

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54316; File No. SR-NYSE-2006-59)

August 15, 2006

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Specialists Hitting Bids and/or Taking Offers Algorithmically on a Temporary Basis Until Phase II of the Hybrid Market is Fully Implemented

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 August 8, 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 and II below, which Items have been prepared by the Exchange. NYSE filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) 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

NYSE proposes to amend Exchange Rule 104 (Dealings by Specialists) with respect to the specialists’ ability to establish systems employing algorithms to send messages via a connection to the Display Book<sup>®</sup> for the purpose of quoting or executing trades systemically. The text of the proposed rule change is available on the Exchange’s Web site ([www.nyse.com](http://www.nyse.com)), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

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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).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

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

Through the NYSE HYBRID MARKET<sup>SM</sup> initiative,<sup>5</sup> the Exchange is permitting specialists to establish electronic connections to the Display Book<sup>®</sup> system<sup>6</sup> (“Display Book”). Specialists will have electronic access to certain information which will permit them to make a range of specified quoting and trading decisions based on that information via the Display Book connection. Specifically, the amendments to Rule 104 (Dealings by Specialists) pursuant to the NYSE Hybrid Market<sup>SM</sup> provide specialists with the ability to implement systems that use proprietary algorithms based on predetermined parameters to electronically participate in the Hybrid Market<sup>SM</sup> (“Specialist Algorithm”). The Specialist Algorithm is designed to communicate with the Display Book via an Exchange-owned external application program interface (“API”).

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<sup>5</sup> See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006).

<sup>6</sup> The Display Book system is an order management and execution facility. It receives and displays orders to the specialist, contains the orders received by the specialist (the “Book”), and provides a mechanism to execute and report transactions to the Consolidated Tape.

As approved in the Hybrid Market initiative, the Specialist Algorithm is permitted to send messages to the Display Book via the API to quote or trade on behalf of the specialist's proprietary interest. The Specialist Algorithm will generate these quoting or trading messages in reaction to specific types of information it will have access to. This information includes specialist dealer position, existing quotes, publicly available information the specialist chooses to supply to the algorithm, incoming orders as they are entering Exchange systems, and information about orders on the Display Book such as limit orders, percentage orders, stop orders, and auction limit and auction market orders. This latter information stream is known as "state of the book" information.

The Exchange has continued to discuss Hybrid Market features with its members and advisory committees. Based on these discussions, the Exchange has effected selective changes to certain aspects of the Hybrid Market, to produce a trading venue that best addresses the various needs of the Exchange members and customers.

On June 20, 2006, the Exchange filed a proposed rule change<sup>7</sup> with the Commission that was effective upon filing to amend Rule 104(b). That proposal added Rule 104(b)(i) to permit specialists to send quoting messages via the API in all securities without the specialists having access to information about incoming orders as they are entering Exchange systems. That proposal also specified that Rule 104(b)(i) would be superseded when Phase II of the Hybrid Market is fully implemented.

In this current filing, the Exchange seeks to amend current Rule 104(b)(i) to renumber it as Rule 104(aa)(i) and to clarify that the specialists will have the ability to send quoting messages as described above without the need for Exchange authorization.

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<sup>7</sup> See Securities Exchange Act Release No. 54024 (June 21, 2006), 71 FR 124 (June 28, 2006).

In addition, the Exchange seeks to further amend Rule 104 to add a new section (aa)(ii), to permit specialists to algorithmically execute transactions against the Exchange's best bid or offer ("Hit Bid/Take Offer") in any security. As with the quoting messages governed by Rule 104(aa)(i), the API will not have information about incoming orders as such orders are entering Exchange systems. Pursuant to Rule 104(c), specialist messages to trade with the Exchange published quote must include a code identifying the reason for the algorithmic action, the unique identifier of the order to which the algorithmically-generated message is reacting (if any), the unique identifier of the order immediately preceding the generation of the algorithmically-generated message and any other information the Exchange may require. Hit Bid/Take Offer messages will be processed by the Display Book in such a manner that a specialist's algorithmic message to trade with the Exchange published quotation does not possess any speed advantage in reaching the Display Book by delaying the processing of this type of trading message from the Specialist Algorithm.<sup>8</sup>

The proposed amendments discussed in this filing will be superseded with the Exchange Rule 104 amendments, as previously approved in the NYSE HYBRID MARKET<sup>SM</sup> initiative, when Phase II of Hybrid Market<sup>SM</sup> is fully implemented. All other provisions of Rule 104 remain in effect, including but not limited to, provisions governing stabilization and the specialist's negative obligation.

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<sup>8</sup> See Securities and Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006). Based upon the average transit time from the Exchange Common Message Switch (CMS) system to the Display Book system, the Exchange would determine the appropriate amount of time to delay the processing of algorithmic messages to trade with the Exchange published quotation. The delay parameter would be adjusted periodically to account for changes to the average transit time resulting from capacity and other upgrades to Exchange systems.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>9</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>10</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

The 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.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) by its terms, become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and Rule 19b-4(f)(6) thereunder.<sup>12</sup>

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<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(6).

A proposed rule change filed under Rule 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii)<sup>13</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay and designate the proposed rule change immediately operative upon filing. The Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest because it would allow specialists to begin testing their APIs. Accordingly, the Commission designates the proposal to be effective and operative upon filing with the Commission.<sup>14</sup>

#### 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 Number SR-NYSE-2006-59 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.

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<sup>13</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>14</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

All submissions should refer to File Number SR-NYSE-2006-59. 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-2006-59 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.<sup>15</sup>

Nancy M. Morris  
Secretary

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<sup>15</sup> 17 CFR 200.30-3(a)(12).