

⁶¹ See NYSE Rule 70.20(c)(ii).

⁶² See NYSE Rule 70.20(c)(iii).

⁶³ See NYSE Rule 70.20(c)(iv).

⁶⁴ See NYSE Rule 70.20(j)(i) and (ii).

⁶⁵ See NYSE Rule 70.20(g).

⁶⁶ See *id.*

⁶⁷ See NYSE Rule 70.20(h).

include such excluded interest in the aggregated agency interest displayed to the specialist only during the execution of a manual trade. This information is maintained in the template used by a specialist to execute trades in the Display Book. As such, aggregate Floor broker agency interest visible to the specialist will include agency interest designated to be excluded from the aggregate Floor broker agency interest file. Consequently, NYSE Rule 70.20⁶⁸ prohibits specialists, trading assistants and anyone acting on their behalf from using the Display Book to access information about Floor broker agency interest excluded from the aggregated agency interest other than in situations where there is a reasonable expectation on the part of such specialist, trading assistant or other person acting on their behalf that a transaction will take place imminently for which such agency interest information is necessary to effect such transaction.⁶⁹

Floor brokers may also provide discretionary instructions for e-Quotes related to price and size (*i.e.*, the number of shares to which the discretionary price instructions apply) (“discretionary e-Quotes” or “d-Quotes”). The discretion is used, as necessary, to initiate or participate in a trade with an incoming order capable of trading at a price within the discretionary range.⁷⁰

Discretionary instructions are applicable only to automatic executions; they cannot be utilized in manual transactions and they are not applicable to opening and closing transactions.⁷¹ Discretionary instructions may be entered for all e-Quotes; however, these instructions are active only when the e-Quote is at or would establish the BBO.⁷² Discretionary instructions will be applied only if all d-Quoting prerequisites are met. Otherwise, the d-Quote will be handled as a regular e-Quote, notwithstanding the fact that the Floor broker has designated the e-Quote as a d-Quote.⁷³ Discretionary instructions apply to displayed and reserve size, including reserve interest that is excluded from the aggregate volume visible to the specialist on the Floor.⁷⁴ The specialist on the Floor and the specialist system employing algorithms are both unable to access the discretionary instructions entered by

Floor brokers with respect to their d-Quotes.⁷⁵

(B) Price Discretion

Discretionary instructions as to price allow Floor brokers to set a price range⁷⁶ within which the Floor broker is willing to initiate or participate in a trade. The price range must be included on any d-Quote. Therefore, if the price discretion is set for only a portion of the d-Quote, the residual will be treated as an e-Quote.⁷⁷ Executions of d-Quotes employing price discretion trade first from reserve volume, if any, and then from displayed volume.⁷⁸

(C) Size Discretion

Floor brokers may designate the amount of the e-Quote volume to which price discretion applies.⁷⁹ For example, a Floor broker may specify that only 20,000 shares of a 50,000-share e-Quote employ price discretion. The remaining 30,000-shares are handled as a regular e-Quote, *i.e.*, one without discretionary price instructions. This allows for more specific order management.

A Floor broker may set a minimum and/or maximum size limit with respect to the size of the contra-side interest with which it is willing to trade using price discretion.⁸⁰ Exchange systems will review NYSE published or quoted contra-side volume only in considering whether the volume is within the d-Quote’s discretionary volume range. This prevents the d-Quote from trading with opposite side interest that the Floor broker has judged to be too little or too great in the context of the order or orders he or she is managing. Reserve and other interest at the possible execution price is not considered by Exchange systems.⁸¹ Interest displayed by other market centers at the price at which a d-Quote may trade is not considered when determining whether the minimum volume range is met, unless the Floor broker electronically designates that such away volume should be included in the determination.⁸² An increase or reduction in the size associated with a particular price that brings the contra-side volume within a d-Quote’s minimum or maximum discretionary size parameter, will trigger an execution

of that d-Quote.⁸³ Once the total amount of a Floor broker’s discretionary volume has been executed, the remainder of the e-Quote may not employ price discretion when trading.⁸⁴

(D) Discretionary Executions

The goal of discretionary instructions for e-Quotes is to secure the largest execution for the d-Quote, using the least amount of price discretion. Thus, d-Quotes may often improve the execution price of incoming orders. Conversely, if no discretion is necessary to accomplish a trade, none will be used.⁸⁵ d-Quotes automatically execute against an incoming contra-side order if the order’s price is within the discretionary price range and meets any size requirements that have been set for the d-Quote.⁸⁶

All d-Quotes from different Floor brokers on the same side of the market with the same price instructions trade on parity after interest entitled to priority is executed.⁸⁷ Multiple same-side d-Quotes from different Floor brokers compete for an execution with the most aggressive price range (*e.g.* three cents vs. two cents) establishing the execution price. If the incoming order remains unfilled at that price, executions within the less aggressive price range may occur.⁸⁸ d-Quotes also compete with same-side specialist algorithmic trading messages targeting incoming orders. If the price of d-Quotes and specialist trading messages are the same, the d-Quotes and the specialist messages trade on parity.⁸⁹

d-Quotes from Floor brokers on opposite sides of the market may trade with each other. The d-Quote that arrives at the Display Book last will use the most discretion necessary to effect a trade, subject to NYSE rules and Rule 611 of Reg. NMS.⁹⁰ d-Quotes may provide price improvement to and trade with an incoming contra-side specialist algorithmic trading message to “hit bid/take offer,” just as they can with any other marketable incoming interest.⁹¹

d-Quotes may initiate sweeps in accordance with and to the extent provided by NYSE Rules, but only to the extent of their price and volume discretion.⁹² d-Quotes may participate

⁶⁸ See NYSE Rule 70.25(c)(v).

⁶⁹ See NYSE Rule 70.25(c)(vi).

⁷⁰ See NYSE Rule 70.25(d)(i).

⁷¹ See NYSE Rule 70.25(d)(i)(A)(ii).

⁷² See NYSE Rule 70.25(d)(i)(A)(iii).

⁷³ See NYSE Rule 70.25(d)(i)(A)(iv).

⁷⁴ See NYSE Rule 70.25(d)(i)(A)(v).

⁷⁵ See NYSE Rule 70.25(d)(i)(A)(vi) and 17 CFR 242.611.

⁷⁶ See NYSE Rule 70.25(d)(i)(A)(viii).

⁷⁷ See NYSE Rules 1000–1004. See also NYSE Rule 70.25(d)(i)(A)(ix).

⁷⁸ See NYSE Rule 70.25(b)(iv).

⁷⁹ See NYSE Rule 70.25(c)(i).

⁸⁰ See NYSE Rule 70.25(c)(ii).

⁸¹ See NYSE Rule 70.25(c)(iii).

⁸² See NYSE Rule 70.25(c)(iv).

⁷⁵ See NYSE Rule 70.25(a)(viii).

⁷⁶ See NYSE Rule 70.25(b)(i). The minimum price range for a d-Quote is the minimum price variation set forth in NYSE Rule 62.

⁷⁷ See NYSE Rule 70.25(b)(iii).

⁷⁸ See NYSE Rule 70.25(b)(iv).

⁷⁹ See NYSE Rule 70.25(c)(i).

⁸⁰ See NYSE Rule 70.25(c)(ii).

⁸¹ See NYSE Rule 70.25(c)(iii).

⁸² See NYSE Rule 70.25(c)(iv).

⁶⁸ See NYSE Rule 70.20(h)(ii).

⁶⁹ A pattern and practice of specialists’ accessing reserve order information without trading may constitute a violation of NYSE Rule 70.20.

⁷⁰ See NYSE Rule 70.25(a)(i).

⁷¹ See NYSE Rule 70.25(a)(iii).

⁷² See NYSE Rule 70.25(a)(ii).

⁷³ See NYSE Rule 70.25(a)(v).

⁷⁴ See NYSE Rule 70.25(a)(vii).

in sweeps initiated by other orders but, in such cases, their discretionary instructions are not active. d-Quotes will not trade at a price that would trigger an LRP. Thus a sweep involving a d-Quote will always stop at least one cent before an LRP price.⁹³

Floor brokers further possess a “pegging function” for e-Quotes and d-Quotes, which allows the Floor broker to keep his or her interest in the quote, even as the quote moves. Pegging is a separate type of discretionary instruction and may occur with e-Quotes and/or with d-Quotes using discretionary price instructions. Pegging e-Quotes and d-Quotes peg only to other non-pegging interest within the pegging range selected by the Floor broker. This functionality is only available when auto-quoting is on. Pegging functionality is reactive and does not establish a new BBO price. It will not generally serve as the BBO price when there is no other interest at that price. Pegging will occur only at prices within the pegging price range designated by the Floor broker.⁹⁴ Pegging functionality allows the Floor broker interest to be included in the Exchange BBO as it is systemically updated subject to the price that the Floor broker designated as the lowest or highest price he or she is willing to trade. The Floor broker’s interest will move with the Exchange BBO within the designated range and any discretionary instructions associated with that interest will continue to be applied as long as it is within the Floor broker’s designated price range. Buy side e-Quotes will peg to the best bid, and sell side e-Quotes will peg to the best offer.

A Floor broker using pegging e-Quotes and d-Quotes may set a minimum and/or maximum size of same-side volume to which his or her e-Quote or d-Quote will peg. Pegging instructions apply to the entire e-Quote/d-Quote volume. An e-Quote may have either or both discretionary trading and pegging instructions. Pegging and discretionary instructions are known only to the Floor broker. Specialists do not have access to a Floor broker’s pegging and discretionary instructions.

(E) CAP–DI Order

Pursuant to NYSE Rule 13, Floor brokers are permitted to submit CAP liquidity to the Display Book in order to have customer orders trade along with the market and with the specialist proprietary transactions. The type of CAP order used by the Floor broker is the CAP–DI order. NYSE Rule

123A.30(a) provides that a CAP–DI order is the elected or converted portion of a percentage order that is convertible on a destabilizing tick and designated immediate execution or cancel election. A CAP–DI order may be automatically executed and may participate in a sweep. Marketable CAP–DI orders are automatically converted and trade along with specialist proprietary executions. CAP–DI orders participate in sweeps. Specifically, when an automatically executing order is sweeping the Display Book on the same side as the CAP–DI orders, such CAP–DI orders will be elected at each execution price that is part of the sweep. To the extent that the order sweeping the book has additional volume, the elected same-side CAP–DI orders will not participate in a transaction at the executing price; rather, Exchange Systems will automatically and systemically un-elect the CAP–DI orders in accordance with its terms. If at the last execution price that is part of the sweep, the sweeping order is filled or unable to continue executing, and there is volume remaining on the Display Book or from contra-side elected CAP–DI orders, then the same-side CAP–DI orders may participate in the final transaction. CAP–DI orders on the contra-side of an automatically executing order sweeping the Display Book are also elected at each execution price that is part of the sweep and participate at each of the execution prices if there is volume available on the Display Book or from CAP–DI orders on the same side of the market as the sweeping order.

(3) Off-Floor Participants

Off-Floor participants may submit any valid order type as defined in Exchange Rules. Orders entered on the Exchange by Off-Floor participants are maintained on the Display Book in a separate file from Floor broker agency interest, passively converted CAP orders and specialist interest. These orders are aggregated at each price point and sequenced in time priority of receipt. Off-Floor participants have the ability to submit Reserve Orders pursuant to NYSE Rule 13. Interest represented through Reserve Orders trade according to Exchange rules governing priority and parity.⁹⁵ A Reserve Order must include the specific amount of shares that is designated for display when the order is eligible to be quoted (*i.e.*, the “displayable” portion). A Reserve Order must display a minimum of one round lot. Reserve Orders have the ability to

automatically replenish the displayable amount of interest at the Exchange BBO when trades reduce or exhaust such displayable interest. This provides Exchange customers the flexibility to replenish liquidity that is in keeping with the market need at the specific time and at that price point. When the displayable size of a Reserve Order is replenished from reserve, the replenished displayable quantity is assigned a time sequence based on the time it is replenished. The remaining original displayed quantity, if any, retains its original time sequence.

As with reserve interest in a Floor broker’s agency interest file not designated DND, information on Reserve Orders entered directly into Exchange systems is made available to the specialist only in the aggregate at each price point for the express purpose of the specialist effecting a manual execution. The reserve interest is not distinguished from other interest available to be executed at a specific price point. Rather, Exchange systems display to the specialist the total number of shares available for execution at the price point and include reserve interest in the total number. In this manner such reserve interest is available for trades that take place on the Floor of the Exchange that will not be conducted automatically. Such trades take place at the opening and close of the Exchange, during the trading day in situations involving auction market transactions that are not automatic trades, and in certain specific trading situations, such as trades conducted when a LRP is reached after an automatic execution or in a “gap” quote situation.

Off-Floor participants’ interest that is not designated as reserve interest is included in the Exchange quote. Off-Floor participants’ interest away from the Exchange BBO not designated as reserve interest is automatically disseminated via OpenBook and other Exchange data distribution channels.

(4) Execution of Bids and Offers

Exchange executions are governed by its rules of priority, parity, and precedence.⁹⁶ These rules dictate which order or quote is able to execute against an incoming order and the allotment of shares, if more than one order or quote is at the BBO. Generally, the first bid (offer) at the BBO has priority to execute against the next incoming order.⁹⁷ Once

⁹⁶ See NYSE Rules 72, 104, and 108.

⁹⁷ See NYSE Rule 72 I(a). A bid (offer) that establishes the Exchange BBO is entitled to priority at that price for one trade, except a specialist bid

Continued

⁹³ See NYSE Rule 70.25(d)(ix)(A).

⁹⁴ See NYSE Rule 70.26(vii).

⁹⁵ Reserve Orders will also be subject to Federal securities regulations, including the order entry requirements of Section 11(a) of the Act.

a trade occurs with the bid (offer) that has priority, other bids (offers) at that price (including any remaining interest from the bid (offer) that had priority) generally trade on parity, meaning they split evenly with the remainder of the incoming order, up to the size of their own order.⁹⁸ A specialist must always yield priority to the Off-Floor participant orders entered on the Display Book.⁹⁹ The allotment of shares is also dependent on whether execution is at the BBO or if it is outside the BBO.

Under current Exchange rules, the first bid or offer made at a particular price is entitled to priority at that price.¹⁰⁰ Once a trade occurs with a bid or offer that has priority, other bids or offers at that price representing Off-Floor Participant orders (DOT orders) and Floor broker agency interest files (*i.e.*, e-Quotes and d-Quotes) trade on parity. Specialist interest (s-Quotes) yields to DOT orders; once DOT orders are satisfied, s-Quotes trade on parity with e-Quotes and d-Quotes.

For example, assume that immediately following a Floor clearing event, the bid on the Exchange is \$20.05 for 1,000 shares, consisting of a DOT order of 300 shares, Floor broker agency interest file (e-Quote) volume of 400 shares representing interest of two Floor brokers for 200 shares each, and specialist interest of 300 shares. This is all displayed interest, *i.e.*, there is no reserve interest involved. There is no priority as all bids were reentered following the Floor clearing event. An incoming market order to sell 400 shares is executed against the DOT bid and the e-Quotes since the specialist interest (s-Quote) must yield to DOT interest. If the incoming order had been for 800 shares, the DOT orders and Floor broker interest would be executed in full and the specialist would receive 100 shares.

The displayable portion of the Reserve Order interest is executed first in accordance with the above rules governing priority and parity. Once all displayable interest, including DOT orders, e-Quotes, d-Quotes and s-Quotes that are quoted at the Exchange BBO has been traded, any remainder of an

incoming order is executed against any reserve, *i.e.*, non-displayable interest at the Exchange BBO. Such non-displayable interest trades on parity except that specialist reserve interest at the Exchange BBO yields to all Reserve Orders and CAP orders. Outside the Exchange BBO, e-Quotes and d-Quotes trades with all interest represented by DOT orders, including DOT Reserve Orders, both displayable (*i.e.*, the interest that will be published if such interest becomes the Exchange best bid or offer) and non-displayable, on parity. Reserve interest represented by s-Quotes outside the Exchange BBO yields to reserve interest represented by Reserve Orders and CAP orders. Within DOT orders, interest that would be displayable is allocated on a time priority basis. After displayable DOT order interest is completely executed, any remaining shares are allocated to eligible non-displayable Reserve Order interest in time priority. Interest represented by a Floor broker is allocated equally among the Floor broker's customers without regard to whether that interest was displayable or non-displayable.

To illustrate how this works for a trade at the quote, assume the same scenario as above, but in addition to the displayed interest of 1,000 shares, there is reserve interest for the DOT order of 600 shares, 400 for each Floor broker (total of 800 shares) and 700 shares for the specialist for a total of 2,100 shares in reserve. An incoming order to sell 2,500 shares would be executed as follows: 1,000 shares trade with the displayed bid and is allocated 300 shares to the DOT order, 200 shares to each Floor broker (400 shares total), and 300 shares to the specialist, leaving 1,500 shares to be executed. The 1,500 remaining shares execute against the reserve portion of the DOT Reserve Order (600 shares), and 400 shares of reserve interest for each of the Floor brokers and 100 shares for the specialist.

When the amount of shares contained in an incoming order are greater than the shares at the Exchange BBO and trigger a sweep to execute the order, orders on the Display Book outside the Exchange BBO at each price point trade on parity at each successive price during the sweep. Specialist interest may participate in the sweep at each successive price point provided such interest participates after Off-Floor participant limit orders on the Display Book are satisfied at each successive price point. Specialist interest participating in the sweep trades on parity with any remaining Floor broker agency interest at each successive price point.

A trade outside the quote will occur when the displayed and reserve interest volume at the Exchange BBO is not sufficient to completely fill the incoming contra side order. Assume the bid on the Exchange is \$20.05 for 1,000 shares, consisting of a DOT order of 300 shares, Floor broker agency interest file (e-Quote) volume of 400 shares representing interest of two Floor brokers for 200 shares each, and specialist interest of 300 shares. In addition to the displayed interest of 1,000 shares, there is reserve interest for the DOT order of 600 shares, 400 for each Floor broker (total of 800 shares) and 700 shares for the specialist for a total of 2,100 shares in reserve. The incoming order to sell is for 4,800 shares, thus out-sizing the displayed and non-displayed interest at the bid by 1,700 shares. At the next bid price of 20.03, there are 400 shares of a DOT Reserve Order, of which 100 shares are displayable, three Floor brokers using the reserve function bidding for 400 shares each, with 100 shares displayable and 300 shares in reserve and 1,000 shares of specialist interest, 100 shares displayable and 900 shares in reserve. After the execution at the bid price of 20.05, the execution of the remaining 1,700 shares at 20.03 would be as follows: 400 shares each to the DOT Reserve Order and the Floor brokers, since they trade on parity with each other outside the Exchange best bid (offer) for a total of 1,600 shares; 100 shares to the specialist, since the DOT Reserve Order was executed in full.

If there had been additional volume in the DOT Reserve Order of 100 shares, the specialist would not have traded at all.

Proposed New Market Model

(a) Overview and Background

The Exchange believes that in order to adapt to the current equities market environment, its trading model must be modified to allow all participants the ability to compete efficiently consistent with the participant's respective responsibilities to the market.

As the Hybrid Market has evolved, the more electronic market has fundamentally altered the NYSE's traditional trading environment, in which price discovery took place largely and almost exclusively on the Floor of the Exchange in the form of face-to-face interactions among brokers and specialists. As these interactions have diminished, the perceived time and place advantage of the Floor has diminished as well. In particular, information that once was exclusive to the Floor—in particular, the most up-to-

or offer entitled to priority must yield to limit orders on the Book at the same price.

⁹⁸ See NYSE Rule 72 III. When bid (offers) are on parity, Exchange rules dictate that in certain circumstances, a particular participant is guaranteed a portion of an order based on the size of its bid (offer), *i.e.*, precedence based on size. See NYSE Rule 72 I(c).

⁹⁹ See NYSE Rule 92.

¹⁰⁰ See NYSE Rule 72 I(a) through (g). While a priority bid or offer may be established it is usually broken by a "Floor clearing" event. "Floor clearing" events include a trade or an update of the NYSE quote. After such an event, all bid and offers at the price are on parity.

date quotes, available interest and last sale prices—is now widely available off the Floor through electronic means. At the same time, increasingly fragmented trading in NYSE-listed securities—a byproduct of sophisticated algorithmic trading and Regulation NMS—has lessened the importance to traders of so-called “market color” from the Floor; in an era where no one trading venue can claim dominance of market share and mostly automated trading, specialists and Floor broker no longer glean a heightened sense of the market in a particular security based on the “open outcry” of participants at the point of sale on the Floor or based on the observation over the course of a day or days of the activity at the particular post where a security trades.

Competition from other market centers and growth of alternative trading systems, coupled with increased internalization by broker-dealers, has challenged the dominance of the trading post as the centralized locus of orders in a particular security. Among other things, the rapid dissemination of consolidated quote and trade information and real-time updates of the Exchange limit order book has increased exponentially the amount and accuracy of available information and the speed with which it is disseminated. The immense increase in electronic executions on the Exchange and the general explosion of the use of smart routing engines by market participants of all types, especially “upstairs” traders, also has had a huge impact on the perceived informational advantages once enjoyed by Floor brokers and specialists. Automatic executions and quote updates occur without audible notice and with such rapidity that even those present at the trading post are virtually unable to process the information manually. Indeed, it could be argued that the informational advantage has shifted “upstairs” where orders are now first “shopped” within a firm and then to others before being sent to the Floor for execution and, even then, is likely to be sent in pieces to multiple markets. These trends have also been influenced by the reduction of displayed interest across equity market centers resulting from the reduction of quote increments to pennies and in some instances sub-pennies (for securities that trade below a dollar). Further compounding the trends is the ever increasing proliferation of competing electronic trading venues.

In the face of these challenges, the NYSE is proposing to adopt its New Model, which will provide a more robust trading model on the Floor while preserving the existing framework for

trading and some of the key responsibilities of its market participants that make the NYSE unique. In so doing, the Exchange seeks to strike a balance among market participants that retains a role for liquidity providers responsible for maintaining fair and orderly markets, agents on the Floor, and Off-Floor participants. The Exchange believes that the proposed changes will improve market quality in the form of tighter spreads, greater liquidity and opportunities for price improvement.

(b) Changes to Exchange Systems

One of the key changes in the New Model will be enhancing the Exchange’s technology. Among other things, the Exchange proposes to enhance its Display Book to incorporate the majority of execution logic and to assume primary responsibility for tracking the liquidity available at each specified price point. In the New Model, incoming orders to buy and sell will continue to be available for automatic quoting and immediate and automatic execution. Unlike today, however, NYSE systems will also automatically review the liquidity available on the Display Book for execution and then access the necessary liquidity to consummate trades. To do this, the Exchange is proposing to replace its specialists with a new participant—the DMM—who will make available a pre-determined pool of liquidity that Exchange systems can access to execute orders. In so doing, the Exchange expects to increase the speed of automatic executions. It is also anticipated that modifications to the Exchange systems will further speed executions by reducing the number of trading messages, which should ultimately reduce latency within Exchange systems.

(c) Updating the Roles of the Various Exchange Market Participants

As it updates its technology to reflect the New Model’s mode of trading, the Exchange is also changing the roles of the various market participant groups who use that technology to reflect new patterns of trading and new obligations. The most significant change will be the phasing out of the NYSE’s specialist system and the adoption of a designated market maker structure. But in addition, the Exchange is also making changes to the role of, and tools available to, the Floor broker, and is also giving new tools to Off-Floor participants that will enable them to participate in the market more directly. These changes are described in more detail below.

(1) Designated Market Makers

(A) Overview

The Exchange believes that its new market model requires a new market maker¹⁰¹ with the ability (and affirmative obligation) to contribute liquidity in a security by trading competitively for its dealer account. The Exchange therefore proposes to phase out the existing specialist system and to establish in place of the specialists Designated Market Makers who will be employees of Designated Market Maker Units (“DMM Units”).¹⁰²

Although the specialist system has served a central role in equities trading at the NYSE for well over a century, specialist trading is, by nature, well-suited to manual trading, and less suitable for electronic trading. As a result, although specialists were able to provide a strong stabilizing influence when all or most trading was manual, that influence has waned as the markets have evolved toward mostly or fully automatic trading. And while the Exchange continues to believe that there is value to having a designated person assigned to maintain an orderly market in its listed securities, the Exchange nevertheless recognizes that the existing scheme of rules and obligations governing specialists can unduly hamstring them in an electronic market and prevent them from easily fulfilling their appointed role.

To address this new reality, DMM Units will be given tools and opportunities that are not available to specialists currently, but that are more commensurate with trading in electronic markets. At the same time, the Exchange will preserve several aspects of the specialist system that are beneficial to the market and the investing public. For example, like the specialist system, and in contrast to the competitive market maker structure, each NYSE-listed security will be assigned to a single DMM Unit, but unlike the specialist system, each DMM will have a minimum quoting requirement in its assigned securities, and DMM Units who do not meet the minimum quoting requirement will be ineligible to participate in the process to receive additional securities. Through this combination of carrot (exclusivity) and stick (minimum quoting

¹⁰¹ The term “market maker” shall have the same meaning as that term in section (3)(a)(38) of the Act. See e-mail from Deanna G. W. Logan, Associate General Counsel, NYSE to David Liu, Assistant Director, Division, Commission, dated July 16, 2008 (making clarifying edits) (“July 16th e-mail”).

¹⁰² As of October 15, 2008, pursuant to proposed Rule 104(f)(iv) DMMs will be designated as “market makers” on the Exchange for purposes of the Act. See July 16th e-mail, *supra* note 101.

requirement), the Exchange believes that it can ensure greater depth and liquidity, and consequently, better prices for customers, in its listed securities.

Current NYSE Rule 104 will be amended and renamed 104T as described further below and will be operative and effective until October 14, 2008. Thereafter, the Exchange proposes a new Rule 104 that will be effective October 15, 2008.

(B) DMMs and DMM Units Approved by the Exchange

The Exchange intends to require, in new Rule 103, that member organizations who want to operate a DMM Unit file an application in writing and be approved by the Exchange prior to operating a DMM Unit. Accordingly, the Exchange is proposing to amend NYSE Rule 2 to include definitions of "Designated Market Maker" ("DMM") and "Designated Market Maker Unit." The application and approval requirement would be waived for existing NYSE specialist firms that decide to create a DMM Unit.¹⁰³

In deciding whether to approve an application, the Exchange will consider, among other things, the member organization's market making ability, the capital that the member is willing or able to make available for market making and such other factors as the Exchange deems appropriate.¹⁰⁴

DMMs employed by DMM Units to work on the Floor of the Exchange will be required to be approved and registered with the Exchange. In order to obtain such approval, applicants will need to submit an application to NYSE Regulation, Inc., which will assess an applicant's regulatory fitness, and successfully complete a qualifications examination prescribed by the Exchange. Once approved and registered as a DMM, such individual may conduct business only on behalf of the DMM Unit in which he or she is employed.

A DMM Unit may also employ individuals who may be called upon to act as a Relief DMM. A Relief DMM may be called upon to act as a DMM in one of its securities for an entire business day.¹⁰⁵ In such instances the Relief DMM is required to have net liquid assets of \$150,000.¹⁰⁶ A Relief DMM that is called upon to act as a Relief DMM for less than the entire business day, usually for lunch periods, etc. has

no such requirement; however, dealings effected by such Relief DMM while relieving the regular DMM must be made for the account of the regular DMM whom he or she is relieving.¹⁰⁷

As with existing specialist firms, individuals who are currently employed by specialist member organizations as specialists and relief specialists will be automatically approved and registered as DMMs and Relief DMMs.¹⁰⁸

In addition, pursuant to proposed NYSE Rule 104(j), a Floor Governor will have the ability to designate an individual to be a Temporary DMM. In the event of an emergency, such as the absence of the DMM, or when the volume of business in the particular stock or stocks is so great that it cannot be handled by the DMMs without assistance, a Floor Governor may authorize a member of the Exchange who is not registered as a DMM in such stock or stocks, to act as Temporary DMM for that day only.

A Temporary DMM that substitutes for a DMM when no DMM is present, is expected to assume the obligations and responsibilities of a DMM for the maintenance of the market.

A member who acts as a temporary DMM by such authority is required to file a report showing (a) the name of the stock or stocks in which he or she so acted, (b) the name of the regular DMM, (c) the time of day when he or she so acted, and (d) the name of the Floor Governor who authorized the arrangement with Division of Market Surveillance of NYSE Regulation, Inc., at the end of the day.

Pursuant to proposed NYSE Rule 104(j), a Floor Governor will not give such authority for the purpose of permitting a member not registered as DMM habitually to relieve another DMM at lunch periods, etc.

(C) DMMs Not Responsible Broker-Dealer for All Orders

The Exchange proposes to amend the provision in Exchange rules that makes specialists the "responsible broker-dealer" for purposes of Limit Order Display and other obligations under both the Act and regulations promulgated thereunder.

Under NYSE Rule 60, specialists are currently solely responsible for quoting the highest bids and lowest offers on the Exchange for all reported securities. This rule is appropriate in a manual trading environment, where the specialist post was the primary locus for trading in securities and where the

specialist oversaw the reporting of all executions.

Because of automation, the rule makes less sense today. Among other things, market participants who are not specialists post their interest electronically in the form of DOT orders and/or e-Quotes (broker agency interest files), and Exchange systems process and publish that interest automatically. When there is an execution against the published quote, Exchange systems report the execution, and allocate the executed shares to the various participants automatically. In a manual market, the specialist was solely responsible for quoting the highest bids and lowest offers on the Exchange for all reported securities. The Exchange's quote today now includes the Floor broker's agency interest, specialist interest and electronically entered interest of off-Floor Participants. More importantly, all interest in Exchange systems and included in the quote is identifiable by the Exchange's systems.

Given this change from how interest was processed in a manual environment, the notion that the specialist (or the new DMM) is the sole responsible broker-dealer is obsolete, but not harmlessly so. In particular, because various obligations either attach or do not attach based on whether a participant is designated as the responsible broker-dealer, designating the specialist (or DMM) as the "responsible broker dealer" can lead to unintentionally placing an obligation on a nominal participant while relieving the logically responsible participant of that same obligation.

To address these limitations, the NYSE is proposing to amend NYSE Rule 60 to reflect that the member or member organization entering a bid or offer in a security is the "responsible broker-dealer" to the extent of such bid or offer.¹⁰⁹ The Exchange also proposes to eliminate the phrase "on the Floor" which refers to a "responsible broker or dealer" for the purposes of meeting obligations under Reg. NMS, since the Exchange believes all broker-dealer members and member organizations

¹⁰⁹ See 17 CFR 240.11Ac1-1. For ease of reference, relevant text of Section 11A(c)(1) of the Act and Rule 11Ac1-1 thereunder was included as part of the rule text preceding NYSE Rule 60. Similarly, the text of Section 11(a)(1) of the Act and Rules 11a-1 through 11a2-2 was also included as text preceding Exchange Rule 90. Insofar as it is not the general practice of the Exchange to include federal securities laws and rules in its rule book, the Exchange proposes to delete them from its rule book. Moreover, since the federal securities laws and rules are now readily available through any number of sources, the Exchange has determined that it is no longer necessary to include the aforementioned text as part of NYSE Rule 60 and NYSE Rule 90.

¹⁰³ See Proposed NYSE Rule 103(b)(ii).

¹⁰⁴ See Proposed NYSE Rule 103(a).

¹⁰⁵ See Proposed NYSE Rule 103(f).

¹⁰⁶ See Proposed NYSE Rules 104T.24 and 103.21.

¹⁰⁷ *Id.*

¹⁰⁸ See Proposed NYSE Rules 103(c)(ii) and (f)(iii).

bear these responsibilities. In addition, the Exchange proposes to amend the rule to reflect that the Exchange rather than the specialist or DMM disseminates quotations to vendors.

The Exchange also proposes to remove subsection (a)(iv) from Exchange Rule 1001, which provides that “the specialist shall be the contra party to any automatic execution where interest reflected in the published quotation against which the automatically executing order was executed is no longer available.” This rule was adopted to address an anomaly of the Exchange’s systems that no longer exists. Specifically, at the time the rule was adopted, Exchange systems were programmed such that where the identity of the interest for an automatically executing order was unknown, the specialist would automatically be assigned as the contra party for that trade, even where interest from other market participants was reflected in the published quotation. Since the Exchange systems are now capable of accurately identifying each participant whose interest is reflected in the published quote and who should be held responsible to be the contra party for the automatically executing order, the Exchange believes it is no longer necessary that the market maker in the security shoulder the burden of being the contra party to un-reconciled executions. Similarly, NYSE Rule 123B(b)(2)(B) is proposed for deletion reflecting the fact that reports of executions are handled by Exchange systems and are no longer sent by specialists, and will not be sent by DMMs.

(D) DMMs Retain the Specialists’ Affirmative Obligation

As noted above, although the Exchange does not intend to impose undue obligations on DMMs as responsible broker-dealers, the Exchange intends to preserve the requirement that a DMM has an affirmative obligation to the quality of the markets in securities assigned to it. The function of a member acting as a DMM on the Floor of the Exchange includes the maintenance, in so far as reasonably practicable, of a fair and orderly market on the Exchange in the stocks in which he or she is so acting.¹¹⁰ The maintenance of a fair and orderly market implies the maintenance of price continuity with reasonable depth, to the extent possible consistent with the ability of participants to use reserve orders, and the minimizing of the effects of temporary disparity between supply

and demand.¹¹¹ In connection with the maintenance of a fair and orderly market, it is commonly desirable that a member acting as DMM engage to a reasonable degree under existing circumstances in dealings for the DMM’s own account when lack of price continuity, lack of depth, or disparity between supply and demand exists or is reasonably to be anticipated.¹¹²

In addition, DMM Units will be required to maintain adequate minimum capital¹¹³ based on its registered securities, and will be required to use their capital to engage in a course of dealings for their own accounts to assist in the maintenance, so far as practicable, of a fair and orderly market. Transactions on the Exchange by a DMM for the DMM Unit’s account are to be effected in a reasonable and orderly manner in relation to the condition of the general market and the market in the particular stock.¹¹⁴ To support this requirement, the Exchange will continue to provide depth guidelines¹¹⁵ for each security.

DMMs will further be required to maintain displayed bids and offers at the NBBO for a certain percentage of the trading day in assigned securities. Specifically, with respect to maintaining a continuous two-sided quote with reasonable size, DMMs must maintain a bid or offer at the National Best Bid and National Best Offer (“inside”) for securities in which the DMM is registered at a prescribed level based on the average daily volume of the security.¹¹⁶ Securities that have a consolidated average daily volume of

less than one million shares per calendar month are defined as Less Active Securities and securities that have a consolidated average daily volume of equal to or greater than one million shares per calendar month are defined as More Active Securities.¹¹⁷

For Less Active Securities, a DMM Unit must maintain a bid or an offer at the NBBO for at least 10% of the trading day during a calendar month. For More Active Securities, a DMM Unit must maintain a bid or an offer at the NBBO for at least 5% or more of the trading day during a calendar month. DMM Units will be expected to satisfy the quoting requirement for both volume categories in their assigned securities.

Time at the inside is calculated as the average of the percentage of time the DMM has a bid or offer at the inside. For example, if a DMM maintains a quote at the National Best Bid for 6% of the trading day and a quote at the National Best Offer for 4% of the trading day, then the average of these times is 5%. *The Exchange will determine whether a DMM Unit has met its quoting requirements on a month-by-month basis by calculating:*

- (1) The “Daily NBB Quoting Percentage” by determining the percentage of time a DMM Unit has at least one round lot of displayed interest in an Exchange bid at the National Best Bid during each Trading Day for a calendar month;
- (2) the “Daily NBO Quoting Percentage” by determining the percentage of time a DMM unit has at least one round lot of displayed interest in an Exchange offer at the National Best Offer during each Trading Day for a calendar month;
- (3) the “Average Daily NBBO Quoting Percentage” for each Trading Day by summing the “Daily NBB Quoting Percentage” and the “Daily NBO Quoting Percentage” then dividing such sum by two;
- (4) the “Monthly Average NBBO Quoting Percentage” for each security by summing the security’s “Average Daily NBBO Quoting Percentages” for each Trading Day in a calendar month then dividing the resulting sum by the total number of Trading Days in such calendar month; and
- (5) for the total Less Active Securities (More Active Securities) assigned to a DMM unit, the Exchange will determine the “Aggregate Monthly Average NBBO Quoting Percentage” by summing the Monthly Average NBBO Quoting Percentages for each Less Active Security (More Active Security) assigned to a DMM unit, then dividing such sum by the total number of Less Active Securities (More Active Securities) assigned to such DMM Unit.

Below is an example of a quoting requirement calculation. For purposes of this example, it is assumed that DMM Unit 1 has two assigned securities, A

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Capital requirements are identical to the current capital requirements computed in accordance with Rule 15c3-1 and current NYSE Rule 104. In this filing the Exchange seeks to move the placement of these requirements into proposed NYSE Rule 103.

¹¹⁴ See Proposed NYSE Rule 104(g)(i).

¹¹⁵ Currently, the Exchange provides each security with a daily depth guideline and depth sequence size that reflects its individual trading characteristics including intra-day price volatility. Depth sequence sizes over which depth is calculated and the depth guidelines against which the calculated depth movements are compared are dynamically updated each day for each symbol based on the symbol’s recent trading characteristics. These characteristics include: Its previous NYSE closing price; its NYSE adjusted volume; and its intra-day consolidated high/low range. Systemic calculations of these values occur each day and are used in the creation of a formulaic individualized depth guideline and depth sequence size that is unique for each security. The Exchange proposes to provide DMMs with the same information pursuant to proposed NYSE Rule 104(f)(iii).

¹¹⁶ The Exchange intends to formally file with the Commission a proposal to modify the method by which the Exchange allocates and reallocates securities to specialist units; see July 17th e-mail, *supra* note 3.

¹¹⁷ See Proposed NYSE Rule 104(a)(1)(A).

¹¹⁰ See Proposed NYSE Rule 104(f)(ii).

and B, and that there were 5 trading days in the selected calendar month.

The Average Daily NBBO for a DMM Unit is calculated for each security by summing the daily NBB and NBO of

each security for that day and dividing that number by two:

Trading days	NBB	NBO	Calculation average daily NBBO for DMM Unit 1	Average daily NBBO
Security A				
T1	4%	6%	4% + 6% = 10% divided by 2 = 5%	5%
T2	3%	5%	3% + 5% = 8% divided by 2 = 4%	4%
T3	4%	4%	4% + 4% = 8% divided by 2 = 4%	4%
T4	6%	8%	6% + 8% = 14% divided by 2 = 7%	7%
T5	5%	5%	5% + 5% = 10% divided by 2 = 5%	5%
Security B				
T1	5%	7%	5% + 7% = 12% divided by 2 = 6%	6%
T2	4%	6%	4% + 6% = 10% divided by 2 = 5%	5%
T3	6%	8%	6% + 8% = 14% divided by 2 = 7%	7%
T4	7%	9%	7% + 9% = 16% divided by 2 = 8%	8%
T5	9%	9%	9% + 9% = 18% divided by 2 = 9%	9%

The monthly average NBBO quoting percentage for a DMM Unit for each security is then calculated by summing

the security's average Daily NBBO Quoting Percentages for all the Trading Days of the calendar month and then

dividing the resulting total by the number of Trading Days in the calendar month (in this instance 5).

Average daily NBBO					Calculation monthly average NBBO for DMM Unit 1	Monthly Average NBBO
T1	T2	T3	T4	T5		
Security A						
5%	4%	4%	7%	5%	5% + 4% + 4% + 7% + 5% = 25% divided by 5 = 5%	5%
Security B						
6%	5%	7%	8%	9%	6% + 5% + 7% + 8% + 9% = 35% divided by 5 = 7%	7%

The Aggregate Monthly Average NBBO Quoting Percentage for a DMM

Unit is determined by summing the Monthly Average NBBO for each

security and then dividing such sum by the total number of securities.

Aggregate Monthly Average for Specialist Unit 1

Monthly Average NBBO Security A + Monthly Average NBBO Security B divided by 2
 5% + 7% = 12% divided by 2 = 6% Aggregate Monthly Average

Reserve or other hidden orders entered by the DMM will not be included in the inside quote calculations.¹¹⁸

The Exchange further proposes that DMMs retain the re-entry requirements currently imposed on specialists contained in NYSE Rule 104. As such, DMMs effecting Neutral, Non-Conditional and Conditional transactions will still be required to re-enter liquidity on the opposite side of the market depending on the type of transaction executed by the DMM.¹¹⁹

(E) DMMs Will Not See Public Customer Order Information Before Other Market Participants

In a significant departure from the existing specialist system, DMMs will be required to meet all of the above requirements without the benefit of access to order by order information. The Exchange proposes to gradually decrease the orders provided to the DMM over time as the Exchange completes the required modifications to technology.¹²⁰ Upon completion of the

modifications to Exchange technology, the DMM will no longer receive any order by order information. The decrease in the flow of order information to the specialists will begin in July 2008, with the DMM no longer receiving order by order information by October 15, 2008.

The DMM Unit's system employing algorithms will have access to information with respect to orders entered on the Exchange, Floor Broker agency interest files or reserve interest, to the extent such information is made publicly available. DMM unit algorithms will receive the same information with respect to orders

¹¹⁸ See July 17th e-mail, *supra* note 3.

¹¹⁹ See *supra* notes 52 and 53. DMMs will be subject to the same requirements currently imposed on specialists pursuant to proposed NYSE Rule 104(g)(i)(A). Currently Conditional Transactions operate as a separate pilot, through this filing the Exchange seeks to incorporate those provisions into

the New Model pilot through proposed NYSE Rule 104(g)(i)(A); see July 17th e-mail, *supra* note 3.

¹²⁰ The Exchange will propose in a separate filing to the Commission to reduce the order by order information sent to the DMM prior to the implementation of the changes sought herein. Pursuant to the proposal to be filed, the specialist's system employing algorithms will only have access to orders entering NYSE systems that are market

orders or are limit orders that are priced at the current NYSE quote, in between the current NYSE quote or are at a price that goes through the opposite side of the current NYSE quote.

entered on the Exchange, Floor Broker agency interest files or reserve interest as is disseminated to the public by the Exchange and shall receive such information no sooner than it is available to other market participants.

Although the DMM will no longer receive order by order information, there will continue to be certain times when human interaction is essential to market quality and maintaining a fair and orderly market. Specifically, the Exchange contemplates human interaction during opening and re-opening transactions, closing transactions, block transactions, gap quote situations and when trading reaches LRP that would lock or cross the market, and thus requires a market maker.¹²¹ DMMs will be responsible for choosing the price¹²² and the executions of the orders at that price during those specific situations.

(F) DMMs Will Not Retain the Specialists' Negative Obligation

Given that after October 15, 2008, DMMs will not have access to information on an order by order basis the Exchange further proposes that DMMs not be subject to the negative obligation that currently applies to specialists. The U.S. equities markets have entered a uniquely competitive phase that involves many players—upstairs liquidity providers, multiple OTC dealers, crossing networks and Alternative Trading Systems, and even other national and regional exchanges, which compete through Unlisted Trading Privileges (“UTP”) and dual listings. Generally, the Exchange favors this kind of robust competition, which is exactly the type of competitive landscape that Congress envisioned when it overhauled financial market regulation in 1975 and gave the Commission the flexibility to define dealer obligations.¹²³ However, at the

same time, the Exchange believes strongly that the changing market environment requires participants and regulators to re-examine and discard outmoded ways of thinking about trading and the markets. In particular, as the market has evolved, the Exchange has consistently argued that these changes in the marketplace warrant changes in the scope of the dealer obligation. The increased use of computer application and communication technology makes it difficult, if not impossible for any one market participant to have a time-and-place advantage over any other market participants. At the same time, the fragmentation of liquidity among multiple markets—and the algorithmic tools available to process and manage order flow across multiple markets—often means that the direction and extent of movements in Exchange-listed securities is influenced not by the market maker in the primary market, but by the increases in the average daily trading volume off the Floor, and by trading decisions made away from the Floor.

The transformation of the equities markets in the United States have led the Exchange to conclude that the so-called negative obligation no longer makes sense, and should finally be eliminated entirely. It is an outmoded vestige of trading in a wholly different market environment and is unnecessary. Among other things, the negative obligation arose as a check on specialists, who were, as noted above, at the center of substantially all of the activity in a given security. In that environment, it made sense to require the specialist not to trade for his or her own account unless reasonably necessary to maintain depth of market or continuity of prices. By contrast, a hallmark of modern markets has been the increased dissemination of market information. The result has been a radical increase in market transparency, which gives all market participants, both on and off the Floor, a greater ability to see and react to market changes.

changes in the marketplace might warrant changes in the scope of the dealer obligation:

It might well be that with active competition among market makers and the elimination of trading advantages specialists now enjoy, such a restriction on specialists' dealings would become unnecessary. Because trading patterns and market making behavior in the context of a national market system cannot now be predicted, it appears appropriate to expand the Commission's rulemaking authority in this area so that the Commission may define responsibilities and restrict activities of specialists in response to changing market conditions S. Rep. No. 94-75, at 100 (1975).

Given the market environment and the elimination of the control of order information by the proposed DMM, the Exchange believes that the imposition of a negative obligation on DMMs is unnecessary. Accordingly, the Exchange is proposing that beginning October 15, 2008, DMMs no longer be deemed to be the agent for orders on the Display Book.

Given that there would no longer be an agency function for the DMM, the Exchange is further proposing to rescind NYSE Rule 92(d)(6) (specialist after hours trading when there are unexecuted orders on the Display Book) as being inconsistent with the proposed responsibilities of the DMM. Moreover, the provisions of NYSE Rule 92 no longer apply to the DMM in general as DMMs will not be members that have knowledge of unexecuted customer orders.¹²⁴

The Exchange further proposes to rescind NYSE Rule 92.15 because DMM algorithms will no longer receive order by order information before the order is posted to the Display Book and therefore will be incapable of generating quoting or trading messages based on knowledge of an incoming order. As such this provision of NYSE Rule 92 is unnecessary as it relates to DMM trading. The Exchange notes that the DMM algorithm will receive “Book State” information, which is the same information that is available to other market participants that subscribe to NYSE market data feeds, and shows aggregated displayed interest at various price points.

Notwithstanding that DMMs will not be agents for orders in Display Book, DMMs will continue to facilitate manual transactions on the Exchange. When DMMs are facilitating manual transactions, Exchange systems will provide DMMs the total volume of all orders eligible to participate (*i.e.*, not including Non-displayed Reserve Orders and aggregated Floor broker agency interest designated DND) in the transaction. Those orders will be aggregated by the Exchange system and

¹²⁴ It is for this reason that the Exchange further proposes to delete NYSE Rule 104.10(5)(c)(II)(ii) and 104.10(5)(c)(II)(iii) that restrict the specialist's ability to effect principal purchases of a specialty security in another market center based on the concept of the specialist as a “holder” of orders. The Exchange further proposes to delete the last sentence of NYSE Rule 127(d)(3) because it too restricts trading based on the premise that the specialist is the “holder” of orders. DMMs will no longer serve this function and thus the Exchange proposes to delete the sentence from NYSE Rule 127(d)(3) that reads as follows:

As provided in Rule 92, the specialist may not retain any stock for his or her own account obtained at a price at which he or she holds executable, but unfilled, orders.

¹²¹ See Proposed NYSE Rule 104(a)(2)–(5).

¹²² In an opening and reopening trade, Display Book will verify that all interest that must be executed in the opening or reopening can be executed at the price chosen by the DMM. If all the interest that must be executed in the transaction cannot be executed at that price, the Display Book will block the execution. In addition, when executing blocks (10,000 shares or more or value of \$200,000 or more), trading out of a gap quote situation or an LRP that locks or crossed the market, the Display Book may adjust the execution price if there is enough interest on the Display Book to complete the transaction at a better price.

¹²³ In 1975, Congress eliminated the negative obligation clause from Section 11(b) in connection with the 1975 amendments to the Act. See Securities Acts Amendments of 1975 (“1975 Amendments”), Public Law No. 94-29, 89 Stat. 97. At that time Congress gave the Commission the flexibility to define dealer obligations for both exchange members and over-the-counter market makers. In making the changes, Congress noted that

shown to DMMs as available interest eligible to participate in the manual execution. With this tool, DMMs will have the necessary information to appropriately price the opening (re-opening) transaction, the closing transaction and trade out of GAP quote and LRP locking and crossing the market situations. DMMs will not have access to such information on an order by order basis as Exchange specialists do today.

(G) DMMs Interest for Quoting and Trading

Although DMMs will no longer be restricted by a negative obligation, DMMs will be responsible to commit capital in order to add liquidity to the market when there is little or no liquidity, bridging the gap between supply/demand by purchasing when no one else is buying or selling when no one else is selling as part of their responsibility to maintain a fair and orderly market.

To assist DMMs in meeting their market making responsibilities, DMMs will be permitted to maintain systems that employ algorithms to make trading and quoting decisions ("DMM Interest") on behalf of each DMM.

DMM Interest will be permitted to: (i) Supplement the size of the existing Exchange BBO; (ii) maintain displayed and non-displayed DMM Interest, as described more fully below; (iii) layer interest at varying prices outside the Exchange BBO; (iv) partially or completely fill an order at the Exchange BBO or at a sweep price; (v) trade at and through the Exchange BBO; (vi) trade in a sweep transaction; (vii) provide price improvement; and (viii) match better bids and offers published by other market centers where automatic executions are immediately available.

Exchange systems will prevent DMM Interest from executing against itself, *i.e.*, executing wash trades. The Display Book will ignore any DMM Interest on the opposite side of the arriving marketable DMM Interest and exclude such DMM Interest from the trade. Further, to prevent the excluded DMM Interest from rebidding through the last sale, Exchange systems will cancel the DMM Interest that was excluded in the execution.

DMM Interest will be capable of trading at and through the Exchange BBO in a sweep trade. In those instances where arriving DMM Interest will be priced and sized such that it is able to

trade at and then through the Exchange BBO and the *only* interest represented in the Exchange BBO is DMM Interest, the arriving DMM Interest is incapable of trading because that would constitute a wash sale. In those instances, Exchange systems will once again exclude the DMM Interest at the Exchange BBO and proceed to sweep the Display Book at prices through the excluded DMM Interest. Exchange systems will then cancel the DMM Interest that was excluded and re-quote the new best interest.

(H) DMMs Capital Commitment Schedule

In addition to DMM Interest, DMMs will be permitted to transmit to the Display Book additional liquidity that the DMM is committed to provide at specific price points. This liquidity, known as the DMM Capital Commitment Schedule ("CCS"), will provide the Display Book with the amount of shares that the DMM is willing to trade at price points outside, at and inside the Exchange BBO. CCS is separate and distinct from the DMM Interest. DMM algorithms will be enabled to send the Exchange this schedule of additional non-displayed trading interest. The Exchange anticipates that this will create increased opportunities for price improvement on the Exchange.

CCS interest can be accessed by the Exchange's systems in two ways, depending on whether an incoming order is between the spread, or at the NYSE BBO. When an order is entered, the Exchange's system will review all the liquidity available on the Display Book including CCS interest and will determine the price at which the full size of the order can be satisfied (the "completion price"). Exchange systems determine the completion price by calculating the unfilled volume of the contra side order (*i.e.*, the volume of the contra side order that exceeds the volume available to execute against it that is then present in the Exchange bid or offer) and reviewing the additional displayed and non-displayed interest available in the Display Book, which may be at more than one price point, including the CCS interest submitted by the DMM unit that is available at the completion price if the CCS interest were to participate at the completion price, and any protected bids or offers on markets other than the Exchange ("away interest") to determine the price

at which the remaining volume of the contra side order can be executed in full.

Exchange systems will then review the amount of liquidity offered by the CCS to determine if the number of shares provided via the DMM's CCS at the completion price is less than the number of CCS shares provided at the next different price that has interest that is one minimum price variation ("MPV") (as that term is defined in Exchange Rule 62¹²⁵) or more higher (in the case of an order to sell) or at the next different price that has interest that is one MPV or more lower (in the case of an order to buy) (hereinafter collectively referred to as "better price"). If the volume of CCS interest that would be accessed is the same at the completion price and the better price, the CCS interest will participate at the completion price with CCS interest yielding to any other interest in Exchange systems at the completion price.

If the number of shares that would be allocated to the DMM CCS interest at the better price is more than the number of shares that would be allocated to the DMM's CCS interest at the completion price, then the order will be executed at the better price with CCS interest yielding to any other interest in Exchange systems at the better price. Any remaining balance of the incoming order will be executed at the completion price against displayable and non-displayable interest pursuant to NYSE Rule 72.

A DMM's CCS interest may only participate once in the execution of an incoming order. As such, CCS interest that may exist at the completion price is ineligible to trade with any remaining balance of the incoming order if the DMM's CCS interest was included in the execution of any portion of such order at the better price.

Any DMM interest included in the displayed quantity and non-displayed quantity will be executed pursuant to NYSE Rule 72.

For example, an order to sell 100,000 at the market is entered into Exchange systems. The bid price is \$50.02. The Display Book has the following available interest:

¹²⁵ Pursuant to NYSE Rule 62, the minimum price variation is currently one cent (\$0.01) except that with respect to equity securities trading on the Exchange at a price of \$100,000 or greater, the minimum price variation shall be ten cents (\$0.10).

Price	Displayable interest	Reserve interest ¹²⁶	CCS
\$50.02	5,000	10,000	10,000
\$50.01	5,000	20,000	15,000
\$49.99	10,000	10,000	25,000
\$49.98	5,000	20,000	15,000

The system has determined that the completion price based on the available liquidity ¹²⁷ will be \$49.98. At the completion price of \$49.98 the DMM's CCS interest is 15,000 shares; however, at the better price of \$49.99 the DMM's CCS interest is 25,000 shares. Exchange systems will therefore, execute 15,000 shares of the sell order at the bid price of \$50.02, representing the 5,000 shares available from displayable interest and 10,000 shares available from reserve interest. The displayable and reserve interest totaling 25,000 will be executed the price of \$50.01. At the price of

\$49.99 Exchange systems will execute the 20,000 shares of the displayable and reserve interest and the 25,000 shares of CCS interest. The remaining 15,000 will be executed at the completion price of \$49.98, representing 5,000 shares from the displayable interest and 10,000 shares from the reserve interest. In allowing CCS to participate in this manner, the incoming buy order receives price improvement on 25,000 shares of its order by executing that amount at the better price of \$49.99.

In the event the number of shares to be allocated to the DMM's CCS interest

at the better price is less than the number of shares to be allocated to the DMM's CCS Interest at the completion price, then the DMM CCS Interest will participate at the completion price with CCS interest yielding to any other interest in Exchange systems at the completion price. For example, an order to sell 100,000 shares at the market is entered into Exchange systems. The bid price is \$50.02. The available liquidity on the Display Book however, is now as follows:

Price	Displayable interest	Reserve interest ¹²⁸	CCS
\$50.02	5,000	10,000	10,000
\$50.01	5,000	10,000	15,000
\$49.99	10,000	10,000	15,000
\$49.98	5,000	20,000	25,000

In this example, the CCS Interest will be executed at the completion price of \$49.98 because it is greater than the CCS interest available at \$49.99. Exchange systems will execute 15,000 shares of the order at the bid price of \$50.02 (5,000 shares displayable interest and 10,000 shares reserve interest). An additional 15,000 shares will be executed at \$50.01 (5,000 shares displayable interest and 10,000 shares reserve interest). The 20,000 shares of displayable and reserve interest will be executed at \$49.99. The remaining portion of the sell order (50,000 shares) will be executed against the 50,000 shares (5,000 shares displayable interest, 20,000 shares reserve interest and 25,000 CCS interest) available at the price of \$49.98. In this case, the CCS model allows the incoming sell order to be filled at the price of \$49.98 through the available CCS interest at that price, whereas, without CCS interest, part of

the order would have received a price inferior to \$49.98.

A DMM's CCS interest inside the Exchange BBO will be accessed by Exchange systems to provide price improvement to incoming orders and to match better-priced bids and offers if available on away market centers. DMMs will not be required to be represented in the bid or the offer in order to provide price improvement interest.

Pursuant to proposed NYSE Rule 1000(e), CCS interest may trade inside the Exchange BBO with interest arriving in the Exchange market that: (i) Will be eligible to trade at or through the Exchange BBO; (ii) will be eligible to trade at the price of interest in Exchange systems representing non displayable reserve interest of Reserve Orders and Floor broker agency interest files reserve interest ("hidden interest"); or (iii) will be eligible to route to away market

interest for execution if the total volume of CCS interest, plus d-Quote interest in Floor broker agency interest files, plus any interest represented by hidden interest would be sufficient to fully complete the arriving interest at a price inside the Exchange BBO. The Display Book will determine the price point inside the Exchange BBO at which the maximum volume of CCS interest will trade, taking into account the volume, if any, available from d-Quotes and hidden interest. The arriving interest will then be executed at that price, with all interest (CCS, d-Quote, non-displayed reserve interest) trading on parity.¹²⁹ Any reserve interest of the DMM that is also eligible to trade at the price inside the Exchange BBO at which the CCS interest will participate will be aggregated with the DMM's CCS interest at that price when the trade execution is allocated.¹³⁰ In this manner, an incoming order may be executed at

¹²⁶ These quantities assume there is no DMM interest represented in the aggregate reserve quantity available on the Display Book. If there were such DMM interest, that interest would be able to trade irrespective of where the DMM's CCS interest trades. The example further assumes that there is no better priced interest at another market center. In the event there is interest available at other market centers that is a "protected quotation" as provided in Reg. NMS, Exchange systems will ship orders to satisfy the Exchange's obligations

with respect to such protected quotations. See generally, Rule 611 of Reg. NMS.

¹²⁷ The available liquidity is determined by adding the sum of 15,000 shares of displayed and non-displayed interest at the price point of \$50.02, the sum of the 25,000 shares of displayed and non-displayed interest at the price point of \$50.01, the sum of the 20,000 shares of displayed and non-displayed at the price point of \$49.99 and the sum of the 25,000 shares of displayed and non-displayed at the price point of \$49.98 and the CCS interest at \$49.98 for a total of 100,000 shares.

¹²⁸ These quantities assume there is no DMM interest represented in the aggregate reserve quantity available on the Display Book. If there were such DMM interest, that interest would be able to trade irrespective of where the DMM's CCS interest trades.

¹²⁹ An explanation of how the parity allocation of executions will be accomplished is provided in the text of subsection (d)(2) of Proposed New Market Model Section.

¹³⁰ See July 16th e-mail, *supra* note 101.

multiple price points in between the quote against d-quotes, Non-Displayed Reserve interest of all participants and CCS interest. However, CCS interest may only participate once if more than one execution is required to fill the order.

(2) Floor Brokers

Along with rules addressed to DMMs, the Exchange is proposing changes to existing rules that apply to Floor brokers.

(A) Elimination of Percentage Orders

The Exchange proposes to amend NYSE Rule 13 and to delete NYSE Rules 70.25(d)(i)(A), 123A.30 and 1000(d)(2)(D) to rescind percentage orders as an acceptable order type on the Exchange. As a result of these proposed amendments, Floor brokers will no longer be permitted to enter CAP-DI orders. In place of this order type, the Exchange intends to provide Floor brokers access to algorithmic technology that will replicate the trading strategy achieved by the use of CAP-DI orders through the Floor broker's handheld electronic device.

The Exchange believes that this change is necessary to improve the efficiency of the Display Book. The current processing of CAP-DI orders impedes the efficiency of the Display Book for a number of reasons. Among other things, CAP-DI orders require the system to monitor and calculate many variables including when the CAP-DI order is eligible for conversion and execution; for each individual execution the system must calculate the number of shares the CAP-DI order is entitled to act dynamically update the remaining quantity of the order until the CAP-DI order is executed in full. Moreover, because CAP-DI orders are now executed in tandem with executions for the specialist account the system is also required to monitor and calculate this information for additional executions.

In addition, system efficiency is affected by the fact that CAP-DI orders may be passively converted. The process of passively converting CAP-DI orders impedes the specialist's ability to function efficiently in an automated market because the specialist must manually complete the passive conversion. The increase in the speed of trading and the delay inherent in requiring the DMM to manually passively convert CAP-DI orders is inconsistent with the Exchange's proposed more electronic model.

(B) d-Quote Trading with Non-Marketable IOC Orders and at the Open and Close

The Exchange further proposes to amend NYSE Rule 70 to enhance the functionality of the Floor broker d-Quote to increase the liquidity available for executions on the Exchange. Specifically, the Exchange proposes to allow d-Quotes to partially or completely fill a non-marketable immediate or cancel order ("IOC") which includes NYSE IOC, Reg. NMS IOC and an Inter-market Sweep Order ("ISO")¹³¹ that are within the d-Quotes discretionary range.¹³²

In allowing the d-Quote to interact with a non-marketable IOC, the Exchange seeks to provide the IOC an opportunity to receive a partial or complete execution. In instances where the d-Quote only partially completes the order, the remaining portion of the non-marketable IOC will be automatically and immediately cancelled.

To further increase the liquidity available at the opening and closing transaction, the Exchange additionally proposes to amend NYSE Rule 70.25(a)(ii) to allow d-Quotes to be active in the opening and closing transactions which will allow a d-Quote to execute up to its maximum amount of discretion.

(C) Floor Broker Interest Published to OpenBook

The Exchange proposes to have Floor broker interest not designated DND published to OpenBook system at every price point. The displayable portions of Floor broker interest designated DND will only be included in OpenBook when such interest is at the Exchange BBO. Floor broker agency interest employing Non-Displayed Reserve functionality, as described further below, will not be included in OpenBook. The Exchange believes that including this interest in OpenBook will benefit customers by providing its customers with a fuller view of the liquidity available on the Exchange.

(d) Changes to NYSE Order Types and Order Processing

(1) Additional Undisplayed Liquidity

Floor brokers, Off-Floor participants and DMMs will continue to have the ability to maintain reserve liquidity on the Exchange; however, the NYSE

¹³¹ See NYSE Rule 13. By their definition, these order types are never quoted but must be automatically executed. Any remaining unfilled portion is immediately and automatically cancelled. Non-marketable IOC orders are immediately and automatically cancelled.

¹³² See Proposed NYSE Rule 70.25(d)(ix).

proposes to modify each participant's ability to provide reserve interest. As a threshold matter, the Exchange intends to amend NYSE Rule 13 to refer to all undisplayed Off-Floor interest as "Reserve Orders." Within that broad category, the Exchange proposes to create two types of reserve interest, "Minimum Display" and "Non-Displayed Reserve."¹³³

(A) Minimum Display Orders

"Minimum Display Order" would require that a portion of the shares in the order, a minimum of one round lot, be designated for display and the Exchange would provide Floor brokers and DMMs with equivalent functionality (collectively "Minimum Display Interest"). Each time a Minimum Display Reserve Order is replenished from reserve interest, a new time-stamp is created for the replenished portion of that Minimum Display Reserve Order, while the remaining reserve interest retains the time-stamp of its original entry.

Minimum Display Interest will participate in manual executions. Exchange systems will include all Minimum Display interest in the aggregate order information available for execution at a price point when the DMM facilitates a manual transaction. The Minimum Display Interest will not be identifiable but will be included, where eligible, in any resulting execution.

The Exchange further proposes that the aggregate interest of Minimum Display Interest be included in the aggregate interest available to be seen by the DMM in order to provide information about orders available in Exchange systems for response to a Floor broker's market probe request pursuant to NYSE Rule 115.

Currently, during a manual execution, Floor broker DND reserve interest that has a displayed quantity and Reserve Orders pursuant to NYSE Rule 13 are included in the aggregated order information displayed to the specialist only during manual executions (e.g., the opening and closing trade on the Exchange, resuming trades after a LRP is reached, or during a gap quote situation). Pursuant to Exchange Rule 70.20(h),¹³⁴ access to the Display Book

¹³³ Through this filing, the Exchange proposes to make permanent NYSE Rule 13 governing Reserve Orders. The Exchange further proposes conforming amendments in proposed NYSE Rules 70(e) and 104 to provide Floor brokers and DMMs with equivalent functionality.

¹³⁴ NYSE Rule 70.20(h)(ii) provides, "Specialists, trading assistant and anyone acting on their behalf are prohibited from using the Display Book system to access information about Floor broker agency interest excluded from the aggregated agency

system for information on reserve interest is only for the purpose of effecting transactions that are reasonably imminent. The Exchange proposes to amend NYSE Rules 13, 70.20 and 115 to include as eligible information a DMM may provide, all Minimum Display Order Interest in response to a Floor broker's market probe request. Specifically, the Exchange proposes to amend NYSE Rules 13 and 115 to specifically state that the aggregate interest of the proposed "Minimum Display Order" will be included in the information disseminated pursuant to NYSE Rule 115.

Pursuant to NYSE Rule 115(iii) a specialist may provide information about orders contained in the Display Book, referred to also as a market probe, "* * *" to provide information about buying or selling interest in the market, including aggregated buying or selling interest contained in Floor broker agency interest files other than interest the broker has chosen to exclude from the aggregated buying and selling interest in response to an inquiry from a member conducting a market probe in the normal course of business."

The Exchange further proposes to amend NYSE Rule 70.20(h)(ii) to remove the prohibition against specialist's ability to provide information about Floor broker reserve interest. The Exchange proposes that all Floor broker interest not designated DND be included in the information eligible for dissemination pursuant to NYSE Rule 115.

(B) Non-Displayed Reserve Orders

In addition to Minimum Display Interest, the Exchange further proposes to provide all market participants with the ability to maintain completely non-displayed interest. This proposed type of reserve interest for all market participants will not have any of the order designated for display. The Exchange proposes to create the "Non-Displayed Reserve Order" for Off-Floor participants and provide Floor brokers and DMMs with equivalent functionality.

Non-Displayed Reserve Orders will not be included in the information available to the DMM for manual execution.

Floor brokers may also utilize Non-Display Reserve functionality to enter reserve interest. If the Floor broker uses this functionality, there is no interest

interest other than for the purpose of effecting transactions that are reasonably imminent where such Floor broker agency interest information is necessary to effect such transaction."

displayed in the published quotation, but the interest will be eligible for manual executions because the DMM has the ability to view the Floor broker agency interest in the aggregate. Floor broker agency interest file reserve interest may also be designated as "Do Not Display" ("DND"), meaning such interest will not be available to the DMM for manual executions. As such, Non-Displayed Reserve Order and Floor broker Non-Display functionality designated DND will not participate at the open or the close, during a gap quote situation or when a manual execution is required to trade out of an LRP that locks or crosses the market. Therefore, these types of interest may be executed at an inferior price, and will not be protected in any manual trade—at the choice of the customer.

DMM interest employing Non-Displayed Reserve functionality will, however, be eligible to participate in a manual transaction.

Off-Floor participants that want to have non-displayed liquidity participate in a manual transaction will be required to send a Minimum Display Order. Similarly, Floor brokers that choose to have non-displayed liquidity participate in a manual transactions must not designate such interest DND.

(2) Execution of Bids and Offers

The Exchange believes that the changes proposed herein create a market model where all participants have the ability to compete. As such, the Exchange proposes to amend NYSE Rule 72 to provide to all market participants the ability to receive executions on an equal basis ("parity") with other interest available at that price.¹³⁵ Individual Floor brokers and the DMM registered in the security shall each constitute a single market participant. All Off-Floor orders entered in Exchange systems at the Exchange BBO shall together constitute a single market participant ("Off-Floor Participant") for the purpose of share allocation. Specifically, unlike the

¹³⁵ The amendments proposed herein apply only to round-lot executions. Odd-lot executions will continue to be executed in the Odd-lot system and priced pursuant NYSE Rule 124. The DMM will act as the contra to all odd-lot executions as specialists do currently. The Exchange also proposes to delete NYSE Rule 123A.22 as it is no longer applicable because odd-lot orders are automatically executed in the Odd-lot system. In addition, conforming amendments are proposed to NYSE Rule 70.20 (a) to remove text pertaining to restrictions on a specialist's ability to trade on parity. In addition, the Exchange proposes to remove text in NYSE Rule 70.20(b) that refers to precedence based on size. The Exchange also proposes conforming amendments to NYSE Rule 108 subparagraphs (a) and (b) to remove language that discusses restrictions to parity and precedence based on size.

current specialists, who must yield to all off Floor interest, DMM Interest at any price point will no longer be restricted in its ability to receive shares during an execution and no longer would be required to yield to any Off-Floor interest.

(A) Priority and Parity for Setting Interest

Proposed NYSE Rule 72 would modify the concept of priority to provide that where there is more than one bidder (offerer) participating in an execution and one of the bids (offers) was established as the first made at a particular price and such bid or offer is the only interest when such price is or becomes the best bid or offer published by the Exchange (the "Setting Interest"), that the displayed portion of such Setting Interest is entitled to priority. In order to qualify as Setting Interest, it must have been the *only*¹³⁶ interest quoted at a price. Only the *quoted* (i.e., displayed) portion of the Setting Interest is entitled to priority ("Priority Interest").

Exchange systems will be responsible for share allocation and thus will create interest files for each market participant.

Exchange systems will allocate the first 15% of any execution (a minimum of one round lot)¹³⁷ at that price to the Priority Interest. For the remainder of that execution, Setting Interest will receive executions on parity with other interest available at that price. Exchange systems will repeat the allocation logic for the Setting Interest until the Priority Interest is completely executed. Any remaining non Priority Interest of the Setting Interest will be executed on parity.

The Exchange proposes to have Priority Interest retain its standing even if the Exchange BBO moves away from the price point. For example, assume that the DMM is established as the Setting Interest at \$30.05 bid. A sell order is executed against the DMM's Priority Interest at \$30.05 that does not completely execute the DMM's Priority

¹³⁶ If, at the time of quoting, Non-Displayed Reserve Orders or Floor broker and DMM interest employing Non-Displayed Reserve Functionality exist at the price point along with a single order or quote that has a published quantity, the single order will be deemed to be a setting order even if the Hidden Reserve Orders and Floor broker and DMM interest employing Hidden Reserve Functionality arrived first. In addition, if prior to quoting, there are two orders at the price point and one of those orders cancels, the remaining order that is the only interest quoted at the price is conspired the Setting Interest. *see* Proposed Rule 72(a)(ii); *see* also July 17th e-mail, *supra* note 3.

¹³⁷ All allocations will be done on a round lot basis. If 15% would result in the Priority Interest receiving a mixed lot, Exchange systems will round up to the nearest round lot.

Interest. The Exchange best bid then moves to \$30.07. If the Exchange best bid again becomes \$30.05 on that day, the remaining portion of the DMM's Priority Interest will again receive the first 15% of any subsequent execution at the \$30.05 bid until the DMM's Priority Interest is executed or cancelled, trading in the stock is halted or the trading session ends.

Partial cancellations will count first against the non Priority interest of any Setting Interest. All allocations to the Setting Interest will be decremented from the Priority Interest first whether the allocation is based on priority or parity. Setting Interest may be executed on parity with no priority allocation if the quote moves to a better price point and thereafter an incoming order exceeds the shares available for execution at the newly established Exchange BBO. In those instances, the Setting Interest will be executed on parity and the Priority Interest will be decremented first. For, example, assume that Customer X is established as the Setting Interest at a bid of \$30.05. A sell order is executed against Customer X's Priority Interest at \$30.05 that does not completely execute Customer X's Priority Interest. The Exchange best bid then moves to \$30.07. A subsequent sell order is entered into Exchange systems to execute against the \$30.07 bid that exceeds the number of shares available for execution at the \$30.07 bid. There is bid interest at the price of \$30.06. In order to complete the execution of the sell order, Exchange systems will execute the remainder of the order against all the available interest at the bid prices of \$30.06 and \$30.05. Customer X's Priority Interest will be executed with all other available interest at \$30.05 on parity as if there was no Setting Interest.

Where there is more than one bidder (offeror) participating in an execution and none of the bids (offers) was established as the Setting Interest at a particular price, the shares will be allocated on parity.

(B) Priority and Parity in the Absence of Setting Interest

Where there is no Setting Interest, Exchange systems will divide the size of the executing order by the number of participants. The total number of shares to be allocated to each participant will be distributed equally among the participants where possible. Within the single Off-Floor Participant, shares executed will be allocated in order of time priority of receipt of Off-Floor Participant Interest into Exchange systems. Executions will be allocated in round-lots. In the event the number of

shares to be executed at the price point is insufficient to allocate round lots to all the participants eligible to receive an execution at the price point, the Exchange systems will create an allocation wheel of the eligible participants at the price point and the available shares will be distributed to the participants in turn.

On each trading day, the allocation wheel for each security is set to begin with the participant whose interest is entered or retained first on a time basis. Thereafter, participants are added to the wheel as their interest joins existing interest at a particular price point. If a participant cancels his, her or its interest and then rejoins, that participant joins as the last position on the wheel at that time.

Thus, if Display Book has displayed two bids from Off-Floor Participants for a total volume of 200 shares, the DMM and three Floor brokers are bidding at the same time for 100 shares each, Exchange systems will divide an execution among the participants as explained below.

Order #1 100 shares & Order #2 100 shares	Book participant
DMM 100 shares	Participant A.
Floor Broker 1 100 shares	Participant B.
Floor Broker 2 100 shares	Participant C.
Floor Broker 3 100 shares	Participant D.

In instances where the shares to be executed are insufficient to split among Participants, the distribution of shares will be executed serially. For example, a market order for 300 shares to sell entered in Exchange systems will allocate 100 shares to Book Participant Order #1, Participant A and Participant B. Subsequently, another order to sell 300 shares at the same price is received by Exchange systems. Those shares will be allocated to Participant C, Participant D, and Order #2 Book Participant.

Non-Displayed Interest at price points between the Exchange BBO will also trade on parity. Thus non-marketable orders that are priced in between the Exchange BBO will be eligible to be executed against all non-displayed interest in Exchange systems at those price points. The total number of shares to be allocated will be distributed based on parity.

The Exchange further proposes to change its overall allocation logic to require that for all executions, at the Exchange BBO or outside the Exchange BBO, the displayable bids (offers) shall trade first with orders to sell (buy). In the event that all displayable interest is completely executed at the price point and there is non-displayable interest available for execution at that price

point, the remainder of the incoming order will be executed against the non-displayable bids (offers) at the price point. The non-displayable bids (offers) will trade on parity with the orders to sell (buy) at the price point.

(e) Additional Amendments

In addition to the substantive amendments discussed above, the Exchange proposes to make certain conforming amendments. Where applicable, the word "specialist" is proposed to be changed to "DMM," "specialty stock" changed to "registered security" and related conforming changes throughout the NYSE Rulebook.

The Exchange further proposes to amend NYSE Rule 7 to delete the term "Exchange Ticket" and define the Exchange BBO as the best bid and offer disseminated by the Exchange to the Consolidated Quotation System.

Conforming amendments are proposed to NYSE Rule 35 in order to remove rule text that refers to "tickets" for entrance on the Floor and clarify that such entrance is subject to Exchange approval.

In NYSE Rule 46A "Executive Floor Governors" the Exchange proposes to change the word "consist" to "comprise" in order to provide greater clarity in the rule. The Exchange further proposes to amend the rule to allow supervising DMMs to serve in the capacity of an Executive Floor Governor.

Conforming amendments are proposed for NYSE Rule 52 in order to clarify that pre-opening indications are disseminated pursuant to NYSE Rule 15 ("Pre-Opening Indications").

The Exchange proposes to amend NYSE Rule 60 ("Dissemination of Quotations") to include the appropriate names for the divisions of the Exchange, include modified vocabulary, remove language relating to "liquidity bid" and "liquidity "offer" from paragraphs (d) and (e), and reflect the accurate citations for the federal securities laws referenced therein. For example, the Exchange proposes to amend references to "reported security" to use the term "NMS security." In addition, references to Rule 11Ac1-1 will be amended to refer to Rule 602 under Reg. NMS. A reference to the Exchange's Market Surveillance Division is proposed to be amended to refer to NYSE Regulation, Inc.¹³⁸ In addition, the Exchange proposes to make clear the role of Initiating Officials in the review of market conditions when a security is in

¹³⁸ The Exchange has proposed similar conforming amendments to NYSE Rules 36 and 460.

“non-firm mode.”¹³⁹ Further, NYSE Rule 60 clarifies the role of Initiating Officials when the Exchange quotation is not available for automatic execution.

NYSE Rule 79A.15(6) is proposed for deletion as “all or none” orders are no longer valid order types on the Exchange. Similarly, NYSE Rule 104A.20 (Specialists exchanging names) and 104A.30 (Specialists “stopping” stock on book) are proposed for deletion. These provisions relate to practices that were utilized when the Exchange had a system of competing specialists. Neither of these practices currently occurs on the Exchange.

The Exchange further proposes to amend NYSE Rules 61, 118.30, 122, 123B, 123C, 902, 904 and 906 to reflect that orders are entered on the Exchange or transmitted to the Display Book rather than presented to the specialist.

NYSE Rule 63.10 will be amended to remove the phrase “in the hands of the specialist and odd-lot dealers,” as that phrase no longer accurately reflects the Exchanges current more electronic trading environment. Similarly, NYSE Rule 79A.15 (“Miscellaneous Requirements on Stock Market Procedures”) will be amended to substitute the phrase “Exchange BBO” for “specialist’s bid or offer” and to make conforming changes. The Exchange further proposes to delete the procedures described in NYSE Rule 79A.20, as the procedure described is no longer used. The Exchange proposes to amend current NYSE Rule 70 (“Bids and Offers”) to have the title more accurately reflect the subject matter of the rule. As such, it is proposed that NYSE Rule 70 be titled “Execution of Floor Broker Interest.” The Exchange further proposed to move the first two paragraphs of NYSE Rule 70 and Rule 70.10 to NYSE Rule 71 (“Precedence of Highest Bid and Lowest Offer”) as the Exchange believes the subject matter in those paragraphs (establishing bids and offers) is more properly addressed in that rule.

NYSE Rule 85 “Cabinet Securities” is proposed for deletion as the Exchange no longer has securities dealings by means of cabinets.

Conforming changes are proposed to NYSE Rule 123A.71 to change the word “specialist” to “members.” NYSE Rule 123A.72 is proposed for deletion because that rule served only to make NYSE Rule 123A.71 applicable to Floor brokers and the proposed amendment to NYSE Rule 123A.71 makes it unnecessary.

The Exchange further proposes to delete Supplementary Material .22 of

NYSE Rule 123A as there are no longer odd-lot brokers operating on the Exchange. NYSE Rule 123A.25 (“Standard Machine Order Forms”) is also proposed for deletion as it is no longer applicable in the current automated trading environment. Moreover, NYSE Rules 123D subparagraph (1) and 299A subparagraph (2) are also proposed for deletion because DMMs will, similar to current specialists, not be allowed to “stop” stock.¹⁴⁰

The Exchange further proposes to amend NYSE Rule 91 (“Taking or Supplying Securities Named In Order”) to delete Supplementary Material .20, because the Exchange will no longer have specialists. NYSE Rule 91.20 under Supplementary Material provides for the executions as principal of orders for accounts carried or serviced by specialist organizations. The Exchange does not propose to allow DMM units to carry or service customer accounts and therefore this portion of the rule is proposed for deletion.

In addition to designating current Rule 104 as Rule 104T and making conforming changes, the Exchange proposes a number of clarifications to describe changes to the text of the Rule. In Rule 104(b)(iii)(B), the exchange proposes to replace “published best bid or offer” with the defined term “BBO,” when referring to the Exchange published best bid or offer. Similarly, the Exchange proposes to replace “best bid and offer” with “BBO” in Rule 104(c)(viii). In NYSE Rule 104T (b)(i) and (d)(i), the Exchange proposes to clarify that DMMs may have reserve interest at the Exchange best bid or offer by substituting the word “or” for “and” in the phrase “Exchange best bid and offer.”

Conforming amendments to sections (9) (a) and (b) of Rule 440G (Transactions in Stocks and Warrants for the Accounts of Members, Allied Members and Member Organizations) are proposed.

Conforming amendments are proposed to NYSE Rule 1000 in order to reflect that the order size eligibility, on the Exchange is up to a maximum of 6,500,000 shares.

(f) Implementation Schedule

The proposed amendments herein require the Exchange to make significant modifications to Exchange systems. Such modifications must be done over time. The Exchange therefore proposes that amendments approved herein be implemented over time pursuant to the schedule outlined below.

(1) Non-Pilot Rules

The Exchange proposes that upon Commission approval of the instant filing, that the amendments to NYSE Rules 13 be permanent rules of the Exchange. Specifically, the establishment of Reserve Order types on the Exchange and the rescission of CAP orders as viable order types on the Exchange would be approved established as permanent changes to the NYSE rulebook. Similarly, all conforming changes to other Exchange rules to all Floor brokers and DMMs to use equivalent reserve order functionality are established as permanent changes to the NYSE rulebook.

In addition, the Exchange proposes that amendments to NYSE Rules 2 and 103 establishing the DMMs and DMM units be also approved as permanent changes to the NYSE rulebook.

The Exchange further proposes that upon Commission approval of the instant filing that amendments to NYSE Rule 70 that: (i) Allow for the publication of Floor broker interest to Open Book; (ii) provide for the availability for additional liquidity on the Exchange by allowing d-Quote instructions to be active during the open and close; and (iii) offer additional opportunities for price improvement by allowing d-Quotes to trade with non-marketable IOC orders be approved as a permanent change to the NYSE rulebook.

(2) Pilot Rules

The Exchange further proposes to commence the New Model Pilot, subject to Commission approval, at which time, proposed NYSE Rule 72 and proposed NYSE Rule 104T will become effective.¹⁴¹ The New Model Pilot will operate for a period of approximately one year and will be scheduled to end on September 1, 2009 or such earlier time as the Commission may determine to make the New Model Pilot rules permanent.

During the operation of the New Model Pilot, all market participants will have the ability to receive executions on an equal basis (“parity”)¹⁴² with other interest available at that price. It is anticipated that until October 14, 2008, DMMs will still receive order information about orders that are at or between the Exchange quote. DMMs must abide by their affirmative

¹⁴¹ Proposed NYSE Rule 104T will operate until October 14, 2008.

¹⁴² “Parity” refers to the allocation of shares in an execution on an equal basis among all participants to a transaction. A fuller description of parity is included in subsection (d)(2) of Proposed New Market Model.

¹³⁹ See July 17th e-mail, *supra* note 3.

¹⁴⁰ See July 16th e-mail, *supra* note 101.

obligations, meeting his or her requirements to maintain displayed bids and offers at the NBBO and re-enter liquidity pursuant to NYSE Rule 104T. Beginning October 15, 2008, DMMs will no longer be subject to a negative obligation.

Commencing on October 15, 2008, NYSE Rule 104T will cease operation and new NYSE Rule 104 will supersede it. As of October 15, 2008 the DMM will no longer receive any order by order information. DMMs will then be permitted to transmit CCS interest to the Display Book to trade at price points outside, at, and inside the Exchange BBO. The new Rule 104 and the portions of Rule 1000 relating to CCS interest of DMMs are subject to the Pilot that is scheduled to run until September 1, 2009.

During the operation of the New Model Pilot, the Exchange is committed to providing the Commission's Division of Trading and Markets and the Office of Economic Analysis with statistics related to market quality, trading activity, and sample statistics as requested by the Commission.

(g) Conclusion

The Exchange believes that the New Model will allow the Exchange to further enhance the speed of execution currently enjoyed by Exchange customers in the current more electronic trading environment on the Floor while providing the additional anonymity of execution sought by market participants.

The Exchange believes that the proposed modifications will provide a trading environment where market participants are competing on more equal footing relative to their responsibilities to the market. In providing certain functionality to one market participant and not another the Exchange acknowledges the reality that a level playing field is not created by treating unlike participants the same. DMMs, Floor brokers and Off-Floor participants do not have the same responsibilities to the market.

A DMM's ability to trade is constrained by his or her responsibility to cushion market volatility and to replenish liquidity when the DMM trades for his or her own account to establish or increase a position by reaching across the market to trade with the Exchange's published bid or offer. Similarly the Floor broker is constrained in his or her ability to trade for his or her account at the point of sale pursuant SEC Rule 11(a) described above. None of these responsibilities is imposed on the Off-Floor participant. Off-Floor participants are therefore able to trade

unfettered by the constraints of market responsibilities.

However, DMMs, Floor brokers and Off-Floor participants have access to the same market information, although in certain instances Off-Floor participants may be privy to information available about an order that is being "shopped" off the Floor. Moreover, armed with equal information, in certain instances more than DMMs and Floor brokers, the Off-Floor participant uses a computer program for entering orders that employs an algorithm to decide the venue, timing, price, or even the final quantity of the orders to be sent to the market center for execution. In this manner, Off-Floor participants are able to break up a large trade into several smaller trades to manage their risk by having little to no market impact. The Exchange submits that a significant portion of executions on equities markets are the result of the use of algorithms.

The Exchange further submits that the proposed New Model will allow the Exchange to continue to provide a quality market that maintains a competitive market maker responsible for providing liquidity to the market when there is a recognized need for additional liquidity. DMMs will bridge the gap between supply/demand by purchasing when no one else is buying or selling when no one else is selling and by overall maintaining a fair and orderly market.

The New Model will allow the Exchange to maintain the element of human judgment that is particularly valuable in less liquid securities, at openings (re-openings), closings, and in order to trade out of Gap quote and LRP situations that would lock and cross the market. The Exchange further believes that the New Model will allow the Exchange to continue to make quality markets in securities during times of uncertainty, such as when an earnings surprise, news, or an outside event leads to market volatility and/or instability. In these situations, DMMs will act as a liquidity provider to reduce volatility, thus stabilizing prices, and maintaining a fair and orderly market that is the hallmark of the NYSE.

2. Statutory Basis

NYSE believes that the proposed rule change is consistent with Section 6(b) of the Act¹⁴³ in general, and the requirement in Section 6(b)(5) of the Act,¹⁴⁴ in particular, that the rules of an exchange be, among other things, 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. The Exchange believes the proposed rule change is consistent with these principles 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. The Exchange further believes that the proposed New Model will increase the speed and efficiency of automatic execution on the NYSE and create a trading environment where market participants compete more equally.

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

The proposed amendments reflect significant changes to the structure of the Exchange's market. As such, there have been numerous valuable discussions with Exchange customers, members, and member organizations concerning the concepts underlying these proposals. Specifically, there have been discussions concerning the structure and functioning of the new market model received from various constituencies of the Exchange. For example, current specialists and specialist member organizations commented on the nature of the duties and responsibilities of the DMM in the new model through a review of the current duties and responsibilities of today's specialists. This resulted in several suggestions that were made part of proposed Rules 104 with respect to duties and obligations of DMMs, Rule 72 with respect to parity allocation of executions and amendments to Rule 1000 with respect to the functioning of the Capital Commitment Schedule interest to be entered by DMMs. Customers of the Exchange provided input on the proposed revisions to the Reserve Orders (Rule 13) and parity allocation of executions. In certain instances, member organizations have provided written comment to draft rule text. Where necessary, those comments

¹⁴³ 15 U.S.C. 78f(b).

¹⁴⁴ 15 U.S.C. 78f(b)(5).

have been addressed in modifications to the original proposal.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which NYSE consents, the Commission will:

(A) By order approve such proposed rule change; or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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-2008-46 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.
- All submissions should refer to File Number SR-NYSE-2008-46. 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, 100 F Street, NE., Washington, DC 20549, on official business days

between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal offices 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-2008-46 and should be submitted on or before August 13, 2008.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴⁵

Florence E. Harmon,
Acting Secretary.

[FR Doc. E8-16823 Filed 7-22-08; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-58175; File No. SR-Phlx-2008-12]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval to a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Relating to an Exemption From Examination Requirements for Off-Floor Traders

July 16, 2008.

On April 14, 2008, 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"),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Phlx Rule 604(e)(iii) to modify the category of persons who are exempt from the requirement that Off-Floor Traders³ complete the Series 7 General Securities Registered Representative Examination ("Series 7"). On May 30, 2008, Phlx filed Amendment No. 1 to the proposed rule change.⁴ The proposal was published for comment in the

¹⁴⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Phlx Rule 604(e)(i) defines an off-floor trader as a "person who is compensated directly or indirectly by a member or participant organization for which the Exchange is the DEA [Designated Examining Authority], or any other associated person of such member or participant organization, and who executes, makes trading decisions with respect to, or otherwise engages in proprietary or agency trading of securities, including, but not limited to, equities, preferred securities, convertible debt securities or options off the floor of the Exchange."

⁴ Amendment No. 1 replaced and superseded the original filing in its entirety.

Federal Register on June 12, 2008.⁵ The Commission received no comments on the proposal. This order approves the proposed rule change, as modified by Amendment No. 1.

Phlx states that the Series 7 exemption meant to apply to persons who traded on its equity trading floor and were associated with either a specialist organization or a floor brokerage organization that executed orders on an agency basis ("Former Floor Participants"). When Phlx replaced its equity trading floor with XLE, an electronic trading system, certain persons became Off-Floor Traders by definition, and consequently subject to the requirement to pass the Series 7. Phlx did not intend for this category of persons to be subject to the Series 7 requirement. Therefore, Phlx proposed to exempt these persons from the Series 7 by expanding the exemption in Rule 604 to include Market Maker Authorized Traders (MMATs) and Off-Floor Traders who only handle and/or make trading decisions regarding agency orders and any bona fide errors related to those agency orders.

Phlx believes the proposed rule change will make the administration of the Series 7 requirements for Off-Floor Traders more efficient, because under the current rule, the exemption applies to persons "primarily engaged" in submitting orders to XLE or making trading decisions with respect to XLE, which requires the Former Floor Participant and the Exchange's enforcement staff to make a judgment call. Under the proposed rule, however, an XLE participant needs to register with the Exchange in order to be an MMAT, so the determination of MMAT status is straightforward. In addition, Phlx staff can examine what type of orders (agency or proprietary) Off-Floor Traders handle for net capital purposes and could identify whether Off-Floor Traders would qualify for the proposed exemption. Finally for the same reasons, the proposed rule change should improve Phlx's enforcement efforts, because Phlx and its members will be able to more easily determine which persons are subject to the Series 7 requirement.

After careful review of the proposal, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to

⁵ See Securities Exchange Act Release No. 57923 (June 4, 2008), 73 FR 33479 (June 12, 2008).