

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49649; File No. SR-NYSE-2004-21)

May 4, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 thereto by the New York Stock Exchange, Inc. to Extend for an Additional Year the Pilot Relating to the Allocation Policy for Trading of Exchange-Traded Funds on an Unlisted Trading Privileges Basis (NYSE Rule 103B)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 13, 2004, the New York Stock Exchange, Inc. (“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 prepared by the NYSE. On April 23, 2004, NYSE filed Amendment No. 1 to the proposal.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The proposed rule change seeks to extend for an additional year⁴ the pilot relating to the allocation policy for trading certain ETFs (“Pilot”), which has been codified in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated April 22, 2004 (“Amendment No. 1”). In Amendment No. 1, NYSE amended the filing to request that the Commission waive the 30-day delayed operative date to ensure that the pilot relating to the allocation policy for trading certain Exchange-Traded Funds (“ETFs”) continued without interruption.

⁴ The Exchange is continuing to develop its market in ETFs and is reviewing the results of utilizing the allocation procedures adopted in the pilot. As greater experience is gained, the Exchange will evaluate the continued usefulness of these procedures and consider whether to make the procedures permanent.

NYSE Rule 103B (“Rule 103B”), Section VIII. The Pilot is set to expire on May 8, 2004. In addition, the Exchange proposes to substitute the term “Chief Executive Officer” for “Chairman” in NYSE Rule 103B, Section VIII as a result of changes to the governance structure of the NYSE, which differentiated the authority and responsibilities of the Chairman of the Board of Directors and the Chief Executive Officer (CEO). For purposes of the allocation policy, ETFs include both Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual) and Trust Issued Receipts (as defined in Rule 1200), which trade on an Unlisted Trading Privileges Basis (“UTP”). The text of the proposed rule change is available at the NYSE and at the Commission.

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 NYSE included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below.

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

1. Purpose

The Exchange seeks to extend for an additional year the allocation policy for trading certain ETFs, as codified in NYSE Rule 103B,⁵ Section VIII. This proposed rule change was originally filed as a one-year pilot in SR-NYSE-2001-07⁶, and subsequently

⁵ See Securities Exchange Act Release No. 46579 (October 1, 2002), 67 FR 63004 (October 9, 2002) (SR-NYSE-2002-31).

⁶ See Securities Exchange Act Release No. 44272 (May 7, 2001), 66 FR 26898 (May 15, 2001) (SR-NYSE-2001-07).

amended by SR-NYSE-2001-10⁷ and SR-NYSE-2002-07.⁸ The pilot was subsequently extended for an additional two years, and is due to expire on May 8, 2004.⁹

The Exchange also proposes to make one change to NYSE Rule 103B. The Exchange proposes to replace the term “Chairman” with “Chief Executive Officer” in NYSE Rule 103B, Section VIII (the Allocation policy for trading certain ETFs). This change is being made as a result of amendments to the governance structure of the Exchange, which differentiated the authority and responsibilities of the Chairman and CEO.¹⁰

Since the inception of the Allocation Policy, 36 ETFs have been allocated. This includes 17 Merrill Lynch Holding Company Depositary Receipts (HOLDRs), a type of Trust Issued Receipt, nine types of Select Sector Standard & Poor’s Depositary Receipts (SPDRs), one MidCap SPDR, five types of iShares, one Vanguard Index Participation Equity Recipient (VIPER) Shares, the Nasdaq-100 Index Tracking Stock (symbol QQQ), the Standard & Poor’s 500 Index (symbol SPY), and The Dow Industrials DIAMONDS (symbol DIA).

⁷ See Securities Exchange Act Release No. 44306 (May 15, 2001), 66 FR 28008 (May 21, 2001) (SR-NYSE-2001-10).

⁸ See Securities Exchange Act Release No. 45729 (April 10, 2002), 67 FR 18970 (April 17, 2002) (SR-NYSE-2002-07).

⁹ See Securities Exchange Act Release No. 45884 (May 6, 2002), 67 FR 32073 (May 13, 2002) (SR-NYSE-2002-17). See also Securities Exchange Act Release No. 47690, 68 FR 20205 (April 24, 2003) (SR-NYSE-2003-07).

¹⁰ See Securities Exchange Act Release No. 48946 (December 17, 2003), 68 FR 74678 (December 24, 2003) (SR-NYSE-2003-34). See Securities Exchange Act Release No. 49345 (March 1, 2004), 69 FR 10791 (March 8, 2004) (SR-NYSE-2004-02).

Allocation Policy for ETFs Trading Under UTP

The purposes of the Exchange's current Allocation Policy and Procedures (the "Policy") is to: (1) ensure that the allocation process is based on fairness and consistency and that all specialist units have a fair opportunity for allocations based on established criteria and procedures; (2) provide an incentive for ongoing enhancement of performance by specialist units; (3) provide the best possible match between specialist unit and security; and (4) contribute to the strength of the specialist system.

The Allocation Committee has sole responsibility for the allocation of securities to specialist units under this policy pursuant to authority delegated by the Board of Directors, and is overseen by the Quality of Markets Committee of the Board ("QOMC"). The Allocation Committee renders decisions based on the allocation criteria specified in this Policy.¹¹

The Exchange believes that it would be appropriate to modify the listed equities allocation process to provide that ETFs traded on a UTP basis be allocated by a special committee, consisting of the Chairman of the Allocation Committee, the three most senior Floor broker members on the Allocation Committee, and four members of the Exchange's senior management as designated by the CEO of the Exchange. This will permit Exchange management, acting with designated members of the Allocation Committee, to oversee directly the introduction of the UTP concept to the NYSE. For purposes of the Allocation Policy, ETFs collectively include Investment Company Units

¹¹ See Securities Exchange Act Release No. 42746 (May 2, 2000), 65 FR 30171 (May 10, 2000) (SR-NYSE-99-34).

(as defined in paragraph 703.16 of the Listed Company Manual) and Trust Issued Receipts (as defined in Exchange Rule 1200).

Allocation applications would be solicited by the Exchange, and this special committee would review the same performance and disciplinary material as is reviewed by the Allocation Committee.¹² In addition, specialist unit applicants would be required to demonstrate:

- (a) an understanding of the trading characteristics of ETFs;
- (b) expertise in the trading of derivatively-priced instruments;
- (c) ability and willingness to engage in hedging activity as appropriate;
- (d) knowledge of other markets in which the ETF which is to be allocated trades;
- and
- (e) willingness to provide financial and other support to relevant Exchange publicity and educational initiatives.

A specialist organization cannot be both the specialist in the ETF and the specialist in any security that is a component of the ETF. This restriction is necessary to avoid the possibility of "wash sales" in a situation where the specialist in the ETF needs to hedge by buying or selling component stocks of the ETF, and could inadvertently be trading with a proprietary bid or offer made by a specialist in the same member organization who is making a market in the component security.

The special committee would review specialist unit applications and reach its allocation decision by majority vote. Any tie vote would be decided by the CEO of the

¹² See Section IV ("Allocation Criteria") of the Allocation Policy and Procedures approved in Securities Exchange Act Release No. 42746 (May 2, 2000), 65 FR 30171 (May 10, 2000) (SR-NYSE-99-34) for details of the performance and disciplinary material available to the Allocation Committee.

Exchange. The Exchange has determined that due to the unique aspects of certain ETF products, it may be helpful for the special committee to meet with and interview specialist units before making an allocation decision.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)¹³ that an Exchange have rules that are designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act,¹⁴ and subparagraph (f)(6) of Rule 19b-4,¹⁵ thereunder because it does not: (i)

¹³ 15 U.S.C. 78f(b)(5).

¹⁴ 15 U.S.C. 78s(b)(3)(A).

¹⁵ 17 CFR 240.19b-4(f)(6).

significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.¹⁶

The Exchange requests that the Commission waive the 30-day delayed operative date of Rule 19b-4(f)(6)(iii). Waiver of this period will allow the Exchange to continue the pilot without interruption. The Exchange believes that this is in the public interest. The Commission also believes that it is consistent with the protection of investors and the public interest to waive the 30-day operative delay and make this proposed rule change immediately effective as of April 23, 2004.¹⁷

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

¹⁶ For the purposes of calculating the 60-day abrogation period, the Commission considers the proposed rule change to have been filed on April 23, 2004, the date NYSE filed Amendment No. 1.

¹⁷ For purposes of only accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send E-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2004-21 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NYSE-2004-21. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such 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-2004-21 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁸

Margaret H. McFarland
Deputy Secretary

¹⁸ 17 CFR 200.30-3(a)(12).