

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51329; File No. SR-NYSE-2004-71)

March 8, 2005

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. to Amend NYSE Rule 104 Regarding the Requirement that Specialists Obtain Floor Official Approval for Destabilizing Dealer Account Transactions in ETFs

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 December 15, 2004, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NYSE. On February 28, 2005, the NYSE submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange is proposing to amend NYSE Rule 104 (Dealings by Specialists) to remove the requirement that specialists obtain Floor Official approval for destabilizing dealer account transactions in investment company units and Trust Issued Receipts (collectively referred to as "Exchange Traded Funds" or "ETFs"). Below is the text of the proposed rule change, as amended. Proposed new language is italicized; proposed deletions are in [brackets].

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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> Amendment No. 1 superseded the originally filed proposed rule change in its entirety.

## Dealings by Specialists

### Rule 104

- (a) No specialist shall effect on the Exchange purchases or sales of any security in which such specialist is registered, for any account in which he, his member organization or any other member, allied member, or approved person, (unless an exemption with respect to such approved person is in effect pursuant to Rule 98) in such organization or officer or employee thereof is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market, or to act as an odd-lot dealer in such security.
- (b) No change.

### Supplementary Material:

#### Functions of Specialists

.10 Regular specialists.-Any member who expects to act regularly as specialist in any listed stock and to solicit orders therein must be registered as a regular specialist.

The function of a member acting as regular specialist on the Floor of the Exchange includes, in addition to the effective execution of commission orders entrusted to him, the maintenance, in so far as reasonably practicable, of a fair and orderly market on the Exchange in the stocks in which he is so acting. This is more specifically set forth in the following:

(1)-(6) No change.

(7) The requirement to obtain Floor Official approval for transactions for a specialist's own account contained in subparagraphs (5)(i)(A), (B) and (6)(i)(A) above shall not apply to transactions effected [for the purpose of bringing the price of] in an investment company unit (the "unit"), as that term is defined in

Section 703.16 of the Listed Company Manual, or a Trust Issued Receipt (the "receipt") as that term is defined in Rule 1200 [into parity with the value of the index on which the unit is based, with the net asset value of the securities comprising the unit or the receipt, or with a futures contract on the value of the index on which the unit is based]. Nevertheless such transactions must be effected in a manner that is consistent with the maintenance of a fair and orderly market and with the other requirements of this rule and the supplementary material herein.

No changes to remainder of rule.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposal. 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

The Exchange proposes to eliminate the current restriction on the ability of specialists to buy ETFs on plus ticks or sell ETFs on minus ticks without Floor Official approval for the transactions.

NYSE Rule 104 governs specialists' dealings in their specialty stocks. In particular, NYSE Rules 104.10(5) and (6) describe certain types of transactions that are not to be effected

unless they are reasonably necessary to render the specialist's position adequate to the needs of the market. The Exchange states that, in effect, these restrictions generally require specialists' transactions for their own accounts to be "stabilizing" (i.e., against the trend of the market) and prohibit specialists from making transactions that are "destabilizing" (i.e., with the market trend by buying on plus ticks and selling on minus ticks), except with the approval of a Floor Official.

The Exchange is proposing to remove these restrictions in connection with destabilizing transactions in ETFs by specialists for their own account. These products are based on a portfolio of underlying securities and are derivatively priced based upon the value of those securities. Therefore, according to the Exchange, specialists would be unable to effect ETF transactions for their own accounts in a manner that would likely lead the market price in those securities, even if the transactions were effected on destabilizing ticks. The Exchange notes that the Commission has previously recognized this aspect of ETFs.<sup>4</sup>

Specialists are not currently required to obtain Floor Official approval for proprietary destabilizing transactions that bring an ETF into parity with the value of the index on which the ETF is based. The Exchange believes that, in light of the derivative nature of ETFs and the Commission's recognition that specialists are generally unable to lead the market through

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<sup>4</sup> See Securities Exchange Act Release No. 49087 (January 15, 2004), 69 FR 3622 (January 26, 2004) ("[T]he Commission believes that because ETFs are priced derivatively, an Exchange specialist would not be able to manipulate the pricing of an ETF.").

proprietary transactions in ETFs, NYSE Rule 104.10(7) should be amended to delete the need for Floor Official approval for any specialist destabilizing dealer account transactions in ETFs.

The Exchange notes that in addition to the diminished benefit of Floor Official approval of specialists' proprietary destabilizing tick transactions in ETFs, the time required to obtain Floor Official approval for such transactions can have the effect of delaying trading in these products and could result in inferior execution prices for customer orders. Finally, the Exchange believes that removing these restrictions should enhance the specialist's ability to make competitive markets in ETFs, since other markets where they are traded do not have such restrictions.

## 2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)<sup>5</sup> that an Exchange have rules that are designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

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

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

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

The Exchange has not solicited, and does not intend to solicit, comments regarding the proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

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 such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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-2004-71 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-2004-71. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-NYSE-2004-71 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>6</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>6</sup> 17 CFR 200.30-3(a)(12).