

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55559; File No. SR-NYSE-2005-03)

March 29, 2007

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment No. 3 to and Order Granting Accelerated Approval of Proposed Rule Change, as Amended Related to Exchange Rule 325 (Capital Requirements for Member Organizations) and Rule 326 (Growth Capital Requirement, Business Reduction Capital Requirement, Unsecured Loans and Advances)

I. Introduction

On January 5, 2005, the 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”),¹ and Rule 19b-4 thereunder,² the proposed rule change relating to Exchange Rules 325 and 326. The NYSE filed Amendment No. 1 to the proposed rule change on February 13, 2006. The NYSE filed Amendment No. 2 to the proposed rule change on March 17, 2006.³ The proposed rule change was published in the Federal

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Partial Amendment No. 2 (“Amendment No. 2”), the Exchange clarified the application of proposed amendments to NYSE Rule 326 to make explicit the ability of the Exchange to restrict the growth or business of a member organization, respectively, when its tentative net capital declines below the early warning notification amount required by the Exchange Act Rule 15c3-1(a)(7)(ii).

Register on August 8, 2006.⁴ The Commission received one comment on the proposal.⁵ On February 1, 2007, the Exchange filed Amendment No. 3 to the proposed rule change.⁶

This order provides notice of Amendment No. 3 to the proposed rule change and approves the proposed rule change as amended on an accelerated basis.

II. Description of the Proposal

The proposed rule change consists of amendments to Rule 325 and Rule 326 to reflect Commission amendments under the Exchange Act, including amendments to Exchange Act Rule 15c3-1 that established an alternative method of computing net capital for broker-dealers, and to reflect amendments to Commodity Futures Trading Commission rules (“CFTC”) under the Commodities Exchange Act⁷ with respect to minimum net capital requirements for futures commission merchants.⁸

The Commission’s net capital rule, Exchange Act Rule 15c3-1, imposes minimum financial requirements on broker-dealers.⁹ To help insure that broker-dealers maintain

⁴ Exchange Act Release No. 54255 (July 31, 2006), 71 FR 45086 (August 8, 2006).

⁵ See letter from Thomas Petrone, Managing Director, Citigroup Global Markets, Inc. to Nancy M. Morris, Secretary, Commission, dated September 13, 2006.

⁶ See Partial Amendment No. 3 dated February 1, 2007 (“Amendment No. 3”). Amendment No. 3 proposed amended language to Rules 325 and 326 to add an early warning notification more restrictive than Commission/CFTC requirements. The text of Amendment No. 3 is available at the NYSE, the Commission’s Public Reference Room, and <http://www.nyse.com>.

⁷ 7 U.S.C. 1 et seq.

⁸ The CFTC rules became effective on September 30, 2004. See 69 FR 49784 (Aug. 12, 2004). The Commission also recently proposed amendments to Exchange Act Rule 15c3-1 and Rule 17a-11 to conform provisions of its net capital rule to the CFTC amendments. See Exchange Act Release No. 54575 (October 5, 2006), 71 FR 60636 (October 13, 2006).

⁹ 17 CFR 240.15c3-1.

sufficient liquid assets to satisfy promptly the claims of customers and cover potential market and credit risks, the net capital rule requires broker-dealers to maintain different minimum levels of capital based upon the nature of their business and whether they handle customer funds or securities.

On June 8, 2004, the Commission adopted rule amendments under the Exchange Act, including amendments to Exchange Act Rule 15c3-1, that established a voluntary, alternative method of computing net capital for certain large broker-dealers that are part of consolidated supervised groups referred to as consolidated supervised entities (“CSEs”).¹⁰ Under the Commission amendments, a broker-dealer may use this alternative method only if its ultimate holding company agrees to compute group-wide allowable capital and allowances for market, credit, and operational risk in accordance with the standards adopted by the Basel Committee on Banking Supervision, and consents to group-wide Commission supervision. The alternative method of computing net capital permits a broker-dealer to use models, such as “value-at-risk” (“VAR”) models and scenario analysis, which are already part of its internal risk management control system to calculate the market risk and derivatives-related credit risk components of its net capital requirement. The deduction for market risk calculated using internal models replaces the traditional “haircut” approach to calculating net capital.¹¹

¹⁰ Exchange Act Release No. 49830 (June 8, 2004), 69 FR 34425 (June 21, 2004).

¹¹ The “haircut” approach to computing net capital involves reducing the value of firms’ proprietary securities by pre-determined percentages to allow for potential reductions in market value. See paragraph (c)(2)(vi) of Rule 15c3-1.

In 2004, the CFTC amended Rule 1.17 and adopted certain new “risk-based” capital requirements applicable to futures commission merchants.¹² CFTC Rule 1.17, as amended, requires a futures commission merchant to maintain adjusted net capital equal to a specific percentage of the margin required to be collected under exchange or clearing organization rules for positions carried in customer and noncustomer accounts.¹³

When NYSE member firms allow their net capital to decline below certain levels, the firms risk non-compliance with the requirements of Exchange Act Rule 15c3-1. NYSE Rules 325 and 326 are designed to alert the Exchange before such problems occur, and to enable the Exchange to prevent membership non-compliance by restricting the business activities of any member organization whose net capital falls below certain defined levels.

Proposed Amendment to NYSE Rule 325

Rule 325, the Exchange’s primary net capital rule, requires NYSE member firms to comply with Exchange Act Rule 15c3-1 and imposes additional requirements to ensure such compliance. Rule 325(b) requires a member organization to notify the Exchange if its net capital falls below certain percentages. The proposed amendments to Rule 325(b)(1) reflect recent changes to the CFTC rules with respect to risk-based capital requirements for futures commission merchants. The proposed amendments conform Rule 325 to these CFTC rule changes.¹⁴

¹² See supra note 8.

¹³ 17 CFR 1.17.

¹⁴ See supra note 8; see also 17 CFR 1.17.

In addition, the proposed amendments also add Rule 325(b)(3), which would require a member organization to provide concurrently to the Exchange a copy of any report or notification made to the Commission pursuant to Exchange Act Rule 17a-11¹⁵ or CFTC Rule 1.12.¹⁶ The NYSE stated that this new requirement is necessary to help ensure that the Exchange continues to receive timely notification of potential violations of Exchange Act Rule 15c3-1, including the rule's CSE provisions. Therefore, because CFTC Rule 1.12 requires notification by any futures commission merchant that experiences a decline in net capital below the CFTC's early warning levels, the Exchange will continue to receive notification if a member organization acting as futures commission merchant is in danger of violating CFTC minimum capital requirements.

Proposed Amendments to NYSE Rule 326

NYSE Rule 326, which enables the Exchange to restrict a member organization's business activities if its net capital falls below certain defined levels, uses a two-step approach to preventing membership non-compliance with Exchange Act Rule 15c3-1. First, Rule 326(a) allows the Exchange to prohibit a member organization from expanding its business if its net capital falls below specified levels. Second, if a member organization's net capital falls below lower, specified levels, Rule 326(b) allows the Exchange to compel it to reduce its existing business. To enable the Exchange to regulate its membership proactively (that is, to act if a member or member organization is in danger of violating Exchange Act Rule 15c3-1, rather than waiting until Exchange Act

¹⁵ 17 CFR 240.17a-11.

¹⁶ 17 CFR 1.12.

Rule 15c3-1 has been violated), the levels specified in NYSE Rule 326 are higher than those contained in Exchange Act Rule 15c3-1.

The proposed amendments would add language to provide minimum tentative net capital¹⁷ and net capital levels for the Exchange to use when prohibiting, under Rule 326(a), the expansion of business by a member organization using the alternative method of computing net capital under the Commission's CSE rules. The proposed amendments also conform the rule language with respect to member organizations registered as futures commission merchants to the CFTC rule amendments regarding risk-based capital requirements.

The NYSE stated that the levels proposed in Rule 326(a) for CSE firms (50 percent of the tentative net capital level that triggers Commission notification or a net capital level of less than \$1.25 billion) would not unduly restrict a member organization's business, but would allow the Exchange, after evaluating a member organization's financial condition, to use the disincentive of restricted business expansion to encourage necessary corrective action by a member organization whose net capital has fallen to levels that risk violation of Exchange Act Rule 15c3-1.

The Exchange also proposes to amend Rule 326(a) to require a futures commission merchant to restrict its business activities during any period in which its net capital is less than 120 percent of the minimum risk-based capital requirements of CFTC Rule 1.17.

¹⁷ Tentative net capital" is defined in the CSE rules as net capital before deductions for market and credit risk. See Exchange Act Rule 15c3-1(c)(15).

The Exchange also proposes to amend Rule 326(b) to provide minimum tentative net capital and net capital levels for the Exchange to use in requiring a CSE firm to reduce its business pursuant to Rule 326(b). The Exchange stated that the levels proposed in Rule 326 (40 percent of the tentative net capital level that triggers Commission notification or net capital of less than \$1 billion) would not unduly restrict a member organization's business, but would allow the Exchange, after evaluating a member organization's financial condition, to use the disincentive of mandatory business reduction to encourage necessary corrective action by a member organization whose net capital has fallen to levels that risk violation of Exchange Act Rule 15c3-1.

The proposed rule changes to Rule 326(b) also would require a member organization to reduce its business if its net capital falls below 110 percent of the minimum capital requirements of CFTC Rule 1.17 (the same level that triggers notification to the CFTC under CFTC Rule 1.12). Therefore, the Exchange will retain the ability to compel a member organization to reduce its business if its net capital falls to levels that may violate CFTC minimum capital requirements.

The Exchange also proposed rule amendments to Rules 326(c) and (d) to reflect the CFTC rule amendments with respect to risk-based capital requirements for futures commission merchants. These proposed rules amendments are parallel to the proposed changes to Rules 326(a) and (b), respectively.

Finally, the proposed rule amendments contain proposed language changes to renumber certain paragraphs and other non-substantive changes.

III. Summary of Comment Received

The Commission received one comment letter to the proposed rule change.¹⁸ The commenter supported prompt implementation of the proposal and commented specifically on the proposed changes to NYSE Rule 431(e). The NYSE, however, deleted this proposed paragraph in Amendment No. 3, and determined to proceed with the proposed rule change addressing amendments to NYSE Rules 325 and 326 only. No specific comments were received with respect to the proposed amendments to these rules.

IV. Discussion and Commission Findings

The Commission has carefully reviewed the proposed rule change and comment letter and finds that the proposed rule change is consistent with the requirements of Section 6(b)(5)¹⁹ of the Exchange Act, which requires that the rules of the 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 a national market system, and, in general, to protect investors and the public interest.²⁰

The Commission believes that the proposed amendments are consistent with the requirements of Section 6(b)(5) of the Act in that they align the language in Rules 325 and 326 to reflect the Commission amendments to Rule 15c3-1 with regard to the alternative method of computing net capital for broker-dealers and they incorporate the

¹⁸ See supra note 5.

¹⁹ 15 U.S.C. 78f(b)(5).

²⁰ In approving the proposed rule change, as amended, the Commission notes that it has considered the propose rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

CFTC rule amendments for NYSE member firms registered as futures commission merchants.

NYSE has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of Amendment No. 3 in the Federal Register. The Commission notes that the proposal, as modified by Amendment Nos. 1 and 2, was published for notice and comment,²¹ and that the Commission received one comment letter.²² In Amendment No. 3, NYSE made proposed changes to NYSE Rules 325 and 326 to make conforming changes to CFTC early warning requirements for futures commission merchants and determined not to proceed with amendments to Rule 431(e).²³ Accordingly, the Commission does not believe that Amendment No. 3 raises any new or novel issues. Based on the above, the Commission finds good cause to accelerate approval of the proposed rule change, as amended.

V. 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

²¹ See supra note 4.

²² See supra note 5.

²³ The CFTC rules became effective on September 30, 2004. See 69 FR 49784 (Aug. 12, 2004).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2005-03 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSE-2005-03. 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. Copies of such filing also will be available for inspection and copying at the principal office of NYSE.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁴ that the proposed rule change (SR-NYSE-2005-03), as amended, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁵

Florence E. Harmon
Deputy Secretary

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).