

SECURITIES AND EXCHANGE COMMISSION  
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June 27, 2008

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change Amending NYSE Rule 98 and Related Rules to Redefine Specialist Operations at the NYSE

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 June 11, 2008, 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 substantially prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Rule 98 and related rules to redefine specialist operations at the NYSE. The text of the proposed rule change is available at NYSE’s principal office, the Commission’s Public Reference Room, and <http://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 those 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

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

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

the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The NYSE is proposing to amend Rule 98 to reduce the regulatory burdens imposed by the rule and to provide flexibility to member organizations as to how they can structure their specialist operations and manage their risks. In particular, because of changes to the marketplace, including changes to the specialist's role as a result of the increased use of electronic trading, the Hybrid Market®, and Regulation NMS, as well as technological advances in surveillance and internal controls, the NYSE believes that current Rule 98 imposes unnecessary restrictions on member organizations seeking to engage in specialist operations at the Exchange.

Accordingly, the NYSE proposes revising Rule 98 in its entirety to provide a framework for specialist operations that meet both the regulatory concerns of the current rule and the reality of today's marketplace. In addition to changes to Rule 98, the NYSE proposes making conforming changes to other NYSE rules that rely on Rule 98 exemptions for approved persons. As discussed in further detail below, the revisions to Rule 98 would include: (1) redefining the persons to whom Rule 98 would apply; (2) allowing specialist operations to be integrated into better capitalized member organizations; (3) permitting a specialist unit to share non-trading related services with its parent member organization or approved persons; and (4) providing flexibility to member organizations and their approved persons in how to conduct risk management of specialist operations.

To achieve these changes, the NYSE proposes shifting the paradigm of Rule 98 from one that assumes that the approved persons of a specialist member organization are subject to certain

NYSE rules unless an exemption is provided to one where NYSE Regulation, Inc. (“NYSE Regulation”) reviews whether a trading unit that proposes to engage in specialist operations is sufficiently walled off from either its approved persons or parent member organization. Under the new paradigm, rules governing specialist operations, such as Rule 104, will apply only to the unit approved to engage in specialist operations at the NYSE.

As the NYSE market model continues to evolve, the NYSE believes that the proposed amendments to Rule 98 will provide a platform from which to further modernize specialist operations.

A. Background

The NYSE adopted Rule 98 in 1987 in response to consolidation in the securities industry, when NYSE specialist firms that had been independent member-owned entities increasingly became subsidiaries of larger, better capitalized broker-dealers. Because of the specialists’ unique position within the markets, and the restrictions on dealers under Section 11(a) of the Act,<sup>3</sup> the Exchange crafted a rule that governed how larger member organizations could be connected to specialist firms.

The rule establishes a functional separation between the specialist organization and the rest of the broker-dealer. The purpose of that separation was to eliminate or control conflicts of interest between the specialist’s actions as market maker in an issuer’s securities and other interactions among the specialist’s parent or sibling entities and the issuer.

In its current form, Rule 98 applies to specialist units and so-called “approved persons” of a specialist organization – that is, entities that are in a control relationship with a specialist organization, or share a common corporate parent with the specialist organization and are

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<sup>3</sup> See 15 U.S.C. 78k(a).

engaged in a kindred business.<sup>4</sup> Such entities are, by virtue of their association with the specialist organization, subject to the rules and restrictions applicable to specialists. These include, among other things, restrictions on the approved persons' ability to trade in specialty stock options, restrictions on certain of their business transactions with issuers for whom the specialist organization is the registered specialist, and limits on the amount of securities of such issuers that the specialist and approved persons may own in the aggregate.

So as not to unreasonably hamstring a broker-dealer organization overall, Rule 98(b) provides that an approved person may seek Exchange approval to be exempted from most of those restrictions. To obtain a Rule 98(b) exemption, the approved person must establish policies and procedures that are consistent with the Guidelines for Approved Persons Associated with a Specialist's Member Organization ("Rule 98 Guidelines"). These guidelines set out in detail how approved persons and associated specialist organizations should structure and conduct their respective businesses in order to ensure complete separation between the specialist organization and the rest of the member organization.

Among other things, the Rule 98 Guidelines provide that the specialist member organization be housed in a separate corporate entity and broker-dealer from its approved persons. Further, to ensure that information does not flow improperly from the specialist organization to approved persons and that approved persons do not have undue influence over particular trading decisions by the specialist, the guidelines establish "functional regulations" that enforce the required separateness. These include requirements that the organizations maintain separate books and records, separate financial accounting, and separate required capital, and that each organization have in place procedures to safeguard confidential information

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<sup>4</sup> See NYSE Rules 2(d) and 304(e).

derived from business interactions with the issuer or contained in draft research reports prepared by the approved person.

The assumption that all entities affiliated with a specialist are subject to specialist rules unless they have obtained a Rule 98(b) exemption creates a substantial administrative burden on specialist organizations and their approved persons: each approved person of a specialist organization must establish and continually update a separate exemption under Rule 98 if it wishes to engage in activity that would otherwise be restricted under applicable specialist rules. This burden creates a real and substantial barrier to entry for new broker-dealers who may want to establish specialist units.

In the face of significant structural changes to the NYSE and the equity markets, and in recognition of the vastly different competitive landscape compared to 1987, the Exchange believes that Rule 98 must be updated in order to provide both existing and prospective specialist firms with the necessary tools to remain competitive while at the same time meeting their obligations as specialists at the NYSE. The proposed changes to Rule 98 also address the Exchange's desire to ease the burdens of a new member organization seeking entry to supplement the six specialist firms currently trading on the Exchange, or the very real possibility of such a firm replacing one or more of the existing specialist firms if they withdraw from the market. Concerning the latter possibility, the NYSE notes that this is not just a theoretical concern: within the past six months, two specialist firms have already withdrawn.

To address these very real concerns, the Exchange proposes to fundamentally amend Rule 98. The proposed rule is described in detail below, but at root, the amendment reverses the assumption that all affiliated entities of a specialist firm are automatically governed by the rules

applicable to specialists, and shifts the focus of the rule onto the specialist unit rather than the approved person.

As part of this restructuring, the NYSE proposes to eliminate the prescriptive approach of the current rule and move towards a more principle-based approach. The NYSE believes that a principle-based rule closely overseen by NYSE Regulation can achieve the same goals as a rule that attempts to enumerate every possible situation that must be avoided. For that, the proposed rule still requires NYSE Regulation to review whether a specialist unit's policies and procedures are reasonably designed to protect confidential information. However, the rule provides sufficient flexibility so that as the type of information that needs to be protected and the manner in which such information can be protected evolves with changes to the trading environment, so too can the manner in which NYSE Regulation conducts its review.

The NYSE believes that the proposed changes to Rule 98 will minimize regulatory burdens and barriers to entry while at the same time provide the necessary level of regulatory scrutiny to ensure that confidential information continues to be protected. In addition, the proposed changes will reduce the regulatory burdens on existing specialist member organizations to enable them to continue such operations at lower cost.

B. Proposed Amendments to Rule 98

1. Applicability of Rule 98

Under the proposed rule, a member organization seeking to operate a specialist unit, either as its entire business or as one of its trading units, would need to apply for and be approved by NYSE Regulation before it can begin, or if applicable, continue operations as a specialist unit. As described in more detail below, NYSE Regulation will review whether a proposed specialist unit has: (1) adopted written policies and procedures governing the conduct

and supervision of the business handled by the specialist unit; (2) established a process for regular review of such written policies and procedures; and (3) implemented controls and surveillances reasonably designed to prevent and detect violations of those policies and procedures. Among other things, these policies and procedures must be reasonably designed to protect specialist confidential information and non-public order information, as defined below.

Once approved, the NYSE specialist rules, as defined below, including Rule 104, would generally only be applicable to the approved specialist unit and not to its approved persons or, if applicable, parent member organization. As discussed in more detail below, on a case-by-case basis, NYSE Regulation will assess whether an integrated proprietary aggregation unit that manages the risk for a specialist unit could be subject to the specialist rules if the integrated proprietary aggregation unit causes the specialist unit to violate its obligations.

The NYSE recognizes that despite the proposed rule changes, an existing specialist member organization may determine to either keep its current operational structure or wait before it implements changes to its operational structure, as permitted by the proposed amended rule. Because current Rule 98 would still be applicable to those specialist units that would not have yet sought the relief available under proposed Rule 98, the Exchange proposes keeping current Rule 98 in its rulebook as “Rule 98 (Former)” until such time as all specialist units are approved pursuant to proposed Rule 98(c). Any new entrant to become a specialist unit would be required to comply with proposed Rule 98; current Rule 98 procedures would not be available to new entrants to the specialist business. As proposed, current Rule 98(b) exemptive relief would be available only so long as the member organization and its approved persons have not materially changed their operational structure, internal controls, or compliance and audit procedures. In such case, the current Rule 98, i.e., Rule 98 (Former), would govern the specialist

member organization and its approved persons.<sup>5</sup> Any significant changes to the status quo after the effective date of the proposed new rule would require the member organization to apply for approval pursuant to the procedures described below.

The Exchange recognizes that an existing specialist member organization that does not implement structural changes to its operations that would require it to apply for approval under the proposed rule may still need certain relief available under the proposed version of the Rule. Accordingly, the Exchange proposes that a member organization operating pursuant to Rule 98 (Former) may apply for relief pursuant to proposed Rule 98(e), which concerns sharing non-trading related services, without first obtaining approval under other provisions of proposed Rule 98. In such situation, the specialist member organization would need to apply for approval from NYSE Regulation to share non-trading related services, as specified in proposed Rule 98(e). If approved, except for the sharing of non-trading related services, such member organization and its approved persons would continue to be subject to Rule 98 (Former) as well as the “(Former)” versions of NYSE rules that reference exemptions from Rule 98 for approved persons, as discussed in more detail below.

Once approved pursuant to proposed Rule 98 to operate a specialist unit, share non-trading related services, or engage in risk management, any material changes in how a specialist unit operates its business would require the specialist unit to resubmit its revised written policies

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<sup>5</sup> As discussed in more detail below, in addition to amending Rule 98, the Exchange proposes to amend related rules that reference the current Rule 98 exemptions for approved persons. To ensure that member organizations operating pursuant to Rule 98 (Former) are subject to the appropriate rules, the Exchange proposes to maintain two forms of the related rules: the amended version and an otherwise unchanged version, except for the title “(Former)” added to the unamended version of the rule or, if applicable, the section affected by the proposed rule change. Once all member organizations are subject to the proposed Rule 98, the Exchange will file to delete any “Former” versions of Rule 98 and the related rules or sections.

and procedures to NYSE Regulation for review. For example, if a specialist unit is approved to operate as a stand-alone aggregation unit and would like to change its business operations to include the specialist unit as part of a larger integrated proprietary aggregation unit, as permitted by proposed Rule 98(d), such change would require pre-approval.

## 2. Proposed Definitions

To ensure clarity, the proposed amendments include a number of defined terms that are applicable throughout the rule. These definitions are designed to provide a level of scalability to the rule so that as the NYSE market model evolves, the definitions used throughout the rule will have common meaning. Among the proposed definitions are:

- “Specialist unit” – this definition is intended to apply to any trading unit that is seeking approval to operate as a specialist at the Exchange. As proposed, a specialist unit could be a stand-alone member organization, an aggregation unit within a member organization, or a trading unit (or “desk”) within a larger aggregation unit. Regardless of which corporate structure a member organization chooses, the term “specialist unit” would refer to the unit that is responsible for specialist activities at the Exchange. If approved pursuant to proposed Rule 98(c), a specialist unit would be eligible for allocations under NYSE Rule 103B and be subject to specialist rules. For purposes of Exchange rules, the term “specialist unit” is synonymous with the term “specialist organization” or “specialist member organization.”
- “Specialist’s account” – this definition refers to any account through which a specialist unit trades at the Exchange. Sometimes referred to as a dealer account, this revised definition would encompass any of the variously-defined accounts that a specialist unit may use to trade at the Exchange.

- “Specialist rules” – this definition refers to those rules that govern specialist conduct or trading at the Exchange. Currently, the specialist rules include, among others, Rules 104, 105, and 113, but as the rules at the Exchange change, these rule designations may change. Accordingly, so that proposed Rule 98 evolves along with changes to other rules, this proposed definition does not identify specific rules.
- “Specialist confidential information” – this definition concerns the principal or proprietary trading activity of a specialist unit at the Exchange in the securities allocated to it pursuant to Rule 103B, including the unit’s positions in those securities, decisions relating to trading or quoting in those securities, and any algorithm or computer system that is responsible for such trading activity and that interface with Exchange systems, such as the specialist application protocol interface (“specialist API”).<sup>6</sup> The definition does not include information about non-public order information, as described below.
- “Non-public order” – this definition refers to any information relating to order flow at the Exchange, including verbal indications of interest made with an expectation of privacy, electronic order interest, e-quotes, reserve interest, or information about imbalances at the Exchange, that is not publicly-available on a real-time basis via an Exchange-provided datafeed, such as NYSE OpenBook®, or otherwise publicly-available. The definition also encompasses information regarding a reasonably imminent non-public transaction or series of transactions. For example, if in requesting information about the state of the Book, a Floor broker informs the specialist about an order that he or she has, such

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<sup>6</sup> The specialist API is the electronic link between specialist trading algorithms and the NYSE Display Book®. Via this interface, specialist organization trading algorithms send quoting and trading messages to the Exchange for implementation in the NYSE Display Book®, and the Exchange transmits information necessary to acting as a specialist to specialist organizations.

information would fall under the definition of “non-public order.” As defined, non-public orders include order information at the open, any re-openings, the close, when the security is trading in a slow mode (e.g., in a Gap quote or LRP situation), and any other information in the NYSE Display Book<sup>7</sup> that is not available via NYSE OpenBook<sup>8</sup>. As proposed, the linchpin to the definition of “non-public order” is that it is information not publicly available on a real-time basis. Currently, specialists have unique access to certain non-public order information. However, in its proposed new market model, the Exchange will be proposing to change the specialist’s access to such non-public order information. The proposed definition is intended to take into consideration such future changes so that as the specialist’s or specialist API’s access to non-public order information changes, so will the specialist unit’s responsibilities to protect that information change, but without having to revise Rule 98.

- “Investment banking department” and “Research department” – these definitions refer to the same departments that are defined as such in NYSE Rule 472 and NASD Rule 2711.
- “Customer-facing department” – this definition is intended to encompass any department, division, market-making desk, aggregation unit, or trading desk that receives, routes, or executes orders for customer execution or clearing accounts, regardless of whether such unit also engages in principal or proprietary trading. A hallmark of this definition is that

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<sup>7</sup> The Display Book system is an order management and execution facility. The Display Book system receives and displays orders to the specialists, contains the Book, and provides a mechanism to execute and report transactions and publish results to the Consolidated Tape. The Display Book system is connected to a number of other Exchange systems for the purposes of comparison, surveillance, and reporting information to customers and other market data and national market systems.

<sup>8</sup> NYSE OpenBook<sup>®</sup> provides aggregate limit-order volume that has been entered on the Exchange at price points for all NYSE-traded securities.

a customer has an expectation of confidentiality and best execution on its behalf, which could include a customer that is another broker-dealer. Examples of trading desks that would meet this definition include a Nasdaq market-making desk and most block-trading desks. However, this definition is not intended to include an aggregation unit that solely conducts proprietary trading or proprietary market making (sometimes referred to as electronic market making).

- “Aggregation unit” – this definition adopts the standard of Rule 200(f) of Regulation SHO.<sup>9</sup> The proposed rule uses this term throughout to refer to any department, division, unit, or trading desk that has been segregated pursuant to the requirements of Regulation SHO. The NYSE believes that the Regulation SHO requirements for establishing an aggregation unit, including any requirements for information barriers, would be sufficient for segregating a specialist unit’s operations from the remainder of a member organization or its approved persons.
- “Non-trading related services” – this definition refers to the type of support services that a specialist unit may share with its parent member organization or approved person. The core of the proposed definition is that the type of services are not related to making decisions about the day-to-day trading of the specialist unit or provide trading support to such activity, such as by a trading assistant or specialist clerk. Examples of non-trading related services include stock loan (so long as consistent with Regulation SHO), clearing and settlement, controllers (for financial accounting purposes), technology support, and personnel who develop applications and algorithmic models.

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<sup>9</sup> See 17 CFR Part 242.200(f).

- “Integrated proprietary aggregation unit” – this definition is intended to encompass any aggregation unit that has a trading objective to engage in proprietary trading, including proprietary market-making activities. As defined, an integrated proprietary aggregation unit must not include any activities that would be performed by an investment banking, research, or customer-facing department. Subject to proposed Rule 98(d), a specialist unit could be part of a member organization’s integrated proprietary aggregation unit. Alternatively, an approved person or member organization could maintain an integrated proprietary aggregation unit separate from the specialist unit. In such case, the definition of an integrated proprietary aggregation unit becomes relevant in connection with proposed Rule 98(f)(3) and the ability of an approved person to engage in risk management activities on behalf of the specialist unit of an associated member organization.
- “Related products” – this definition refers to any derivative instrument that is related to a security allocated to a specialist unit. It can include options, warrants, hybrid securities, single-stock futures, security-based swap agreements, a forward contract, or any other contract that is exercisable into or whose price is based upon or derived from a security listed at the Exchange. The list referenced in the definition is not intended to be exhaustive and the definition is intended to cover any existing or future products that could be related to a security listed at the Exchange.

3. Proposed Rule 98(c): Approval to operate a specialist unit

Pursuant to proposed Rule 98(c), a member organization must obtain prior written approval from NYSE Regulation before it can operate a specialist unit. For approval, a specialist unit must demonstrate that it has: (i) adopted and implemented comprehensive written

procedures and guidelines governing the conduct and supervision of business handled by the specialist unit; (ii) established a process for regular review of such written policies and procedures; and (iii) implemented controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines.

As proposed, these policies and procedures must be reasonably designed to provide that the specialist unit will maintain the confidentiality of both specialist confidential information and non-public orders. The proposed rule enumerates certain bright-line divisions that the specialist unit must maintain, including information barriers between the specialist unit and investment banking, research, and customer-facing departments and approved persons. Such information barriers should guarantee confidentiality two ways: the specialist unit cannot access material non-public information about securities allocated to that unit from either its approved persons or non-specialist operations of a parent member organization and vice versa.

With respect to a specialist unit's internal controls and surveillances, NYSE Regulation will be reviewing such surveillance plans to determine whether they are reasonably designed to protect information as required under the proposed rule. Where feasible, NYSE Regulation will expect specialist units to use automated surveillances to check for breaches of the information barriers required by the proposed rule. As with the current rule, NYSE Regulation will also review whether a member organization has implemented internal audit procedures relating to compliance with the proposed Rule 98 policies and procedures.

In addition to the specific information barriers enumerated in the proposed rule, if a member organization proposes to operate a specialist unit as a stand-alone unit, the Exchange proposes importing the requirements of a Regulation SHO independent trading unit for specialist

units. Accordingly, as required by Rule 200(f) of Regulation SHO,<sup>10</sup> NYSE proposes requiring a specialist unit to have a written plan of organization that specifies its trading objectives and meet all of the other requirements of an independent trading unit under Regulation SHO. If a specialist unit seeks to avail itself of the exemption from NYSE Rule 105 under proposed Rule 98(f)(1), that written plan of organization would need to include its trading objectives for trading in related products.

As with the current rule, proposed Rule 98 would require the specialist unit to maintain net capital sufficient to meet the requirements of NYSE Rule 104.21. The NYSE believes that if a specialist unit is integrated within a larger member organization, the net capital requirement can be met by having the requisite capital amount allocated to the specialist unit by the member organization.

Despite the segregations required by the rule, the NYSE believes that senior managers who are not dedicated to the specialist unit and are associated with either an approved person or a member organization that runs a specialist unit should still be able to provide management oversight to the specialist unit. As proposed, the revised rule is not intended to be more restrictive than the current rule, which permits an approved person to provide general oversight over its associated specialist member organization. The proposed rule instead shifts from a detailed list of specific types of oversight that is permissible to a principle-based approach that focuses on protecting specialist confidential information and non-public order information. As with the current rule, as proposed, senior management oversight of a specialist unit should not conflict with or compromise in any way with the specialist unit's market-making obligations.

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<sup>10</sup> See 17 CFR Part 242.200(f).

Proposed Rule 98(c)(2)(E) provides guidance on how a member organization or approved person should handle situations where a senior manager is called upon for risk management purposes and in connection with that role, gains access to specialist confidential information or non-public order information. The Exchange notes that non-public order information could become stale if the order is executed or cancelled without the specialist's knowledge. To ensure that there is no misuse of such information, whether material or not, the senior manager must not make (directly or indirectly) specialist confidential information or non-public order information available to the persons or systems responsible for making trading decisions in aggregation units, departments, divisions, or trading desks that are not part of the specialist unit, including the customer-facing departments. The senior manager also must not use such information to directly or indirectly influence the day-to-day trading decisions of the other aggregation units of the member organization or approved person with respect to the securities allocated to the specialist unit.

The NYSE believes that these restrictions on the use of specialist confidential information and non-public order information are similar to how broker-dealers currently handle situations where a senior manager has oversight over multiple aggregation units and in such capacity, becomes privy to confidential information of one aggregation unit. For such situations, broker-dealers have already developed procedures for protecting confidential information and the NYSE believes that such procedures should be reasonable for the oversight of a specialist unit as well.

The Exchange notes that although the proposed amendments to Rule 98 eliminate the exemption process under current Rule 98(b), the review that NYSE Regulation would conduct when approving a specialist unit would be as rigorous as the current review for obtaining an

exemption, just simply a different focus of what is reviewed. As with the current Rule 98 exemption process, staff from both the Market Surveillance Division of NYSE Regulation as well as relevant staff from the Financial Industry Regulatory Authority, Inc. (“FINRA”) who are responsible for the routine examinations of specialist units would be involved in reviewing a specialist unit’s written policies and procedures and proposed automated surveillances and controls.<sup>11</sup>

For existing specialist firms, the initial approval process associated with any changes to how they operate may require upfront work to ensure that the specialist unit’s policies and procedures are reasonably designed to meet the requirements of the proposed rule. However, unlike the current rule, as proposed, specialist units would be relieved of the requirement to update any written statements to the Exchange for changes in approved persons or dually-affiliated employees. Once approved, NYSE Regulation and FINRA would examine whether a specialist unit’s policies and procedures continue to meet the rule requirements and whether the implemented controls and automated surveillances are functioning as designed. As part of such examination review, NYSE Regulation and FINRA will conduct on-site reviews of a specialist unit to review for breaches of the controls or surveillances. And, as noted above, if the specialist unit proposes making any material changes to its operations, it would need to seek additional approval before it can change its operations.

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<sup>11</sup> In connection with the July 2007 transfer of certain member firm regulation functions from NYSE Regulation to FINRA, NYSE Regulation and FINRA entered into a regulatory services agreement (“RSA”) whereby FINRA agreed to provide NYSE Regulation with certain services relating to NYSE’s retained responsibilities to examine for compliance with NYSE rules that govern trading on or through the systems and facilities of the Exchange. In particular, pursuant to the RSA, FINRA participates in the current Rule 98(b) exemption process and examines specialist firms for compliances with that rule. As proposed, FINRA would continue to participate in the approval process under the proposed Rule 98 and examine specialist units for compliance with the rule.

4. Proposed Rule 98(d): Operating a Specialist Unit Within an Integrated Proprietary Unit

One of the goals of proposed Rule 98 is to provide a member organization with greater flexibility in how it manages the risk of a specialist unit. As discussed below, in proposed Rule 98(f), the NYSE proposes providing member organizations with an array of options of how to conduct risk management. The NYSE believes that the flexibility afforded by these options will meet the varying business models of the member organizations currently operating or seeking to operate a specialist unit at the Exchange.

As discussed in more detail below, one proposed risk management model would be to permit a member organization to integrate a specialist unit within a larger aggregation unit that meets the requirements of an integrated proprietary aggregation unit. Proposed Rule 98(d) sets forth the minimum requirements for how to structure such an integrated unit. While such a unit would be considered a single aggregation unit for Regulation SHO purposes, as proposed, the member organization would need to establish information barriers within the integrated proprietary aggregation unit to restrict access to non-public order information to the specialist unit only. And depending on the risk management model proposed by a specialist unit, a member organization or approved person may need to further segregate the flow of information within a specialist unit.

As proposed, the specialist unit that would operate within the integrated proprietary aggregation unit would need to meet the requirements of proposed Rule 98(c)(2)(A), (C), (D), and (E) of the rule, which concern the information barriers associated with the specialist unit and non-specialist unit operations, net capital requirements, and senior management oversight. Because an integrated proprietary aggregation unit that includes a specialist unit would likely already be subject to Rule 200(f) of Regulation SHO that it qualify as an independent trading

unit, the specialist unit operating within the integrated proprietary aggregation unit would not need to separately meet the Rule 200(f) requirement for an independent trading unit.

Accordingly, as proposed, a specialist unit that operates within an integrated proprietary aggregation unit would not need to meet the requirements of proposed Rule 98(c)(2)(B), which requires a specialist unit to separately comply with all of the Regulation SHO independent trading unit requirements.<sup>12</sup>

In addition to meeting certain requirements of proposed Rule 98(c), under proposed Rule 98(d)(2)(B), the specialist unit must restrict access to non-public order information or specialist confidential information from the rest of the integrated proprietary aggregation unit. Such information barriers must ensure that both individuals and systems that are not assigned to the specialist unit do not have access to non-public order information, or, unless otherwise provided for in proposed Rule 98(f), specialist confidential information.

The NYSE believes that as proposed, Rule 98(d)(2)(B) provides sufficient flexibility for how a member organization structures its operations to evolve as the NYSE market model changes. For example, the specialist API currently has access to limited non-public order information, but does not have access to information available in the NYSE Display Book. So long as the specialist API has access to that non-public order information, the Exchange believes that systems not dedicated to the specialist unit should not be integrated with the specialist API. Accordingly, the trading algorithms of the integrated proprietary aggregation unit that are not

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<sup>12</sup> The Exchange recognizes that there may be some Regulation SHO issues in connection with how a member organization may choose to structure its specialist unit within an integrated proprietary aggregation unit or provide risk management to the specialist unit pursuant to proposed Rule 98(f). In such case, approval to operate under proposed Rule 98 would not be provided until all Regulation SHO issues that may arise have been resolved.

dedicated to the specialist unit would not have access to any non-public order information via the specialist API, or any other system.

Proposed Rule 98(d)(2)(B)(iii) addresses the situation of communications from the Floor of the Exchange to the rest of the integrated proprietary aggregation unit. Currently, specialist unit employees on the Floor of the Exchange have access to non-public order information, whether via access to information in the Display Book® or because of verbal representations of imminent orders. The NYSE believes that the best way to ensure that such information is not provided to individuals or systems not dedicated to the specialist unit is to restrict communications while the employee is still on the Floor of the Exchange.

Proposed Rule 98(d)(2)(B)(iv) considers the possibility that an individual who works on the Floor of the Exchange<sup>13</sup> may also, on an intra-day basis, move to an off-Floor location and engage in a non-specialist related role within the integrated proprietary aggregation unit pursuant to proposed Rule 98(d) or for an “upstairs” desk trading in related products within the specialist unit pursuant to proposed Rule 98(f)(1). In such case, the individual must not make any non-public order information or, unless specifically provided for, specialist confidential information, available to individuals or systems that are not dedicated to the specialist unit. Nor may that individual use such non-public information, or, except as provided for in the Rule, specialist confidential information, in any way in connection with responsibilities that are not related to Floor-based activities of the specialist unit. For purposes of proposed Rule 98(f)(1), once off the Floor, a specialist may not use non-public information to directly or indirectly trade in related products. However, nothing in the rule bars a specialist unit from moving personnel among

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<sup>13</sup> Note that NYSE rules define being on the Floor to include the trading Floor of the Exchange, and the premises immediately adjacent thereto, such as the various entrances and lobbies of 11 Wall Street, 18 New Street, 12 Broad Street, and 18 Broad Street, as well as the telephone lobby in the first basement of 11 Wall Street. See Rule 112(b).

different positions intraday, so long as the restrictions on information flow and use are followed. The NYSE believes that this would provide member organizations with sufficient flexibility to transfer its employees among various roles, including on the Floor of the Exchange and in a specialist unit upstairs location during a given trading day. For intra-day transfers, the Exchange will expect specialist units to have written policies and procedures reasonably designed to ensure that non-public order information and specialist confidential information (unless otherwise permitted) would not be used from an off-Floor location. The Exchange notes that in addition to the information barriers required by proposed Rule 98, specialists must continue to abide by Exchange rules that govern their access to and use of non-public order information.<sup>14</sup>

As noted above, an integrated proprietary aggregation unit would need to qualify as an aggregation unit, which for Regulation SHO purposes, requires the unit to net its positions. While the proposed rule would no longer require separate books and records for a specialist unit, to ensure that NYSE Regulation can review the trading activity by the specialist unit at the Exchange without having to parse through commingled records, under proposed Rule 98(d)(2)(C), in addition to meeting Regulation SHO requirements, an integrated proprietary aggregation unit must maintain records of its specialist's accounts in a manner that is separate from the accounts of the integrated proprietary aggregation unit.<sup>15</sup>

In addition to the above, the integrated proprietary aggregation unit must have written policies and procedures that address how it will ensure that the unit will not engage in any activities that could violate other Exchange rules or federal securities laws and regulations,

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<sup>14</sup> See, e.g., NYSE Rules 70.20(h)(ii), 104(b), 115, and 115A.

<sup>15</sup> The Exchange is engaging in a separate discussion with Commission staff of the Regulation SHO implications of requiring a specialist unit to separately aggregate its trading positions for purposes of Exchange rules.

including Regulation SHO. The policies and procedures must address, at a minimum, how the unit will ensure against front running, wash sales, and market manipulation.

In connection with wash sales, a potential concern for an integrated proprietary aggregation unit is the possibility that the specialist unit could be selling (buying) one of the securities registered to it and an individual or trading system of the integrated proprietary aggregation unit could at the same time be buying (selling) that same security at the Exchange. With the proper use of mnemonics associated with those orders, Exchange systems are capable of rejecting one side of those orders. Because the presumption would be in favor of the specialist unit trading, i.e., to meet its affirmative obligations at the Exchange, the NYSE proposes rejecting the order from the integrated proprietary aggregation unit.

The NYSE also proposes that to the extent an integrated proprietary aggregation unit directs its trading at the Exchange in any security that has been allocated to the specialist unit through the specialist unit, such trading would be subject to the specialist rules. In other words, while the specialist unit would be subject to certain market-making obligations while trading at the Exchange, the integrated proprietary aggregation unit's independent "upstairs" operations would be able to trade freely.

Finally, to ensure that NYSE Regulation can review the trading activities of the integrated proprietary aggregation unit, proposed Rule 98(d)(4) requires member organizations to maintain audit trail information for any trading by such unit, including trading at the Exchange and at other market centers. The NYSE proposes to amend NYSE Rule 132B to have the Order Tracking System ("OTS") requirements apply to trading by a specialist unit, and if applicable, an integrated proprietary aggregation unit. Member organizations must maintain sufficient records to reconstruct in a time-sequenced manner its trading in securities allocated to the specialist unit

and any trading by the integrated proprietary aggregation unit in those securities in other market centers or trading in related products.

As with the approval process under proposed Rule 98(c), to obtain approval to operate a specialist unit within an integrated proprietary aggregation unit, a member organization would need to submit its written policies and procedures to NYSE Regulation for review of whether such policies and procedures are reasonably designed to meet the rule requirements. Once approved under proposed Rule 98(d), NYSE Regulation and FINRA would continue to examine whether a specialist unit's policies and procedures continue to meet the rule requirements and whether the implemented controls and surveillances plans are functioning as designed.

5. Proposed Rule 98(e): Sharing Non-Trading Related Services

One of the restrictions of current Rule 98 is the limit on a specialist member organization and its approved persons to share operational support personnel. In its current form, Rule 98(c) permits dual affiliation only if the specialist member organization and approved person provide the Exchange with a written statement of the duties of such person and why it is necessary for the individual to have a dual affiliation. Any changes to dual affiliations must be submitted to the Exchange for approval in advance of making such change.

The NYSE believes that current Rule 98(c) unnecessarily restricts the ability of a specialist member organization and its approved person to share non-trading related services, *i.e.*, operational support services. Accordingly, the NYSE proposes amending Rule 98 to permit the sharing of non-trading related services, subject to the approval of NYSE Regulation.

As with the approval process to become a specialist unit, the approval process for a specialist unit to share non-trading related services with its parent member organization or approved person would require the specialist unit to: (1) adopt written policies and procedures

governing the sharing or non-trading related services; (2) establish a process for regular review of such written policies and procedures; and (3) implement controls and surveillances reasonably designed to prevent and detect violations of those policies and procedures. In accordance with the purpose of Rule 98, such policies and procedures must be reasonably designed to protect specialist confidential information and non-public order information.

The NYSE understands that personnel or systems that provide non-trading related services may have access to specialist confidential information or non-public order information. For example, clearance and settlement services would have knowledge of specialist positions in securities, and technological support personnel may have knowledge of how a specialist algorithm conducts its trading. However, access to such information should not be the basis for restricting the sharing of such personnel or systems. Rather, such personnel or systems can be shared so long as the specialist unit has controls reasonably designed to ensure that the individuals or systems who have access to specialist confidential information or non-public information neither provide nor make available that information to any individuals or systems not part of the specialist unit. In particular, under no circumstances should non-public order information or specialist confidential information be made available to the investment banking, research, or customer-facing departments.

Before a specialist unit can share non-trading related services, NYSE Regulation will review whether the specialist unit has adopted policies and procedures and controls and surveillances reasonably designed to protect specialist confidential information and non-public order information. Once approved, a specialist unit would no longer need to provide NYSE Regulation with a written statement of why a certain individual has a dual affiliation and update such written statements if the individual involved changes. On an ongoing basis, NYSE

Regulation and FINRA will examine whether the specialist unit's policies and procedures and controls comply with the requirements of the rule.

6. Proposed Rule 98(f): Risk Management

Specialist member organizations and their approved persons are currently limited in their ability to manage the specialist member organization's trading risks: Rule 98 currently restricts an approved person from being involved in any trading decisions of an associated specialist member organization; Rule 105 currently restricts the specialist member organization's ability to trade in options and single-stock futures related to the securities allocated to the specialist member organization. Together, these restrictions place specialist member organizations at a competitive disadvantage vis-à-vis other market-making or trading firms.

The NYSE believes that the changes to the marketplace that have occurred since 1987, when Rule 98 was adopted, call for an overhaul of how specialist units are permitted to manage their risk. For example, when Rule 98 was adopted, the NYSE enjoyed an approximately 85% market share in trading of NYSE-listed securities and specialists participated in approximately 12% of the transactions at the Exchange. Now, the NYSE's market share for listed securities hovers under 40%, and of that, specialist participation is in the range of two percent. These numbers are telling: because of automatic executions at the Exchange, specialists no longer have a unique advantage over other market participants. To the contrary, specialists are now at a disadvantage to other market participants because they must meet their affirmative and negative obligations to the Exchange, yet cannot participate in the type of hedging activities that other market participants may and can do.

Accordingly, the Exchange proposes providing specialist units with the ability to manage their risks by broadening the ability to trade in related products and expanding the universe of

who may be involved in managing the risk of the specialist unit. Because there is no single correct model for risk management, the NYSE proposes providing specialist units with options of how to manage their risk, which they can choose to use in combination or alone. Regardless of which model a specialist unit proposes to adopt for risk management, at all times, the specialist unit will be ultimately responsible for its quoting or trading decisions at the Exchange.

a. Specialist Unit Risk Management

In order to provide a specialist unit with greater risk management tools, the NYSE proposes permitting specialist units to apply for an exemption from the Rule 105(b)-(d) restrictions on trading options and single-stock futures. In connection with this change, the NYSE proposes amending Rule 105 so that it applies only to a specialist unit, and not to any other departments or units of a member organization or approved person. If approved for an exemption from Rule 105, a specialist unit would be permitted to trade in related products, subject to proposed Rule 98(f)(1).<sup>16</sup>

As proposed, to obtain an exemption from Rule 105, the specialist unit must: (i) adopt and implement comprehensive written procedures and guidelines governing the conduct of trading in related products; (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines.

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<sup>16</sup> The Exchange also proposes amending section (m) of the Rule 105 Guidelines to provide that a specialist unit is not permitted to engage in market-making activities in single-stock futures or options. However, if eligible for an exemption under Rule 105(b)-(d), nothing restricts a specialist unit from having a trading desk that trades in options or single-stock futures. Because an integrated proprietary aggregation unit that includes a specialist unit may engage in options market making, the Exchange proposes eliminating sections (m)(ii) and (iii) of the Rule 105 Guidelines.

These policies and procedures must be reasonably designed to ensure that the individuals or systems responsible for trading related products do not have access to non-public order information, or, unless otherwise specifically provided for, specialist confidential information. In addition, individuals who work on the Floor of the Exchange would not be permitted to trade or direct trading in related products, nor would the specialist API be permitted to make any trading decisions in related products. Accordingly, any trading in related products by the specialist unit must be conducted by an off-Floor, i.e., “upstairs” office. All trading in related products must be conducted by individuals who are qualified and registered to trade in the marketplaces where such trading occurs. Moreover, the member organization that houses the specialist unit must be a member of FINRA or other self-regulatory organizations, as required by each marketplace where the specialist unit proposes to trade.

The NYSE believes that a specialist unit should have the flexibility to transfer its employees among different functions within the unit. Accordingly, the proposed rule does not expressly prohibit specialists from trading in related products; it only bars directly entering or executing trades in related products while on the Floor of the Exchange.<sup>17</sup> As proposed, a specialist unit could transfer a specialist back and forth from the Floor of the Exchange to a specialist unit upstairs desk that trades in related products, so long as that specialist is registered and qualified to trade in related products and non-public order information is not used when trading in related products. In such case, however, a specialist unit must have policies and procedures reasonably designed to ensure that a specialist who moves off the Floor of the Exchange does not make available or use any non-public information or, unless otherwise

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<sup>17</sup> The Exchange notes that a specialist unit that has not been approved for an exemption from Rule 105 under proposed Rule 98(f)(1) would still be permitted to enter orders in options or single-stock futures from the Floor, subject to the requirements of Rule 105.

specified, specialist confidential information, to which the specialist may have had access while on the Floor of the Exchange. As noted above, while off the Floor of the Exchange, specialists continue to be subject to other NYSE rules that govern their access to and use of non-public order information.

To ensure that the specialist unit upstairs desk that trades in related products can effectively hedge the specialist unit's positions, the NYSE proposes that the specialist unit upstairs desk have electronic access to the trades by the specialist unit at the Exchange in securities allocated to the specialist unit that have been printed to the Consolidated Tape.

Currently, senior managers of specialist member organizations can be privy to information about trading on the Floor of the Exchange as well as any hedging conducted by the specialist member organization, even though such hedging opportunities are limited. For example, currently, a specialist on the Floor can call his or her senior manager to discuss hedging strategies. Under the proposed exemption from Rule 105, the NYSE believes that specialist unit senior managers should be able to continue in that role and provide oversight of both Floor specialist operations and any specialist unit upstairs trading in related products. The NYSE believes that the oversight model that works for larger broker-dealers, whose senior managers have a role with respect to multiple aggregation units, should apply within a specialist unit as well.

Accordingly, the NYSE proposes Rule 98(f)(1)(vi) to address how a senior manager of a specialist unit should handle situations where he or she has access to non-public order information in connection with his or her role as a senior manager. As with proposed Rule 98(c)(2)(E), when trading in related products, the specialist unit must have policies and procedures reasonably designed to ensure that the specialist unit senior manager who has access

to non-public order information does not provide such information to the specialist unit upstairs trading desk responsible for trading related products or use such non-public information to directly or indirectly influence trading by that upstairs desk.

b. Integrated Proprietary Aggregation Unit Risk Management

Proposed Rule 98(f)(2) addresses how an integrated proprietary aggregation unit that has been approved pursuant to proposed Rule 98(d) to include a specialist unit could engage in risk management of the specialist unit's positions. At a minimum, an integrated proprietary aggregation unit must have policies and procedures that are reasonably designed to meet the protections enumerated in the rule, including how it trades in related products on behalf of a specialist unit and how it electronically accesses the specialist unit's trades at the Exchange in securities allocated to the specialist unit that have been printed to the Consolidated Tape.

In addition, proposed Rule 98(f)(2)(A)(i) would permit an integrated proprietary aggregation unit to send appetites of trading or quoting direction to the specialist unit. In practice, this would permit a non-specialist unit "upstairs" risk management desk that has real-time access both to the specialist unit's positions in securities allocated to it and to the integrated proprietary aggregation unit's positions in related products and other securities to provide electronic direction to the specialist unit of whether to trade or quote in a certain direction. The Exchange believes that permitting an integrated proprietary aggregation unit to send quoting messages that are based on real-time positions of the unit as a whole will enable a specialist unit to better meet any quoting requirements at the Exchange. In other words, the specialist unit will no longer need to operate in a vacuum when determining how or when to quote at the Exchange.

As proposed, the specialist unit would be ultimately responsible for whether to accept the electronic trading direction submitted by the integrated proprietary aggregation unit upstairs

desk; a specialist unit must comply at all times with its market-marking obligations, including the specialist rules, notwithstanding any electronic trading directions received from that upstairs desk. Stated otherwise, the specialist unit would operate independently and be free to accept or reject the electronic trading directions sent by the integrated proprietary aggregation unit. However, to the extent an integrated proprietary aggregation unit causes a specialist unit to violate one or more of the specialist rules, the Exchange proposes that in such case, the integrated proprietary aggregation unit should also be held to those standards.

At this time, as noted above, because of access to non-public order information, the NYSE does not believe it would be feasible to permit communications, whether verbal or electronic, from the specialist or the specialist API to the individuals or systems responsible for trading in related products and other securities within the integrated proprietary aggregation unit, or, if applicable, to an upstairs desk within the specialist unit. However, as the NYSE market model evolves, the NYSE will continue to review how best to integrate a specialist unit within an integrated proprietary aggregation unit, including the possibility of fully integrating the trading systems that interact with the Exchange for the specialist unit and the trading systems that trade in related products and other securities. The NYSE believes that ultimately, a competitive trading model would permit full integration, including permitting two-way communications among trading desks.

c. **Approved Person Risk Management**

As proposed, another option available to firms to manage the risk of the specialist unit is to permit a separate integrated proprietary aggregation unit that is housed in either an approved person or a member organization that runs a specialist unit to provide the same level of risk management as proposed for an integrated proprietary aggregation unit that includes a specialist

unit. This option would provide flexibility for broker-dealers that want to keep the specialist unit as a separate member organization or aggregation unit, yet still have an approved person or separate aggregation unit provide risk management services for the specialist unit.

As with proposed Rule 98(f)(2), proposed Rule 98(f)(3) would require that the approved person not have access to either specialist confidential information and non-public order information, except as provided for in that section of the rule. Specifically, an integrated proprietary aggregation unit of an approved person could have access to the trades by a specialist unit at the Exchange in securities allocated to that unit, so long as such trades have been printed to the Consolidated Tape.

And as with proposed Rule 98(f)(2), an approved person could send electronic appetites of how the specialist unit should trade or quote in its allocated securities. As discussed above, a specialist unit would be free to reject or accept such electronic directions as it sees fit to meet its market-making obligations at the Exchange.

The Exchange notes that an approved person that provides risk management under this proposed section may not itself be an NYSE member organization. In such case, the individuals at the approved person responsible for making risk management decisions on behalf of the specialist unit should be dually employed by the specialist unit that is part of an NYSE member organization and the approved person so that they are subject to the jurisdiction of NYSE Regulation.

7. Proposed Rule 98(g): Failure to Maintain Confidentiality, Reporting Obligations, and Breaches

The NYSE proposes to keep certain provisions of current Rule 98, but adjust them to reflect the changes to the rest of the rule. In particular, current Rule 98(i) has been amended and is included in proposed Rule 98(g); current Rule 98(j) has been amended and is included in

proposed Rule 98(h); and, current Rule 98(k) has been amended and is included in proposed Rule 98(i).

Under proposed Rule 98(g), as with the current rule, if a specialist becomes aware of non-public material information from its approved person or parent member organization, such specialist may have to cease acting as a specialist in the security involved, which was formerly referred to as “giving up the Book.” The proposed rule does not change how such determinations would be made. However, the proposed rule updates the language of the rule and separates the rule into easier-to-read subsections.

Under proposed Rule 98(h), the NYSE proposes adding to the existing reporting obligations that a specialist unit must report any actual breaches or internal investigations of possible breaches of the information barriers required by the rule. The reporting obligation for internal investigations is intended to be similar in effect to the reporting obligation pursuant to NYSE Rules 351(e) and 342.21. In particular, under proposed Rule 98(h)(4), a specialist unit will be required to conduct an internal investigation into any trading activity that may be a result of a breach of the information barriers required by proposed Rules 98(c), (d), (e), and (f). On a quarterly basis, a specialist unit must report in writing to NYSE Regulation whether it has commenced such an internal investigation, the quarterly progress of any open investigations, what remedial measures, if any, were taken, and the completion of any internal investigation, including the methodology and results of such investigation, any internal disciplinary action taken, and any referral of the matter to the NYSE, another self-regulatory organization, or the Commission.

Finally, as with the current rule, proposed Rule 98(i) provides that any breach of the proposed Rule could result in disciplinary action, including the withdrawal of one or more

securities allocated to the specialist unit or withdrawal of approval to operate a specialist unit. The Exchange notes that as with the current rule, any trading by any person while in possession of material, non-public information received as a result of any breach of internal controls required by proposed Rule 98 may violate Rule 10b-5 of the Act,<sup>18</sup> Rule 14e-3 of the Act,<sup>19</sup> NYSE Rule 104, just and equitable principles of trade or one or more provisions of the Act, or regulations thereunder or rules of the Exchange. The Exchange intends to review carefully any such trading of which it becomes aware with a view towards determining whether any such violation has occurred.

C. Proposed Amendments to Related Rules

As noted above, because of the shift in paradigm away from approved persons, the NYSE proposes amending those NYSE rules that refer to approved persons and the need for an exemption from Rule 98.

1. Proposed Amendments to Rule 98A

NYSE Rule 98A requires approved persons to agree in writing not to cause a specialist or odd-lot dealer to violate rules applicable to the specialist or odd-lot dealer. The rule further requires that approved persons report to the Exchange any off-Floor orders for securities in which an associated specialist member organization specializes for any account in which the approved person has a direct or indirect interest.

Because of the proposed changes to Rule 98, and in particular, the recognition that an appropriately walled-off specialist unit ameliorates the need to scrutinize the trading by an approved person, the NYSE proposes eliminating those portions of Rule 98A that concern

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<sup>18</sup> See 17 CFR Part 240.10b-5.

<sup>19</sup> See 17 CFR Part 240.14e-3.

approved persons. However, the NYSE would keep the limitation on an issuer, or a partner or subsidiary thereof, from becoming an approved person of a specialist unit.

2. Proposed Amendments to Rules 99, 102, 103B, 104, and 113

In their current form, NYSE Rules 99, 103B, 104, and 113 specifically apply to approved persons, unless such approved person has obtained an exemption under Rule 98. To ensure consistency among NYSE rules, and in particular, to ensure that the revised paradigm of proposed Rule 98 is consistently applied, the NYSE proposes to amend Rules 99, 103B, 104, and 113 to eliminate the references to approved persons.<sup>20</sup>

In addition, the Exchange proposes to delete Rule 102, which concerns trading in options by odd-lot dealers. Because the Exchange no longer has separate odd-lot dealers and all specialists are also responsible for odd-lot trading in securities in which they are registered, there is no need for a separate rule governing trading in related products by an odd-lot dealer. Accordingly, because Rule 102 is duplicative of the standards set forth in proposed Rules 98 and 105, the Exchange proposes deleting that rule.

3. Proposed Amendments to Rule 460

In addition to amending Rule 460 to ensure consistent application of proposed Rule 98 and making other non-substantive changes, the NYSE proposes eliminating Rule 460.20 that approved persons of specialist member organizations be held to any limits on beneficial ownership of any equity security in which an associated specialist unit is registered. Instead, as proposed, any limitations on beneficial ownership should apply only to the specialist unit that

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<sup>20</sup> For the period of time that the current Rule 98 stays in the NYSE Rules as “NYSE Rule 98 (Former),” each of NYSE Rules 99, 103B, 104, and 113 will have two forms: one to meet the requirements of NYSE Rule 98 (Former) and one to meet the requirements of proposed Rule 98. The version of the rules that relate to Rule 98 (Former) will be similarly designated with the “(Former)” title either for the entire rule, or for a section of a rule, as appropriate.

has been approved pursuant to proposed Rule 98, and not to any other aggregation unit or other department or division of the member organization.

With respect to the specialist unit's beneficial ownership of outstanding shares of securities allocated to such unit, the NYSE proposes to amend NYSE Rule 460.10 to require that a specialist unit report when its beneficial ownership of outstanding shares exceeds 5% and to update such report if the beneficial ownership either falls below 5% or exceeds 10%. The NYSE thus proposes to eliminate the requirement that a specialist unit seek NYSE Regulation approval before it may have more than 10% beneficial ownership of a listed security. The NYSE believes that because of the reduced market share of the NYSE and the limited impact of specialist trading on securities allocated to a specialist unit, the protections of the existing rule are no longer necessary. However, the NYSE proposes retaining the prohibition on a specialist unit having beneficial ownership of more than 25% of the outstanding shares in a security allocated to such unit. Because the changes to the marketplace are in effect now, the Exchange believes that the changes to Rule 460 should be implemented notwithstanding whether a specialist member organization continues to operate under Rule 98 (Former). Accordingly, the Exchange proposes having a single version of Rule 460 to reflect the proposed amendments.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with and furthers the objectives of Section 6(b)(5) of the Act,<sup>21</sup> in that it is designed to prevent fraudulent and manipulative acts and practices, 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.

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<sup>21</sup> 15 U.S.C. 78f(b)(5).

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.

II. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

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 the proposed rule change, or
- (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](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2008-45 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSE-2008-45. 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 ([www.sec.gov/rules/sro.shtml](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 NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that

you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2008-45 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.<sup>22</sup>

Florence E. Harmon  
Acting Secretary

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<sup>22</sup> 17 CFR 200.30-3(a)(12).