

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58979; File No. SR-NYSE-2008-116)

November 19, 2008

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change Amending Rule 411(b) Concerning Certain Odd-Lot Order Handling Requirements, Rescinding NYSE Information Memorandum 94-14 and Issuing a New Information Memo that Provides Comprehensive and Updated Interpretive Guidance on, and Application of, Current NYSE Odd-Lot Trading Practices and Rules

Pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (“Act”)² and Rule 19b-4 thereunder,³ notice is hereby given that, on November 6, 2008, New York Stock Exchange LLC (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I, II, and III below, which Items have been 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 (i) amend Rule 411(b) concerning certain odd-lot order handling requirements, (ii) rescind NYSE Information Memorandum (“Information Memo”) 94-14 to the extent it created a distinction in the regulatory treatment of odd-lot limit and odd-lot market orders, and (iii) issue a new Information Memo that provides comprehensive and updated interpretive guidance on, and application of, current NYSE odd-lot trading practices and Rules. This rule filing is available on the Exchange’s Web site at www.nyse.com, at the Exchange’s principal office, and at the Public Reference Room of the Commission.

¹ 15 U.S.C.78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

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 self-regulatory organization 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 the most significant parts of such statements.

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

1. Purpose

This proposal is to (i) amend NYSE Rule 411(b) concerning certain odd-lot order handling requirements, (ii) rescind NYSE Information Memo 94-14 to the extent it created a distinction in the regulatory treatment of odd-lot limit and odd-lot market orders, and (iii) issue a new Information Memo that provides comprehensive and updated interpretive guidance on, and application of, current NYSE odd-lot trading practices and Rules.

Current Operation of the Odd-Lot Order System

The odd-lot order system is used for all orders for less than a unit of trading (a unit of trading is generally referred to as a "round-lot"), currently set at 100 shares for most NYSE-listed securities.⁴ These orders, which are too small to be handled efficiently in the regular auction market on the Exchange, traditionally, have been used by retail investors to buy and sell

⁴ The vast majority of securities trade in round-lots of 100 shares; however, there are some securities that trade in round-lots of 10 or even 1 share.

small amounts of stock. More recently, market professionals using certain trading strategies and programs have also accessed the odd-lot system.

NYSE Rule 124 prescribes certain rules governing the execution of odd-lot orders. Among other things, because odd-lot orders are executed outside the regular auction market, Rule 124(a) prescribes that the Designated Market Maker (“DMM”) is the contra party for all odd-lot orders, thereby providing execution and price guarantees. Pursuant to NYSE Rule 124(c), odd-lot market orders and marketable limit orders are subject to automatic execution at the price of the next round-lot transaction in the subject security on the Exchange.

NYSE Rule 411(b) prescribes certain order-handling requirements for odd-lot orders. In particular, Rule 411(b)(1) provides that member organizations may not combine (or “bunch”) multiple odd-lot orders from different customers without prior approval. The Rule also requires member organizations to aggregate odd-lot orders, where possible, into as many round lot orders as possible rather than process them separately. Although not expressly stated, Rule 411(b) also implicitly prohibits a customer or member organization from unbundling a round-lot order in order to avoid the round-lot market and take advantage of the odd-lot market.

Background

The odd-lot system was initially created to replace odd-lot dealers on the Exchange. Before the creation of the odd-lot system, odd-lot dealers made markets in odd-lots and either paired-off odd-lot orders against each other or traded with them as dealers. When the Exchange eliminated separate odd-lot dealers and adopted Rule 124, DMMs (at the time, specialists) were made the counter-party for each odd-lot order execution in their respective stocks.

Because the system forces DMMs to provide liquidity, the Exchange has always sought to limit the use of the odd-lot order system to only the types of trading it replaced (so-called

“traditional” or “standard” odd-lot trading practices) in order to ensure the system’s continued economic viability. In particular, the Exchange has long prohibited the specific use of the odd-lot order system as a professional trading platform, because it reduces the DMMs’ willingness to provide cost effective and efficient liquidity for the odd-lot system as a whole. Accordingly, the Exchange has on many occasions issued guidance that any use of the odd-lot system in a manner that is inconsistent with traditional or standard odd-lot investment activity is strictly prohibited.

Distinction in Regulatory Treatment of Odd-Lot Limit and Odd-Lot Market Orders

Information Memo 94-14 provides that certain trading practices that rely specifically on odd-lot limit orders are flatly prohibited.⁵ Under the terms of Information Memo 94-14, however, odd-lot market orders were not subject to the same restrictions.

This distinction in the regulatory treatment between odd-lot limit and odd-lot market orders noted in Information Memo 94-14 evolved from changes made to the odd-lot order system in and around 1991.⁶ Before then, DMMs were permitted to charge a differential on (i) all odd-lot limit orders executed through the automated system, and (ii) any odd-lot order that required manual handling; all other odd-lot orders, including market orders, were executed without a differential.⁷

⁵ See Information Memo 94-14 (April 18, 1994). See also Securities Exchange Act Release No. 34-33678 (February 24, 1994), 59 FR 10192 (March 3, 1994) (SR-NYSE-92-13).

⁶ In May 1992, because it made changes to existing NYSE Rule 124, the Exchange submitted to the Commission the interpretive guidance that would later become Information Memo 94-14, which was approved in February 1994 after several amendments. See Securities Exchange Act Release No. 34-33678 (February 24, 1994), 59 FR 10192 (March 3, 1994) (SR-NYSE-92-13) (formally adopting Information Memo 94-14). Information Memo 94-14 was subsequently distributed to all members and member organizations on April 18, 1994.

⁷ See Securities Exchange Act Release No. 34-28837 (January 14 [sic], 1991), 56 FR 4660 (February 5, 1991) (SR-NYSE-91-03).

In February 1991, at the conclusion of a six month pilot program, the Exchange amended NYSE Rule 124 to eliminate price differentials on odd-lot orders executed on the Exchange and extended the “no commission policy” to cover floor brokerage charges on all systematized odd-lot orders. The Exchange stated that, by providing more economic pricing, the amendments would enhance the efficiency of odd-lot order executions compatible with the traditional odd-lot investing practices of smaller investors. Although there were concerns about possible adverse impacts to the odd-lot market, the data collected during the implementation of the pilot program reflected that the mix of odd-lot limit and market orders had remained at or near historical levels and there was no evidence of regulatory issues or trading abuses.⁸

In July 1991, after implementation of the amendments and further observation of the odd-lot market, the Exchange released Information Memo 91-29. In that Information Memo, the Exchange identified and precluded certain trading practices that had developed that were inconsistent with traditional or standard odd-lot trading practices and that undermined the economic benefits derived by the market from the elimination of differential pricing for odd-lot orders. These practices included the unbundling of round-lot orders for the purpose of entering odd-lot limit orders in comparable amounts, the failure to aggregate into round-lots odd-lot orders from the same account or accounts with a common monetary interest, and the entry of odd-lot limit orders on both sides of the market for a security in order to capture the “spread”. The Exchange also emphasized more generally that any odd-lot order entry practices intended to circumvent the round-lot auction market were prohibited.⁹

⁸ See Securities Exchange Act Release No. 34-28837 (January 14 [sic], 1991), 56 FR 4660 (February 5, 1991) (SR-NYSE-91-03). See also Securities Exchange Act Release No. 34-33678 (February 24, 1994), 59 FR 10192 (March 3, 1994) (SR-NYSE-92-13).

⁹ See Information Memo 91-29 (July 25, 1991).

To address these issues in part, in 1992 the Exchange amended NYSE Rule 411(b) to expand the requirement for aggregating odd-lot orders to include market participants who entered multiple orders on behalf of various accounts over which they had investment discretion.¹⁰

In Information Memo 94-14, the Exchange identified and precluded additional types of trading using odd-lot limit orders in particular, including index arbitrage, program trading and day trading, as inconsistent with traditional or standard odd-lot trading practices and that undermined the integrity of the odd-lot order system and its purpose. At that time, the Exchange noted that such trading practices using odd-lot market orders were not precluded.¹¹

More recently, in Information Memo 07-60, the Exchange provided additional interpretive guidance concerning the odd-lot system, including an overview of various types of prohibited trading practices.¹²

Proposed Rule Changes

The rules and interpretive guidance (in the form of Information Memos and Enforcement Decisions) for the Exchange's odd-lot order system have evolved over the years in response to

¹⁰ See Securities Exchange Act Release No. 34-31048 (August 18, 1992), 57 FR 38706 (August 26, 1992) (SR-NYSE-92-03).

¹¹ See Information Memo 94-14 (April 18, 1994). See also Securities Exchange Act Release No. 34-33678 (February 24, 1994), 59 FR 10192 (March 3, 1994) (SR-NYSE-92-13).

¹² See Information Memo 07-60 (June 29, 2007). This Information Memo was not filed with the SEC.

changes in the way market participants use the system. This has resulted in a set of rules and policies that, while comprehensive, is not readily accessible in one source. Moreover, some of the rules (i.e. Rule 411(b)) have not been updated to reflect the Exchange's most current interpretive guidance and application of odd-lot trading practices. As a result, and as described more fully below, the Exchange proposes the following changes in order to update Rule 411(b) and to provide a single source of interpretive guidance in accordance with the current odd-lot order system and trading practices.

1. Proposed Amendments to Rule 411(b)

The Exchange proposes to amend Rule 411(b) to update and clarify certain odd-lot trading practices described in the Rule.

First, the Exchange proposes to amend the first subparagraph of the Rule to clarify that a person, member or member organization shall not enter or accept multiple odd-lot orders in the same security where those orders can be aggregated into round-lots. Under the current Rule, members or member organizations must monitor and aggregate odd-lot orders received from their customers where appropriate. As amended, the Rule would also explicitly provide that members or member organizations must not submit un-aggregated orders.

In addition, the Exchange proposes to limit the requirement to aggregate odd-lot orders to regular trading hours from 9:30 a.m. to 4:00 p.m. The Exchange's member firms have differing systems and procedures that make it difficult to standardize their capability to aggregate odd-lot orders prior to the commencement of trading at 9:30 a.m. As a result, the Exchange believes that it is more equitable to limit the aggregation requirement to regular trading hours.

The Exchange also proposes to add a new subparagraph to the Rule to explicitly provide that no person, member or member organization shall unbundle market or limit round-lot orders

for the purpose of entering multiple odd-lot orders that aggregate to an amount comparable to the amount of the original round-lot order(s).¹³

Finally, the Exchange proposes to make technical amendments to Rule 411(b) to reorder and renumber the subparagraphs in this section in accordance with these proposed amendments.

2. Proposed Rescission of Information Memo 94-14 and Issuance of New Information Memo

The Exchange is seeking approval from the SEC to rescind Information Memo 94-14 and to eliminate the regulatory distinction between odd-lot limit and odd-lot market orders.

The distinction in the regulatory treatment of odd-lot limit and odd-lot market orders as described in Information Memo 94-14 is no longer necessary or practical in today's market. In the past, as observed by the Exchange, odd-lot limit orders could be and were used by market participants to access the odd-lot order system in ways that were inconsistent with traditional or standard odd-lot trading and that undermined the integrity of the odd-lot order system. Since the filing and approval of Information Memo 94-14, however, the market has undergone significant changes, including the adoption of Regulation NMS and technological developments impacting order routing and execution. Today, volume is much greater and the speed of the market has increased such that most limit orders are effectively market orders when entered. In addition, there are numerous programs and algorithmic trading platforms that permit market participants to use trading strategies involving both limit and market orders. At the same time, the Exchange has better tools with which to conduct market surveillance and regulation.

¹³ E-mail from Jason Harman, Consultant, NYSE Regulation, to Nathan Saunders, Special Counsel, and Steve Varholik, Attorney, Division of Trading and Markets, Commission, on November 18, 2008 (clarifying discussion relating to proposed NYSE Rule 411(b)(3)).

In conjunction with these changes to the marketplace, NYSE Regulation has noted the increasing use of odd-lot market orders in trading practices that, were they implemented using odd-lot limit orders (even marketable limit orders), would be violations of the Exchange's current odd-lot rules and interpretive guidance. These trading practices are designed to circumvent the auction market and provide liquidity and pricing that is not otherwise available, or to create an unfair advantage over other market participants, and, as a result, threaten to undermine the economic viability of the odd-lot trading system and reduce the DMMs' willingness to provide cost-effective and efficient liquidity.

Given this trend, the Exchange believes that it is no longer proper, or consistent with the protection of investors, to maintain a regulatory distinction between odd-lot limit and odd-lot market orders in determining whether odd-lot activity is violative and that, moreover, continuation of this distinction impedes the appropriate regulation of abusive trading practices involving both odd-lot limit and odd-lot market orders.

In addition, in the interest of providing market participants with a single, comprehensive source of guidance, the Exchange proposes to issue a new Information Memo that would update and restate the Exchange's most current interpretive guidance and application of odd-lot trading practices and Rules. The proposed new Information Memo would retain the relevant portions of Information Memo 94-14 and prior Information Memos, as well as the more recent guidance issued in Information Memo 07-60.

2. Statutory Basis

The statutory basis for the proposed rule change is Section 6(b)(5) of the Act¹⁴, which requires the rules of an exchange 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. The proposed rule change also supports the principles of Section 11A(a)(1)¹⁵ of the Act, in that it seeks to ensure economically efficient execution of securities transactions and fair competition among brokers and dealers and among exchange markets.

In particular, as noted above, the proposed rule filing would bring the Exchange's odd-lot Rules and interpretive guidance into line with the way the odd-lot system is currently used by market participants. The proposed filing also would eliminate a historical distinction in the regulatory treatment of odd-lot trading that is no longer relevant in today's market. The Exchange has observed patterns of abuse by market participants who have crafted schemes involving odd-lot market orders that, were they implemented using odd-lot limit orders, would be violations of the Exchange's current odd-lot rules and interpretive guidance. The Exchange believes that, in order to effectively regulate the use of the odd-lot system and protect investors, it is necessary to close this loophole. In addition, the proposed filing would provide market participants with a comprehensive source of the Exchange's most current interpretive guidance and application of odd-lot trading practices and Rules.

¹⁴ 15 U.S.C. 78f(b)(5).

¹⁵ 15 U.S.C. 78k-1(a)(1).

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

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. Please include File Number SR-NYSE-2008-116 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-2008-116. 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-2008-116 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.¹⁶

Florence E. Harmon
Acting Secretary

¹⁶ 17 CFR 200.30-3(a)(12).