

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50667; File No. SR-NYSE-2004-05)

November 15, 2004

Self-Regulatory Organizations; Notice of Filing of Amendment Nos. 2 and 3 to a Proposed Rule Change by the New York Stock Exchange, Inc. Relating to Enhancements to the Exchange's Existing Automatic Execution Facility Pilot (NYSE Direct+)

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 November 8, 2004, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") Amendment No. 2<sup>3</sup> to a proposed rule change as described in Items I, II and III below, which Items have been prepared by the NYSE. On November 9, 2004, the NYSE filed Amendment No. 3 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change as amended by Amendment Nos. 2 and 3 from interested persons.

The proposed rule change was filed on February 9, 2004 and amended by Amendment No. 1 on August 2, 2004.<sup>5</sup> The proposed rule change as amended by Amendment No. 1 was

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

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

<sup>3</sup> See Form 19b-4 dated November 8, 2004 ("Amendment No. 2"). Amendment No. 2 supplements the description of certain aspects of the Exchange's hybrid market and proposes additional amendments to the Exchange's rules.

<sup>4</sup> See Partial amendment dated November 9, 2004 ("Amendment No. 3"). In Amendment No. 3, the NYSE submitted the proposed rule changes in the format required in Exhibit 5 to the Form 19b-4, which was inadvertently omitted from Amendment No. 2.

<sup>5</sup> See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated July 30, 2004, and accompanying Form 19b-4, which replaced the original filing in its entirety ("Amendment No. 1").

published for comment in the Federal Register on August 16, 2004.<sup>6</sup> On August 26, 2004, the Commission extended the public comment period with respect to the Notice to September 22, 2004.<sup>7</sup> The Commission received 15 comment letters with respect to the Notice.<sup>8</sup>

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

The Exchange proposes amendments to its rules governing NYSE Direct+<sup>®</sup> ('Direct+'), which were originally proposed in the Notice, supplements the description of certain aspects of the Exchange's hybrid market, and proposes additional amendments to the Exchange's rules.

Below is the text of the proposed rule change, as amended by Amendment Nos. 2 and 3.

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<sup>6</sup> See Securities Exchange Act Release No. 50173 (August 10, 2004), 69 FR 50407 ('Notice').

<sup>7</sup> See Securities Exchange Act Release No. 50277 (August 26, 2004), 69 FR 53759 (September 2, 2004).

<sup>8</sup> See letter to William Donaldson, Chairman, Commission, from Donald E. Weeden, dated August 31, 2004; letters to the Commission from: Kim Bang, President and Chief Executive Officer, Bloomberg Tradebook LLC, dated September 22, 2004; and Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Management & Research Company, dated October 26, 2004; letters to Jonathan G. Katz, Secretary, Commission, from: Ari Burstein, Associate Counsel, Investment Company Institute, dated September 22, 2004; Donald D. Kittell, Executive Vice President, Securities Industry Association, dated October 1, 2004; Ellen L.S. Koplow, Executive Vice President and General Counsel, Ameritrade, Inc., dated September 22, 2004; Bruce Lisman, Bear, Stearns & Co., Inc., dated September 28, 2004; Edward J. Nicoll, Chief Executive Officer, Instinet Group Incorporated, dated October 25, 2004; Thomas Peterffy and David M. Battan, the Interactive Brokers Group, dated September 7, 2004; and Lisa M. Utasi, President and Kimberly Unger, Executive Director, the Security Traders Association of New York, Inc., dated September 22, 2004; and letter to Annette L. Nazareth, Director, Division, Commission, and Robert L.D. Colby, Deputy Director, Division, Commission, from Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Management & Research Company, dated August 10, 2003. See emails to Nancy Reich Jenkins, Managing Director, Market Surveillance, NYSE, from George W. Mann Jr., Executive Vice President and General Counsel, Boston Stock Exchange, Inc., dated September 22, 2004; and emails to the Commission from: Jose L. Marques, Ph.D., Managing Member, Telic Management LLC, dated September 21, 2004; Junius W. Peake, Monfort Distinguished Professor of Finance, Kenneth W. Monfort College of Business, University of Northern Colorado, dated September 22, 2004; and James L. Rothenberg, Esq., dated August 30, 2004.

Proposed new language is italicized; proposed deletions are in brackets.<sup>9</sup> Furthermore, examples of trading under the proposed rules are attached hereto as Exhibit A.

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## **Definitions of Orders**

### **Rule 13**

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#### **All or None Order**

A market or limited price order [which] designated all or none is to be executed in its entirety or not at all, but, unlike a fill or kill order, is not to be treated as cancelled if not executed as soon as it is represented in the Trading Crowd or automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004. The making of "all or none" bids or offers in stocks is prohibited and the making of "all or none" bids or offers in bonds is subject to the restrictions of Rule 61 and Rule 86.

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#### **Auction Limit Order**

An auction limit order is an order that provides an opportunity for price improvement.

The limit price of an auction limit order to buy should be at or above the Exchange best offer at the time the order is entered on the Exchange. The limit price of an auction limit order to sell should be at or below the Exchange best bid at the time the order is entered on the Exchange.

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<sup>9</sup> The rule text as set forth herein includes several minor technical revisions that the Exchange has committed to correct by filing an amendment. Telephone conversation between Cyndi Rodriguez, Special Counsel, Division, Commission, and Jeff Rosenstock, Senior Special Counsel, Market Surveillance, NYSE, on November 15, 2004.

An auction limit order shall be quoted and executed in accordance with Exchange Rules 15A.50, 123F and 79A.15.

### **Auto Ex Order**

An auto ex order is:

(a) a market order designated for automatic execution or a limit order to buy (sell) priced at or above (below) the Exchange best offer (bid) at the time such order is routed to the Display Book<sup>®</sup> or;

(b) an immediate or cancel order; or

(c) an elected stop or stop limit order systemically delivered to the Display Book; or

(d) a buy “minus”, sell “plus” or short sale order systemically delivered to the Display Book;  
or

(e) an all or none order; or

(f) an elected or converted percentage order that is convertible on a destabilizing tick and for which the entering broker has granted permission for the specialist to be on parity with the order; or

(g) a part of round lot order (PRL); or

(h) orders initially eligible for automatic execution that have been cancelled and replaced in a stock, Investment Company Unit (as defined by paragraph 703.16 of the Listed Company Manual), or Trust Issued Receipt (as defined in Rule 1200), subject to [a limit order of 1099 shares or less priced at or above the Exchange's published offer (in the case of an order to buy) or at or below the Exchange's published bid (in the case of an order to sell), which a member or member organization has entered for] automatic execution in accordance with, and to the extent provided by, Exchange Rules 1000-1004[5].

[Pursuant to a pilot program to run until December 23, 2004, orders in Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual), or Trust Issued Receipts (as defined in Rule 1200) may be entered as limit orders in an amount greater than 1099 shares. The pilot program shall provide for a gradual, phased-in raising of order size eligibility, up to a maximum of 10,000 shares. Each raising of order size eligibility shall be preceded by a minimum of a one-week advance notice to the Exchange's membership.]

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### **Immediate or Cancel Order**

A market or limited price order [which] designated immediate or cancel is to be executed [in whole or in part] to the extent possible as soon as such order is represented in the Trading Crowd or automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004, and the portion not so executed is to be treated as cancelled. For the purposes of this definition, a "stop" is considered an execution.

A "commitment to trade" received [on the Floor] through ITS will be automatically executable in accordance with, and to the extent provided by, Exchange Rules 1000-1004, and shall be treated in the same manner, and entitled to the same privileges, as [would] an immediate or cancel order that [reaches the Floor] is systemically delivered to the Display Book at the same time except as otherwise provided in the Plan and except further that such a commitment may not be "stopped," [and the commitment shall remain irrevocable for the time period chosen by the sender of the commitment.] After trading with the Exchange published bid (offer), the unfilled balance of a commitment to trade shall be automatically reported to ITS as cancelled.

## **Limit, Limited Order or Limited Price Order**

An order to buy or sell a stated amount of a security at a specified price, or at a better price, if obtainable after the order is represented in the Trading Crowd.

A marketable limit order is an order on the Exchange that can be immediately executed; that is, an order to buy priced at or above the Exchange best offer or an order to sell priced at or below the Exchange best bid.

A marketable limit order systemically delivered to the Display Book is an auto ex order subject to automatic execution in accordance with, and to the extent provided by, Exchange Rules 1000-1004.

## **Market Order**

An order to buy or sell a stated amount of a security at the most advantageous price obtainable after the order is represented in the Trading Crowd or systemically delivered to the Display Book.

A market order is not an auto ex order unless so designated and shall be quoted and executed in accordance with Exchange Rules 15A.50, 123F.

A market order designated for automatic execution is an auto ex order and shall be executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004.

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## **Percentage Order**

A limited price order to buy (or sell) 50% of the volume of a specified stock after its entry. There are four types of percentage orders:

(a) Straight Limit Percentage Orders-Such an order is elected when a transaction has occurred at the limit price or a better price. Unless otherwise specified, only volume at or below

the limit subsequent to the receipt of the order will be applied in determining the elected portion of buy orders. Conversely, only volume at or above the limit will be calculated in determining the elected portion of sell orders.

(b) Last Sale Percentage Orders-The elected portion of an order designated "last sale" shall be executed only at the last sale price or at a better price, provided that such price is at or better than the limit specified in the order. If the order is further designated "last sale-cumulative volume", the elected portion shall be placed on the book at the price of the electing sale, but if not executed, shall be cancelled and re-entered on the book at the price of the subsequent transactions on the Exchange, provided the price of such subsequent transactions is at or better than the limit specified in the order.

(c) "Buy Minus"- "Sell Plus" Percentage Orders-The elected portion of an order to "buy minus" shall be executed only on a "minus" or "zero minus" tick. Orders of this type must also be qualified further by designating a limit price. The elected portion of an order to "sell plus" shall be executed only on a "plus" or "zero plus" tick. Orders so designated are handled in the same manner as an order to sell short. (See Rule 123A.71) Orders of this type must also be further qualified by designating a limit price.

If so instructed by the entering broker(s), percentage orders to buy will be converted into regular limit orders for transactions effected on "minus" or "zero minus" ticks. Conversely, if so instructed by the entering broker(s), percentage orders to sell will be converted into regular limit orders for transactions effected on "plus" or "zero plus" ticks.

If further instructed by the entering broker(s), as provided in Rule 123A.30, percentage orders to buy may be converted into regular limit orders for transactions on "plus" or "zero plus"

ticks. Conversely, if so instructed by the entering broker(s), percentage orders to sell may be converted into regular limit orders for transactions on "minus" or "zero minus" ticks.

(See also Rule 123A.30.)

(d) "Immediate Execution or Cancel Election" Percentage Orders-The elected portion of a percentage order with this designation is to be executed immediately in whole or in part at the price of the electing transaction. Any elected portion not so executed shall be deemed cancelled, and shall revert to its status as an unelected percentage order and be subject to subsequent election or conversion.

The converted portion of such a percentage order that is convertible on a destabilizing tick (a "CAP-DI order") and which is systemically delivered to the Display Book<sup>®</sup> will be eligible to be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004 consistent with the order's instructions.

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### **Sell "Plus"-Buy "Minus" Order**

A market order to sell "plus" is a market order to sell a stated amount of a stock provided that the price to be obtained is not lower than the last sale if the last sale was a "plus" or "zero plus" tick, and is not lower than the last sale plus the minimum fractional change in the stock if the last sale was a "minus" or "zero minus" tick. A limited price order to sell "plus" would have the additional restriction of stating the lowest price at which it could be executed.

Sell "plus" limit orders which are systemically delivered to the Display Book<sup>®</sup> and sell "plus" market orders designated for automatic execution will be eligible to be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004 consistent with the order's instructions.

A market order to buy "minus" is a market order to buy a stated amount of a stock provided that the price to be obtained is not higher than the last sale if the last sale was a "minus" or "zero minus" tick, and is not higher than the last sale minus the minimum fractional change in the stock if the last sale was a "plus" or "zero plus" tick. A limited price order to buy "minus" would have the additional restriction of stating the highest price at which it could be executed.

Buy 'minus' limit orders that are systemically delivered to the Display Book<sup>®</sup> and buy 'minus' market orders designated for automatic execution will be eligible to be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004 consistent with the order's instructions.

### **Stop Order**

A stop order to buy becomes a market order when a transaction in the security occurs at or above the stop price after the order is represented in the Trading Crowd. A stop order to sell becomes a market order when a transaction in the security occurs at or below the stop price after the order is represented in the Trading Crowd. Stop orders that are systemically delivered to the Display Book<sup>®</sup> will be eligible to be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004 consistent with the order's instructions.

### **Stop Limit Order**

A stop limit order to buy becomes a limit order executable at the limit price, or at a better price, if obtainable, when a transaction in the security occurs at or above the stop price after the order is represented in the Trading Crowd. A stop limit order to sell becomes a limit order executable at the limit price or at a better price, if obtainable, when a transaction in the security occurs at or below the stop price after the order is represented in the Trading Crowd. Stop limit orders that are systemically delivered to the Display Book<sup>®</sup> will be eligible to be automatically

executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004 consistent with the order's instructions.

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(Remainder of rule unchanged)

## **ITS "Trade-Throughs" And "Locked Markets"**

### **Rule 15A**

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#### **Supplementary Material:**

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.10 Nothing in paragraph (d)(2)(B) above is intended to discourage a locking member from electing to ship if the complaint requests him to do so.

.20 The fact that a transaction may be cancelled or the price thereof may be adjusted pursuant to the provisions of paragraph (b)(2) of this Rule 15A, shall not have any effect, under the rules, on other transactions or the execution of orders not involved in the original transaction.

.30 The provisions of this Rule 15A shall supersede the provisions of any other Exchange Rule which might be construed as being inconsistent with Rule 15A.

.40 For the purposes of this Rule:

i. the terms 'Exchange trade-through' and 'Third participating market center trade-through' do not include the situation where a member who initiates the purchase (sale) of an ITS security at a price which is higher (lower) than the price at which the security is being offered (bid) in another ITS participating market, sends contemporaneously through ITS to such ITS

participating market a commitment to trade at such offer (bid) price or better and for at least the number of shares displayed with that market center's better-priced offer (bid); and

ii. a trade-through complaint sent in these circumstances is not valid, even if the commitment sent in satisfaction cancels or expires, and even if there is more stock behind the quote in the other market.

.50 Where a better bid or offer is published by another ITS participating market center or centers in which an automatic execution is immediately available or such bid or offer is otherwise protected from a trade-through by Securities and Exchange Commission rule or ITS Plan, and the price associated with such published better bid or offer has not been systemically matched by the specialist, the Exchange will automatically route to such other market center or centers as a commitment to trade any order or portion thereof that satisfies such better published bid or offer, unless the member entering the order indicates in such manner as required by the Exchange that it is contemporaneously satisfying the better published bid or offer.

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### **Dissemination of Quotations**

#### **Rule 60**

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(e) Autoquoting of highest bid/lowest offer and automated adjustment of size of liquidity bid and offer. The Exchange will autoquote the NYSE's highest bid or lowest offer whenever a limit order is transmitted to the specialist's book at a price higher (lower) than

the previously disseminated highest (lowest) bid (offer). When the NYSE's highest bid or lowest offer has been traded with in its entirety, the Exchange will autoquote a new bid or offer reflecting the total size of orders on the specialist's book at the next highest (in the case of a bid) or lowest (in the case of an offer) price. The size of any liquidity bid or offer shall be systemically increased to reflect any additional limit orders transmitted to the specialist's book at prices ranging from the liquidity bid or offer price to the highest bid (lowest offer). The size of any liquidity bid or offer shall be systematically decreased to reflect the execution of any limit orders on the specialist's book at prices ranging from the liquidity bid or offer price to the highest bid (lowest offer). However, de minimis increases or decreases in the size of limit orders on the book, as determined by the specialist, will not result in automated augmenting or decrementing of the size of the liquidity bid or offer where such bid or offer continues to reflect the actual size of limit orders on the book.

[In any instance where the specialist disseminates a proprietary bid (offer) of 100 shares on one side of the market, the bid or offer on that side of the market shall not be autoquoted. In such an instance, any better-priced limit orders received by the specialist shall be manually displayed, unless they are executed at a better price in a transaction being put together in the auction market at the time that the order is received.]

Autoquote will be suspended when the specialist has gapped the quotation in accordance with Exchange policies and procedures, a block size transaction as defined in Rule 127 that involves orders on the book is being reported manually or when a liquidity replenishment point (LRP) as defined in Exchange Rule 1000 (a)(v)(A) has been reached.

After the specialist has gapped the quotation, autoquote will resume with a manual transaction or the publication of a non-gapped quotation.

Autoquote will resume as soon as possible after a LRP has been reached, but in no more than five seconds, where the auto ex order that reached the LRP is executed in full, or any unfilled balance of such order is not capable of trading at a price above (in the case of a buy order) or below (in the case of a sell order) the LRP. Where the unfilled balance of an auto ex order is able to trade at a price above (below) the LRP, but the price does not create a locked or crossed market, autoquote will resume upon a manual transaction or the publication of a new quote by the specialist, but in any event in no more than 10 seconds. Where the unfilled balance of an auto ex order is able to trade at a price above (below) the LRP and the price creates a locked or crossed market, autoquote will resume upon a manual transaction or the publication of a new quote by the specialist.

Autoquote will resume as soon as possible after a momentum liquidity replenishment point, as defined in Exchange Rule 1000(a)(v)(B), is reached, but in no more than ten seconds unless a locked or crossed market exists. In such case, autoquote will resume upon a manual transaction.

Autoquote will resume immediately after a manual report of a block size transaction is reported.

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### **[Below Best] Bids [-] and [Above Best] Offers**

#### **Rule 70**

When a bid is clearly established, no bid or offer at a lower price shall be made. When an offer is clearly established, no offer or bid at a higher price shall be made.

All bids made and accepted, and all offers made and accepted, in accordance with Exchange Rules [45 to 86] shall be binding.

#### **Supplementary Material:**

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.10 Except for bids and offers made by a specialist pursuant to Rule 104 (b) and (c), [A]ny bid (offer) systemically delivered to the Display Book which is made at the same or higher (lower) price of the prevailing offer (bid) shall result in an automatic execution [transaction at the offer price in an amount equal to the lesser of the bid or offer. The same principle shall apply when an offer is made at the same or lower price as the bid.] in accordance with, and to the extent provided by, Exchange Rules 1000-1004.

.20 (a) A Floor broker may place within the Display Book system a broker agency interest file at varying prices at or outside the Exchange best bid and offer with respect to orders he or she is representing on the Floor, except that the agency interest file shall not include any "G" order interest or customer interest that restricts the specialist's ability to be on parity pursuant to Exchange Rule 104.10(6)(i)(C).

(b) All Floor broker agency interest at the same price shall be on parity, except agency interest that established the Exchange best bid or offer shall be entitled to priority for one trade in accordance with Exchange Rule 72. No Floor broker agency interest in the file shall be entitled to precedence based on size.

(c) The Floor broker agency interest file shall become part of the quotation when it is at or becomes the Exchange best bid or offer and shall be executed in accordance with Exchange Rule 72. Such interest will be displayed in its entirety if less than 1,000 shares, and if greater than 1,000 shares, will be displayed for 1,000 shares or a greater amount chosen by the Floor broker. That portion of the interest displayed at the best bid or offer shall be on parity with other displayed interest at such best bid or offer. That portion not displayed will yield to all other

interest on the book, in the Crowd or of the specialist eligible to trade at the published bid or offer.

Once an execution has taken place against the interest represented by a Floor broker in the agency interest file, if the remaining displayed interest represented by that Floor broker is for less than 1,000 shares and the Floor broker represents additional interest in the Floor broker's agency interest file, such additional interest will be automatically displayed in its entirety if less than 1,000 shares or for 1,000 shares or a greater amount chosen by the Floor broker.

Any unfilled portion of an incoming order that was executed automatically at the displayed bid or offer shall be executed against any undisplayed contra side interest residing in the broker agency interest file at the same price in a transaction directly following the automatic execution.

(d) A Floor broker's agency interest not at the Exchange best bid or offer shall be on parity with orders on the book, the Crowd and the specialist layered interest file if executed as part of a sweep in accordance with, and to the extent provided by, Exchange Rules 1000-1004.

(e) A Floor broker may have an agency interest file in only one Crowd, as determined by the Exchange, at any given time. A Floor broker may trade on behalf of his or her orders as part of the Crowd at the same price and on the same side of the market as his or her agency interest file only to the extent that the volume traded verbally in the Crowd is not included in the agency interest file.

(f) A Floor broker's agency interest file must be cancelled when he or she leaves the Crowd. Failure to do so is a violation of Exchange rules. If the Floor broker leaves the Crowd without canceling his or her agency interest file and one or more executions occur with the agency interest, the Floor broker shall be held to such executions.

(g) A Floor broker has discretion to exclude his or her agency interest from the aggregated agency file interest information available to the specialist.

(h) Broker agency interest excluded from the aggregated interest information available to the specialist is able to participate in automatic executions, but will not participate in a manual execution unless the broker representing this interest verbally trades on its behalf as part of the Crowd and may trade at a price that is inferior to the price of such transaction.

(i) Nothing in this rule shall be interpreted as modifying or relieving the Floor broker from his or her agency obligations and required compliance with all Exchange rules, policies and procedures.

**.30 Definition of Crowd** A Floor broker will be considered to be in a Crowd if he or she is present at any one of five contiguous panels at any one post where securities are traded.

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## **Miscellaneous Requirements on Stock and Bond Market Procedures**

### **Rule 79A**

#### **Supplementary Material:**

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**.10 Request to make better bid or offer.**-When any Floor broker does not bid or offer at the limit of an order which is better than the currently quoted price in the security and is requested by his principal to bid or offer at such limit, he shall do so.

**.15** With respect to limit orders received by specialists, each specialist shall publish immediately (i.e., as soon as practicable, which under normal

market conditions means no later than 30 seconds from time of receipt) a bid or offer that reflects;

(i) the price and full size of each customer limit order that is at a price that would improve the specialist's bid or offer in such security; and

(ii) the full size of each limit order that

(A) is priced equal to the specialist's bid or offer for such security;

(B) is priced equal to the national best bid or offer; and

(C) represents more than a de minimis change (i.e., more than 10 percent) in relation to the size associated with the Exchange's bid or offer.

[Each specialist shall keep active at all times the quotation processing facilities (known as "Quote Assist") provided by the Exchange. A specialist may deactivate the quotation processing facilities as to a stock or a group of stocks provided that Floor Official approval is obtained. Such approval to deactivate Quote Assist must be obtained no later than three minutes from the time of deactivation.]

Limit orders received by the specialist that improve the Exchange then-current bid or offer or change the size of the Exchange bid or offer, other than de minimis increases or decreases, shall be autoquoted in accordance with Exchange Rule 60(e). The Exchange shall activate the autoquote facility in each specialty stock by initiating a liquidity quote. Each specialist shall keep

active at all times the autoquote facility provided by the Exchange, except that a specialist may cause the deactivation of the autoquote facility by gapping the quote in accordance with the policies and procedures of the Exchange.  
Autoquoting will also be automatically suspended when a liquidity replenishment point, as defined in Exchange Rule 1000(a)(v), is reached.

The requirements with respect to specialists' display of limit orders shall not apply to any customer limit order that is[;]:

(1) executed upon receipt of the order;

(2) placed by a customer who expressly requests, either at the time the order is placed or prior thereto pursuant to an individually negotiated agreement with respect to such customer's orders, that the order not be displayed;

(3) an odd-lot order;

(4) delivered immediately upon receipt to an exchange or association-sponsored system or an electronic communications network that complies with the requirements of Securities and Exchange Commission Rule 11Ac1-1 (c) (5) (ii) under the Securities Exchange Act with respect to that order;

(5) delivered immediately upon receipt to another exchange member or over-the-counter market maker that complies with the requirements of Securities and Exchange Commission Rule 11Ac1-4 under the Securities Exchange Act with respect to that order;

(6) an "all or none" order;

(7) a limit order to buy at a price significantly above the current offer or a limit order to sell at a price significantly below the current bid that is handled in compliance with Exchange procedures regarding such orders, ("too marketable limit orders"); or

(8) an order that is handled in compliance with Exchange procedures regarding gap quoting or block crosses at significant premiums or discounts from the last sale.

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(Remainder of rule unchanged)

### **Dealings by Specialists**

#### **Rule 104**

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(b) Specialists shall have the ability to establish an external quote application interface ('Quote API') which utilizes proprietary algorithms that allow the specialist, on behalf of the dealer account, to systematically update the Exchange published bid or offer within the Display Book system in Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual), or Trust Issued Receipts (as defined in Rule 1200). [Nothing in this rule shall be interpreted as modifying or relieving the specialist from his or her obligations and required compliance with all Exchange rules, policies and procedures.]

(c) Except as otherwise provided in paragraph (b) above, specialists shall have the ability to establish an external quote application interface ('Quote API') which utilizes proprietary algorithms that allow the specialist, on behalf of the dealer account, to systemically:

- (i) when not reacting to an order entering the Display Book<sup>®</sup>, establish the best bid or offer on the Exchange ;
- (ii) when not reacting to an order entering the Display Book<sup>®</sup>, withdraw the specialist interest at the best bid or offer on the Exchange;
- (iii) supplement the size of the existing Exchange published best bid or offer;
- (iv) provide price improvement to automatic executions subject to the conditions outlined below;
- (v) match bids and offers published by other market centers;
- (vi) facilitate a single-price execution at the Exchange published best bid or offer, provided the specialist purchases or sells all of the remaining volume on the order being facilitated; or
- (vii) place within the Display Book<sup>®</sup> system a specialist interest file at varying prices outside the published Exchange quotation.

The specialist Quote API may permit the specialist dealer account to systemically participate in a transaction to provide price improvement as provided in (iv) only when:

(A) the quotation spread is .03 or greater;

(B) the specialist's interest at the Exchange published bid or offer in that security is the lesser of 10,000 shares or twenty percent of the size of the market on the side which the transaction will take place;

(C) the size of the order to be executed is 2,000 shares or less;

(D) the specialist satisfies the entire order; and

(E) the price improvement to be supplied by the specialist's

participation is at least .02 where the quotation spread at the time of the transaction is .03 to .05, is at least .03 where the quotation spread at the time of the transaction is .06 to .10, is at least .04 where the quotation spread at the time of the transaction is .11 to .20, and is at least .05 where the quotation spread at the time of the transaction is greater than .20.

(d) Quote API pursuant to paragraphs (b) and (c) above:

(i) must not enable the specialist to trade at the best bid or offer except as permitted in (c)(vi) above;

(ii) must be designed and must operate in such a manner that its functionality is based on the consideration of only the order most recently accessed by or available to the Quote API at the time the Quote API is generating a message;

(iii) must identify the order it is reacting to in a manner prescribed by the Exchange;

(iv) must not be operative during the time a block size trade as defined in Rule 127 involving orders on the book is being reported pursuant to manual procedures or at any time that autoquoting or automatic executions are not available on the Exchange; and

(v) must be able to participate in a trade in a manner that complies with all Exchange rules, policies and procedures with respect to the specialist's ability to establish, increase or liquidate a position.

The identification of a particular order that the Quote API is reacting to when it sends a message will not guarantee that the specialist will trade with that order or that the specialist will have priority in trading with that order. Specialist interest established by the Quote API that does not trade with a particular order it identifies will be automatically cancelled by the Exchange.

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(Remainder of rule unchanged)

### **Disclosure of Specialists' Orders**

#### **Rule 115**

A member acting as a specialist may disclose any information in regard to the order entrusted to the specialist:

- (i) for the purpose of demonstrating the methods of trading to visitors to the Floor;
- (ii) to other market centers in order to facilitate the operation of ITS or any other

Application of the System; and

(iii) while acting in a market making capacity, to provide information about buying or selling interest in the market, including aggregated buying or selling interest contained in any broker agency interest file other than interest the broker has chosen to exclude from the aggregate buying and selling interest in response to an inquiry from a member conducting a market probe in the normal course of business. Information regarding stop orders may be provided if the specialist has a reasonable basis to believe that the member intends to trade the security at a price at which stop orders would be relevant. A specialist shall make information available in a fair and impartial manner to any member while on the Floor. A specialist shall not disclose the identity of any buyer

or seller represented on his book if expressly requested not to do so by the broker who entered the order with the specialist.

\* \* \* \* \*

(Remainder of rule unchanged)

### **Orders of Members To Be in Writing**

#### **Rule 117**

No member on the Floor shall make any bid, offer or transaction for or on behalf of another member except pursuant to a written or electronically recorded order. If a member to whom an order has been entrusted leaves the Crowd without actually transferring the order to another member, the order shall not be represented in the market during his or her absence, except with respect to any portion of his or her agency interest file that was not cancelled before the member left the Crowd, notwithstanding that such failure to cancel an agency interest file is a violation of Exchange rules.

#### **Supplementary Material:**

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**.10 Absence from Crowd.**-When a member keeps an order in his or her possession and leaves the Crowd in which dealings in the security are conducted, the member is not entitled during his or her absence to have any bid, offer or transaction made in such security on his or her behalf or to have dealings in the security held up until he or she is summoned to the Crowd, except that the member shall be held to any executions involving his or her agency interest file. To insure representation of an order in the market during his or her absence, a member must therefore actually turn the order over to

another member who will undertake to remain in the Crowd. If a member keeps the order in his or her possession and during his or her absence from the Crowd the security sells at or through the limit of his or her order, the member will be deemed to have missed the market.

\* \* \* \* \*

(Remainder of rule unchanged)

### **Record of Orders**

#### **Rule 123**

\* \* \* \* \*

#### **(e) System Entry Required**

Except as provided in paragraph .21 and .22 below, no Floor member may represent or execute an order on the Floor of the Exchange or place an agency interest file within the Display Book<sup>®</sup> system unless the details of the order and the agency interest file have been first recorded in an electronic system on the Floor. Any member organization proprietary system used to record the details of the order and agency interest file must be capable of transmitting these details to a designated Exchange data base within such time frame as the Exchange may prescribe.

The details of each order required to be recorded shall include the following data elements, any changes in the terms of the order and cancellations, in such form as the Exchange may from time to time prescribe:

1. Symbol;
2. Clearing member organization;
3. Order identifier that uniquely identifies the order;
4. Identification of member or member organization recording order details;

5. Number of shares or quantity of security;
6. Side of market;
7. Designation as market, limit, stop, stop limit[;], auction limit;
8. Any limit price and/or stop price;
9. Time in force;
10. Designation as held or not held;
11. Any special conditions;
12. System-generated time of recording order details, modification of terms of order or cancellation of order;
13. Such other information as the Exchange may from time to time require.

The Floor member must identify which orders or portions thereof are being made part of the agency interest file pursuant to such procedures as required by the Exchange.

\* \* \* \* \*

**(Remainder of rule unchanged)**

### **Miscellaneous Requirements**

#### **Rule 123A**

\* \* \* \* \*

**.30 A specialist may accept one or more percentage orders. –**

\* \* \* \* \*

(a) The elected or converted portion of a ‘percentage order that is convertible on a destabilizing tick and designated immediate execution or cancel election’ (‘CAP-DI order’) may be automatically executed and may participate in a sweep.

(i) An elected or converted CAP-DI order on the same side of the market as an automatically executed electing order may participate in a transaction at the bid (offer) price if there is volume associated with the bid (offer) remaining after the electing order is filled in its entirety. An elected or converted CAP-DI order on the same side of the market as an automatically executed electing order that sweeps the book will participate in a transaction at the sweep clean up price if there is volume remaining on the book or from contra-side elected CAP-DI orders at that price.

(ii) An elected or converted CAP-DI order on the contra-side of the market as an automatically executed electing order may participate in a transaction at the bid (offer) price and the sweep clean up price, if any.

\* \* \* \* \*

(Remainder of rule unchanged)

### **Order Handling – Auction Limit Orders and Market Orders**

#### **Rule 123F**

##### (a) Auction Limit Orders

(1) An auction limit order will be automatically executed or routed pursuant to Rule 15A.50 upon entry if there is a minimum variation quotation on the Exchange at the time the order reaches the book or the national best bid (offer) is displayed by another ITS participating market center and such bid (offer) creates a minimum variation market compared with the Exchange best offer (bid).

(2) If not executed upon entry, an auction limit order to buy with a limit price that is at or above the Exchange best offer when it reaches the book shall be autoquoted the minimum variation better than the Exchange best bid at the time and an auction limit order to sell with a limit price that is at or below the Exchange best bid when it reaches the book shall be autoquoted the minimum variation better than the Exchange best offer at that time, thereby becoming the new Exchange best bid or offer.

The size associated with a subsequent auction limit order to buy with a limit price that is at or above the Exchange best offer when it reaches the book will be added to the bid. The size associated with a subsequent auction limit order to sell with a limit price that is at or below the Exchange best bid when it reaches the book will be added to the offer.

(3) The arrival of a subsequent order on the same side of the market capable of trading at a price better than the auction limit order is bidding (offering), the execution of an order on the same side, of the market as an auction limit order that exhausts some or all of the contra-side volume available in the Exchange quotation, the cancellation of some or all of the contra-side volume, or a change in the price of the contra-side of the quotation that would enable an execution of the auction limit order with price improvement shall cause the auction limit order to be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004.

(4) An auction limit order that has not been executed within 15 seconds after it reaches the book shall be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004.

(5) An auction limit order may be executed at a price inferior to the market price prevailing at the time it was entered.

(6) An auction buy limit order with a limit price that is not at or above the Exchange best offer when it reaches the book or an auction limit order to sell with a limit price that is not at or below the Exchange best bid when it reaches the book shall be displayed on the book at its limit price. An auction limit order that is unable to automatically execute because of its limit price shall be handled as a regular limit order.

(b) Market Orders

(1) A market order designated for automatic execution will be automatically executed in accordance with and to the extent provided by Exchange Rules 1000-1004.

(2) A market order not designated for automatic execution but delivered systemically to the Display Book<sup>®</sup> will be automatically executed or routed pursuant to Rule 15A.50 upon entry if there is a minimum variation quotation on the Exchange at the time the order reaches the Display Book<sup>®</sup> or the national best bid (offer) is displayed by another ITS participating market center and such bid (offer) creates a minimum variation market compared with the Exchange best offer (bid).

(3) If not executed upon entry, such market order to buy shall be autoquoted the minimum variation better than the Exchange best bid and such market order to sell shall be quoted the minimum variation better than the Exchange best offer at that time, thereby becoming the new Exchange best bid or offer.

(4) The arrival of a subsequent order on the same side of the market capable of trading at a better price than such market order is bidding (offering), the execution of an order on the same side of the market as such market order, that exhausts some or all of the contra-side volume available in the Exchange quotation, the cancellation of some or all of the contra-side volume, or a change in the price of the contra-side of the quotation that would enable an execution of such

market order with price improvement shall cause such market order to be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004.

(5) A market order that has not been executed within 15 seconds shall be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004.

(6) A market order may be executed at a price inferior to the market price prevailing at the time it was entered.

\* \* \* \* \*

### **Odd-Lot Orders**

#### **Rule 124**

\* \* \* \* \*

#### **Supplementary Material:**

\* \* \* \* \*

**.50** [The odd-lot portion of PRL (part of round lot) orders will be executed at the same price as the round lot portion and will be processed through the round lot system.] The round lot portion of a part of round lot (PRL) order will be automatically executed in accordance with, and to the extent provided by, Exchange Rules 1000-1004. The odd lot portion will be executed with the specialist as contra party.

\* \* \* \* \*

(Remainder of rule unchanged)

**NYSE Direct+<sup>®</sup>**

**Automatic Execution of Limit Orders Against Orders Reflected in NYSE Published**

**Quotation**

## Rule 1000

(a) [Only straight limit orders without tick restrictions are eligible for entry as auto ex orders. Auto ex orders to buy shall be priced at or above the price of the published NYSE offer. Auto ex orders to sell shall be priced at or below the price of the NYSE bid.] An auto ex order shall receive an immediate, automatic execution against orders reflected in the Exchange[s] published quotation, orders on the book, Floor broker agency interest file and specialist interest file, in accordance with, and to the extent provided by, Exchange Rules 1000–1004 and shall be immediately reported as [NYSE] Exchange transactions, unless:

(i) the [NYSE's] Exchange published quotation is in the non-firm quote mode;

[(ii) the execution price would be more than five cents away from the last reported transaction price in the subject security on the Exchange];

[(iii)] (ii) with respect to a single-sided auto ex order, a better [price exists] bid or offer is published in another ITS participating market center where an automatic execution is immediately available or where such better bid or offer is otherwise protected from a trade-through by Securities and Exchange Commission rule or ITS Plan and such better bid or offer has not been systemically matched on the Exchange, unless the member entering the order indicates in such manner as required by the Exchange that it is contemporaneously satisfying such better bid or offer;

[(iv) with respect to a single-sided auto ex order, the NYSE's published bid or offer is 100 shares;]

[(v) a transaction outside the NYSE's published bid or offer pursuant to Rule 127 is in the process of being completed, in which case the specialist should publish a bid and/or offer that is

more than five cents away from the last reported transaction price in the subject security on the Exchange];

[(v)] (iii) trading in the subject security has been halted;

[(vi)] (iv) the specialist has gapped the quotation in accordance with the policies and procedures of the Exchange;

(v) a liquidity replenishment point has been reached. A liquidity replenishment point ('LRP') is reached when:

(A) the price of an automatic execution would be above (below) a minimum of five cents from the Exchange bid (offer), rounded to the nearest five-cent increment, or

(B) an automatic execution reaches a momentum liquidity replenishment point ('MLRP') or an automatic execution would result in a transaction at a price on that side of the market outside a MLRP range. A MLRP range is calculated based on high and low transaction prices on the Exchange in a security within the prior 30 seconds. A MLRP is reached when the execution price of a security has moved the greater of twenty-five cents or 1% of its price (rounded to the nearest cent) on the Exchange within 30 seconds or less;

(vi) a block size transaction as defined in Rule 127 that involves orders on the book is being reported manually; or

(vii) the order is for a security whose price on the Exchange is more than \$300.00.

(b)(i) Auto ex orders to buy shall trade with the Exchange published best offer. Auto ex orders to sell shall trade with the Exchange published best bid.

(ii) Where the volume associated with the Exchange published best bid (offer) is insufficient to fill an auto ex order in its entirety, other than an incoming commitment to trade

received through ITS, the unfilled balance of such order (the ‘residual’) shall ‘sweep’ the book i.e., trade with orders on the book and any broker agency interest file and/or specialist interest file capable of execution in accordance with Exchange rules until it is executed in full, its limit price if any is reached, or a liquidity replenishment point is reached, whichever occurs first. After trading with the Exchange published best bid (offer), the unfilled balance of any incoming commitment to trade received through ITS shall be automatically cancelled.

(iii) The residual shall trade with the orders on the book and any broker agency interest file and/or specialist interest file capable of execution in accordance with Exchange rules at a single price, such price being the best price at which such orders and files can trade with the residual to the extent possible, or a liquidity replenishment point, whichever comes first (‘clean up price’). Orders on the book and Floor broker agency interest trading with the residual shall be on parity and receive the clean up price. If no orders remain on the book capable of trading at the clean up price, specialist interest may trade and will be on parity to the extent permitted by Exchange rules with broker agency interest at that price if any. Any specialist interest that remains after the residual has traded at the clean up price will be immediately cancelled automatically by the Exchange. Where a bid or offer published by another ITS participating market center where an automatic execution is immediately available is better than the sweep clean up price or where such better bid or offer is otherwise protected from a trade-through by Securities and Exchange Commission rule or ITS Plan, the portion of the sweeping residual that satisfies the size of such better priced bid or offer will be automatically routed as a commitment to trade to the ITS participating market center publishing such better bid or offer.

(iv) Any auto ex order residual remaining after the sweep described in (ii) above shall be bid (offered) at the order’s limit price, if any, or the LRP whichever is lower (higher), unless the

order is designated immediate or cancel, in which case the residual shall be automatically cancelled.

[Auto ex orders that cannot be immediately executed shall be displayed as limit orders in the auction market. An auto ex order equal to or greater than the size of the NYSE's published bid or offer shall trade against the entire published bid or offer, and a new bid or offer shall be published pursuant to Rule 60(e). The unfilled balance of the auto ex order shall be displayed as a limit order in the auction market.]

[During a pilot program in 2003, NYSE Direct+ shall not be available in the following five stocks: American Express (AXP), Pfizer (PFE), International Business Machines (IBM), Goldman Sachs (GS), and Citigroup (C). The Exchange will announce in advance to its membership the time the pilot will run.]

\* \* \* \* \*

### **Execution of Auto Ex Orders**

#### **Rule 1001**

(a) Subject to Rule 1000, auto ex orders shall be executed automatically and immediately reported. The contra side of the execution shall be [orders reflected in the Exchange's published quotation], as follows:

- (i) the first contra side bid or offer at a particular price shall be entitled to time priority, but after a trade clears the Floor, all bids and offers at such price shall be on parity with each other;
- (ii) all bids or offers on parity shall receive a split of executions in accordance with Exchange Rule 72;

(iii) the [specialist shall be responsible for assigning] assignment of the number of shares to each contra side bidder and offeror as appropriate, in accordance with Exchange Rule 72, with respect to each automatic execution of an auto ex order shall be done systemically;

(iv) the specialist shall be the contra party to any automatic execution of an auto ex order where interest reflected in the published quotation against which the auto ex order was executed is no longer available, except with respect to transactions occurring with the broker agency interest file;

[(v) a universal contra shall be reported as the contra to each automatic execution of an auto ex order.]

[(b) If the depth of the published bid or offer is not sufficient to fill an auto ex order in its entirety, the unfilled balance of the order shall be routed to the Floor and shall be displayed in the auction market.]

[(c)] (b) No published bid or offer shall be entitled to claim precedence based on size with respect to executions against auto ex orders.

\* \* \* \* \*

### **Availability of Automatic Execution Feature**

#### **Rule 1002**

[Orders designated as "a] Auto ex["] orders in a particular stock, Investment Company Unit (as defined in paragraph 703.16 of the Listed Company Manual), or Trust Issued Receipt (as defined in Rule 1200) shall be eligible to receive an automatic execution if entered after the Exchange has disseminated a published bid or offer, until 3:59 p.m. for stocks and Trust Issued Receipts, or 4:14 p.m. for Investment Company Units, or within one minute of any other closing time of the Exchange's floor market. [Orders designated as "a] Auto ex["] orders in a particular stock, Trust

Issued Receipt, or Investment Company Unit that are entered prior to the dissemination of a bid or offer, or after 3:59 p.m. for stocks and Trust Issued Receipts, after 4:14 p.m. for Investment Company Units, or within one minute of any other closing time, shall be [displayed as limit orders] displayed as market or limit orders as applicable [in the auction market] unless it is an incoming commitment to trade received through ITS or an auto ex order designated as immediate or cancel, in which case such order would be cancelled .

\* \* \* \* \*

### **Application of Tick Tests**

#### **Rule 1003**

If a transaction has been agreed upon in the auction market, and an automatic execution involving auto ex orders is reported at a different price before the auction market transaction is reported, any tick test applicable to such auction market transaction shall be based on the last reported trade on the Exchange prior to such execution of auto ex orders.

\* \* \* \* \*

### **Election of Stop Orders and Percentage Orders**

#### **Rule 1004**

Automatic executions of auto ex orders shall elect stop orders, stop limit orders and percentage orders electable at the price of such executions. Any stop orders so elected shall be automatically executed pursuant to [the] Exchange[s auction market procedures] rules, and shall not be guaranteed an execution at the same price as subsequent automatic executions of auto ex orders.

\* \* \* \* \*

**[Orders May Not Be Broken Into Smaller Amounts]**

**[Rule 1005**

An auto ex order for any account in which the same person is directly or indirectly interested may only be entered at intervals of no less than 30 seconds between entry of each such order in a stock, Investment Company Unit (as defined in paragraph 703.16 of the Listed Company Manual), or Trust Issued Receipt (as defined in Rule 1200), unless the orders are entered by means of separate order entry terminals, and the member or member organization responsible for entry of the orders to the Floor has procedures in place to monitor compliance with the separate terminal requirement.]

\* \* \* \* \*

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. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

In the Notice, the Exchange proposed enhancements to the operation of Direct+, the Exchange's electronic execution facility, and to other Exchange rules. The Exchange believes that, taken together with Amendment Nos. 2 and 3, the proposal would create a unique, integrated market—a hybrid market—that would improve on the speed and efficiency of technology by preserving the advantages of human knowledge and expertise that are central to

the agency-auction process. The Exchange believes that by increasing the array of available trading choices, the hybrid market would benefit all customers, from the smallest investors to the largest institutions.

The Exchange believes that the proposed enhancements to Direct+ would offer immediate execution at the best bid and offer without restrictions on order size or order frequency, as well as anonymity and speed to the extent of the displayed volume associated with the bid and offer. Under the proposal, any residual would sweep existing orders on the Display Book<sup>®</sup> ("book") until either the order is filled, its limit price (if any) is reached, or a liquidity replenishment point ("LRP") is reached.

The Exchange describes LRPs as pre-determined price points at which electronic trading would briefly convert to auction market trading. LRPs could be triggered by an electronic sweep or if electronic trading results in rapid price movement over a short period. Because the LRP would convert the market solely to an auction market on a temporary basis, it would moderate volatility by permitting new orders, as well as Crowd and specialist interest, to add liquidity. The Exchange believes that this would promote reasonable continuity and foster the market quality that is a hallmark of the Exchange.

The Exchange believes that the hybrid market proposal would preserve the best aspects of the agency-auction market. For example, customers who want the opportunity for price improvement provided by the auction process would still be able to access the full extent of the book and liquidity represented by brokers on the Floor. The interaction of specialists and brokers in the Crowd would create a value proposition by offering opportunities for price improvement that are central to the auction market process. For instance, by committing capital and adding depth to the market in response to customer demands, specialists would continue to

stabilize prices and reduce volatility. Their ability and commitment to inject liquidity into the market, in order to bridge temporary gaps in supply and demand, would keep the market fair and orderly, which is in the interest of all customers. Floor brokers would also continue to play a critical role in the price discovery process. Competition between orders represented by Floor brokers in the Crowd would help ensure fair, orderly, and liquid markets. Interaction between Floor brokers and specialists would provide a flow of information regarding changing market conditions and would serve as a catalyst to trading.

In short, the Exchange believes that the hybrid market would combine the benefits of specialist and Floor broker expertise with the speed and certainty of electronic execution to create a system offering maximum choice to customers without eliminating time-tested trading procedures that have proven immensely successful in providing stable, liquid, and less volatile markets.

The manner in which the Exchange's hybrid market would operate has been described in the Notice. Amendment Nos. 2 and 3 supplement the description of certain aspects of the hybrid market and makes further amendments to the Exchange's rules.

Specifically, the Exchange discusses the following aspects of the hybrid market:

- Execution of auction limit orders and market orders;
- Tick-restricted orders, stop orders, and other orders eligible for automatic execution;
- The broker agency interest file;
- Definition of the Crowd;
- The specialist interest file and algorithm;
- Sweeps and LRP;

- Gap quoting; and
- Availability of automatic executions and autoquote.

### Auction Limit Orders and Market Orders

According to the Exchange, proposed Auction Limit (“AL”) orders and market orders not designated for automatic execution would provide an opportunity for price improvement, thereby preserving a very important choice for customers. The objective would be for specialists to represent these orders in the auction market, where the Crowd could offer an opportunity for execution at a price better than the Exchange bid or offer, while retaining as a backup the electronic functionality of automatic execution in case the specialist is unable to interact with the order immediately. Price improvement could also result from the order’s participation in an automatic execution. AL and market orders could provide price improvement to the contra-side of an execution.

Under the proposal, AL and market orders would be electronically executed when they arrive at the book if the Exchange quotation is the minimum variation (e.g., 20.45 bid, offered at 20.46). Where the national best bid (offer) is published by another market center,<sup>10</sup> and it causes a minimum variation market when compared with the Exchange best offer (bid), an AL or market order (or the requisite portion thereof) would be automatically routed to such other market center for execution unless the specialist matches the price of the better away offer (bid) (e.g., Assume that an AL or market order to buy arrives, and the Exchange quotation is 20.45 bid, offered at 20.50, and a 20.46 offer is published by another market center. The AL or market

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<sup>10</sup> The other market center must be an Intermarket Trading System (“ITS”) participant in which an automatic execution is immediately available or such bid (offer) is otherwise protected from a trade-through by a Commission rule or ITS Plan. For the purpose of Amendment Nos. 2 and 3, any discussion of another market center or an away market refers only to those fitting this description.

order would be electronically routed to such other market center unless the specialist matches the away offer of 20.46).

Under the Exchange's proposal, if not automatically executed or routed away upon entry, AL and market orders to buy would be autoquoted the minimum variation above the Exchange best bid, and those to sell would be autoquoted the minimum variation below the Exchange best offer, thereby becoming the Exchange best bid or offer (e.g., If the quote is 20.45 bid, offered at 20.50, and a market order to buy or an AL buy order with a limit of 20.51 arrives, then the new quote would be 20.46 bid, offered at 20.50. Similarly, if the quote is 20.45 bid, offered at 20.50 and a market order to sell or an AL sell order with a limit of 20.45 arrives, the new quote would be 20.45 bid, offered at 20.49).

Under the proposal, the fact that the bid (offer) is on behalf of an AL or market order would not be shown on NYSE OpenBook. An AL or market order would be shown in the quote at the price it is bidding (offering). An AL order's limit price would be available to the specialist, who would require such information in order to properly represent the order.

Furthermore, the size associated with the bid or offer would be the size of the AL or market order. The size of subsequent AL and market orders on the same side of the market would be aggregated in the bid (offer) and executed based on time priority, consistent with AL orders' limit prices.<sup>11</sup>

Although an AL or market order would risk missing the market in its attempt to obtain price improvement, the Exchange believes that electronic representation would limit that possibility. Once on the book, an AL or market order could participate in any execution, including automatic executions and sweeps (e.g., Assume that the quote is 20.46 bid, offered at

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<sup>11</sup> See Exhibit A.

20.50, 2,500 x 2,000, and the bid is an AL order. If a market order designated for automatic execution (an “NX” market order) to sell 2,500 shares arrives, that order would automatically execute against the AL order’s bid at 20.46).<sup>12</sup>

If an AL or market order has not been executed within 15 seconds of being quoted, the order would automatically execute like any other auto ex order (e.g., Buy orders would execute against the displayed offer, and sell orders would execute against the displayed bid), provided autoquote and automatic executions are available. In addition, three events would cause automatic execution of an AL or market order before 15 seconds has elapsed. The three events are: (i) the arrival of a subsequent order at a better price on the same side of the market as an AL or market order; (ii) the execution of an order on the same side of the market as an AL or market order that exhausts some or all of the displayed contra-side volume or the cancellation of some or all of the displayed contra-side volume; and (iii) the displayed contra-side price improves, creating a minimum variation market or allowing execution of the AL or market order with price improvement. In these situations, the order causing the AL or market order to automatically execute would trade first. Where the limit of an AL order would prevent it from automatically executing, it would be placed on the book at its limit price and handled as a regular limit order.

The Exchange proposes to renumber proposed NYSE Rules 60(h) and 60(i), describing AL and market orders, as proposed NYSE Rules 123F(a) and 123F(b). The application of (ii) above to market orders would amend proposed NYSE Rule 123F(b). Furthermore, the NYSE proposes additional amendments to proposed NYSE Rules 13 and 123F to clarify the operation of AL and market orders.

#### Tick-Restricted Orders, Stop Orders, and other Orders Eligible for Automatic Execution

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<sup>12</sup>

Id.

As proposed, tick-restricted orders on the book would be filed electronically and participate in automatic executions and sweeps as their ticks and limits, if any, allow. The direction of the sweep relative to the automatic execution would be in the correct direction: buy sweeps would cause short sales and sell plus orders to be executed above the offer, while sell sweeps would cause buy minus orders to be executed below the bid. Sell short orders, other than those involving Regulation SHO<sup>13</sup> pilot securities, would not sweep the book after automatically executing against bid, as the sweep transaction would occur on a minus tick.<sup>14</sup>

Under the proposal, stop orders, including stop limit orders (“stop orders”) on the book would be electronically elected and participate in automatic executions and sweeps by appropriately-priced electing manual or automatic execution transactions.<sup>15</sup> Stop orders would be elected by an automatic execution at the bid or offer price and would trade after the sweep, if any. The sweep price could also elect stop orders. The Exchange proposes amendments to NYSE Rules 13 and 1004 to reflect this. Stop orders elected on the contra-side of the market would trade as part of the sweep because they would add liquidity.

Furthermore, stop orders and CAP-DI orders (convert and parity percentage orders) could be elected at the same time by automatic executions and sweeps. If there is insufficient volume to fill the elected orders, stop orders could be executed first as they become market or marketable limit orders upon their election, whereas the elected portion of CAP-DI orders would revert to CAP-DI status if it is unable to trade. In addition, CAP-DI orders would trade on parity with

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<sup>13</sup> See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).

<sup>14</sup> See Exhibit A.

<sup>15</sup> Investment Company Units, as defined in paragraph 703.16 of the Exchange Listed Company Manual, and Trust Issued Receipts (together, Exchange-Traded Funds) are elected based on bids or offers, rather than transactions. See NYSE Rule 13.30.

each other,<sup>16</sup> which could also affect the sequence in which elected stop and CAP-DI orders would trade.

The Exchange proposes to amend NYSE Rule 13 to clarify the types of orders that would be eligible for automatic execution in the hybrid market.<sup>17</sup> These would include auto ex market orders, marketable limit orders, incoming ITS commitments, “all or none” (AON) orders, CAP-DI orders, stop orders, stop limit orders, tick-sensitive orders and part of round lot orders.<sup>18</sup> In addition, orders initially eligible for automatic execution that have been cancelled and replaced would remain eligible for automatic execution.

Orders that would be ineligible for automatic execution at this time include “opening only” (OPG), “fill or kill” (FOK), “limit on close” (LOC), “market on close” (MOC), “basis” (BAS), and odd lot orders. In addition, orders in high-priced securities, currently defined as securities priced above \$300, would be ineligible for automatic execution. These would include: Berkshire Hathaway Inc. (BRK.A), Berkshire Hathaway Inc. (BRK.B), Wyeth \$2 Convertible Preferred Stock (WYEPR), Markel Corporation (MKL), Pitney Bowes Inc. (PBIPR), The Washington Post Company (WPO), and White Mountains Insurance Group, Ltd. (WTM).

#### Broker Agency Interest File

The proposed rules provide Floor brokers on the Exchange with the ability to express electronically that which they are currently able to do in the Crowd—represent customer interest at varying prices at or outside the quote with respect to the orders they are handling.

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<sup>16</sup> See NYSE Rule 123A.30.

<sup>17</sup> This revises the descriptions of orders ineligible for automatic execution as stated in footnotes 22 and 45 of the Notice and the accompanying text. See note 6, supra.

<sup>18</sup> A part of round lot (“PRL”) order is an order for one or more units of trading plus an amount less than a unit of trading. NYSE Rule 55 defines a unit of trading as 100 shares unless otherwise designated. Accordingly, an example of a PRL would be an order to buy (sell) 517 shares. The specialist is the contra-side of the odd-lot portion of a PRL.

According to the Exchange, the broker agency interest file would serve the public interest by giving customers the benefit of Floor broker knowledge and trading expertise in “working” their orders, while not precluding them from participating in electronic executions and sweeps. It would give customers choice and Floor brokers flexibility in representing orders over time at the point of sale, thereby maximizing their ability to obtain the best execution possible. In this way, the hybrid market would meld the value of the agency-auction with the benefits of automatic execution.

Under the proposal, the broker agency interest would not be displayed publicly unless it is at or becomes the Exchange best bid or offer. This is consistent with the Commission’s Quote Rule.<sup>19</sup> When a broker’s agency interest is at or becomes the Exchange best bid or offer, a minimum of 1,000 shares per broker would be displayed for agency interest greater than or equal to 1,000 shares and would be included in the quote. A broker would have the discretion to display more than 1,000 shares of his or her agency interest at the best bid or offer. The actual amount of a broker’s agency interest, if less than 1,000 shares, would be displayed and included in the quote. The displayed agency interest at the best bid or offer would be entitled to parity with displayed orders at the bid or offer price, other than an order or broker interest entitled to priority in accordance with NYSE Rule 72. Broker agency interest at the best bid or offer that is not displayed (‘reserve interest’) would yield to displayed interest in the best bid or offer, but would participate in automatic executions provided there is sufficient contra-side liquidity. An auto ex order would trade against the displayed interest in the quote and any reserve at the bid or offer price before it would sweep the book. This would amend proposed NYSE rules.

After an execution, if there is less than 1,000 shares of broker agency interest displayed at

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<sup>19</sup> Rule 11Ac1-1, 17 CFR 240.11Ac1-1.

the best bid/offer, but additional amount in the reserve, the displayed amount would replenish so that at least 1,000 shares of agency interest at the best bid/offer would be displayed. For example, if there are 1,000 shares of broker agency interest displayed at the best bid/offer, and 500 shares of reserve (undisplayed at that price), and a 500 share order executes against the 1,000 share of displayed interest, the remaining 500 shares of reserve interest would be added to the 500 shares of remaining broker agency interest at the best bid/offer to total 1,000 shares displayed interest at the best bid/offer.

If what is remaining in the displayed broker agency interest and the reserve at the best bid/offer do not equal 1,000 shares, all of the reserve and remaining displayed broker agency interest at that price would be displayed. For example, if there are 1,600 shares of broker agency interest displayed at the best bid/offer, and 300 shares of reserve interest (undisplayed at that price), and a 1,500 share order executes against the 1,600 shares of displayed broker agency interest, then the remaining 100 shares of broker agency interest plus the full amount of the reserve interest (300 shares), totaling 400 shares, would be displayed at the best bid/offer.

In addition, where there is reserve interest at the best bid (offer) and an incoming contra-side auto ex order arrives to trade, there would be two separate Tape prints at the bid (offer) price, if the amount of the incoming order exceeds the displayed interest at the best bid (offer). In such case, the first print would be at the best bid (offer) price for the amount of the displayed interest. The second print, also at the best bid (offer) price, would include any contra-side CAP-DI orders<sup>20</sup> elected by the first print and reserve interest. Any residual remaining on the incoming order would then sweep the book until executed, its limit price, if any, is reached, or an

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<sup>20</sup> CAP-DI orders on the same side of the market as the incoming order could also be elected by this print, but would not trade unless additional interest remains after the incoming order is executed at the bid (offer) price.

LRP is reached. For example, there are 5,000 shares of broker agency interest at the best bid (offer) consisting of 1,000 shares of displayed interest, which is the best bid, and 4,000 shares of reserve interest. The specialist has a CAP-DI order for 10,000 shares to buy with a limit price, which allows it to trade at the best bid (offer). If an auto-ex order to sell 5,000 shares arrives, it would be automatically executed as follows: 1,000 shares at the best bid prints first. This automatically elects 1,000 shares of the CAP-DI order and then 4,000 shares print at the best bid price. The 4,000 shares consist of 1,000 shares elected from the buy CAP-DI order and 3,000 shares of the reserve interest. The incoming order would have traded a total of 5,000 shares at the bid price. 1,000 shares would remain in the reserve interest.

Furthermore, displayed agency interest in the broker file that establishes the Exchange best bid or offer would be entitled to priority at that price for one trade, as is the case with any other bid or offer. Broker agency interest that is outside the quote would participate on parity during sweeps, providing liquidity to the market.

Floor broker agency interest at the same price would be on parity with each other unless the interest was entitled to priority under NYSE Rule 72, and no interest would be able to invoke precedence based on size.

In addition, Floor brokers with an agency interest file would be required to be in the Crowd, representing those orders. The agency interest file would allow Floor brokers to represent their customers as they do in the auction market, negotiating execution prices without being required to disclose their intentions. The Exchange believes that parity is the agency-auction principle designed as an incentive for Crowd participation in the price discovery process, to deepen liquidity particularly as it relates to the working of orders with potential market impact. It has the very positive effect of lowering execution costs for customers by providing the

opportunity to leverage human judgment for price improvement, potentially on both sides of a trade, lowering market volatility.

The broker agency interest file would not be publicly disseminated except for the amount of agency interest displayed at the best bid or offer. The only information concerning the broker agency interest file available to the specialist would be the aggregate amount of agency interest at each price. This aggregate information, which would include any reserve interest at the Exchange best bid or offer unless excluded from the aggregate as described below, could be included in a specialist's response to a member's market probe in accordance with NYSE Rule 115, as amended.

Proposed NYSE Rule 70.20 is amended to provide a Floor broker with the discretion to remove his or her agency interest, including any reserve interest at the best bid (offer), from the aggregate information available to the specialist. Broker agency interest removed from the aggregate would be displayed as described above when it becomes, or is at, the Exchange best bid or offer. If a better bid or offer is made on the Exchange, such interest would no longer be displayed and would not be included in the aggregate information unless the Floor broker chooses otherwise. Broker agency interest removed from the aggregate information would participate in automatic executions and sweeps. It would be the responsibility of the broker representing interest not included in the aggregate information to ensure that such interest is properly represented with respect to any manual trade that may occur because the specialist would not have any knowledge of such interest.

Furthermore, the broker agency file could not include G order<sup>21</sup> interest or customer interest that prevents the specialist from trading on parity with the Crowd pursuant to NYSE

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<sup>21</sup> 'G'orders refer to proprietary orders represented pursuant to Section 11(a)(1)(G) of the Act, 15 U.S.C. 78k(a)(1)(G).

Rule 104.10(6)(i)(C).

Proposed NYSE Rule 70.20 has been amended to reflect the matters noted above.

#### Definition of the Crowd

Floor brokers would be permitted to have agency interest files in only one Crowd at a time. The Exchange proposes an amendment to proposed NYSE Rule 70.30 to add that a Crowd would consist of five contiguous panels at a single post where securities are traded.

#### Specialist Interest File and Algorithms

The Exchange believes that specialists provide value to the market, committing capital to add liquidity and stabilize prices. Specialists' ability and commitment to absorb short-term fluctuations by bridging temporary gaps in supply and demand keeps the Exchange market fair and orderly and lowers volatility.

To assist specialists in this effort and to enable them to more readily comply with their market-making responsibilities, the Exchange proposes to provide specialists with the ability to implement an external quote application interface (Quote API) which would utilize proprietary algorithms based on predetermined parameters that would enable them to electronically represent their dealer account, replicating electronically some of the things specialists are permitted to do manually. This would allow specialists to provide value and liquidity within the context of an electronic market.

Based on predetermined parameters, the algorithms could only: (i) generate a bid (offer) that would improve the Exchange best bid (offer) price; (ii) withdraw a previously made best bid (offer), provided the algorithmic decision to improve or withdraw a bid or offer is not based on a particular order entering the book; (iii) supplement the size of an existing best bid (offer); (iv) match better bids (offers) published by other market centers; (v) facilitate a single-priced

execution at the Exchange best bid or offer, provided the entire order is filled; (vi) layer specialist interest at prices outside the quote, enabling the specialist, to the extent permitted by Exchange rules, to participate in or price improve a sweep; and (vii) provide meaningful price improvement to orders, as described below.

The algorithms would not be able to hit bids or take offers. All specialist trading whether manual or electronically generated by algorithms would have to be in accordance with Exchange Rules. Items (i) - (vii) above reflect proposed amendments to NYSE Rule 104.

The algorithms would enable the specialists on behalf of the dealer account to electronically provide price improvement to automatic executions, provided the following conditions are met: (i) the quotation spread is at least three cents; (ii) the specialist is represented in the published bid or offer in a meaningful amount: the lesser of 10,000 shares or 20% of the respective bid (offer) size; (iii) the order receiving price improvement is of 'retail' order size, i.e., 2,000 shares or less and the specialist fills the order; and (iv) the price improvement provided by the specialist is (a) at least .02 where the quote spread is .03 - .05, (b) at least .03 where the quote spread is .06 - .10, (c) at least .04 where the quote spread is .11 - .20, and (d) at least .05 where the quote spread is more than .20.

After a sweep, existing specialist interest below the sweep price, in the case of a buy sweep, or above the sweep price, in the case of a sell sweep, that was not included in the sweep due to yielding requirements, would be immediately cancelled so that this interest would not be autoquoted as the Exchange best bid or offer. The algorithms could send a separate message in order to bid or offer at a price inferior to the sweep price, provided Exchange rules governing specialist trading permit bidding or offering at that price.

Furthermore, the algorithms could be designed to have access to public information as

well as orders entering the system. As noted above, an algorithmic message improving the Exchange best bid (offer) or withdrawing a previously established best bid (offer) could not be based on an incoming order. Such new bid (offer) could be the minimum variation or more than the previous best bid (offer). An algorithmic message to provide price improvement to an automatic execution generated in reaction to an incoming order would have to comply with the conditions noted above, including price improvement of more than the minimum variation. Electronic messages could not be generated by algorithms while a manual block-size trade is being reported or when autoquote and automatic executions are unavailable. Specialists' use of algorithms would be subject to review by the Exchange's regulatory division.

The algorithms could also generate messages only in reaction to one order at a time and only as that order is entering the system. Algorithms would be required to identify, in the manner required by the Exchange, the specific order to which they are reacting. The fact that algorithms would have generated a message in response to a particular order would not guarantee that the specialist interest would be able to interact with that order, nor would it give the specialist interest priority in trading with that order. Specialist interest that does not trade with the order identified by the algorithms, for example, because the specialist order did not arrive at the book in time, or the specialist has to yield to the book, would be automatically cancelled.

The Exchange believes that the algorithms and specialist interest file would enhance market quality by enabling the specialist to interact with orders electronically, providing capital and liquidity to the market as they do today. Proposed NYSE Rule 104 has been amended to clarify these rules.

#### Sweeps and Liquidity Replenishment Points

The Exchange believes that LRPs would protect customers by moderating volatility

resulting from electronic executions. Where specialists and Floor brokers participate in the price discovery process, volatility moderators would not be necessary, and auction market transactions would not be subject to them. The Exchange represents that the LRP parameters have been selected by the Exchange after careful evaluation and discussions with market participants. They would be designed to impact automatic executions infrequently. When reached, LRPs would allow buyers and sellers to react to fast changing market conditions and provide an opportunity for orders to interact with Crowd interest not encompassed in the broker agency interest file and with specialist interest, enabling the auction market to supplement liquidity and lower volatility. Consistent with the Exchange's goal of expanding customer choice, IOC orders would be cancelled automatically when automatic execution is suspended as a result of a LRP.<sup>22</sup> This would provide customers with the opportunity to obtain an automatic execution in another market, even if that price is inferior to the Exchange best bid or offer consistent with Regulation NMS proposals.<sup>23</sup>

The Exchange proposes two LRPs: a price-based or sweep LRP and a momentum-based LRP.<sup>24</sup> The Exchange represents that the most restrictive LRP would be disseminated via NYSE OpenBook<sup>®</sup> or another data distribution channel.

#### Priced-based or Sweep LRP

The sweep LRP would be set at the nearest five-cent increment outside the Exchange best

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<sup>22</sup> IOC orders would be cancelled in all instances when automatic executions are unavailable.

<sup>23</sup> See Securities Exchange Act Release No. 49325 (February 26, 2004), 69 FR 11126 (March 9, 2004). See also Securities Exchange Act Release No. 49749 (May 20, 2004), 69 FR 30142 (May 26, 2004).

<sup>24</sup> In this amendment, the NYSE proposes to eliminate NYSE Rule 1000(a)(ii), which prohibits automatic executions at a price more than five cents away from the last reported transaction price on the Exchange in the relevant security.

bid and offer, that is at least five cents away from the Exchange best bid and offer (e.g., If the Exchange quote is 20.05 bid, offered at 20.10, then the sweep LRP would be 20.00 and 20.15. If the Exchange quote is 20.04 bid, offered at 20.11, then the sweep LRP would be 19.95 and 20.20). When a LRP is reached, the sweeping order would trade at that price to the extent of the volume available and then the market would be autoquoted at the LRP if there is stock remaining on the order. If not, the next best bid (offer) would be autoquoted. Automatic executions and autoquote would be suspended, but incoming orders and cancellations would continue to be reflected automatically on the book. If the displayed bid (offer) on the contra-side cancels, a new bid (offer) would be autoquoted, in effect overriding the suspension (partial autoquote).

Under the proposal, automatic executions and autoquote would resume in no more than five seconds where the sweeping order is filled in its entirety (e.g., no residual exists), where the residual is cancelled (e.g., the sweeping order is IOC), or where the residual's limit price is the LRP price, unless the specialist manually trades or quotes the market before five seconds have elapsed.

Similarly, automatic executions and autoquote would resume in no more than 10 seconds where a residual exists and its limit price is above the LRP price, but it does not create a locked or crossed market, unless the specialist has manually traded or quoted the market before 10 seconds have elapsed. It is expected that the specialist would quote or trade before 10 seconds have elapsed, unless an imbalance exists, a trade is being put together in the Crowd, or market conditions otherwise prevent. In any event, automatic executions and autoquote would resume after 10 seconds.

Finally, where a residual exists limited to a price above the LRP, and the limit price creates a locked or crossed market, or when a locked or crossed market results from the entry of

orders and cancellations during the 5 and 10-second periods described above, automatic executions and autoquote would resume with a manual trade. If the locking or crossing residual order cancels, automatic executions and autoquote would resume within the relevant 5 or 10-second timeframe described above, unless a manual trade or quote occurs before then.

### Sweeps and Price Protection

The Exchange believes that nothing in this filing or in the operation of sweeps would be inconsistent with or undermine the fundamental tenet of the trade-through rules (“TTR”)—that better bids and offers published by other market centers are entitled to protection. The proposals, including automatic electronic routing of orders to the market centers displaying better priced bids and offers, would be consistent with the TTR. Best bids (offers) published by away markets that are better than a sweep price would be satisfied in their entirety.<sup>25</sup> As is today, best bids and offers in these markets (i.e., “top of the book”) would be entitled to price protection. The Exchange believes that intermarket price-time priority has been extensively debated,<sup>26</sup> but has not been viewed to be in the best interest of the national market system. In any event, Regulation NMS proposes to permit customers to sweep multiple markets contemporaneously to access better priced liquidity that may be available.<sup>27</sup>

The ability of the specialist to match a better published bid or offer rather than shipping an order to that bid or offer is permitted today. According to the Exchange, the proposed rules

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<sup>25</sup> This presumes that the order is not labeled as an intermarket sweep consistent with the proposed Regulation NMS concept of an intermarket sweep order. Telephone conversation between Kelly Riley, Assistant Director, Division, Commission, and Jeff Rosenstock, Senior Special Counsel, Market Surveillance, NYSE, on November 15, 2004.

<sup>26</sup> See, e.g., Securities Exchange Act Release No. 42450 (February 23, 2000), 65 FR 10577 (February 28, 2000) (Commission request for comment on issues relating to market fragmentation).

<sup>27</sup> See note 23, supra.

would simply speed the process by permitting the specialist to electronically match or ship. During the sweep, a commitment to trade that would satisfy the full amount of any better bid or offer that is published as the best bid or offer by another market center would be auto-routed to such market (if a trade-through would otherwise occur). According to the Exchange, this would be similarly consistent with the TTR.

According to the Exchange, it has been suggested that the proposed rules would enable the specialist to avoid complying with the TTR by publishing what has been termed a 'preemptive' 100-share bid or offer. The Exchange believes that this is erroneous. For example, assume that the Exchange quotation is 19.91 bid, offered at 20.01, 100 x 500, and that there are offers on the book to sell 100 shares at 20.04, 500 shares at 20.05, 300 shares at 20.07, 100 shares at 20.08, and 1,000 shares at 20.09. If another market center also has published an offer to sell for 500 shares at 20.01, and an NX order to buy 2,000 shares arrives at the Exchange, then 500 shares would automatically execute at 20.01 on the Exchange, and 500 shares would be automatically routed to the other market center as a commitment to trade at 20.01. The remaining 1,000 shares would sweep the Exchange book, trading at 20.08, providing price improvement to the orders on the book.<sup>28</sup> Alternatively, the specialist algorithms could determine to execute the entire order on the Exchange at 20.00. This example presumes that only one market center has a better published bid (offer) than the Exchange best bid (offer) or sweep price. All market centers that have a better published bid (offer) than the price the Exchange would trade at would be satisfied.

#### Momentum LRP ('MLRP')

The Exchange believes that excessive volatility could occur in situations other than

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<sup>28</sup> Telephone conversation between Cyndi Rodriguez, Special Counsel, Division, Commission, and Don Siemer, Director, Market Surveillance, NYSE, on November 10, 2004.

electronic sweeps. For this reason, the Exchange proposes a LRP based on price movement over a period of time.

A MLRP would be reached when the price of a security has moved the greater of twenty-five cents or 1% of its price,<sup>29</sup> within 30 seconds or less. For example, a MLRP would be reached in a security that is trading at 18.00 when the price moves 0.25 in 30 seconds or less. Also, a MLRP would be reached in a security that is trading at 81.00 when the price moves 0.81 in 30 seconds or less. Intraday price changes would be taken into account and could widen or narrow the MLRP range. (e.g., a security could start the day with an MLRP range of twenty-five cents, with intraday price changes expanding the MLRP range to 1% of its price).

MLRP ranges would be calculated using the high and low trades on the Exchange within the prior 30 seconds. The MLRP range could change based on an event (e.g., a new trade) or the passage of time.<sup>30</sup>

After the auto ex order reaching a MLRP price trades at that price to the extent possible, automatic executions and autoquote would be suspended. The book would be automatically updated by incoming orders and cancellations. Automatic executions and autoquote would resume in no more than 10 seconds unless the specialist has quoted or traded before then. As noted above, the specialist would be expected to trade or requote the stock in less than 10 seconds unless conditions in the stock prevent this. Where incoming orders and cancellations cause a locked or crossed market, autoquote and automatic executions would resume with a

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<sup>29</sup> When calculating 1% of a security's price, the result will be rounded to the nearest cent using usual rounding conventions. For example, if a security is trading at \$26.49, and 1% of its price is calculated, this would be rounded down to 0.26. If a security is trading at \$26.53 and 1% of its price is calculated, this would be rounded up to 0.27.

<sup>30</sup> See Exhibit A.

trade.<sup>31</sup>

In addition, a MLRP could cause the suspension of automatic executions on the side of the market where the bid or offer is at a price beyond the MLRP range, as an automatic execution could not occur at that price. For example, if the market is 20.05 bid, offered at 20.10, and the last sale is 20.08, and the MLRP range is 19.80-20.09 based on high and low trades within the operative 30-second period, a trade could take place at the bid price because it would fall within the MLRP range, but a trade could not take place at the offer price (20.10) because it would fall outside the MLRP range. As a result, automatic executions would be suspended on the offer side, but continue on the bid side. This would be indicated systemically in the same way as any other time an automatic execution is unavailable. Autoquoting would continue and orders and cancellations would update the book. Automatic executions would resume when a bid or offer within the MLRP range is autoquoted or the MLRP range changes as a result of the moving 30-second timeframe.

### Gap Quoting

Gap quotes<sup>32</sup> would be used by specialists in response to trading scenarios in which price dislocation is expected. Gap quotes would be used to signal the potential price movement so as to attract contra-side liquidity in an attempt to mitigate volatility. Gap quote situations would involve clearly large imbalances compared with the typical trading volume in a security. The size of an imbalance suitable for gapped quoting would be at least 10,000 shares or a quantity of stock having a value of \$200,000 or more, although depending on the trading characteristics of the security, the appropriate conditions for gapped quoting could be higher.

The specialist determines when to gap the quotation based on certain market conditions

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<sup>31</sup> Id.

<sup>32</sup> For a complete description of Gap quotes, see footnote 18 of the Notice, supra note 6.

such as a sudden influx of orders on one side of the market, one or more large-size orders with no off-setting interest, or when a member proposes to effect a one-sided block transaction or a cross at a significant premium or discount to the prevailing market. Specialists could only gap the quotation in accordance with Exchange procedures. When the quotation is gapped, automatic executions and autoquote would be suspended, although incoming orders and cancellations would update the book electronically. Better priced orders would be taken into account in the transaction resulting from the gapped quotation. Floor Officials would oversee the gap quote process, including its duration.

#### Availability of Automatic Executions and Autoquote<sup>33</sup>

The Exchange believes that autoquote and automatic executions would be suspended infrequently and only in certain, limited circumstances: when trading on the Exchange reaches a LRP; when the quote is gapped in accordance with Exchange procedures; when trading in a security has been halted; or when the quote is not firm. A systemic indication would be disseminated when automatic executions are unavailable. Each of these circumstances would serve the public interest; the rationale for and benefit of LRPs and gap quotes are discussed above. No executions, automatic or manual, would be possible when trading has been halted, and it would not be in the customer's best interest to automatically execute against a bid or offer that is not firm.<sup>34</sup>

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<sup>33</sup> This discussion presumes the Direct+ facility is available. NYSE Rule 1002 provides that automatic executions are available if entered after the Exchange has disseminated a published bid or offer in that stock and until one minute before the closing time of the Exchange's Floor market. In the unlikely event of an equipment failure preventing automatic executions during a time they would otherwise be available, a systemic indication of auto ex unavailability would be made.

<sup>34</sup> The Exchange believes that trading halts and non-firm quotations occur extremely infrequently. For example, during the first nine months of 2004, there have been only four non-firm quote situations. One or more Floor Governors or senior Floor Officials

Autoquote, but not automatic executions, would be suspended during the extremely brief moment it would take to manually report a block-sized transaction.<sup>35</sup> Automatic executions would continue until the size of the bid (offer) decrements to 100 shares. Autoquote (and automatic executions, where the quote has decremented to 100 shares) would resume when the manual reporting is concluded. This would be the only instance in which manual reporting would cause the suspension of autoquote and could cause the suspension of automatic executions. This would protect customer orders on the specialist's book during the execution of block transactions pursuant to NYSE Rules 72(b) and 127 and would facilitate orderly executions in limited "breakout" situations when liquidity is present but conditions are such that the existence of a fair and orderly market would depend on the ability of the specialist to quickly and efficiently effect block-size trades that could involve multiple parties.

The Exchange represents that once the hybrid market is implemented, all other instances of manual reporting,<sup>36</sup> autoquote, and automatic executions would continue to operate without suspension. The quote would automatically update to reflect the entry of better bids and offers and cancellations. Automatic executions would continue to take place in the manner described in this proposal. This represents a change to the operation of autoquote and automatic executions as described in Amendment No. 1 of this filing.<sup>37</sup> Although the Exchange expects autoquote and automatic executions to be available at least 99.7% of the time as originally proposed, the

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must oversee trading halts and non-firm quotes. See NYSE Rule 60. Exchange rules regarding trading halts and non-firm quotes have been approved by the Commission and are in accordance with Rule 11Ac1-1 of the Act, 17 CFR 240.11Ac1-1.

<sup>35</sup> NYSE Rule 127 defines a "block" size as at least 10,000 shares or a quantity of stock having a market value of \$200,000 or more, whichever is less.

<sup>36</sup> Trades occurring within the Crowd or between the Crowd and the specialist, as either agent or dealer, are reported manually.

<sup>37</sup> See Amendment No. 1, supra note 5.

Exchange believes that maximizing their availability even more would benefit the Exchange's customers.

Furthermore, when autoquote and automatic executions are suspended, incoming orders and cancellations would continue to arrive at the book, which would be electronically updated to reflect these changes. When the Exchange best bid or offer cancels during a time when autoquote is suspended, the next best bid (offer) on the book would be autoquoted. Auto ex orders, other than IOC orders, would be placed on the book. IOC orders would be cancelled automatically, as are incoming ITS commitments to trade.<sup>38</sup>

The continuation of automatic executions while a manual trade is being reported could result in the manual trade being reported to the Tape out of its proper sequence. Out of sequence trades would be identified as such. If a bid or offer at a better price arrives at the book before a manual report is concluded, the system would automatically report the trade at such better price (e.g., Assume that the quote is 20.05 bid, offered at 20.10, and a broker in the Crowd takes the offer, but before the report of the trade is completed, an offer to sell 1,000 shares at 20.09 arrives at the book. The system would automatically report the trade at 20.09, with the seller being the newly-arriving better offer.)

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act<sup>39</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>40</sup> in particular, because it is designed to promote just and equitable principles of trade, to remove

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<sup>38</sup> The Exchange believes that this would be consistent with concepts discussed in proposed Regulation NMS. See note 23, *supra*.

<sup>39</sup> 15 U.S.C. 78f(b).

<sup>40</sup> 15 U.S.C. 78f(b)(5).

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 Exchange also believes that the proposed rule change is designed to support the principles of Section 11A(a)(1) of the Act<sup>41</sup> in that it seeks to assure economically efficient execution of securities transactions, makes it practicable for brokers to execute investors' orders in the best market, and provides an opportunity for investors' orders to be executed without the participation of a dealer.

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

The Exchange does not believe that the proposed rule change, as amended, 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

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 Exchange 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.

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<sup>41</sup> 15 U.S.C. 78k-1(a)(1).

#### 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 by Amendment Nos. 2 and 3 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-2004-05 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-2004-05. 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 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-2004-05 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.<sup>42</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>42</sup> 17 CFR 200.30-3(a)(12).

**EXHIBIT A**  
**TRADING EXAMPLES**

AL Orders and Market Orders

1. AL and market orders on the same side of the market are aggregated in the quote and executed based on time priority:

The quotation is 20.45 bid, offered at 20.50, 500 x 2,000. An AL order to buy 1,000 shares with a limit of 20.55 arrives. The market is autoquoted the minimum variation (one cent) better than the existing bid, 20.46 bid, offered at 20.50, 1,000 x 2,000. An AL order to buy 500 shares at a limit of 20.57 and a market order to buy 1,000 shares arrive. The market is autoquoted 20.46 bid, offered at 20.50, 2,500 x 2,000, aggregating the volume of the AL and market buy orders. An NX<sup>43</sup> market order to sell 1,500 shares arrives and automatically executes against the bid, filled by the first two AL orders. The market is autoquoted 20.46 bid, offered at 20.50, 1000 x 2000.<sup>44</sup>

2. The execution of an order on the same side of the market that exhausts some or all of the displayed contra-side volume will cause an AL or market order to automatically execute:

The quotation is 20.46 bid, offered at 20.50, 1,000 x 500. The bid is an AL order limited to 20.52. The next best offer on the book is 20.51 for 1,000 shares. An NX market order to buy 500 shares arrives. The NX order automatically executes against the offer at 20.50. The AL buy order automatically executes against the next best offer, 20.51. If 1,000 shares had been offered at 20.50 instead of 500 shares, the AL order automatically executes at 20.50 for 500 shares and 500 shares at 20.51, presuming the AL order's limit

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<sup>43</sup> Automatic execution orders are designated NX.

<sup>44</sup> The Commission corrected a typographical error in this example. Telephone conversation between Kelly Riley, Assistant Director, Division, Commission, and Don Siemer, Director, Market Surveillance, NYSE, on November 12, 2004.

permits it to trade at 20.51.

3. The arrival of an order at a better price on the same side of the market as an AL or market order causes the AL or market order to automatically execute:

The quote is 20.46 bid, offered at 20.50. The next best offer on the book is at 20.51. The bid is an AL order. An order to buy at 20.47 arrives. A new bid of 20.47 is autoquoted.

The buy AL order automatically executes against the 20.50 offer.

4. A change in the displayed contra-side price that creates a minimum variation market or allows execution of the AL or market order with price improvement causes the AL or market order to automatically execute:

The quote is 20.46 bid, offered at 20.50. The bid is comprised of an AL or market order.

A limit order to sell at 20.49 arrives on the book. The AL or market order automatically executes against this new offer, to the extent of the volume associated with the new offer and then sweeps the book until filled, an LRP is reached or, in the case of an AL order, its limit price is reached.

5. Where the limit of an AL order prevents it from trading, the AL order will be quoted and handled as a regular limit order on the book:

The quote is 20.05 bid, offered at 20.09, 2,000 x 2,000. An AL order arrives to buy 3,000 shares at 20.12, which is autoquoted as the best bid, 20.06 for 3,000 shares. Also on the book are the following offers: 1,500 shares at 20.10, 1,500 shares at 20.11, 1,000 shares at 20.12 and 1,000 shares at 20.13. An NX market order to buy 6,000 shares arrives, automatically executing 2,000 shares at 20.09, with 4,000 shares sweeping the book, executing at 20.12. This execution depletes the liquidity on the book at 20.12. The original AL order is pushed to trade by the NX order, but its limit, 20.12, prevents it from

trading at the next available offer price, 20.13. The AL order goes on the book as a regular limit order and the market is autoquoted 20.12 bid, offered at 20.13, 3,000 x 1,000.

#### Broker Agency Interest File

6. A minimum of 1,000 shares of broker agency interest per broker at the Exchange best bid or offer will be displayed at that price and be on parity with other displayed interest, other than interest entitled to priority:

The quote is 20.05 bid, offered at 20.07, 1,500 x 1,000. A Floor broker enters interest in the agency interest file to buy 2,000 shares at 20.04 and to buy 1,000 shares at 20.05.

The quote automatically updates to show 2,500 shares to buy at 20.05, which includes the 1,000 shares of broker agency interest to buy at 20.05 because it is at the best bid; the amount shown on NYSE OpenBook<sup>®</sup> to buy at 20.04 will not change as broker agency interest will not be disseminated. The aggregate broker file information available to the specialist will show 2,000 shares to buy at 20.04, unless the broker has excluded it from the aggregate information. An order arrives on the book to buy 1,500 shares at 20.06.

The market autoquotes 20.06 bid, offered at 20.07, 1,500 x 1,000. Only 1,500 shares to buy at 20.05 is shown on NYSE OpenBook,<sup>®</sup> which does not include any broker agency interest. The aggregate broker information available to the specialist will show 1,000 shares to buy at 20.05 and 2,000 shares to buy at 20.04 unless one or both have been excluded from the aggregate information by the broker.

7. Brokers have discretion to display more than 1,000 shares at the best bid or offer. The displayed size is entitled to parity. Undisplayed reserve at the best bid or offer yields to displayed interest at the best bid or offer.

The quote is 20.31 bid, offered at 20.36, 1,500 x 7,000. The 7,000 share offer side consists of 2,000 shares on the book and 5,000 shares of specialist interest. A Floor broker enters interest in the agency interest file to sell 10,000 shares at 20.36. 1,000 of the shares are displayed and the reserve interest, 9,000 shares, is not displayed. An NX market order to buy 8,000 shares arrives. The following automatic executions take place: 2,000 shares from the book, 1,000 shares from the displayed interest of the Floor broker, and 5,000 shares from the specialist interest trade at 20.36. The 9,000 shares of reserve broker file sell interest does not participate in the trade, since the entire buy order can be filled by the displayed interest.

8. Broker agency interest participates on parity during sweeps:

(a) The quote is 20.05 bid, offered at 20.07, 1,500 x 1,000. The book also shows bids of 1,600 shares to buy at 20.04, 2,000 shares to buy at 20.03, and 1,000 shares to buy at 20.02. Broker agency interest to buy 2,600 shares at 20.04 arrives. An order to sell 4,700 shares at 20.03 arrives and automatically executes. 1,500 shares trade at the bid of 20.05 and the remaining 3,200 shares trade at 20.04, with the book receiving 1,600 shares and the broker agency interest receiving 1,600 shares. 1,000 shares to buy remain in the broker agency interest file at 20.04. The market is autoquoted 20.04 bid, offered at 20.07, 1,000 x 1,000. The volume associated with the bid is the 1,000 shares remaining in the broker agency interest file.

(b) The quote is 20.05 bid, offered at 20.07, 1,500 x 1,000. Also shown on the book is 2,000 shares bid at 20.03 and 1,000 shares bid at 20.02. The broker agency interest file has 2,000 shares bid at 20.04. An order to sell 5,000 shares at 20.03 arrives and automatically executes. 1,500 shares trade at 20.05 (the bid price) and the remainder of

the sell order, 3,500 shares, trades at 20.03, the sweep price. Trading at 20.03 are the 2,000 shares of broker agency interest that was in the file to buy at 20.04 and 1,500 shares on the book to buy at 20.03.

#### Specialist Interest and Algorithm<sup>45</sup>

9. Specialist interest may automatically supplement the size of the Exchange best bid and offer, but always yields to orders on the book:

The quote is 20.05 bid, offered at 20.07, 1,500 x 1,000. The bid is comprised of limit orders on the book. The specialist algorithm automatically generates a bid for 1,000 shares at 20.05. The size of the bid automatically changes to 2,500. A new limit order to buy 500 shares at 20.05 arrives and the size associated with the bid automatically changes to 3,000 shares. Agency interest to buy 1,500 shares at 20.05 is entered in the broker agency interest file. Assuming the broker displays all 1,500 shares, the bid size automatically changes again, to 4,500 shares. The first 1,500 share buy limit order on the book has priority, the 500 share buy limit order on the book and the 1,500 share broker agency buy interest are on parity. The specialist interest must yield to the book. An order to sell 3,500 shares at 20.05 arrives and automatically executes at 20.05. The contra-side consists of the first 1,500 shares to buy, the second order to buy 500 shares and the broker agency buy interest for 1,500 shares.

10. The specialist algorithm may automatically facilitate a single price execution at the Exchange best bid or offer:

The quote is 20.05 bid, offered at 20.07, 1,000 x 1,000. The next best bid on the book is

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<sup>45</sup> All specialist trading, whether manual or electronically generated by algorithms, must be in accordance with Exchange Rules. These examples presume compliance with these rules.

2,000 shares at 20.03. An NX market order to sell 2,000 shares arrives and the preset parameters of the algorithm determine to facilitate an execution of the sell order at a single price. The sell order automatically executes against the bid and the specialist automatically buys the remaining 1,000 shares at the bid price of 20.05. Had the specialist not done so, the sell order would have traded at two prices—1,000 shares at 20.05 and 1,000 shares at 20.03. By facilitating a single price execution, the specialist gave price improvement to the sell order.

11. Specialist algorithm may provide price improvement between the bid and offer if certain conditions are met:

- (i) the quotation spread is at least three cents;
- (ii) the specialist is represented in the published bid or offer: the lesser of 10,000 shares or 20% of the respective bid/offer size;
- (iii) the order receiving price improvement is 2,000 shares or less and the entire order is filled; and
- (iv) the price improvement provided by the specialist is (a) at least .02 where the quote spread is .03 - .05, (b) at least .03 where the quote spread is .06 - .10, (c) at least .04 where the quote spread is .11 - .20, and (d) at least .05 where the quote spread is more than .20.

The market is 20.31 bid, offered at 20.36, 1,500 x 3,000. The offer size includes 1,000 shares on behalf of the specialist. The specialist interest represents 33% of the offer size (1,000 shares/3,000 shares at 20.36). A limit order arrives to buy 2,000 shares at 20.36. The algorithm determines to provide price improvement to this order and 2,000 shares automatically execute at 20.34. The market then is autoquoted 20.31 bid, offered at

20.36, 1,500 x 3,000.

12. Better priced specialist interest yields to the book at a worse price during a residual sweep:

The quotation is 20.05 bid, offered at 20.07, 1,500 x 1,000. 1,000 shares to buy at 20.04 arrives in the broker agency interest file. Specialist interest arrives to buy 1,000 at 20.04. 2,000 shares to buy are on the book at 20.03. A limit order to sell 3,600 shares at 20.03 arrives and automatically executes, as follows: 1,500 trades against the bid at 20.05, with the remaining amount, 2,100 shares, sweeping the book to trade at 20.03. Orders on the book trade 1,100 shares and the broker agency file trades 1,000 shares. This leaves 900 shares on the book to buy at 20.03. The specialist interest to buy at 20.04 does not trade even though it is better priced, because orders remain on the book to buy at 20.03 and the specialist must yield. If no buy orders on the book capable of trading at 20.03 remained and the sell order had not been filled, the specialist interest would be able trade as part of the sweep on parity with any broker agency interest at that price.

13. Specialist interest trades during a sweep, adding liquidity and improving a sweep price:

The quotation is 20.05 bid, offered at 20.07, 1,500 x 1,000. 1,000 shares to buy at 20.04 arrived in the broker agency interest file. Specialist interest to buy 1,000 shares at 20.04 arrives. 2,000 shares are on the book to buy at 20.03. A limit order to sell 3,500 shares at 20.03 arrives and automatically executes as follows: 1,500 shares trade against the bid at 20.05, with the remaining 2,000 shares trading with the broker agency buy interest and specialist buy interest at 20.04.

14. During sweeps, specialist interest trades if no orders remain on the book at the sweep price:

The quote is 20.05 bid, offered at 20.07, 1,600 x 1,000. Broker agency interest to buy 800 shares at 20.04 arrives. Specialist interest to buy 800 shares at 20.04 arrives. The

book shows 1,000 shares to buy at 20.03. A limit order to sell 3,600 shares at 20.03 arrives. The sell order automatically executes 1,600 shares against the bid at 20.05, with the residual, 2,000 shares, sweeping the book at 20.03. The book trades 1,000 shares, the broker file trades 800 shares and the specialist file trades 200 shares.

15. During a sweep, specialist interest trades on parity with broker interest, as long as no orders on the book at the sweep price remain:

The quote is 20.05 bid, offered at 20.07, 1,500 x 1,000. Broker agency interest to buy 2,000 shares at 20.03 arrives. Specialist interest to buy 2,000 shares at 20.03 arrives. The book shows 1,000 shares to buy at 20.03. A limit order to sell 5,500 shares at 20.03 arrives. The sell order automatically executes 1,500 shares against the bid at 20.05, with the residual, 4,000 shares, sweeping the book to trade at 20.03. The book and the broker file are on parity and each trade 1,000 shares. Once the buy order on the book is filled at 20.03, the specialist interest can trade, on parity with the broker file. The remaining 1,000 shares of broker buy interest and 1,000 shares of specialist buy interest also trade.

16. During a sweep, the best bid or offer displayed on each ITS market center is checked to avoid a trade-through:

The Exchange quote is 20.05 bid, offered at 20.07, 2,000 x 1,000. The ITS best offer is also 20.07 for 1,000 shares, published by market center B. A third market center, P, displays 500 shares to sell; at an inferior offer of 20.08. Also on the book are offers at 20.08 for 1,000 shares, at 20.09 for 1,000 shares, and at 20.10 for 3,000 shares.

An NX market order arrives on the Exchange to buy 5,000 shares. 1,000 shares automatically execute against the Exchange offer at 20.07. 1,000 shares of the order are auto routed as a commitment to buy at 20.07 to market center B. The remainder, 3,000

shares, sweep the book to 20.10. However, because the sweep price, 20.10, is inferior to the best offer displayed by market center P (20.08), 500 shares of the buy order residual are auto routed as a commitment to buy at 20.08 to market center P and only 2,500 shares of the buy order trade at 20.10 on the Exchange. If both auto routed commitments are satisfied, the executions are as follows: 1,000 shares at 20.07 on the Exchange, 1,000 shares at 20.07 on market center B, 500 shares at 20.08 on market center P, and 2,500 shares at 20.10 on the Exchange. If all or part of one or both commitments are not satisfied, they will return to the Exchange and trade at the prices then available. Under proposed Regulation NMS,<sup>46</sup> had the member entering the order indicated that it was contemporaneously satisfying better prices away, none of the order would have been auto routed. A new quote is autoquoted, 20.05 bid, offered at 20.10, 2,000 x 2,500.

17. Orders are auto routed to multiple away markets publishing better bids or offers:

The Exchange quote is 20.05 bid, offered at 20.08, 2,000 x 2,500. The national best offer, at 20.07 for 1,000 shares, is published by market center B. A third market center, P, also displays an offer to sell 500 shares at of 20.07. An NX market order to buy 2,500 shares arrives on the Exchange. The specialist would have two options: match the better displayed offers or ship the order to market centers B and P:

(a) If the better priced offers away are not electronically matched by the specialist, 1,000 shares of the buy order are auto routed as a commitment to buy to market center B and 500 shares of the buy order are auto routed as a commitment to buy to market center P. The remainder, 1,000 shares to buy, automatically executes against the Exchange offer at 20.08.

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<sup>46</sup> See note 23, supra.

(b) If the specialist matches the better price offers away, he or she would have to fill the entire buy order of 2,500 shares at 20.07 before trading at 20.08.<sup>47</sup>

18. Specialist algorithm may automatically match the better displayed ITS bid or offer or ship the order:

The Exchange quotation is 20.05 bid, offered at 20.07, 2,000 x 1,000. The better displayed ITS offer to sell 400 shares at 20.06 is published by another market center. A market order to buy 1,400 shares arrives and based on predetermined parameters, the specialist algorithm decides to match or ship:

Option 1—The specialist matches the better displayed offer, automatically executing 1,400 at 20.06.

Option 2—The specialist sends 400 shares of the buy order to the other market center, satisfying the better displayed offer. The remaining 1,000 shares of the buy order is automatically executed against the offer at 20.07.

#### Sweep LRP

19. Where the order sweeping the book is filled after trading at the LRP price or a residual exists limited to the LRP price, automatic executions and autoquote automatically resume in no more than five seconds:

The quotation is 20.30 bid, offered at 20.36, 1,500 x 2,000. The LRP is 20.45. The next best offer is 20.46 for 14,000 shares. The following offers are on the book: 1,000 shares to sell at 20.37, 4,000 shares to sell at 20.38, 1,500 shares to sell at 20.39, 5,000 shares to sell at 20.40, 500 shares to sell at 20.41, 2,000 shares to sell at 20.42, 8,000 shares to sell

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<sup>47</sup> Telephone conversation between Kelly Riley, Assistant Director, Division, Commission, and Jeff Rosenstock, Senior Special Counsel, Market Surveillance, NYSE, on November 15, 2004.

at 20.43, 3,000 shares to sell at 20.44, 3,000 shares to sell at 20.45, and 14,000 shares to sell at 20.46. An IOC order arrives to buy 36,000 shares at 20.45. 2,000 shares automatically execute against the offer at 20.36. The order sweeps the book to the LRP, trading 28,000 shares at 20.45. The offers on the book from 20.37 to 20.44 receive price improvement at 20.45. The residual, 6,000 shares, automatically cancels. The market is autoquoted 20.30 bid, offered at 20.46, 1,500 x 14,000. Automatic executions and autoquote resume automatically in five seconds if the specialist has not manually traded or re-quoted the market before then.

20. Where the sweeping order is not filled before the LRP is reached, and is able to trade above (below) the LRP, but its limit price does not create a locked or crossed market—automatic executions and autoquote resumes automatically in no later than 10 seconds.

The quotation is 20.30 bid, 20.36 offered, 1,500 x 2,000. The LRP is 20.45. The next best offers on the book are 1,000 shares to sell at 20.37, 4,000 shares to sell at 20.38, 1,500 shares to sell at 20.39, 5,000 shares to sell at 20.40, 500 shares to sell at 20.41, 2,000 shares to sell at 20.42, 8,000 shares to sell at 20.43, 3,000 shares to sell at 20.44, 3,000 shares to sell at 20.45, and 5,000 shares to sell at 20.47. An order to buy 36,000 shares at 20.46 arrives. The first 2,000 automatically executes against the offer at 20.36. The remainder sweeps the book to the LRP at 20.45, with 28,000 being executed. Offers at 20.37 through 20.45 trade at the sweep price of 20.45, receiving price improvement. A residual of 6,000 shares to buy remains limited at 20.46. The market auto-quotes 20.45 bid, offered at 20.47, 6,000 x 5,000. Here, since a LRP is reached and a residual capable of trading at a price above the LRP remains, but the residual does not lock or cross the

market, automatic executions and autoquote will automatically resume in 10 seconds unless the specialist manually trades or re-quotes the market before then.

21. Where the order sweeping the book is not filled during the sweep, and is able to trade above (below) the LRP, but the limit price creates a locked or crossed market, automatic executions and autoquote are suspended until a manual trade occurs.

The quotation is 20.30 bid, offered at 20.36, 1,500 x 2000. The LRP is 20.45. Also on the book are the following offers: 1,000 shares to sell at 20.37, 4,000 shares to sell at 20.38, 1,500 shares to sell at 20.39, 5,000 shares to sell at 20.40, 500 shares to sell at 20.41, 2,000 shares to sell at 20.42, 8,000 shares to sell at 20.43, 3,000 shares to sell at 20.44, 3,000 shares to sell at 20.45, and 14,000 shares to sell at 20.46. An order to buy 36,000 shares at 20.46 arrives. 2,000 shares automatically execute against the offer at 20.36. The remainder sweeps the book to the LRP at 20.45. Offers on the book from 20.37 to 20.45, 28,000 shares, trade at 20.45, receiving price improvement. The residual, 6,000 shares to buy cannot continue sweeping because the LRP has been reached. The market is autoquoted the LRP, 20.45, offered at 20.46, the next available offer on the book. Because the residual's limit price, 20.46, creates a locked market, a manual trade or quote is required for automatic execution and autoquote to resume.

22. Specialist interest trades during a sweep, adding liquidity and improving a sweep price:

The quotation is 20.30 bid, offered at 20.36, 1,500 x 2,000. The sweep LRP is 20.45. Specialist interest to sell 5,000 shares at 20.37 arrives. The book consists of 1,000 shares offered at 20.37, 4,000 shares offered at 20.38, 1,500 shares offered at 20.39, 5,000 shares offered at 20.40, 500 shares offered at 20.41, 2,000 shares offered at 20.42, 8,000 shares offered at 20.43, 3,000 shares offered at 20.44, and 3,000 shares offered at 20.45.

A limit order to buy 29,000 shares at 20.45 arrives. 2,000 shares automatically execute at 20.36, with the residual of the buy order, 27,000 shares, sweeping the book, executing at 20.43. The 5,000 shares of specialist sell interest at 20.37 participate in the sweep.

Without the specialist sell interest, the book would have been swept to 20.45 (the LRP), a worse price for the buyer.

23. Momentum Liquidity Replenishment Point (MLRP)

Momentum LRP range is based on the high and low trade prices within a rolling 30 second horizon

Trades		30 Sec. Range	Momentum LRP	
			Min	Max
10:04:45	19.85	19.85 – 19.85	19.60	20.10
10:04:50	19.87	19.85 – 19.87	19.62	20.10
10:04:54	19.90	19.85 – 19.90	19.65	20.10
10:05:06	19.92	19.85 – 19.92	19.67	20.10
10:05:11	19.95	19.85 – 19.95	19.70	20.10
10:05:17	20.00	19.87 – 20.00	19.75	20.12
10:05:22	20.08	19.90 – 20.08	19.83	20.15
10:05:25	20.15	19.92 – 20.15	19.90	20.17
10:05:31	20.13	19.92 – 20.15	19.90	20.17
10:05:35	20.09	19.92 – 20.15	19.90	20.17

30 Second Window

AutoEx at prices lower than 19.90 and higher than 20.17 would be outside MLRP and not be allowed

24. MLRP may be reached during an automatic execution, pausing a sweep:

At 10:05:36, the bid is 20.05, offered at 20.09, 1,500 x 1,000. The books shows additional offers of 500 shares to sell at 20.13, 1,000 shares to sell at 20.17, 1,500 shares to sell at 20.21, 1,000 shares to sell at 20.22, and 2,000 shares to sell at 20.25. The MLRP range, based on the high and low trades during the prior 30 seconds (20.15 and

19.92 for the purposes of this example) are 19.90 and 20.17.

An NX market order to buy 1,500 shares arrives. 1,000 shares automatically execute at 20.09 and the residual, 500 shares, sweeps the book, trading at 20.13. The quote automatically updates to 20.05 bid, offered at 20.17, 1,500 x 1,000.

A second later, at 10:05:37, the high and low trades within the new 30-second period are 19.95 and 20.15 and the corresponding new MLRP range is 19.90 and 20.20.

At 10:05:40, a limit order arrives to buy 2,000 shares at 20.21. This crosses the market as the offer is at 20.17. The crossing buy order automatically executes against the offer (1,000 shares) at 20.17, creating a new high trade within the operative 30-second MLRP time parameter. This new high price causes the MLRP to change from 19.90 to 19.92 (20.17 less .25) on the low side. The MLRP on the high side, 20.20 has remained the same. The residual of the buy limit order, 1,000 shares, cannot sweep the book to the next available offer at 20.21, because that price is outside the MLRP range. The market is autoquoted 20.20 bid (the MLRP) for 1,000 shares, 1,500 offered at 20.21. Automatic executions and autoquote are suspended. As the order to buy is capable of trading at 20.21, locking the market, a manual trade clearing the locked condition will cause automatic executions and autoquoting to resume and the quote automatically updates to 20.05 bid, offered at 20.21, 1,500 x 500.

25. MLRP may be reached during a sweep, providing a partial sweep:

At 10:05:36, the bid is 20.05, offered at 20.09, 1,500 x 1,000. The book shows additional offers of 500 shares at 20.13, 1,000 shares at 20.17, 2,000 shares at 20.18, 1,000 shares at 20.19, and 1,500 shares at 20.22. The MLRP range is 19.90–20.20, based on high and low trades within the operative 30-second period (19.92 and 20.15 in this example).

An NX market order to buy 1,500 shares arrives and automatically executes at 20.09. The residual, 500 shares, sweeps the book, trading at the next best offer, 20.13. The quote automatically updates to 20.05 bid, offered at 20.17, 1,500 x 1,000.

At 10:05:40, a limit order to buy 5,000 shares at 20.21 arrives crossing the market. 1,000 shares automatically execute at the offer, 20.17. This creates a new high price within the operative 30-second parameter (20.17) causing the MLRP range to change from 19.90 on the low side to 19.92 (20.17 less .25). The MLRP on the high side remains at 20.20. The buy order residual, 4,000 shares, sweeps the book to 20.19. 3,000 shares trade at that price, exhausting the available liquidity within the MLRP range. The quote automatically updates, bidding the remaining size of the residual, 1,000 shares, at 20.20, the MLRP, offering 1,500 shares at 20.22, the next best offer on the book. An automatic execution cannot occur at 20.22 as that price is outside the MLRP range, so automatic executions and autoquote are suspended. Cancellations and orders are electronically reflected on the book. Electronic executions and autoquote will resume automatically in 10 seconds, unless the specialist manually trades the security before then, or the MLRP range changes. Once autoquote resumes, the bid will automatically change to 20.21 for 1,000 shares, the limit price and the size of the residual. The offer remains 20.22 for 1,500 shares.

## 26. Gap Quote

The quotation is 20.08 bid, offered at 20.09, 10,000 x 5,000, last sale at 20.08. Crowd interest arrives to buy 350,000 shares at the market. The specialist executes 5,000 shares at the offer, 20.09, then gaps the quote, making the bid price 'touch' the last sale price (20.09), showing the size of the imbalance in that bid (345,000 shares). On the contra side, the specialist makes the offer the price where stock may trade if no other sell interest

arrives, and the size as 100 shares, to draw in sellers. Thus, e.g., the gap quote<sup>48</sup> is 20.09 bid, offered at 20.30, 345,000 x 100. Automatic executions and autoquote are suspended, but incoming orders and cancellations are reflected electronically on the book. Crowd, specialist interest and other liquidity providers are taken into account in determining the price and size of the next transaction. Automatic executions and autoquote then resume.

## 27. Tick-restricted Orders

- (a) The quotation is 20.05 bid, offered at 20.07, 1,500 x 1,000. Other orders on the book to sell include 1,000 at 20.09 (sell short), and 1,000 at 20.11 (sell plus). An NX market order to buy 2,500 shares arrives. 1,000 shares of the buy order are automatically executed against the 1,000 shares offered at 20.07. The remaining 1,500 shares to buy sweep up to 20.11. The sell short and sell plus orders are executable as the sweep occurs on a direct plus tick. As a result, the 20.09 sell short offer on the book is price improved to 20.11.
- (b) The quotation is 20.05 bid, offered at 20.07, 1,500 x 1,000. Also on the book to buy are 1,000 shares (buy minus) at 20.04, 1,000 shares to buy at 20.03 and 1,500 shares to buy at 20.01. An NX order to sell 3,000 shares arrives, automatically executing 1,500 shares against the bid at 20.05, sweeping down to 20.03. The 1,000 share bid at 20.04 was executable as the sweep occurred on a minus tick.

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<sup>48</sup> See Securities Exchange Act Release No. 50237 (August 24, 2004), 69 FR 53123 (August 31, 2004) (SR-NYSE-2004-37) (Information Memo 04-27–June 9, 2004). The gapped quote procedures provide that a gapped quotation should remain in place for a reasonable time to allow for interested parties to respond to the order imbalance. What constitutes a reasonable time is determined by the unique circumstances of each gapped quotation situation. However, the gapped quotation generally should last at least 30 seconds unless offsetting interest is received earlier, and generally should not exceed two minutes, unless circumstances require otherwise. The duration of a gapped quote is determined with input from a Floor Official.

(c) The quotation is 20.05 bid, offered at 20.07, 1,500 x 1,000. Also on the book to buy are 1,000 shares at 20.04, 1,000 shares to buy at 20.03, and 1,500 shares to buy at 20.01. The last sale is at 20.04. An NX order to sell short 3,000 shares arrives. The security in question is not part of the Regulation SHO pilot.<sup>49</sup> 1,500 shares automatically execute at 20.05. The residual, 1,500, cannot sweep the book because that would violate short sale rules. The market is autoquoted 20.04 bid, the next best bid on the book, offered at 20.05, the price at which the sell short order can trade, 1,000 x 1,500.

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<sup>49</sup> See note 13, supra.