

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57845; File No. SR-NYSE-2008-32)

May 21, 2008

Self-Regulatory Organizations; the New York Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change, and Amendment No. 1 Thereto, to Amend NYSE Rule 123A.30 to Permit Certain Convert-and-Parity Orders to Trade on Parity with Other Limit Orders, Including Orders Entered through Its Designated Order Turnaround System[®]

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 April 24, 2008, 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 substantially prepared by the Exchange. Originally, NYSE filed the proposed rule change pursuant to Section 19(b)(2) of the Act.³ On May 16, 2008, however, NYSE filed Amendment No. 1 to the proposed rule change pursuant to Section 19(b)(3)(A) of the Act⁴ and Rule 19b-4(f)(6) thereunder.⁵ Accordingly, the proposal became effective upon the filing of Amendment No. 1 with the Commission. 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 NYSE Rule 123A.30 to permit certain convert-and-parity (“CAP”) orders to trade on parity with other limit orders, including orders entered through NYSE’s Designated Order Turnaround (“DOT”) system[®]. The text of the proposed rule change

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(2).

⁴ 15 U.S.C. 78s(b)(3)(A).

⁵ 17 CFR 240.19b-4(f)(6). Amendment No. 1 superseded the original filing in its entirety.

is available at the Exchange, the Commission's Public Reference Room, and www.nyse.com.

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

This rule filing effects an amendment to NYSE Rule 123A.30, which, together with NYSE Rule 1000, governs the automatic execution of CAP orders. The amendment permits passively converted CAP orders – that is, CAP orders that are converted by the specialist for the purpose of bidding or offering – to trade on parity with other limit orders, including DOT system orders that were on NYSE's Display Book[®] at the time of the conversion and could trade on the same side of the market and at the same price as the converted CAP orders. Before this amendment, CAP orders were placed in the same parity group as DOT orders for purposes of parity allocations among all orders upon execution. Within that parity group, those DOT orders had priority over the converted CAP orders.

a. Background

The Exchange states that CAP orders are not actually live orders, but rather are memoranda of orders that can be made live either automatically via an electing trade (a trade at a price that automatically triggers the CAP order to become a live order and immediately execute

at the triggering price) or manually via conversion by the specialist. In the latter situation, the specialist converts the CAP into a limit order, and bids or offers on behalf of that order (referred to as a “passive conversion”). Thereafter, a trade may take place against some or all of the converted CAP order; any portions that are not executed may be “unconverted” and revert to their status as CAP orders.

The Exchange states that, although they are not live orders, CAP orders nevertheless represent public customer interest in which the customer has consented to trading on parity with the specialist when they are either elected or converted. Because CAP orders are linked, either through election or conversion, to other customer interest at a given price, CAP orders give customers a way to participate in trades – that is, to “go along” with other interest at a price – but protect them from either initiating a trade or constituting 100% of one side of a trade.

The Exchange states that, at the time that specialists were given the ability to passively convert CAP orders as agents for customers, the Commission was concerned that specialists not have unfettered discretion in representing those orders; although the Commission recognized that the specialist could exercise some degree of control over the timing and size of the conversions, the Commission insisted on, and the Exchange agreed to implement, certain restrictions that would prevent the specialist from misusing CAP orders to drive the price of a security up or down inappropriately.⁶ Among these restrictions was the requirement that passively converted CAP orders could not be executed before “conventional” limit orders, e.g., DOT orders, that were on the Display Book at the time of the conversion and could trade at the same price and on the same side as the converted CAP order.

b. Amendment to NYSE Rule 123A.30

⁶ See Securities Exchange Act Release No. 24505 (May 22, 1987), 52 FR 20484 (June 1, 1987) (SR-NYSE-1985-01).

The instant proposal would change the treatment of passively converted CAP orders to permit the CAP orders to trade as a group on parity with other agency interest, including same-side same-price DOT orders (i.e., DOT orders that can trade on the same side of the market and at the same price as the CAP orders). The Exchange states that the proposed rule change is necessitated by other changes that the Exchange is making that will permit market participants to enter non-displayed reserve interest directly into the Display Book.

As initially implemented, under Rule 123A.30, passively converted CAP orders were combined with DOT orders for purposes of determining the overall parity allocation in any trade; this so-called “DOT group” was treated as a single agent in the parity divisor. Thus, for example, in an execution involving two brokers’ orders, DOT orders, and passively converted CAP orders, all on parity, the DOT group and the brokers would each be allocated one-third of the traded shares, even though the DOT group contained two different customer groups (conventional limit orders and passively converted CAP orders). The Exchange’s system would then internally allocate shares within the DOT group in time priority. As a consequence of this allocation methodology, passively converted CAP orders did not receive allocations until all DOT orders that were on the Display Book at the time of the conversion were satisfied in full.

As noted above, NYSE implemented foundational changes to its systems that permit customers to enter undisplayed reserve orders from off-Floor directly into the Display Book through DOT (previously, only Floor brokers could enter undisplayed reserve interest on behalf of customers).⁷ Such off-Floor reserve interest will be included in the DOT group for purposes of parity allocations when there is a trade and, despite being non-displayed, would within that DOT group, currently be entitled to priority over passively converted CAP orders.

⁷ See Securities Exchange Act Release Nos. 57792 (May 7, 2008), 73 FR 27601 (SR-NYSE-2008-36) and 57688 (April 18, 2008), 73 FR 22194 (SR-NYSE-2008-30).

NYSE has determined that it is not feasible at this time to have the system differentiate between displayed DOT interest and non-displayed DOT interest when doing parity allocations. This could result in two unintended consequences vis-à-vis passively converted CAP orders: first, the changes will result in non-displayed interest (DOT reserves) taking priority over displayed interest (passively converted CAP orders); and second, if there is substantial interest in reserve, the change will make it difficult (if not impossible) for passively converted CAP orders to receive an execution, since all displayed and non-displayed DOT interest would need to be satisfied first.

The Exchange has further determined that it is not feasible to undo the various foundational programming changes necessary to implement off-Floor reserves in the near future. To address these issues, the Exchange is proposing to amend NYSE Rule 123A.30 to change the parity allocation methodology. Under the proposed rule change, passively converted CAP orders would become their own parity group for purposes of the parity divisor. For example, in the execution described above, involving two brokers, DOT orders and passively converted CAP orders, each group would receive one-fourth of the executed shares, instead of the DOT orders and CAP orders sharing a one-third allocation.

The Exchange believes that the instant proposal is appropriate because fundamental changes in the market – both in terms of market structure and in terms of the behavior of market participants – have made it significantly less likely that specialists could or would use passively converted CAP orders to engage in manipulative or destabilizing conduct.

The Exchange states that, among other things, the restrictions on passive CAP conversions were implemented at a time when NYSE enjoyed a market share in excess of 80% of transactions in its listed securities. Today, NYSE market share is approximately half that

amount. The Exchange states that, where the specialist once had substantial influence over the price of a stock, and could extend his influence further through the misuse of CAP orders, the specialist today has significantly less influence over the price of a stock.

According to the Exchange, market share aside, the process of converting CAP orders also impedes the specialist's ability in an automated market to misuse CAP orders to drive the market. Passive conversions must be conducted by the specialist manually. The Exchange states that, because of the increased automation of modern markets, and the resulting exponential increase in the pace of trading over years past, the delay inherent in a manual process further erodes the possibility that a specialist could realistically use the passive conversion of CAP orders to manipulate the market.

The Exchange believes that a specialist's ability to drive the market through CAP conversions is further diminished simply by the fact that the number of customers using CAP orders has dropped off substantially. For example, during March 2008, there was an average of 2,125 conversions per day across the entire NYSE Floor, as compared to 4,401 conversions per day during October 2007 and 6,762 conversions during June 2007. More tellingly, the average number of passive conversions during 2008 (an average of 2,484 conversions per day, year-to-date) represented only .0004% of quotes initiated per day by specialists ("s-quotes") during the same period,⁸ and .000045% of all quotes disseminated per day overall.⁹ Therefore, the Exchange believes that the likelihood that a specialist could misuse a passive conversion to affect prices is small.

According to the Exchange, the sharp reduction in the number of CAP orders reflects the increased popularity of reserve orders, which permit customers to achieve the same go-along

⁸ Specialists have averaged 5,268,000 s-quotes per day during 2008.

⁹ NYSE has disseminated an average of 54,201,000 quotes per day during 2008.

benefits of CAP orders, but retain greater control of the pricing of their orders. Significantly, despite the fact that reserve interest and CAP orders can perform similar functions, they receive disparate parity treatment: reserve interest trades on parity,¹⁰ while CAP interest does not.

Finally, the Exchange states that it is also important to keep in mind that, under the current scheme, CAP orders, although they represent public customer orders, are penalized in their parity treatment for no other reason than that they have been entrusted to the specialist for execution. When the specialist had outsized influence in the market, this was arguably appropriate because, in return for inferior parity treatment, CAP orders received the benefit of the specialist's knowledge of the market and expertise on the optimal time to bid or offer. But in today's environment, where market fragmentation has reduced the specialist's ability to know the overall market, the Exchange believes this trade-off no longer makes sense. Accordingly, the proposed rule change would eliminate this disadvantage to CAP orders. At the same time, the proposal would not eliminate all disadvantages to CAP order relative to e-Quotes: all passively converted CAP orders would share one slice of the allocation on an execution, whereas brokers using e-Quotes each take their own slice. Thus, the parity divisor is being increased by one, though only on executions where: (1) there are passively converted CAP orders being bid or offered; and (2) the execution size is in an amount less than necessary to completely fill all orders at that price. The Exchange states that, because this will be the case only a very few times per day (fewer than once per day per stock, on average), it does not believe that the potential harm to DOT orders is significant.

In short, given the ways in which liquidity has been fractured among markets, the sharply reduced number of conversions today, the disparate treatment of passively converted CAP orders

¹⁰ See NYSE Rule 70.20.

and reserve interest, and the automation of markets making manual trades commensurately more difficult, the Exchange believes that: (1) the harm of manipulation-by-passive-conversion that NYSE set out to protect against in 1985 is not present today; and (2) when weighed against the fact that CAP orders are agency orders on behalf of public customers just as DOT orders are, it does not seem appropriate to continue to discriminate against the passively converted CAP orders by forcing them to step behind the DOT orders.

For these reasons, NYSE proposes to eliminate the restriction on giving passively converted CAP orders parity with other limit orders, including resting DOT orders.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹¹ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹² in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system. As described more fully above, the proposed rule change is intended to ensure fair treatment of displayed public orders (passively converted CAP orders) in connection with changes being made to other Exchange systems to permit customers to directly place non-displayed interest into the Display Book. In addition, the Exchange believes that in view of both the substantial changes to the marketplace and the Exchange since the original rule was adopted, and the paucity of affected orders, the proposed change does not substantially affect the public interest or unreasonably disadvantage another group of public customers. Conversely, without the proposed rule change, the Exchange states

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

that there is a substantial risk that a group of public customers would be shut out of the market entirely, or would receive an inferior treatment vis-à-vis non-displayed interest, which the Exchange believes is contrary to the policy of the Commission regarding rewarding customers willing to display liquidity in the market.

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 states that written comments on the proposed rule change were neither solicited nor received.

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

Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹³ and Rule 19b-4(f)(6) thereunder.¹⁴

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative for 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to

¹³ 15 U.S.C. 78s(b)(3)(A).

¹⁴ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to provide the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has fulfilled this requirement.

designate a shorter time if such action is consistent with the protection of investors and the public interest. The Commission notes NYSE's representation regarding its determination that it is not feasible at this time to have the Exchange's system differentiate between displayed DOT interest and non-displayed DOT interest when doing parity allocations. Accordingly, given the fact that CAP orders represent customer orders, the Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest.¹⁵

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.¹⁶

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-2008-32 on the subject line.

Paper Comments:

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

¹⁶ 15 U.S.C. 78s(b)(3)(C). For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposal, the Commission considers the period to commence on May 16, 2008, the date on which the Exchange submitted Amendment No. 1.

- 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-2008-32. 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 the 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-2008-32 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁷

Florence E. Harmon
Deputy Secretary

¹⁷ 17 CFR 200.30-3(a)(12).