

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54368; File No. SR-NYSE-2005-58)

August 25, 2006

Self-Regulatory Organizations; New York Stock Exchange, Inc. (n/k/a New York Stock Exchange LLC); Order Approving Proposed Rule Change and Amendment No. 1 Thereto Relating to Exchange Rule 312(f) Regarding Changes Within Member Organizations

I. Introduction

On August 15, 2005, the New York Stock Exchange, Inc. (n/k/a New York Stock Exchange LLC) (“NYSE” or the “Exchange”) filed with the Securities and Exchange Commission (“SEC” or the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change and on May 5, 2006, NYSE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change, as amended, concerns amendments to Rule 312(f) to, among other changes, permit the recommendation of purchases and sales of shares of companies controlled by and under common control with member organizations (other than MAPs), subject to appropriate customer disclosure of the relationship. The proposed rule change, as amended, was published for comment in the Federal Register on May 26, 2006.<sup>4</sup> The Commission received two comment letters on the proposal.<sup>5</sup> On August 11,

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

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

<sup>3</sup> Amendment No. 1 replaced the rule text in the original filing in its entirety and proposed to clarify that Rule 312(f) applies only to non-investment grade debt and equity securities. Amendment No. 1 also added Material Associated Persons (“MAPs”), as that term is used in Rule 17h-1T of the Exchange Act, to the class of persons for whose securities the solicitation of trades is prohibited.

<sup>4</sup> See Securities Exchange Act Release No. 53840 (May 19, 2006), 71 FR 30458 (May 26, 2006).

<sup>5</sup> See letter from John Ramsay, Managing Director, Deputy General Counsel, Citigroup Global Markets Inc. (“Citigroup”), to Nancy M. Morris, Secretary, SEC, dated June 16, 2006 (the “Citigroup Letter”) and letter from Sullivan & Cromwell LLP (“S&C”) to Nancy M. Morris, Secretary, SEC, dated June 16, 2006 (the “S&C Letter”).

2006, NYSE filed a response to the S&C Letter.<sup>6</sup> This order approves the proposed rule change, as amended.

## II. Description of the Proposed Rule Change

NYSE Rule 312(f) (the “Rule”), in pertinent part, currently prohibits a member organization from soliciting transactions in its own publicly traded securities and from making any recommendations with respect to its publicly traded securities or the securities issued by any corporation controlling, controlled by or under common control with such member corporation (i.e., the securities of any parent, sister, or subsidiary corporation relative to the member organization). The Exchange’s regulatory experience relative to Rule 312(f) has generally involved determinations as to the existence, or not, of a control relationship involving a member organization among the complicated interrelationships of, and equity investments by, financial organizations.

The purpose of the proposed rule change is to retain a process for mitigating conflicts of interest that may arise when recommending the securities of companies in which a member organization may have an interest, while also reducing burdens on the industry and the Exchange with respect to making determinations regarding the existence of a control relationship by establishing clearer standards and reducing interpretative questions.

- (i) Proposed Codification to Exclude Investment Grade Debt from Rule 312(f)

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<sup>6</sup> See letter from Mary Yeager, Assistant Secretary, NYSE, to Catherine McGuire, Chief Counsel, Division of Market Regulation, SEC, dated August 11, 2006 (the “NYSE Response”).

NYSE has interpreted Rule 312(f) to apply only to non-investment grade debt and equity securities.<sup>7</sup> This proposal would codify that interpretation.

(ii) Proposed Expansion to Include All Non-Investment Grade Debt and Equity Securities

The proposed rule change would also broaden the application of the Rule to all non-investment grade debt and equity securities, including privately placed issues. The current Rule's prohibition applies only to publicly traded securities.

In addition, the proposed rule change would extend the prohibition against solicited transactions to the non-investment grade debt and equity securities of companies controlling member organizations (e.g., parent companies) and MAPs. By their nature, MAPs can substantially influence a registered broker-dealer, and the inclusion of such entities along with controlling organizations<sup>8</sup> acts to limit inevitable conflicts of interest.

(iii) Proposed Amendment to Permit Certain Recommendations If Disclosed

Finally, the proposed rule change would permit the recommendation of purchases and sales of shares of companies controlled by and under common control with member organizations (other than MAPs), subject to appropriate customer disclosure of the relationship (e.g., any recommendation would be subject to a requirement to disclose to the customer the existence and nature of the control

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<sup>7</sup> Another common interpretive inquiry with respect to Rule 312(f) involves, and NYSE anticipates would continue to involve, a determination as to whether the security in question has "debt-like characteristics." The Exchange has generally interpreted Rule 312(f) restrictions to not apply to investment grade debt and securities that function as investment grade debt. The interpretation as to whether a security functions as investment grade debt is based on the totality of the circumstances, e.g., 1) whether the shares of stock have fixed dividends; 2) whether the shares of stock are non-participatory in common dividends; 3) whether the shares of stock have limited voting rights; and 4) whether the shares of stock are non-convertible into common stock.

<sup>8</sup> See NYSE Rule 2.

relationship at the time of recommendation).<sup>9</sup> The Exchange states that for these types of relationships disclosure is likely to function as an adequate method for addressing the conflicts of interest that could arise with respect to a member's recommendation to buy or sell securities of many affiliated entities. The Exchange proposes to retain the prohibition on the recommendation of purchases in the securities of the member organization, any controlling organization or a MAP given the greater potential for a conflict of interest inherent in such relationships.

### III. Summary of Comments Received and NYSE Response

The Commission received two comment letters (the Citigroup Letter and the S&C Letter) on the proposal and a response to the S&C Letter by NYSE.<sup>10</sup> The Citigroup Letter expresses support for the proposed changes to Rule 312(f).

The S&C Letter generally expresses support for the proposed rule change, but also notes reservations regarding: (1) the expansion of the Rule 312(f) restrictions to non-public securities, and (2) the prohibitions contained in Rule 312(f)(1) concerning solicitation of transactions in the securities of a member organization, its parent or a MAP.<sup>11</sup>

In responding to S&C's reservation regarding the extension of the coverage of Rule 312(f) to non-publicly traded securities, NYSE states that there is a "need to assure coverage of all post-distribution transactions by member organizations in affiliated

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<sup>9</sup> See proposed Rule 312(f)(2). If the disclosure at the time of the recommendation is not made in writing, then the member must also provide this disclosure in writing prior to the completion of the transaction.

<sup>10</sup> S&C Letter. See also NYSE Response. Because the Citigroup Letter did not express any disagreement with the proposed rule change, the NYSE Response does not address the Citigroup Letter.

<sup>11</sup> S&C Letter.

securities, and not solely those which are sold pursuant to public offerings.”<sup>12</sup> NYSE also expresses the view that the proposed change will not impose a significant burden on trading in non-publicly traded securities.<sup>13</sup>

In responding to S&C’s reservation regarding the prohibitions contained in Rule 312(f)(1), NYSE states that it “respectfully disagree[s] with the suggestion that the prohibition against the solicitation of transactions in the securities of the member organization, parent or [MAP] is at present unwarranted [because] [t]he conflicts which the original rule was written to prevent have not disappeared.”<sup>14</sup> NYSE also clarifies that “[i]t is not the transaction which is prohibited, but rather the recommendation of the transaction; the Rule allows unsolicited transactions.”<sup>15</sup>

#### IV. Discussion and Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act, and the rules and regulations thereunder applicable to a national securities exchange, and in particular, with the requirements of Section 6(b)(5)<sup>16</sup> of the Exchange Act. Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and national market system, and in general, to protect investors and the public interest. Section 3(f) of the Exchange Act also requires, among other things, whenever there is a requirement to consider or determine whether an action is necessary

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<sup>12</sup> NYSE Response.

<sup>13</sup> Id.

<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> 15 U.S.C. 78f(b)(5).

or appropriate in the public interest, to also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The Commission believes that the proposed rule change, as amended, will act to assure adequate and continuing protection for investors while promoting efficiency, competition, and capital formation by permitting the recommendation of purchases and sales of shares of companies controlled by and under common control with member organizations (other than MAPs), subject to appropriate customer disclosure of the relationship, by expanding restrictions on effecting solicited transactions to include non-public securities, and by codifying NYSE interpretations as described above.

V. Conclusions

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>17</sup> that the proposed rule change (SR-NYSE-2005-58), as amended, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

Nancy M. Morris  
Secretary

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<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>18</sup> 17 CFR 200.30-3(a)(12).