

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54142; File No. SR-NYSE-2006-46)

July 13, 2006

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Revise Equity Transaction Fees and to Exempt Specialist Firms from ETF Transaction Fees

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 10, 2006, the New York Stock Exchange LLC (“Exchange” or “NYSE”) 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 Exchange has designated this proposal as one establishing or changing a due, fee, or other charge imposed by the Exchange under Section 19(b)(3)(A)(ii) of the Act<sup>3</sup> and Rule 19b-4(f)(2) thereunder,<sup>4</sup> which renders the proposed rule change effective upon filing with the Commission. 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 Exchange proposes (i) to revise the fees it charges to its member organizations in connection with transactions in equity securities, and (ii) to exempt specialist firms from the fees it charges to its member organizations in connection with transactions in Exchange Traded Fund (“ETF”) securities. The fee changes will take effect on August 1, 2006. The text of the

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

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

proposed rule change is available on NYSE's Web site (<http://www.nyse.com>), at NYSE's principal office, and at the Commission's Public Reference Room.

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 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 Exchange proposes (i) to revise the fees it charges to its member organizations in connection with transactions in equity securities, and (ii) to exempt specialist firms from the fees it charges to its member organizations in connection with transactions in ETF securities. The fee changes will take effect on August 1, 2006. The amended section of the 2006 Exchange Price List was filed with the Commission as Exhibit 5 to the proposed rule filing. The fee changes are also described below.

The Exchange proposes to implement a more simplified transaction fee structure for equities that it believes will make its fees more transparent and will distribute costs more equitably across our customer base. In place of the current policy of charging a variable fee on equity transactions depending on the number of shares traded, the Exchange intends to implement a flat fee of \$0.00025 per share, which will continue to be subject to the current \$80 per transaction cap. System trades (trades executed electronically) for less than 2,100 shares, which were previously exempt from Exchange transaction fees, will be subject to the same

\$0.00025 per share fee as all other equity transactions. The Exchange is also eliminating the 1.2% rebate on floor brokerage (fees a member organization receives from another member organization for which it executes a transaction) previously paid to the member organization that had paid the floor brokerage.

Monthly equity transaction fees are currently capped at the lesser of: (i) \$600,000 per month or (ii) 2% of the member organization's self-reported monthly net commissions.<sup>5</sup> The Exchange proposes to increase the cap, for the first time since 2003, from \$600,000 to \$750,000 per month and to eliminate the 2% cap alternative, which has been in place since 1981. The Exchange believes that doing so will enable it to grow its trading revenues over time, as it will be able to charge fees on certain transactions that are currently free because a significant number of member organizations routinely exceed the 2% cap. Since trading volume has increased substantially since 2003, the average fee per share executed by member organizations paying the \$600,000 cap has decreased significantly over that period. The proposed increase is intended to raise the average fee per share paid by member organizations that pay under the cap to a level that is closer to the historical average paid by those member organizations. Raising the cap to \$750,000 compensates the Exchange for additional system usage, but continues to reward customers that significantly enhance the NYSE liquidity pool.

Under the Exchange's historical structure as a member-owned New York not-for-profit corporation, the 2% fee cap was a requirement of Article X, Section 4 of the Exchange's constitution. At the annual members' meeting of the Exchange on April 7, 2005, the members of the Exchange adopted an amendment to Article X, Section 4 to eliminate the 2% cap. The Exchange's membership at the time of its 2005 annual meeting was composed largely of

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<sup>5</sup> A member organization's net commissions are calculated as the difference between gross commissions charged and commissions payable to other members.

representatives of the Exchange's current member organizations. As such, while the Exchange is no longer a member-owned not-for-profit corporation, the Exchange's member organizations have previously accepted the removal of the 2% cap. The constitutional amendment approved by the members at the 2005 annual members' meeting specified that the Exchange's board would determine the effective date of the removal of the 2% cap. Although approved last year by the members, the Exchange has not implemented the elimination of the cap to this point as it had always intended to do so in conjunction with a broader revision of Exchange pricing.

The 2% cap was originally introduced in 1981 when the Exchange first moved away from charging members a fee based on their net commissions and introduced the variable, transaction-related fee structure in use today. The cap was intended to alleviate concerns of certain members at that time that the variable fee structure would result in substantially higher fees, thereby rendering trading activity unprofitable. However, as a result of the dramatic reduction in commission rates, a shift to business models not based on commissions, and a greater emphasis on principal trading as a source of revenue since 1981, many member organizations who continue to pay transaction fees based on the 2% cap currently pay disproportionately low transaction fees. The Exchange believes that the elimination of the 2% cap will allow it to more equitably allocate fees among member organizations based on system usage rates.

Since the implementation of the decimalization of equities trading in 2001 and the growing influence of program and algorithmic trading, there has been an increasing trend towards smaller order sizes. The average execution size on the Exchange is now less than 600 shares per trade. System orders constituted 72% of the Exchange's equity trading volume in the first six months of 2006, and in the week of June 26, 2006, 95% of system orders were for less

than 2,100 shares. The Exchange expects even more trades to be executed in the form of system orders as its hybrid market initiative is fully implemented. In light of this trend, it is not a sustainable business model for the Exchange to continue to exempt these trades from fees. Given the Exchange's investment in technology and system redundancy, it is essential that the Exchange generate revenue from this large and growing aspect of the equities trading business.

The Exchange proposes to exempt specialists from the fees payable with respect to transactions in ETF securities. This is consistent with the Exchange's current policy of charging no fees in connection with trading by specialists in equity securities. The Exchange believes that the specialists are paying a sufficient amount for their transactions through the specialist trading privilege fee in connection with each stock or ETF for which they act as specialist.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>6</sup> in general and furthers the objectives of Section 6(b)(4)<sup>7</sup> in particular in that it is intended to provide for the equitable allocation of reasonable dues, fees, and other charges among its members and other persons using its facilities.

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

The Exchange has carefully considered the impact of the proposed fee changes on member organizations and does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purpose of the Act. The proposed fee changes are not designed to adversely impact any particular business model or any individual member organization or category of member organizations. In contrast

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<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(4).

with the current pricing system, under which some trades are completely free of charge, all trades will be charged the same \$0.00025 per share fee. The \$750,000 fee cap is a bulk discount to attract more business to the Exchange, which furthers competition among markets and is consistent with the Exchange's own historical fee structure and general industry practice. The Exchange's fee cap has not been changed in response to the large growth in trading volume since it was last increased in 2003, so the average fee per share executed by member organizations paying the cap has decreased significantly over that period. The proposed increase is intended to raise the average fee per share paid by member organizations that pay under the cap to a level that is closer to the historical average paid by those member organizations.

The Exchange has received written comments from two parties on the proposed rule change.<sup>8</sup> In addition, the Exchange has been provided with a letter that was submitted directly to the Commission.<sup>9</sup> The commenters argue that subjecting system trades of less than 2,100 shares to the same per share fee as all other transactions is unfairly discriminatory to smaller member organizations and smaller investors.<sup>10</sup> Moreover, they believe the proposed pricing will be advantageous to large member organizations whose fee obligations will be limited by the

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<sup>8</sup> See letter from Mark D. Fitterman, Partner, Morgan, Lewis & Bockius LLP, to John A. Thain, CEO, and Catherine R. Kinney, President and Co-COO, NYSE Group, Inc., dated June 27, 2006 (on behalf of Jeffries Execution Services, Inc.) ("Jeffries Letter"); and e-mail from Joseph McCaffrey, CEO and Managing LLC Member, Bay Crest Partners, LLC, to Bob Airo, Vice President, and Laura Morrison, Managing Director, NYSE Group, dated July 6, 2006 ("Bay Crest Letter").

<sup>9</sup> See letter from Mark D. Fitterman, Partner, Morgan, Lewis & Bockius LLP, to Nancy M. Morris, Secretary, Commission, dated June 30, 2006 (on behalf of RBC Capital Markets Corporation) ("RBC Letter").

<sup>10</sup> See Jeffries Letter at 2; RBC Letter at passim.

monthly cap.<sup>11</sup> One letter also notes that member organizations will lose the benefit of the cap of 2% of monthly commissions.<sup>12</sup>

The Exchange does not believe that it is anticompetitive or discriminatory to impose fees on system orders for less than 2,100 shares. The average execution size on the Exchange is now less than 600 shares per trade and the Exchange expects even more trades to be executed in the form of system orders as its hybrid market initiative is fully implemented. System orders constituted 72% of the Exchange's equity trading volume in the first six months of 2006, and in the week of June 26, 2006, 95% of system orders were for less than 2,100 shares. This increasing trend towards smaller order sizes is largely attributable to changes in trading behavior in response to the introduction of the decimalization of equities trading in 2001 and the growing influence of program and algorithmic trading. In light of this trend, it is not a sustainable business model for the Exchange to continue to exempt these trades from fees. Given the Exchange's investment in technology and system redundancy, it is essential that the Exchange generate revenue from this large and growing aspect of the equities trading business.

The dramatic reduction in commission rates, a shift to business models not based on commissions, and a greater emphasis on principal trading as a source of revenue since the introduction of the 2% cap in 1981 has allowed many member organizations who continue to pay transaction fees based on the 2% cap to pay disproportionately low transaction fees. Rather than seeking to discriminatorily increase the fees levied on those member organizations, the Exchange is actually eliminating the 2% cap so as to more equitably allocate fees among member organizations.

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<sup>11</sup> See Jeffries Letter at 2; RBC Letter at 1; Bay Crest Letter at passim.

<sup>12</sup> See RBC Letter at 2.

The Exchange has examined the impact of the proposed fee changes on its member organizations by analyzing how much each member organization would pay based on its trading activity for the second half of 2005. The small number of member organizations that currently pay the Exchange's \$600,000 fee cap would all reach the new \$750,000 cap and would therefore pay \$150,000 more in fees per month. The majority of member organizations would pay more in fees under the proposed fee structure. As is clear from these statistics, the Exchange is not seeking to discriminate in favor of the largest member organizations or against those that are smaller. Rather, the impact of the fee changes on a particular member organization will result from a number of variables, including its business model and the volume of trades it sends to the Exchange.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others<sup>13</sup>

The Exchange has not solicited written comments on the proposed rule change and has received the two written comments and the letter addressed to the Commission described above.<sup>14</sup> The letters focus primarily on the commenters' belief that the proposed fees are anticompetitive, which is discussed in Section II.B. above. In addition, two commenters argued that it is inappropriate for the proposed fee changes to be filed for immediate effectiveness pursuant to Section 19(b)(3)(A) of the Act<sup>15</sup> and that the filing should be subject to the public

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<sup>13</sup> The Commission notes that subsequent to the filing of this proposed rule change, the Commission received a comment letter from Lek Securities Corporation, a NYSE member. See letter from Samuel F. Lek, CEO, Lek Securities Corporation, to Nancy M. Morris, Secretary, Commission, dated July 6, 2006.

<sup>14</sup> See supra notes 8 and 9 and accompanying text.

<sup>15</sup> 15 U.S.C. 78s(b)(3)(A).

notice and comment process of Section 19(b)(1) of the Act<sup>16</sup> prior to becoming effective.<sup>17</sup> The Exchange believes it is appropriate to file the proposed fee changes for immediate effectiveness pursuant to Section 19(b)(3)(A) of the Act. Pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>18</sup> and Rule 19b-4(f)(2) thereunder,<sup>19</sup> a proposed rule change may take effect upon filing with the Commission if properly designated by the self-regulatory organization as establishing or changing a due, fee, or other charge applicable to a member. The proposed fee changes are of the type contemplated by Rule 19b-4(f)(2) and it has been the Exchange's consistent historical practice to file such fee changes for immediate effectiveness. The Exchange does not believe that there is any reason to do otherwise in this instance.

One letter asks why the Exchange has determined to exempt specialists from fees in connection with their trades in ETF securities.<sup>20</sup> This is consistent with the Exchange's current policy of charging no fees in connection with trading by specialists in equity securities. The Exchange believes that the specialists are paying a sufficient amount for their transactions through the specialist trading privilege fee in connection with each stock or ETF for which they act as specialist.

Two commenters claim that member organizations have had little notice of the proposed changes and a limited ability to provide input.<sup>21</sup> The Exchange notes that the elimination of the 2% cap, which is the most significant change, was voted on by the membership at the

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<sup>16</sup> 15 U.S.C. 78s(b)(1).

<sup>17</sup> See Jeffries Letter at 3; RBC Letter at 2.

<sup>18</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>19</sup> 17 CFR 240.19b-4(f)(2).

<sup>20</sup> See RBC Letter at 2.

<sup>21</sup> See Jeffries Letter at 1; RBC Letter at 2.

Exchange's April 2005 annual meeting. Member organizations were clearly aware from that time that the Exchange intended to eliminate the cap. Furthermore, the Exchange has communicated with member organizations since mid-2005 about its intention to undertake a significant revision of its pricing structure, soliciting member organizations' views on a number of proposed pricing structures since then. Indeed, the changes the commenters oppose have been among those the Exchange has discussed openly with member organizations during that period.

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

The foregoing proposed rule change has become effective upon filing pursuant to Section 19(b)(3)(A) of the Act<sup>22</sup> and Rule 19b-4(f)(2)<sup>23</sup> thereunder because it establishes or changes a due, fee, or other charge imposed by the Exchange. At any time within 60 days of the filing of the 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 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](mailto:rule-comments@sec.gov). Please include File No. SR-NYSE-2006-46 on the subject line.

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<sup>22</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>23</sup> 17 CFR 19b-4(f)(2).

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-2006-46. 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 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-2006-46 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>24</sup>

Nancy M. Morris  
Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(12).