

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54150; File No. SR-NYSE-2006-36)

July 14, 2006

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to Exchange Rule 70 to Provide Floor Brokers With the Ability to Enter Discretionary Instructions and/or Pegging Instructions with respect to Floor Broker Agency Interest Files (e-Quotes)

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 May 16, 2006, the New York Stock Exchange LLC (“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. On June 14, 2006, NYSE filed Amendment No. 1 to the proposed rule change.³ On July 11, 2006, NYSE filed Amendment No. 2 to the proposed rule change.⁴ 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 Exchange proposes to amend Exchange Rule 70 to reflect that Floor brokers will have the ability to enter discretionary instructions (“d-Quotes”) with respect to their Floor broker agency interest files (“e-Quotes”) and that their e-Quotes and d-Quotes will be able to peg to the Exchange best bid and offer. The Exchange also proposes to amend NYSE Rules 70.20, 123(e),

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, NYSE proposed additional changes and clarifications to the proposal.

⁴ Amendment No. 2 supersedes and replaces the original proposed rule change and Amendment No. 1 in its entirety.

104, and 1000. Below is the text of the proposed rule change, as amended. Proposed new language is underlined; proposed deletions are in brackets.

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Bids and Offers

Rule 70

.20 (a)(i) With respect to orders he or she is representing on the Floor, a Floor broker may place within the Display Book[®] system broker agency interest files at multiple price points on both sides of the market at or outside the Exchange best bid and offer with respect to each security trading in the [location(s) comprising the] Crowd such Floor broker is a part of, [with respect to orders he or she is representing on the Floor,] except that the agency interest files shall not include any customer interest that restricts the specialist's ability to be on parity pursuant to Exchange Rules 104.10(6)(i)(C) and 108(a). Broker agency interest files shall also be referred to as "e-QuotesSM".

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(b) All Floor broker agency interest placed within files in the Display Book[®] system at the same price and on the same side shall be on parity with each other, except agency interest that establishes the Exchange best bid or offer shall be entitled to priority in accordance with Exchange Rule 72. No Floor broker agency interest placed within files in the Display Book[®] system shall be entitled to precedence based on size.

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(j)(i) Floor broker agency interest placed within files may participate in the opening and closing trades in accordance with Exchange policies and procedures governing the open and close.

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(k) The ability of a Floor broker to have reserve interest will not be available during the open and during the close. During the close, a Floor broker's reserve interest, if any, will be added to the size of his or her displayed agency ("e-Quoted") interest. The ability of a Floor broker to exclude volume from aggregated agency interest information available to the specialist will not be available during the open. Floor broker agency interest excluded from the aggregate agency interest information available to the specialist will not participate in the close.

.25 Discretionary Instructions for Bids and Offers Represented via Floor Broker Agency Interest Files (e-QuotesSM)

(a) (i) A Floor broker may enter discretionary instructions as to size and/or price with respect to his or her e-Quotes ("discretionary e-Quotes" or "d-Quotes"). The discretionary instructions relate to the price at which the d-Quote may trade and the number of shares to which the discretionary price instructions apply.

(ii) Discretionary instructions are active only when the e-Quote is at or joins the existing Exchange best bid or best offer or would establish a new Exchange best bid or offer.

(iii) Discretionary instructions are active only with respect to automatic executions. Discretionary instructions are not active with respect to the opening and closing transactions.

(iv) Discretionary instructions will be applied only if all d-Quoting prerequisites are met. Otherwise, the d-Quote will be handled as a regular e-Quote, notwithstanding the fact that the Floor broker has designated the e-Quote as a d-Quote. For example, to be considered a discretionary e-Quote, an e-Quote must have a discretionary price range.

(v) The requirements for e-Quotes apply to d-Quotes, including the requirement that the Floor broker be in the Crowd.

(vi) A Floor broker may have multiple d-Quotes, with different discretionary price and size limitations, on the same side of the market. Such multiple d-Quotes do not compete with each other for executions. Trading volume is allocated by Floor broker, not number of d-Quotes participating in an execution.

(vii) Discretionary instructions apply to both displayed and reserve interest, including reserve interest that is excluded from the aggregate reserve size visible to the specialist on the Floor.

(viii) Neither the specialist on the Floor nor the specialist system employing algorithms will have access to the discretionary instructions entered by Floor brokers with respect to their e-Quotes.

(b) Price Discretion

(i) A Floor broker may set a discretionary price range within the Exchange best bid and offer that specifies the prices at which they are willing to trade. This discretion will be used, as necessary, to initiate or participate in a trade with an incoming order capable of trading at a price within the discretionary price range.

(ii) The minimum price range for a discretionary e-Quote is the minimum price variation set forth in Exchange Rule 62.

(iii) Floor brokers may specify that price discretion applies to all or only a portion of their d-Quote. Price discretion is necessary for d-Quotes. Therefore, if price discretion is provided for only a portion of the d-Quote, the residual will be treated as an e-Quote.

(iv) When price discretion is used, d-Quotes trade first from reserve volume, if any, and then from displayed volume.

(c) Discretionary Size

(i) A Floor broker may designate the amount of his or her e-Quote volume to which discretionary price instructions shall apply.

(ii) A Floor broker may designate a minimum and/or maximum size of contra-side volume with which it is willing to trade using discretionary price instructions.

(iii) Only displayed interest will be used by Exchange systems to determine whether the size of contra-side volume is within the d-Quote's discretionary size range. Contra-side reserve and other interest at the possible execution price will not be considered by Exchange systems when making this determination.

(iv) Interest displayed by other market centers at the price at which a d-Quote may trade will not be considered by Exchange systems when determining if the d-Quote's minimum and/or maximum size range is met, unless the Floor broker designates that such away volume should be included in this determination.

(v) An increase or reduction in the size associated with a particular price that brings the contra-side volume within a d-Quote's minimum or maximum discretionary size parameter, will trigger an execution of that d-Quote.

(vi) Once the total amount of a Floor broker's discretionary volume has been executed, the d-Quote's discretionary price instructions will become inactive and the remainder of that d-Quote will be treated as an e-Quote.

(d) Executions of Discretionary e-Quotes

(i) The goal of discretionary e-Quoting is to secure the largest execution for the d-Quote, using the least amount of price discretion. In so doing, d-Quotes may often improve the execution price of incoming orders. Conversely, if no discretion is necessary to accomplish a trade, none will be used.

(A) Future executions that may occur, such as those resulting from the execution of elected contra-side CAP-DI orders, will not be considered in determining when, and to what extent, price discretion is necessary to accomplish a trade.

(ii) Discretionary e-Quotes will automatically execute against a contra-side order that enters the Display Book[®] system if the order's price is within the discretionary price range and the order's size meets any minimum or maximum size requirements that have been set for the d-Quote.

(iii) Discretionary e-Quotes from different Floor brokers on the same side of the market with the same price instructions trade on parity after interest entitled to priority is executed.

(iv) Same-side d-Quotes from different Floor brokers compete for an execution, with the most aggressive price range (e.g. three cents vs. two cents) establishing the execution price. If an incoming order remains unfilled at that price, executions within the less aggressive price range may then occur.

(v) Discretionary e-Quotes compete with same-side specialist algorithmic trading messages targeting incoming orders. If the price of d-Quotes and specialist trading messages are the same, the d-Quotes and the specialist messages will trade on parity.

(vi) Discretionary e-Quotes from Floor brokers on opposite sides of the market will be able to trade with each other. The d-Quote that arrived at the Display Book[®] system last will use the most discretion necessary to effect a trade, except as provided below.

(A) When a protected bid or offer, as defined in Section 242.600(b)(57) of Regulation NMS ("Reg. NMS"), is published by another market center at a price that is better than the price at which contra-side d-Quotes would trade in accordance with (vi) above, the following applies:

(1) the amount of discretion necessary to permit a trade on the Exchange consistent with the Order Protection Rule (Section 242.611 of Reg. NMS) (“OPR”) will be used; or

(2) such portion of the appropriate d-Quote as is necessary will be automatically routed in accordance with OPR in order to permit a trade to occur on the Exchange.

(vii) As with all executions on the Exchange, executions involving d-Quotes will comply with OPR.

(viii) Discretionary e-Quotes may provide price improvement to and trade with an incoming contra-side specialist algorithmic trading message to “hit bid/take offer,” just as they can with any other marketable incoming interest.

(ix) Discretionary e-Quotes may initiate sweeps in accordance with and to the extent provided by Exchange Rules 1000-1004, but only to the extent of their price and volume discretion. Discretionary e-Quotes may participate in sweeps initiated by other orders but, in such cases, their discretionary instructions are not active.

(A) d-Quotes will not trade at a price that would trigger a liquidity replenishment point (“LRP”) as defined in Exchange Rule 1000. Accordingly, a sweep involving a d-Quote will always stop at least one cent before an LRP price.

.26 Pegging for d-Quotes and e-Quotes

(i) An e-Quote, other than a tick-sensitive e-Quote, may be set to provide that it will be available for execution at the Exchange best bid (for an e-Quote that represents a buy order) or at the Exchange best offer (for an e-Quote that represents a sell order) as the Exchange best bid or offer changes, so long as the Exchange best bid or offer is at or within the e-Quote’s limit price.

(ii) A d-Quote may also employ pegging.

(iii) Pegging is only active when auto-quoting is active.

(iv) Pegging e-Quotes and d-Quotes trade on parity with other interest at the Exchange best bid or offer after interest entitled to priority is executed.

(v) Pegging is reactive. An e-Quote or d-Quote will not establish the Exchange best bid or best offer as a result of pegging.

(vi) Price priority cannot be established by pegging, although existence of pegging instructions does not preclude an e-Quote or d-Quote from having priority.

(vii) Pegging e-Quotes and d-Quotes peg only to other non-pegging interest within the pegging range selected by the Floor broker.

(viii) An e-Quote or d-Quote will not sustain the Exchange best bid or best offer as a result of pegging if there is no other non-pegged interest at that price and such price is not the e-Quote's or d-Quote's limit price.

(A) If the lowest quotable price established by the Floor broker for a pegging e-Quote or d-Quote to buy is the Exchange best bid and all other interest at that price cancels or is executed, the pegging e-Quote or d-Quote will remain displayed at that best bid price.

(B) If the highest quotable price established by the Floor broker for a pegging e-Quote or d-Quote to sell is the Exchange best offer and all other interest at that price cancels or is executed, the pegging e-Quote or d-Quote will remain displayed at that best offer price.

(ix) A Floor broker may establish a price range for an e-Quote or d-Quote, beyond which the pegging function will not be available ("quote," "ceiling" and "floor" prices).

(A) The "quote price" is the lowest price to which a buy e-Quote or d-Quote may peg or the highest price to which a sell e-Quote or d-Quote may peg.

(B) The “ceiling price” is the highest price to which a buy-side e-Quote or d-Quote may peg.

(C) The “floor price” is the lowest price to which a sell-side e-Quote or d-Quote may peg.

(D) A quote, ceiling and floor price may be at a price other than the limit price of the order that is being e-Quoted or d-Quoted, but may not be inconsistent with the order’s limit.

(x) As long as the Exchange best bid is at or within the pegging price range selected by the Floor broker with respect to a buy-side e-Quote or d-Quote, or the Exchange best offer is within the price range selected by the Floor broker with respect to a sell-side e-Quote or d-Quote, the pegging e-Quote or d-Quote will join such best bid or best offer as it is auto quoted.

(xi) If the Floor broker does not designate a pegging range, but has instructed that his or her e-Quote or d-Quote shall peg, the e-Quote or d-Quote will peg to the Exchange best bid (offer) as long as such bid (offer) is within the limit of the order that is being e-Quoted or d-Quoted.

(xii) As an e-Quote or d-Quote pegs, its discretionary price range, if any, moves along with it, subject to any floor or ceiling price set by the Floor broker.

(A) If the Exchange best bid is higher than the ceiling price of a pegging buy-side e-Quote or d-Quote, the e-Quote or d-Quote will remain at its quote price or the highest price at which there is other interest within its pegging price range, whichever is higher (consistent with the limit price of the order underlying the e-Quote or d-Quote).

(B) If the Exchange best offer is lower than the floor price of a pegging sell-side e-Quote or d-Quote, the e-Quote or d-Quote will remain at its quote price or the lowest price at

which there is other interest within its pegging price range, whichever is lower (consistent with the limit price of the order underlying the e-Quote or d-Quote).

(C) If the Exchange best bid or best offer returns to a price within the pegging price range selected by the Floor broker, the e-Quote or d-Quote will once again peg to the Exchange best bid or best offer.

(xiii) A Floor broker may establish a minimum and/or maximum size of same-side volume to which his or her e-Quote or d-Quote will peg. Other pegging e-Quote or d-Quote volume will not be considered in determining whether the volume parameters set by the Floor broker have been met.

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Dealings by Specialists

Rule 104

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(c)

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(ix) Specialist algorithmically-generated messages will compete with or trade along with same-side discretionary e-QuotesSM in the manner described in Exchange Rule 70.25.

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Record of Orders

Rule 123

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(e) System Entry Required

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8. Any limit price, [and/or] stop price, discretionary price range, discretionary volume range, discretionary quote price, pegging ceiling price, pegging floor price and/or whether discretionary instructions are active in connection with interest displayed by other market centers;

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The Floor member must identify which orders or portions thereof are being made part of the Floor broker agency interest file and, with respect to such orders or portions thereof, what discretionary and/or pegging instructions, if any, have been assigned pursuant to such procedures as required by the Exchange.

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NYSE Direct+[®]
Automatic Executions

Rule 1000

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(d)

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(D) After trading with the Exchange published best bid (offer), the unfilled balance of any incoming commitment to trade received through ITS shall be automatically cancelled, as described in Rule 13 (definition of immediate or cancel order).

(iii)(A) During a sweep, the residual shall trade with the orders on the Display Book[®] and any broker agency interest files and/or specialist interest file capable of execution in

accordance with Exchange rules, at a single price, such price being the best price at which such orders and files can trade with the residual to the extent possible, (“clean-up price”). A discretionary e-Quote shall participate in a sweep in accordance with and to the extent allowed by Exchange Rule 70.25(d)(ix).

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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

Exchange Rule 70.20 was initially approved by the Commission on December 14, 2005,⁵ as part of a pilot permitting the implementation of Phase 1 of the NYSE HYBRID MARKETSM (“Hybrid Market”) and was permanently approved by the Commission on March 22, 2006.⁶

In order to fully participate in the Hybrid Market, Floor brokers have been given the ability to electronically represent their customers’ orders by placing their trading interest at or outside the Exchange best bid and offer in Floor broker agency interest files within the Display

⁵ See Securities Exchange Act Release No. 52954 (December 14, 2005), 70 FR 75519 (December 20, 2005).

⁶ See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006).

Book[®] system⁷ (“NYSE e-QuotesSM” or “e-Quotes”).⁸

The following proposed changes are being made to clarify certain of Rule 70.20’s provisions in response to questions that have arisen since the rule has been in effect:

1. Rule 70.20(a)(i): Duplicative language has been deleted.
2. Rule 70.20(b): The phrase “and on the same side” has been added to clarify which orders trade on parity pursuant to this provision.
3. Rule 70.20(j)(i): Reference to “the close” has been added to clarify that Floor broker agency interest files participate on the open and close in accordance with the policies and procedures of the Exchange.
4. Rule 70.20(k): A sentence has been added to clarify how a Floor broker’s reserve interest will be handled on the close.

To further replicate in the Hybrid Market the manner in which Floor brokers utilize their judgment in quoting and trading on behalf of customers’ orders today, the Exchange is proposing to provide Floor brokers with the ability to enter discretionary trading and/or pegging (discretionary quoting) instructions for their e-Quotes (“NYSE d-QuotesSM” or “d-Quotes”).

Discretionary instructions for e-Quotes and pegging will give Floor brokers additional tools to compete with other interest, including the specialists’ algorithmic trading and quoting ability. These proposed discretionary features and pegging will facilitate the ability of Floor brokers to participate in trades that they would not be able to reach in the Hybrid Market.

⁷ The Display Book[®] system (“Display Book” or “book”) is an order management and execution facility that receives and displays orders to the specialist and provides a mechanism to execute and report transactions and publish the results to the Consolidated Tape. In addition, the Display Book is connected to a variety of other Exchange systems for the purposes of comparison, surveillance, and reporting information to customers and other market data and national market systems (*i.e.*, the Intermarket Trading System, Consolidated Tape Association, Consolidated Quotation System, etc.).

⁸ See Exchange Rule 70.20.

Discretionary Trading Instructions

In the mostly-manual pre-Hybrid Market, Floor brokers had an opportunity to make trading decisions with respect to arriving orders. In a more electronic trading environment, the Floor broker may not have that opportunity. While e-Quotes enable Floor brokers' customer interest to participate in automatic executions at the Exchange best bid and offer ("BBO") and in sweeps, they do not initiate trades with incoming orders at prices better than the BBO. In other words, currently, e-Quotes do not provide Floor brokers with the means to express a price range within which they are willing to actively trade. Thus, the proposed changes will provide Floor brokers with the ability not only to quote in an attempt to draw interest, but, at the same time, initiate trades with contra-side interest able to trade at prices at or within the BBO. By using d-Quotes, a Floor broker may set a discretionary price range and a discretionary size range. Discretionary size can apply to the amount of an e-Quote to which discretionary instructions apply and/or to the amount of contra-side volume with which the d-Quote is willing to trade, as described below. Discretionary instructions are only active when the e-Quote is at the BBO. Neither the specialist on the Floor nor the specialist system employing algorithms will have access to the discretionary instructions entered by the Floor broker.

Price Discretion

Discretionary instructions for e-Quotes will allow Floor brokers to set a price range for their d-Quotes within which they are willing to initiate or participate in a trade. This discretion will be used, as necessary, to initiate or participate in a trade with an incoming order capable of trading at a price within the discretionary range. Discretionary price instructions may apply to all or part of a d-Quote.

For example, the BBO is .05 bid, offered at .10. A Floor broker enters a d-Quote at .10, with price discretion of .04. A limit order to buy at .06 enters the market. The d-Quote will use its four cents of price discretion and initiate a trade at .06.

When a d-Quote is competing with same-side quoted or trading interest (i.e., displayed interest at the BBO, other d-Quotes, or a same-side specialist algorithmic trading message, such as to provide price improvement), if the d-Quote can get a larger allocation by providing an additional penny (or more) of price improvement and the discretionary instructions permit the d-Quote to trade at that price, it will do so.

Volume Discretion

Floor brokers may designate that discretionary instructions apply only to a portion of their e-Quote. For example, a Floor broker may specify that only 20,000 shares of a 50,000-share e-Quote may use price discretion. The remaining 30,000-shares would be handled as a regular e-Quote, i.e., one without discretionary instructions.

Floor brokers who use e-Quoting price discretion may also set a minimum and/or maximum size limit with respect to the size of contra-side interest with which it is willing to trade using price discretion. This allows for more specific order management by preventing the d-Quote from trading with opposite side interest that the Floor broker has judged to be too little or too great in the context of the order or orders he or she is managing.

For example, the BBO is .05 bid, offered at .10. A Floor broker e-Quotes stock at .10, with price discretion of .04 and minimum/maximum volume discretion of 1,000/10,000 shares. A limit order to buy 500 shares at .06 enters the market. No trade will occur, even though a trade at .06 is within the d-Quote's price discretion range, because the incoming order size is below the d-Quote's minimum discretionary volume size. A new best bid of .06 will be auto-quoted. An

order to buy 1,500 shares at .06 enters the market. The d-Quote will initiate a transaction, selling 2,000 shares at .06, as the size available to trade at .06 is now within the d-Quote's discretionary volume parameters. Similarly, a sufficient reduction in the size of a bid or offer that was previously larger than the maximum discretionary volume will trigger an execution of a discretionary d-Quote.

Only published contra-side volume is considered when determining whether such volume is within the d-Quote's discretionary volume range. Reserve and other interest at the possible execution price is not considered, as it is not displayed. Interest displayed by other market centers at the price at which a d-Quote may trade is not considered when determining if the minimum volume range is met, unless the Floor broker electronically designates that such away volume should be included in this determination.

Pegging

In the Hybrid Market, a Floor broker needs to be represented in the BBO in order to participate in automatic executions. The e-Quotes provide Floor brokers with the mechanism to be part of the quote. However, in a more automated environment, the BBO may change rapidly and the e-Quoting process, as it currently exists, may not be sufficient to enable Floor brokers to stay with a quickly changing quote. The proposed pegging function will allow Floor brokers to keep their interest in the quote, even as the quote moves. Floor brokers will be able to designate a range to which their e-Quotes and d-Quotes will peg and, as long as the BBO is within that range, the e-Quote and d-Quote will be included. Buy side e-Quotes and d-Quotes will peg to the best bid, and sell side e-Quotes and d-Quotes will peg to the best offer.

In addition, pegging e-Quotes and d-Quotes may set a minimum and/or maximum size of same-side volume to which his or her e-Quote or d-Quote will peg. Pegging e-Quotes and d-

Quotes may set a “quote price” specifying the lowest price to which a buy-side e-Quote or d-Quote may peg and the highest price to which a sell-side e-Quote or d-Quote may peg. A “ceiling price” may be set to establish the highest price to which a buy-side e-Quote or d-Quote may peg, and a “floor price” may be set to establish the lowest price to which a sell-side e-Quote or d-Quote may peg. The quote, ceiling and floor prices must be at or within the limit price of the order being e-Quoted or d-Quoted.

A pegging d-Quote’s price discretion range will move along with the d-Quote as it pegs.

Pegging is a separate type of discretionary instruction and may occur with e-Quotes and/or with d-Quotes using discretionary price instructions.

Example

A Floor broker is representing an order to buy 4,000 shares of XYZ with a limit of .97, not-held.⁹ He decides to electronically represent this order as a d-Quote, with a quote price of .92 and with price discretion of .02, in the hope of obtaining a better execution price for his customer. This means that the Floor broker is willing to participate in an execution at the following prices: .92, .93 and .94. Further, he has decided to display 1,000 shares, with 3,000 in reserve. In addition, the Floor broker has decided to have this order peg, with minimum and maximum volume sizes of 500 and 8,000 shares respectively. The Floor broker has set the ceiling price at .97. This means that as long as the Exchange best bid is a minimum of 500 shares and no more than 8,000 shares, the d-Quote would peg to any Exchange best bid at or between .92 and .97

The Exchange best bid becomes 2,000 shares bid for .94. As this is within the minimum and maximum pegging size range, the order will peg to the .94 bid, increasing the displayed size

⁹ A “not held” order is a market or limit order that gives the Floor broker both time and price discretion to attempt to get the best possible price for the customer.

at that price to 3,000 shares (2,000 shares that established that price and the d-Quote's displayed 1,000 shares). The Exchange best bid then becomes 300 shares bid for .95. The d-Quote will not peg to that best bid, as its size is below the minimum pegging size designated by the Floor broker. If an additional 400 shares is added to the best bid as a result of other interest at that price, the d-Quote will peg to it, increasing the displayed size to 1,700 shares. Similarly, if the displayed volume at .95 increased from 300 shares to 10,000 shares (instead of 700 shares), the d-Quote would not peg to that price, as 10,000 shares is more than the maximum pegging size selected by the Floor broker (which was 8,000 shares, as noted above). Again, if the displayed volume at .95 decreases to 6,000 shares, for example, as a result of a trade at that price, the d-Quote will peg to the .95 bid, as the displayed volume size is now lower than the maximum selected by the Floor broker. 7,000 shares will be bid at .95, with the d-Quote's 3,000 shares in reserve.

As the d-Quote pegs, it continues to be able to use its price discretion of .02 to effect a trade. Accordingly, if 7,000 shares is bid at .95, comprised of 6,000 shares of other interest and 1,000 shares of the d-Quote (with 3,000 shares of the d-Quote in reserve at .95) and the Exchange best offer is .97 for 1,700 shares, the d-Quote will initiate an execution, trading 1,700 shares at .97. The d-Quote's reserve size will be decremented by the amount of the trade, leaving 1,300 shares to buy in reserve, with 1,000 shares displayed. The best bid continues to be .95, so the d-Quote remains pegged at that price. The displayed volume at .95 continues to be 7,000 shares, including the displayed portion of the d-Quote (1,000 shares).

General Principles Covering Discretionary e-Quotes and Pegging

The following describes in more detail the general principles governing d-Quotes (i.e., an e-Quote with discretionary trading and/or pegging instructions):

- Discretionary instructions relate to the price at which the d-Quote may trade and the number of shares to which the discretionary price instructions apply.
- The goal of discretionary trading is to secure the largest execution for the d-Quote, using the least amount of price discretion. In so doing, d-Quotes may often improve the execution price of incoming orders. Conversely, if no discretion is necessary to accomplish a trade, none will be used.
- Discretionary instructions are only active when the d-Quote is at the BBO.
- Neither the specialist on the Floor nor the specialist system employing algorithms will have access to the discretionary instructions entered by the Floor broker.
- Specialists will not have the ability to enter discretionary trading or pegging instructions on behalf of a Floor broker.
- The minimum price range for a d-Quote is the minimum price variation set forth in Rule 62.
- The requirements for e-Quoting apply to the d-Quote, including the requirement that the Floor broker be in the Crowd.
- Discretionary instructions apply to displayed and reserve size, including reserve interest that is excluded from the aggregate volume visible to the specialist on the Floor.
- When price discretion is used, d-Quotes trade first from reserve volume, if any, and then from displayed volume.
- Once the total amount of a Floor broker's discretionary volume has been executed, the d-Quote's price instructions will become inactive and the remainder of that d-Quote will be treated as an e-Quote.

- Discretionary instructions are only applicable to automatic executions; they are not utilized in manual transactions.
- Discretionary instructions may be entered for all e-Quotes, however, these instructions are only active when the e-Quote is at or joins the existing Exchange BBO or would establish a new Exchange BBO.
- Multiple same-side d-Quotes from different Floor brokers will compete for an execution with the most aggressive price range (e.g., three cents vs. two cents) establishing the execution price. If the incoming order remains unfilled at that price, executions within the less aggressive price range may occur.
- d-Quotes with the same discretionary price instructions on the same side will trade on parity, after any interest entitled to priority.
- d-Quotes on opposite sides of the market will be able to trade with each other. The d-Quote that arrived last will use the most discretion, if necessary, to effect a trade.
- d-Quotes will compete with same-side specialist algorithmic trading messages targeting incoming orders. If the price of d-Quotes and the trading messages are the same, the d-Quotes and the specialist messages will trade on parity.
- If a d-Quote is competing with same-side quoted or trading interest, including a same-side specialist algorithmic trading message (i.e., to provide price improvement) and the d-Quote can get a larger allocation by providing an additional penny of price improvement (or other applicable minimum price variation), generally, it will do so.
- d-Quotes may price improve and trade with an incoming contra-side specialist algorithmically-generated message to “hit bid/take offer,” just as they can with any other marketable incoming interest.

- d-Quotes may initiate sweeps, but only to the extent of their price and volume discretion. d-Quotes may participate in sweeps initiated by other orders, but their discretionary instructions will not be active.
- A sweep involving a d-Quote will always stop at least one cent (or other applicable minimum price variation) before a liquidity replenishment point is reached.
- Executions involving d-Quotes will comply with the Regulation NMS Order Protection Rule (“OPR”).¹⁰
- When a better price is displayed by an away market and such price is in the middle of contra-side d-Quotes, the amount of price discretion extended to a participating d-Quote will be adjusted to permit a trade consistent with Reg. NMS OPR requirements.
- Discretionary instructions will be applied only if all d-Quoting prerequisites are met. Otherwise, the d-Quote will be handled as a regular e-Quote, notwithstanding the fact that the Floor broker has designated the e-Quote as a d-Quote.
- When price discretion is used, d-Quotes trade first from reserve volume, then from published volume. When no price discretion is used, the e-Quote’s published volume trades first.
- Floor brokers may specify that price discretion applies to all or only a portion of their d-Quote. Price discretion is necessary for d-Quotes. Therefore, if price discretion is provided for only a portion of the d-Quote, the residual will be treated as an e-Quote.
- Floor brokers may have more than one e-Quote/d-Quote per side and price. Trading volume is allocated by broker, not e-Quote/d-Quote, in accordance with Exchange rules.

¹⁰ See 17 CFR 242.611.

- Pegging e-Quotes and d-Quotes may set a “quote price” specifying the lowest price to which a buy-side e-Quote or d-Quote may peg and the highest price to which a sell-side e-Quote or d-Quote may peg. A “ceiling price” may be set to establish the highest price to which a buy-side e-Quote or d-Quote may peg, and a “floor price” may be set to establish the lowest price to which a sell-side e-Quote or d-Quote may peg. The quote, ceiling, and floor prices must be at or within the limit price of the order being e-Quoted or d-Quoted.
- Pegging will not establish a new BBO and it will not generally sustain a BBO when there is no other interest at that price. If the BBO is the lowest quotable price established by the Floor broker for a pegging buy-side e-Quote or d-Quote or the highest quotable price established by the Floor broker for a sell-side pegging e-Quote or d-Quote and all other interest at that price cancels or is executed, the pegging e-Quote or d-Quote will remain displayed at such BBO.
- Pegging will only occur at prices within the pegging price range designated by the Floor broker.
- Pegging applies to the entire e-Quote/d-Quote volume.
- Pegging is reactive and moves in both directions.
- Pegging e-Quotes and d-Quotes peg only to other non-pegging interest within the pegging range selected by the Floor broker.
- Pegging is available only when auto-quoting is on.
- Price priority cannot be established by pegging, although the existence of pegging instructions does not preclude an e-Quote or a d-Quote from having priority.
- Pegging e-Quotes and d-Quotes trade on parity with other interest on the same side at the Exchange best bid or offer after interest entitled to priority.

- Discretionary trading and pegging is not available for tick-sensitive e-Quotes.
- An e-Quote may have either or both discretionary trading and pegging instructions.
- As an e-Quote or d-Quote pegs, its discretionary price range, if any, moves along with it, subject to any floor or ceiling price set by the Floor broker.
- Pegging e-Quotes and d-Quotes may establish a minimum and/or maximum size of same-side volume to which it will peg. Other pegging e-Quote or d-Quote volume will not be considered in determining whether the volume parameters set by the Floor broker have been met.

Other Rule Changes

Rule 104

Rule 104(c)(ix) has been amended to reflect that a specialist's algorithmically-generated messages will compete with or trade along with same side d-Quote as described in NYSE Rule 70.25.

Rule 123

Exchange Rule 123(e)(8) which requires the entry of certain order information into the Exchange's Front End Systemic Capture (FESC") system before such order can be represented, has been amended to add certain required terms regarding e-Quotes and d-Quotes.

Rule 1000

Rule 1000(d)(iii) which governs sweeps has been amended to reflect that d-Quotes will participate in sweeps in the manner described in NYSE Rule 70.25(d)(ix).

Implementation Plans

At present, the Exchange plans to implement proposed Rules 70.25 and 70.26 as part of Phase 3 of the Hybrid Market. The Exchange will consult with the Commission with respect to

any change to this implementation plan.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)(5) of the Act¹¹ because it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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 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

The Exchange has neither solicited nor received written comments on the proposed rule change. The Exchange has received one comment letter on the proposed rule change and will respond to it after the comment period has concluded.

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 self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

¹¹ 15 U.S.C. 78f(b)(5).

(B) institute proceedings to determine whether the proposed rule change 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 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-2006-36 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-2006-36. 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

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 available publicly. All submissions should refer to File Number SR-NYSE-2006-36 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.¹²

Nancy M. Morris
Secretary

¹² 17 CFR 200.30–3(a)(12).