

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56085; File No. SR-NYSE-2007-09)

July 17, 2007

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval to a Proposed Rule Change as Modified by Amendments No. 1, 2, and 3 Thereto Relating to Rule 18 (Compensation in Relation to System Failure)

I. Introduction

On January 26, 2007, the New York Stock Exchange LLC (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposal to adopt Rule 18, “Compensation in Relation to Exchange System Failure,” which will provide a form of compensation to member organizations when a loss is sustained in relation to an Exchange system failure. The Exchange filed Amendments No. 1 and 2 to the proposal on February 1, 2007, and March 28, 2007, respectively. The proposal, as modified by Amendments No. 1 and 2, was published for comment in the Federal Register on April 5, 2007.³ The Commission received one comment letter regarding the proposal.⁴ The Exchange filed Amendment No. 3 with the Commission on June 21, 2007.⁵ This order provides notice of filing

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 55555 (March 29, 2007), 72 FR 16841 (“Notice”).

⁴ See letter from Jerry O’Connell, Chair, Trading Committee, Securities Industry and Financial Markets Association (“SIFMA”), to Nancy M. Morris, Secretary, Commission, dated April 26, 2007 (“SIFMA Letter”). On June 21, 2007, NYSE submitted a response to the SIFMA Letter. See letter from Mary Yeager, Assistant Secretary, NYSE, to Nancy M. Morris, Secretary, Commission (“Response Letter”).

⁵ Amendment No. 3: (i) removed the exclusion of queuing from the proposed definition of Exchange system failure; (ii) withdrew the proposed modification of NYSE Rule 134; and (iii) clarified that the Chief Executive Officer or his or her designee shall make the

of Amendment No. 3 and approves the proposal, as modified by Amendments No. 1, 2, and 3, on an accelerated basis.

II. Description of the Proposal

The Exchange proposes to adopt Rule 18, “Compensation in Relation to Exchange System Failure,” in order to establish a procedure to compensate member organizations in relation to Exchange system failures. The proposed rule defines an Exchange system failure as a “malfunction of the Exchange’s physical equipment, devices, and/or programming which results in an incorrect execution or no execution of an order that was received in Exchange systems. Misuse of Exchange systems is not considered an Exchange system failure.”⁶

For a member organization to be eligible to receive payment for a claim, it must incur a net loss equal to or greater than \$5,000. Member organizations are not permitted to aggregate losses incurred as a result of more than one system failure in order to satisfy the \$5,000 minimum claim requirement.

Proposed Rule 18 would require member organizations to informally notify the Exchange’s Division of Floor Operations of a suspected Exchange system failure by the opening of the next business day following an incident. Formal written notice of the suspected Exchange system failure must be provided to the Exchange’s Division of Floor Operations no later than end of the third business day after the incident.

final determinations on claims in the event that the members of the Compensation Review Panel are deadlocked. The text of Amendment No. 3 is available on the Exchange’s Web site (<http://www.nyse.com>), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

⁶ The Exchange’s original proposal, as described in the Notice, *see supra* note 3, stated that delays in order processing as a result of large volume or other capacity issues, commonly known as “queuing,” are not within the definition of Exchange system failures. In response to a comment in the SIFMA Letter, *see supra* note 4, NYSE revised the proposal to delete this aspect of the definition in Amendment No. 3.

Once in receipt of a claim, the Exchange's Division of Floor Operations will verify that: (i) a valid order was accepted into Exchange's systems; and (ii) an Exchange system failure occurred during the execution or handling of that order. If all of the criteria for submitting a claim have been met, the claim will be qualified for processing with all other eligible claims at the end of the calendar month in which the incident occurred.

The Exchange proposes to allot \$500,000 each calendar month ("Monthly Allotment") to be used for payments to member organizations that qualify for compensation under proposed Rule 18. The Monthly Allotments will not aggregate; however, in the event that less than \$250,000 of the Monthly Allotment is paid out for a given calendar month, \$50,000 of that month's remaining Monthly Allotment ("Supplemental Allotment") will be added to a supplemental fund available for payment in subsequent calendar months. This Supplemental Allotment will be used only to pay claims after the Monthly Allotment is exhausted. If claims are satisfied by the Monthly Allotment, the Supplemental Allotment, or any unused portion thereof, will be carried forward every month.

Under the current proposal, there is no cap on the amount that may accrue over time from the Supplemental Allotments. The Exchange may determine to institute such a cap in the future. Any such determination would be formally reflected in the text of Rule 18. In addition, the Exchange represented in its proposal that, a few years after Rule 18's implementation, Exchange management intends to review both the maximum dollar amount, if any, that may be accrued as part of the Supplemental Allotment and the Monthly Allotment to determine whether they are appropriate. The Exchange represents that any modification of the terms of the Supplemental Allotment or the Monthly Allotment will be filed with the Commission under Section 19(b)(1) of the Act as a proposed rule change.

In the original proposal, the Exchange sought to amend Rule 134.40 to require that profits equal to or greater than \$5,000 gained in relation to an Exchange system failure be remitted to the Exchange in order to be applied to payments to member organizations in the event that the Monthly Allotment and Supplemental Allotment were inadequate. However, in response to industry comment,⁷ in Amendment No. 3, the Exchange withdrew its proposed amendment to Rule 134.40. Thus, under Rule 134.40, member organizations must continue to report profits from Exchange error transactions to the Exchange, but they will not be required to remit any part of such profits to the Exchange.

The Exchange proposes to establish a panel consisting of three Floor Governors and three Exchange employees (“Compensation Review Panel”) that will review qualified claims and administer payments. The Compensation Review Panel will meet and review all the claims that are submitted for a calendar month in order to determine if each claim satisfies all the criteria for payment, and the amount to be paid on the claim (“approved claims”). As part of its determination, the Compensation Review Panel will review the actions of the member organization and its employees before and after the error occurred in order to determine if any of the claimant’s actions contributed to the loss sustained. The Compensation Review Panel may increase or reduce the amount deemed eligible for payment as a result of its review. All decisions by the Compensation Review Panel will be final.

The determinations of the Compensation Review Panel will be by majority vote. In the event of deadlock, all relevant information about the claim will be sent to the Chief Executive Officer of the Exchange (“CEO”) of the Exchange or his or her designee,⁸ who will make a final

⁷ See SIFMA Letter, supra note 4.

⁸ The description of the proposal set forth in the Notice, see supra note 3, provided that, in the event of a deadlock, the CEO of the Exchange or the President or his or her designee would make the final determination. The inclusion of the President in this provision was

determination. Like the determinations of the Compensation Review Panel, all the determinations of the CEO will be final.

If the total dollar amount of approved claims is less than the Monthly Allotment, then the claims will be paid in full. If the total amount of approved claims exceeds the Monthly Allotment, then any Supplemental Allotment will be added to the Monthly Allotment in order to satisfy approved claims. In the event that the approved claims for a month exceed the sum of the Monthly Allotment and any Supplemental Allotment, the approved claims will be paid out to member organizations based on the proportion that each eligible claim bears to the total amount of all approved claims.

Finally, the Exchange proposes to make NYSE Rule 18 effective retroactively to September 1, 2006. Following Commission approval of the proposed rule, member organizations may submit claims to the Exchange for any alleged Exchange system failures that occurred between September 1, 2006, and the date of Commission approval. A Monthly Allotment will be set aside for each calendar month in the period for which Rule 18 is retroactively effective. However, the Supplemental Allotment provision will not be retroactive, but will be effective beginning with the first calendar month after Commission approval of proposed Rule 18.

III. Discussion

After careful consideration of the proposed rule change, the SIFMA Letter, and the NYSE's Response Letter, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to

an error on the Exchange's part. In Amendment No. 3, the Exchange corrected this provision of the proposed rule change to reflect the Exchange's intention that the CEO or his or her designee would serve this function. Telephone conversation between Deanna Logan, Director, Rule Development, NYSE, and Nathan Saunders, Special Counsel, Division of Market Regulation, Commission, on July 16, 2007.

a national securities exchange.⁹ In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,¹⁰ which requires, *inter alia*, that the rules of a national securities exchange be 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.

The Commission believes that proposed Rule 18 provides for a fair and reasonable process by which NYSE member organizations may petition for compensation when they suffer a loss due to a system failure on the Exchange. In addition, the proposed amount of the Monthly Allotment and the Supplemental Allotment and the procedures relating to requests for compensation for Exchange system failures are reasonable. The Exchange has represented that it will review the terms of the Supplemental Allotment and the Monthly Allotment to evaluate whether they are sufficient and will file with the Commission a proposed rule change under Section 19(b)(1) of the Act to reflect any proposed revisions.

The Commission received one comment letter on the proposed rule change.¹¹ First, the commenter objected to the proposed exclusion of queuing delays from the definition of Exchange system failure, stating that the Exchange's proposed definition of system failure was narrower than the definition used by other exchanges.¹² In response to this comment, in

⁹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ See SIFMA Letter, supra note 4.

¹² See NYSE Arca Rule 14.2 and Nasdaq Rule 4626.

Amendment No. 3, the Exchange removed the exclusion of queuing from the definition of Exchange system failure.

Second, the commenter objected to the proposed provision requiring remittance to the exchange of certain net gains resulting from system failure, stating that this element of the proposal would impose new obligations on member organizations to remit profits that result not from any act or omission on their part, but from an act or omission on the part of the Exchange. The commenter also questioned how this proposed requirement could be reconciled with NYSE Rule 411, which requires members to resolve certain erroneous executions in favor of non-member customers.¹³ In response to the comment letter, in Amendment No. 3, the Exchange withdrew its proposal to amend Rule 134.40 to require remittance of certain net gains.

Third, the commenter argued that the guidelines set forth in proposed Rule 18 for the Compensation Review Panel are vague and subjective—specifically, the provision allowing the Panel to award a lesser amount than that claimed based on the actions or inactions of the claiming member. Fourth, with respect to the proposal that any deadlock of the Compensation Review Panel would be broken by the Exchange’s CEO or his or her designee, the commenter argued that decisions impacting the regulation and compensation of NYSE member organizations should be made by the Chief Regulatory Officer or some other senior officer within the Exchange’s regulatory arm. In response to these comments, NYSE stated its view that the business judgment of the Compensation Review Panel should be based on a reasonableness standard when this panel evaluates whether a claimant should have taken, and did take, actions to mitigate the claimed loss. NYSE further noted that the expert professional judgment of the CEO makes the CEO the appropriate person with whom to vest the authority to break a deadlock of the Compensation Review Panel. The Commission believes that the proposed guidelines and tie-

¹³ See NYSE Rule 411(a)(ii).

breaking procedures for the Compensation Review Panel's are reasonable in light of the Exchange's goal to provide a mechanism to compensate members for system failures.

Pursuant to Section 19(b)(2) of the Act,¹⁴ the Commission finds good cause for approving the proposal prior to the thirtieth day after the publication of the proposal, as modified by Amendments No. 1, 2, and 3, in the Federal Register. In Amendment No. 3, the Exchange proposed to eliminate the exclusion of queuing from the definition of system failure, which would make this definition consistent with the definitions of system failure used by Nasdaq and NYSE Arca.¹⁵ In Amendment No. 3, the Exchange also retracted its proposal to amend Rule 134.40 to require remittance of profits resulting from Exchange system failure. Rule 134.40 will remain unchanged under the proposal, as modified by Amendment No. 3. Finally, Amendment No. 3 clarified the tie-breaking procedures of the Compensation Review Panel. Thus, the changes proposed in Amendment No. 3 to the proposed rule change do not introduce any new regulatory issues, and the Commission finds good cause for approving the amended proposal on an accelerated basis.

IV. Solicitation of Comments Concerning Amendment No. 3

Interested persons are invited to submit written data, views, and arguments concerning the proposed rule change as modified by Amendment No. 3, including whether it 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-2007-09 on the subject line.

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ See supra note 12.

Paper comments:

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

All submissions should refer to File Number SR-NYSE-2007-09. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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-2007-09 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁶ that the proposed rule change (File No. SR-NYSE-2007-09), as modified by Amendments No. 1, 2, and 3, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Florence E. Harmon
Deputy Secretary

¹⁶ Id.

¹⁷ 17 CFR 200.30-3(a)(12).