

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51613; File No. SR-NYSE-2004-42)

April 26, 2005

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto to Eliminate the Requirement that a Floor Official Approve Certain Transactions on the Exchange's Automated Bond System

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 August 10, 2004, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NYSE. On March 30, 2005, the NYSE filed Amendment No. 1 to the proposed rule change.³ 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 NYSE proposes to amend Exchange Rule 86(g) relating to the Exchange's Automated Bond System® ("ABS"). The text of the proposed rule change, as amended, is available on the NYSE's Web site (<http://www.nyse.com>), at the NYSE's principal office, and at the Commission's Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, which replaced and superceded the original filing in its entirety, the NYSE supplemented its rationale for the proposal by, among other things, describing the process that a Floor Official follows when considering whether to approve a transaction that would occur at a price that is at least two points or more than 30 days from the last transaction; recounting some of the history of bond trading on the NYSE; explaining that the Exchange has not found it necessary to re-instate the two-point / 30-day provision for convertible bonds since it eliminated its applicability to convertible bonds in 1998; and noting that Exchange Rule 86(g) requires all orders to be entered into ABS at a limit price, and that ABS automatically asks a user to reconfirm the price of an order that is entered at a price two or more points away from the last sale.

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 NYSE 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 aspects of such statements.

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

1. Purpose

The NYSE's Fixed Income Market is centered on its ABS, a fully automated trading and information system that allows subscribing firms to enter, maintain, view, and execute bond orders through screen displays in their offices. Orders are maintained, displayed, and matched in ABS on a strict price-and-time priority basis. ABS displays current market data and provides subscribers with immediate execution reports and locked-in trade comparisons. ABS also provides real-time last sale and quotation information to subscribers and market data vendors.

At year-end 2004, ABS had a subscriber base of 37 member firms with an installed base of 115 screens. All bonds listed on the NYSE trade through ABS. Exchange bond volume for the year 2004 was approximately \$1.3 billion par value. About 94% of NYSE bond volume was in straight, or non-convertible, debt and the remaining 6% of NYSE bond volume was in convertible bonds.

Exchange Rule 86 governs trading in ABS. Existing NYSE Rule 86(g) requires that all ABS transactions in non-convertible bonds that are made two points or more away from the last sale, or more than 30 days after the last sale, may be made only with the approval of a Floor

Official. As a practical matter, the Floor Official may require that the bonds be bid up or offered down before approving such transactions.⁴

The Exchange proposes to eliminate the current NYSE Rule 86(g). The requirement in Exchange Rule 86(g) for Floor Officials to approve orders entered at an increment of two points or greater from the last transaction has long been made unnecessary by the fact that ABS is an order-driven system in which subscribing firms may enter only priced orders, and a firm entering an order in ABS at a variation of two points or greater is already required to immediately confirm the price of such order prior to the order's acceptance into ABS. The entering firm would no longer need to confirm an order entered into ABS more than 30 days from the last trade of the bond issue, if the price of the entered order were less than two points from the previous trade price. The requirements that orders entered into ABS be priced and that the user entering the order must reconfirm the price of an order entered at a variation of two points or greater from the last sale have been programmed into ABS since its inception.

The Exchange believes that, because firms entering orders into ABS control and are responsible for the orders they enter into ABS, the requirements of current NYSE Rule 86(g) are

⁴ If, for example, an order is entered into ABS to buy 10 XYZ bonds at 93 when the last sale for XYZ occurred at 90, the Floor Official could determine that XYZ bond should be "bid up" at a decided price increment away from the limit order for a decided period of time, typically one "point" for one minute. The NYSE bond supervisor would then enter the bidding-up starting price, price increment, time increment, and final price into ABS, upon which a message appears on all ABS screens alerting subscribing firms that bidding up in XYZ has commenced. An ABS user could execute against that "bid" by entering an order to sell at 91 into the system. If, after one minute, the "bid" at 91 generated no interest among ABS users, the order would be bid at 92 for one minute. If that "bid" generated no interest, then the order would, after one minute, be bid at 93 or be matched (traded) at 93, depending on whether there was a contra-side order to sell at 93 in the ABS at that point in time. Telephone conversation between Fred Siesel, Consultant, NYSE, and Tim Fox, Attorney, Commission on April 18, 2005.

unnecessary. They are a legacy from the time when NYSE bond trading was floor-based, rather than screen-based. These requirements slow down trading in ABS and may result in a loss of liquidity. For example, during the period when an order is “bid up” or “offered down” under the existing rule, a resting offer/bid in the system might be cancelled, thus causing the order being bid up/offered down to miss the opportunity to interact with the resting order. The time involved in the Floor Official’s review of the situation, and the time for the Floor Official to determine whether to bid up/offer down can act to the detriment of the order. Once an order is entered into ABS, the process is electronic and still provides a price confirmation component to help ensure that orders are priced correctly.

Before ABS was developed, the NYSE's bond floor involved two trading “arenas.” One was the “free crowd,” where bond floor brokers primarily traded convertible bonds and a handful of active non-convertible bonds. The other arena involved “cabinet” trading. In the free crowd, brokers left their mnemonic broker identifications with indications of buying or selling interest next to the bond symbol on one of a number of boards containing multiple bond symbols. The indications were entered in pencil and the boards were erasable and cleaned after the close of trading. If a broker had an interest on the contra side of an existing indication, the broker would announce that interest to the broker on the opposite side. The brokers would agree on price, subject to the undisclosed limits of their orders. Also, with the broker's announcement of interest in a particular bond, other brokers would often join the crowd and trade according to the floor trading rules of precedence and parity.

Cabinet trading involved cards of orders to buy and sell bonds which were organized, by bond, in racks. The order cards were organized in sequence according to price and time priority under former NYSE Rule 85. When orders matched, bond floor clerks took the matching orders

to bond floor brokers to write the trade tickets. Firms not having brokers regularly on the bond floor were represented by one of the bond floor brokers; however, any equity floor broker could execute bond orders on the bond floor. All completed bond trades were reported on the dedicated bond ticker.

ABS initially replaced manual cabinet trading, providing immediate matching and reporting of non-free-crowd bond trades and quotations with size. Free crowd trade prices, without quotations, were also reported through ABS. In the mid-1980s, the few non-convertible bonds that traded in the free crowd were moved to ABS. In 1998, the convertible bonds commenced trading in ABS on a price-and-time priority basis.

The two-point/30-day provision was eliminated for convertible bonds when, in 1998, the physical bond floor was closed and trading in convertible bonds was transferred to ABS.⁵ The Exchange asserts that, since that time, there have not been any problems with respect to the trading of convertible bonds, nor has there been a situation requiring the reinstatement of the requirement of Floor Official approval if a transaction would occur at two points or more away or more than 30 days away from the last sale.⁶ In addition, since the complete closing of the bond floor, the only officials available to make bond rulings are equity Floor Officials who, in addition to being less familiar with bond trading, may be diverted from their responsibilities to the Exchange's equity market.

⁵ Prior to moving convertible bonds to ABS, convertible bond quotes were non-firm price indications only, with no size. In ABS, convertible bond quotes are firm, with size, and are "live."

⁶ Pursuant to NYSE Rule 86(g), a Floor Governor may, if prevailing market conditions warrant, impose similar requirements on convertible bonds.

In sum, since ABS accepts only limited price orders, and since the entering firm must reconfirm the price of the order being entered if that order is at a price that is two points or more away from the last sale price, the bidding up/offering down requirement of the current NYSE Rule 86(g) is unnecessary.

The Exchange also is proposing to codify in NYSE Rule 86(g) two features that have been programmed into ABS since its inception: (1) the acceptance of priced orders only; and (2) price confirmation, by the entering firm, of orders entered at a price two or more points inferior to the last sale price.

2. Statutory Basis

The basis under the Exchange Act for this proposed rule change is the requirement under Section 6(b)(5) of the Act⁷ that an exchange have rules that are 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.

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

The NYSE does not believe that the proposed rule change, as amended, would 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.

⁷ 15 U.S.C. 78f(b)(5).

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 the NYSE consents, the Commission will:

- A. by order approve such proposed rule change, as amended; or
- B. institute proceedings to determine whether the proposed rule change, as amended, 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, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2004-42 on the subject line.

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-2004-42. 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 Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR-NYSE-2004-42 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.⁸

Margaret H. McFarland
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).