SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50237; File No. SR-NYSE-2004-37)

August 24, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc. Relating to Procedures for Gapping the Quote

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 July 2, 2004, the New York Stock Exchange ("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. The proposed rule change has been filed by the NYSE as a "non-controversial" rule change pursuant to Rule 19b-4(f)(6) under the Act.[3] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The NYSE proposes to describe its new procedures for gapping the quote. The proposed rule text consists of NYSE Information Memo 04-27 (June 9, 2004), which the Exchange previously sent out to its members and member organizations. The text of the proposed rule change is available for viewing on the Commission's website, www.sec.gov/rules/sro.shtml, and at the Exchange and the Commission.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 17 CFR 240.19b-4(f)(6).

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these 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 parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The NYSE believes that its auction market provides valuable opportunities to price transactions fairly to all investors in a way that truly reflects supply and demand. According to the Exchange, at the moment of that pricing, transparency of any imbalance is critical to attract participation to offset the imbalance and facilitate price discovery. In that regard, the NYSE is updating its policies with respect to situations involving gapping the quote to achieve greater transparency in light of faster market conditions and technology. The Exchange believes that the procedures that are being updated will provide improved opportunities for all market participants to access the NYSE market and serve customers, improving transparency in situations where gapped quotations are used.

Background

The purpose of the proposed rule change is to discuss the procedures for gapping the quote, as currently described in Information Memo 94-32 (August 9, 1994)[4] and the 2003 Floor

[4] The Exchange filed Information Memo 94-32 in File No. SR-NYSE-93-48. See Securities Exchange Act Release No. 34303 (July 1, 1994), 59 FR 35157 (July 8, 1994).

Official Manual.[5] The modification involves a new procedure for specifying the size in gapped quoting situations, making the size of the gapped quote 100 shares x size or size x 100 shares, instead of 100 shares x 100 shares. In addition, the new procedure shortens the reasonable period of time for the gapped quotation to remain in place in light of faster market conditions and technology.[6]

According to the Exchange, the purpose of the gapped quote procedures is to provide public dissemination of an order imbalance and to minimize short-term price dislocation associated with such imbalance by allowing appropriate time for the entry of offsetting orders or the cancellation of orders on the side of the imbalance. An imbalance may occur when the specialist receives a sudden influx of orders on the same side of the market at the same time or when there are one or more large-size orders and there is no offsetting interest. An imbalance may also occur when a member proposes to effect a one-sided block transaction at a significant premium or discount from the prevailing market.

When an imbalance exists, the gapped quote procedures provide that the specialist widen the spread between the bid and offer, a process known as "gapping." In such cases, the quote on the side of the imbalance must match ("touch") the prior sale price. Once a quotation has been gapped, it should remain in place for a reasonable time to allow interested parties to respond to the order imbalance. A Floor Governor, Executive Floor Official, or Senior Floor Official oversees and provides input into the gapped quote process.

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5 See NYSE Floor Official Manual at page 38.

6 All other procedures and requirements set forth in NYSE Information Memo 94-32 and File No. SR-NYSE-93-48 remain unchanged and in effect. See Securities Exchange Act Release No. 34303 (July 1, 1994), 59 FR 35157 (July 8, 1994). Telephone conversation between Jeffery Rosenstrock, Senior Special Counsel, Market Surveillance-Rule Development, and Kelly Riley, Assistant Director, Division of Market Regulation, Commission, on August 12, 2004.

Prior Practice

Formerly, the gapped quote procedures provided that the specialist show the size associated with the gapped quotation as 100 x 100 and a senior-level Floor Official determined a reasonable period of time for the gapped quotation to be maintained (generally, not to exceed 5 minutes), to allow for adequate public disclosure and sufficient time to attract contra-side interest.

New Procedures to Accelerate Price Discovery

In order to provide more useful information and accelerate price discovery, the Exchange is updating the gapped quotation procedures to require that the specialist disseminate a quote size of 100 shares on only one side of the market. Size consistent with the order imbalance is to be shown on the other side, i.e., 100 x size or size x 100. The 100-share side represents the specialist's determination of the price at which the stock would trade if no contra-side interest develops or no cancellations occur as a result of the gapped quotation. This determination takes into account executable orders on the book at better prices than the price of the 100-share bid or offer. The size side represents the extent of the order imbalance, which can represent orders of members in the crowd as well as SuperDot® ("DOT") orders.

Under the new procedures, when a gapped quotation situation arises, the specialist must:

- complete all related Display Book reports of transactions that have been consummated to honor the existing firm quotation, and check the status of the order imbalance (to see whether it has increased or decreased);
- gap the quotation:
    - on the side of the imbalance, make the bid or offer price, as appropriate, touch the last sale; and

- show the size of the imbalance in that bid or offer size;
- on the side opposite the imbalance, show the possible extent of price impact in the bid or offer price, as appropriate; and
- make the size on that side of the market one round lot;

- consult with a Floor Governor, Executive Floor Official, or Senior Floor Official as to how to proceed;
- promptly contact known contra-side parties; and
- continue to permit the entry and cancellation of orders in the Display Book.

The procedures provide that a gapped quotation should remain in place for a reasonable time to allow for interested parties to respond to the order imbalance. What constitutes a reasonable time is determined by the unique circumstances of each gapped quotation situation. However, the gapped quotation generally should last at least 30 seconds unless offsetting interest is received earlier, and generally should not exceed two minutes,[7] unless circumstances require otherwise.

The Floor Governor, Executive Floor Official, or Senior Floor Official shall determine whether to:

- execute the orders immediately;

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7 NYSE Rule 123D provides that with respect to a trading halt, a minimum of five minutes must elapse between the publication of the initial indication and the stock's reopening. In the event that more than one indication was published, the stock may re-open three minutes after the last indication was published, provided that at least five minutes had elapsed from the publication of the initial indication. See NYSE Information Memo 03-5 (February 27, 2003) and Securities Exchange Act Release No. 47104 (December 30, 2002), 68 FR 597 (January 6, 2003) (File No. SR-NYSE-2002-39) (decreasing the minimum number of minutes that must elapse from 10 minutes to 5 minutes for the first indication, and from 5 minutes to 3 minutes for subsequent indications, provided that the minimum 5 minutes has elapsed since the first price indication). The Exchange

- direct the specialist to maintain the gapped quotation beyond 30 seconds, but no more than two minutes, unless circumstances require otherwise, in order to allow time for contra-side interest to develop or cancellations to occur; or
- halt trading in the stock.

Under Exchange Rule 60(e), as described in Information Memo 03-21 (May 15, 2003), in a situation involving the use of the new gapped quote procedures, specialists will not be required to modify the 100-share side of the quotation to post better priced buy or sell limit orders or add to size during the reasonable gapped quote period.

Example

At 2:10 P.M., the market in XYZ is $76.45 bid for 2,000 shares, 5,000 shares offered at $76.50 with the last sale at $76.47. The specialist receives a sudden influx of orders through the system and from floor brokers to buy 370,000 shares at the market. The specialist executes a portion of the buy order imbalance against the 5,000 shares offered to honor the firm quote. 5,000 shares at $76.50 are reported to the consolidated tape and the related floor reports are issued. The specialist then gaps the quote, making the market $76.50 bid for 365,000 shares, 100 shares offered at $78.00. Note that this gapped quotation meets all of the requirements discussed above. The bid price touches the last sale. The size of the imbalance, which was reduced when the specialist took the offer, is published as the bid size. The offer price indicates the possible extent of the impact of the buy imbalance on the price of the stock. Lastly, the offer size is shown as 100 shares to indicate that there is insufficient interest on the sell side of the market.

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represents that these time limits guide Floor Officials as to what may be an appropriate duration of a gapped quote.

Autoquote Feature

When the specialist disseminates a 100-share quote on one side of the market (100 x size or size x 100) where the 100-share side represents the specialist's bid or offer, the autoquote feature is temporarily not available on that side of the market for the limited period of the gapped quote. However, the side of the market displaying size will continue to be subject to autoquoting.

NYSE Direct+ ("Direct +")

Auto ex orders will continue to trade with and will reduce the size of the side of the market where the imbalance is being shown. Auto ex executions will not take place on the side of the market showing 100 shares.[8]

Inappropriate Use of Manual 100-Share Market

The Exchange believes that it would not be appropriate for a specialist to repeat or continue to disseminate the manual 100-share by 100-share market as that could have the effect of not displaying or quoting a limit order (unless executed or cancelled) until after 30 seconds.

Changes to the Exchange's Direct+ facility and market structure may affect the procedures described herein. However, until rule changes are submitted to the Commission for comment and review, and approval and implementation, the procedures described above will remain in place.[9]

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8 Under Exchange Rule 1000 (iv), an auto ex order shall receive an immediate, automatic execution against orders reflected in the Exchange's published quotation and shall be immediately reported as NYSE transactions, unless, with respect to a single-sided auto ex order, the NYSE's published bid or offer is 100 shares.

9 The Commission notes that the NYSE filed a proposal to change its Direct+ facility and market structure, which was published for comment in the Federal Register on August 16, 2004. See Securities Exchange Act Release No. 50173 (August 10, 2004), 69 FR 50407 (August 16, 2004) (File No. SR-NYSE-2004-05).

The new procedures on gapping the quote are described in Information Memo 04-27, which has been sent to all members and member organizations.[10]

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,[11] in general, and furthers the objectives of Section 6(b)(5) of the Act,[12] in particular, in that it is designed to promote just and equitable principles of trade and to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, according to the Exchange, is not designed to permit unfair discrimination between customers, brokers, or dealers, or to regulate by virtue of any authority matters not related to the administration of the Exchange.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were neither solicited nor received with respect to the proposed rule change.

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

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10 The Commission notes that the proposed rule change was not effective until filed with the Commission on July 2, 2004.

11 15 U.S.C. 78f(b).

12 15 U.S.C. 78f(b)(5).

Because, the foregoing proposed rule change (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms, does not become operative until 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, and the Exchange provided the Commission with written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission, it has become effective pursuant to Section 19(b)(3)(A) of the Act[13] and Rule 19b-4(f)(6) thereunder.[14]

The NYSE has requested that the Commission waive the 30-day operative delay. The Commission believes waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Acceleration of the operative date will allow the Exchange to transition to the new gapped quoting procedures, which provide more information regarding imbalances, without delay. For these reasons, the Commission designates the proposal to be effective and operative upon filing with the Commission.[15] At any time within 60 days of the filing of this proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments

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13 15 U.S.C. 78s(b)(3)(A).

14 17 CFR 240.19b-4(f)(6).

15 For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NYSE-2004-37. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the NYSE. 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-2004-37 and should be submitted on or before [insert date 21 days from publication in the Federal Register]

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[16]

Margaret H. McFarland
Deputy Secretary

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[16] 17 CFR 200.30-3(a)(12).