



June 21, 2007

Nancy M. Morris, Esq.
Secretary
Securities and Exchange Commission
Station Place
100 F Street, NE
Washington, D.C. 20549-9303

Re: SR-NYSE-2007-09 ("Compensation System Failure")

Dear Ms. Morris:

The New York Stock Exchange (the "Exchange" or "NYSE") is writing to respond to the letter¹ submitted by one commenter in response to the Securities and Exchange Commission's (the "Commission" or "SEC") solicitation of comments in connection with the NYSE Compensation System Failure filing.²

Background

On January 26, 2007, the NYSE filed with the Commission SR-NYSE-2007-09 to adopt Exchange Rule 18 ("Compensation in Relation to Exchange System Failure"), in order to provide a form of compensation to member organizations when a loss is sustained in relation to an Exchange system failure. In the proposal, the NYSE also proposed to amend Exchange Rule 134 ("Differences and Omissions-Cleared Transactions ("QTs")) to require that profits equal to or greater than \$5,000 gained in relation to an Exchange system failure would be remitted to the Exchange to be included in funds available for distribution pursuant to proposed Rule 18.

¹ See The Trading Committee of the Securities Industry and Financial Markets Association ("SIFMA"), letter dated April 26, 2007, hereinafter referred to as "the commenter."

² See Securities Exchange Act Release No.55555 (March 29, 2007), 72 FR 16841 (April 5, 2007)(SR-NYSE-2007-09). The Exchange submitted Amendment No. 1 to the Compensation System Failure filing on February 1, 2007. Amendment No. 2 to the Compensation System Failure filing was submitted on March 28, 2007.

Pursuant to the proposal, Exchange member organizations would be eligible to submit a written claim for compensation when an Exchange system failure as defined by the rule resulted in a net loss of \$5,000 or more to the member organization. A panel consisting of three (3) Floor Governors and three (3) Exchange employees (the "Compensation Review Panel") would review each claim to determine that there is a valid claim pursuant to the proposed rule and what, if any, amount should be paid to the claimant.

The proposal sets forth three potential sources of funds to pay claimants. The NYSE intends to provide the main source of funding each month by contributing \$500,000 ("Monthly Contribution") to be used for reimbursements. In addition, in the event that less than \$250,000 of the Monthly Allotment is paid out for a given calendar month, \$50,000 of that month's remaining Monthly Allotment ("Supplemental Allotment") would be added to a supplemental fund available for payment in subsequent calendar months. The third proposed source of funding would come from amending Exchange Rule 134.40 to require member organizations to remit to the Exchange any profit equal to or greater than \$5,000 ("Profit Contribution") when such profit was the result of an error transaction in a member organization's account in relation to an Exchange System Failure. The Profit Contribution would also be used to reimburse claimants after the Monthly Allotment and any Supplemental Allotment are exhausted.

Response to Comments on Proposed Compensation System Failure

A. Defining System Failures on the Exchange

The Exchange agrees with the commenter's general premise that system failures are one of the more significant issues facing the securities industry today. As such, the Exchange would welcome an opportunity to work with the Commission and other industry participants to establish a uniform standard to address this issue for all exchanges.³ Nevertheless, until such time as that can be accomplished, the Exchange must adopt a means of addressing this issue that is consistent with the Exchange's business model. To that end the Exchange reviewed NYSE Arca Rule 13.2 and proposed a rule that is consistent with the NYSE's business model. Proposed Rule 18 does not copy the NYSE Arca Rule; rather, it adopts the basic tenet of providing a framework for compensation and creates a method that is compatible to the NYSE's business model.

³ Any such dialogue would include the issue of limited liability for exchanges; however, the instant filing is not the appropriate forum to address the unbroken line of legal authority that self regulatory organizations have absolute immunity for running their markets. See D.L. Capital Group, LLC v NASDAQ Stock Market, Inc., 409 F.3d 93, 100 (2d Cir.2005); see generally, D'Alessio v. New York Stock Exchange, Inc., 258 F.3d 93, 105 (2d Cir. 2001).

The proposed rule would establish a method of providing member organizations with compensation for system failures. A System failure is defined as a malfunction of the Exchange's physical equipment, devices and/or programming which results in an incorrect execution of an order or no execution of an order that was received in Exchange systems. The Exchange originally chose not to include queuing⁴ in the definition of a system failure because queuing occurs due to lack of capacity⁵ and not a malfunction of a system. The Exchange has however, decided to amend the proposed definition of system failure such that references to queuing are removed.

In addition to the aforementioned modification to the proposed rule, the Exchange took affirmative steps to reasonably handle order flow by doubling its capacity in order to accommodate order information. The Exchange continues to increase its capacity and is confident that these changes will reduce the instances of queuing in Exchange systems.

Moreover, the NYSE is in the process of reorganizing its systems such that member organizations will no longer receive an acknowledgement of the delivery and receipt of an order from its low level systems. Rather, receipt of orders will be generated from the systems that are in effect the equivalent of the NYSE Display Book[®]. NYSE customers will therefore be able to have greater confidence in receipts of delivery. Again, the Exchange believes that this system reorganization should drastically reduce the occurrence of delays in order processing as a result of large volume.

B. Clarification of Error Rules and Gains

A system failure is not an error although such failures may cause member organizations to have errors. Trading errors on the Exchange occur when an order is executed outside of the customer instructions as entered in the electronic order tracking system of the Exchange pursuant to Rule 123(e)⁶.

⁴ Queuing is defined as delays in order processing as a result of large volume.

⁵ It should be noted that exchanges are not required to and neither do exchanges have the ability to provide infinite capacity for order flow. Moreover, no exchange can predict an aberrant surge in order flow on any given trading day.

⁶ Pursuant to Exchange Rule 134 subparagraphs (g) and (h) an error may include, but is not limited to the following types of situations discussed below.

- When a held or a not held order is executed:
 - in the wrong security; or
 - on the wrong side of the market; or
 - at a price outside the limit price of the order; or
 - by over buying or over selling; or
 - in duplicate.

On February 27, 2007 and March 28, 2007 Exchange systems experienced delays in delivering execution reports in certain stocks. In some cases, duplicate executions resulted. The delays further resulted in some marketable customer orders remaining unexecuted at the Close or cancellations of open orders not being processed before the orders were executed. Although it is unclear whether any or all of the transactions were “errors” as currently defined by the Exchange, the NYSE granted limited relief⁷ to permit Floor broker member organizations to use their error accounts (i) to execute customer orders which remained unexecuted notwithstanding that the order was marketable at some point in time between order entry on the Floor of the Exchange up to and including the closing transaction, or (ii) to unwind trades that were the subject of a valid cancellation. This remedy was the Exchange’s administrative solution of how the Floor broker member organizations could timely and efficiently process orders that were subject to the above described circumstances on February 28, 2007 and March 28, 2007.

The commenter is incorrect that the Exchange discriminated between Floor members and “upstairs” members on February 27, 2007 and March 28, 2007. On both occasions, the Exchange provided electronic mail communication to its non-Floor member organizations in order to alert those members to the problem. Non-Floor member

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- When an error is committed in the execution of a not held order as it relates to symbol, side, or price as noted above, which causes such not held order to remain unexecuted.
 - An error may also occur when: (i) there is a failure to execute a held order when market conditions permitted; or (ii) when a not held order remains unexecuted, in whole or in part, due to the order being lost or misplaced, or as a result of a system malfunction. A system malfunction is the failure of physical equipment, devices and/or programming employed by the Floor broker or otherwise provided by the Exchange and used in the execution of orders.

⁷ See NYSE Information Memo 07-20 (February 28, 2007) (Use of Floor Broker Error Accounts in Connection with Delays in Order Processing due to Large Volume on February 27, 2007); see also NYSE Information Memo 07-29 (March 30, 2007)(Use of Floor Broker Error Accounts in Connection with System Issues Experienced on March 28, 2007). In issuing the aforementioned information memos, the Exchange was in complete compliance with federal securities laws. The information memos were purely administrative. Each information memo specified how the Exchange proposed to handle the specific situations in question. The information memos do not constitute “...a stated policy, practice or interpretation with respect to the meaning, administration or enforcement of an existing rule,” and therefore pursuant to Rule 19b-4 were not required to be filed with the Commission. See 17 CFR 240.19b-4.

organizations had equal opportunity on those dates to avail themselves of the services of Floor broker member organizations in order to check the status of electronically transmitted orders and trade them manually. Moreover, all member organizations of the NYSE are eligible to submit claims for losses pursuant to the proposed rule.

The Exchange is equally committed to all of its member organizations and going forward where appropriate the Exchange will consider providing formal written guidance to non-Floor member organizations as well.

The instant proposal does not modify what constitutes an error. Neither does the proposal modify how member organizations are required to address errors and erroneous reports pursuant to Exchange Rules 134 and 411.

Furthermore, after review, the Exchange has decided to withdraw its request to require member organizations to remit these funds to the Exchange. The Exchange had proposed to amend Exchange Rule 134.40 to establish a Profit Contribution. Pursuant to the proposal member organizations would have been required to remit any net profit of \$5,000 or more to the Exchange. Any such funds received would be included in the Profit Contribution. The Profit Contribution was to be used as additional source of funding for claims after all other funds were exhausted (i.e. Monthly Allotment and any Supplemental Allotment). In the event that the payments to member organizations were satisfied by the Monthly Allotment and any Supplemental Allotment, then the Profit Contribution would be carried over each subsequent calendar month until required for the payments of eligible claims. The Exchange will amend the instant filing to have Exchange Rule 134.40 remain unchanged and member organizations will have to continue to comply with its reporting obligations as outlined in Exchange Rule 134.40.

C. Compensation Review Panel

In order to review qualified claims and administer payments, the Exchange will establish a panel consisting of three (3) Floor Governors and three (3) Exchange employees (the "Compensation Review Panel"). The Exchange believes that the expert professional judgment of the members of the Compensation Review Panel will be a crucial component of the decision making process. To that end the Exchange does not believe that additional factors outside the requirements for submitting a claim are warranted. Nevertheless, the business judgment of the Compensation Review Panel should be based on that of a reasonable business man. The Compensation Review Panel will consider whether the claimant took reasonable steps to mitigate his or her loss. If no action was taken, the Compensation Review Panel will consider whether there was a reasonable business decision for not taking any action to mitigate the claimed loss.

Moreover, because the Exchange believes that the expert professional judgment is crucial in the decision making process, it is the Exchange's position that the final decision in the

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event of a tie should rest with the Chief Executive Office of the Exchange's business and or his or her designee.

Conclusion

The Exchange clearly acknowledges that there have been significant changes in competitive forces, customer expectations, technology, and automation in the securities industry. The Exchange has been and continues to be a major participant in these changes. Given these changes the Exchange agrees that there is a need for clarity and a certain level of uniformity within the securities industry. To that end the Exchange has, where appropriate, worked to achieve that uniformity.⁸ The Exchange strenuously agrees with the commenter that the securities industry would benefit from more uniform standards in this area. NYSE is ready to work with the Commission and all industry participants to create uniform standards related to system failures that will apply not only to the Exchange but the other approximately thirty market centers that currently have no rules that address this issue.

The Exchange is committed to addressing the needs of all its member organizations and providing a market structure that does not negatively impact different classes of member organizations. Nevertheless, the Exchange's business model is distinct from that of NASDAQ and NYSE Arca. The Exchange suspects that the commenter would agree that the existence of different business models among exchanges creates stronger, more diverse, and more competitive marketplaces that serves only work to the benefit of all market participants.

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If you have any questions regarding the foregoing, please feel free to contact Louis Pastina, Executive Vice President, at (212) 656-6821, Deanna Logan, Director, Rule Development, Office of the General Counsel, at (212) 656-2389.

Sincerely yours,



Mary Yeager
Assistant Secretary

⁸ See Press Release, NASD and NYSE Group Announce Plan to Consolidate Regulation of Securities Firms, dated Nov. 28, 2006 (available at <http://www.nyse.com/press/1164625606086.html>).