

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53208; File No. SR-NYSE-2005-74)

February 2, 2006

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto Relating to an Interpretation of Exchange Rule 108(a)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 13, 2005, the New York Stock Exchange, Inc. (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NYSE. On January 31, 2006, NYSE filed Amendment No. 1 to the proposed rule change.³ NYSE has designated the proposed rule change as constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization pursuant to Section 19(b)(3)(A)(i) of the Act⁴ and Rule 19b-4(f)(1) thereunder,⁵ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Partial Amendment dated January 31, 2006 (“Amendment No. 1”). In Amendment No. 1, the Exchange added additional discussion regarding the history of NYSE Rule 108 to its Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others (Item 5 of Form 19b-4).

⁴ 15 U.S.C. 78s(b)(3)(A)(i).

⁵ 17 CFR 240.19b-4(f)(1).

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

The proposed rule change is a NYSE Information Memo that reflects the Exchange's longstanding interpretation of NYSE Rule 108(a) to allow brokers to permit specialists who are establishing or increasing positions in their specialty securities to be on parity with the trading crowd. A copy of the Information Memo, titled Specialist and Floor Broker Obligations in Connection with Specialist Parity with Orders Represented in the Crowd Under Rule 108, is appended to this Notice.

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. The text of these statements may be examined at the places specified in Item IV below. NYSE 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 SR-NYSE-2004-05, Amendment No. 7, the Exchange clarified that by including a customer's order in the broker agency interest file, the broker waives his or her objection to the specialist trading on parity with such order, with the result that the specialist may trade on parity in automatic executions.⁶ As noted in that filing, the proposed change comports with, and would incorporate into the rule text, the Exchange's longstanding interpretation of NYSE Rule 108(a) as permitting a specialist to be on parity with orders in the trading crowd ("Crowd") when the specialist is establishing or increasing his or her position, provided that the brokers representing

⁶ See Amendment No. 7 to File No. SR-NYSE-2004-05, dated October 10, 2005.

orders in the Crowd permit the specialist to trade along with them by not objecting to such participation.

The purpose of this filing is to submit to the Commission an Information Memo concerning NYSE Rule 108(a). The Information Memo reiterates the Exchange's interpretation, and sets forth a procedure for specialists to announce their intention to trade on parity under NYSE Rule 108(a), and for brokers to object to specialist participation. In addition, the Information Memo reminds specialists of their negative obligation and its potential impact on a decision to trade on parity, and reminds Floor brokers of their obligations to disclose to customers that they may permit specialists to trade on parity with a customer order for some or all of the executions associated with that order, seek guidance from their customers with respect to specialists trading on parity, and to conform to that guidance in executing customer orders. The memo also sets forth a documentation requirement that requires brokers to document objections at the time the report of execution is issued in connection with such orders.

The Exchange's interpretation of NYSE Rule 108(a) recognizes that there are situations in which a customer or broker wants a specialist to trade on parity in a transaction. As a general matter, customers often have a strategic desire not to be the sole participant at a particular price, and may instruct the broker as such in connection with working a not-held order. Similarly, in working a not-held order, a broker may determine that the customer's order would benefit from specialist participation on parity, or that the terms of the not-held order do not preclude a specialist from being on parity.

A customer gives a broker a not-held order whenever the customer wants the broker to exercise discretion in how, when, and at what price to execute the order. Even if the customer sets limiting parameters in connection with a not-held order, he is, by virtue of the fact that the

order is “not-held,” granting the broker discretion in how to execute the order so long as it satisfies those parameters. In contrast, when a broker is handling a held order (an order in which he is “held” to an execution at a particular price, and the broker has no discretion on how to execute the order), a broker could permit the specialist to be on parity where the customer has explicitly granted the broker such authority as a term of the order.

As noted above, a broker may work the order in the Crowd, and permit the specialist to trade on parity if, based on the broker’s professional judgment, specialist parity is appropriate. For example, a broker may decide not to object to specialist parity where the broker is handling a go-along order that will benefit from specialist participation because the customer wants some party to trade at the same time; the customer’s concern is only that someone trade alongside, and therefore the customer is likely indifferent as to whether that party is the specialist or another broker. Similarly, a broker may decide not to object to the specialist being on parity whenever the broker determines, as fiduciary for the customer, that specialist participation could improve the market for an order. For example, a broker whose customer is interested in participating only on large trades could permit the specialist to be on parity for one trade in order to increase its overall size.

Alternatively, a broker may decide not to object to a specialist being on parity where the order contains instructions that would accommodate the specialist trading on parity, such as where the customer instructs the broker not to trade more than a fixed number of shares on any single trade (and where the total contra interest in the particular trade exceeds that fixed amount), or where a broker holding a large order is nevertheless trading less than the contra-side interest in a given trade because the terms of the customer’s order limits the broker to a fixed volume over a particular period of the trading day.

The Exchange's interpretation of NYSE Rule 108(a) is consistent with other rules that permit specialists to trade on parity with the Crowd, such as NYSE Rule 123A.30, which expressly authorizes brokers to permit specialists to go along with the brokers' CAP orders, regardless of whether the specialist is increasing or decreasing his position.⁷ The Exchange's interpretation of NYSE Rule 108(a) is also consistent with best execution obligations outlined in NYSE Rules 13.20, 123A.41, 123A.42, and 123A.44.

NYSE Rule 108(a) currently provides that specialists making a bid or offer on an order for their own accounts to establish or increase a position in a stock are not "entitled" to parity with a bid or offer that originates off the Floor. An exception is made for so-called "G" orders, which are orders that originate off the Floor and are executed pursuant to Section 11(a)(1)(G)⁸ of the Act and Rule 11a1-1(T)⁹ thereunder. But, because the rule only speaks to specialists not being "entitled" (*i.e.*, not having an unconditional right) to be on parity rather than flatly prohibiting them from being on parity, the rule, by its terms, does not preclude specialists from trading on parity when establishing or increasing their positions if brokers in the Crowd raise no objections.

The Exchange believes that its interpretation of NYSE Rule 108(a), while potentially increasing the instances in which specialists can trade along with the Crowd, benefits the market

⁷ A CAP ("convert and parity") order is a form of percentage order. Like other percentage orders, a CAP order may be elected when a transaction has occurred at its limit price or a better price. In addition, a CAP order instruction from the broker permits the specialist to convert all or part of the unelected portion either only on stabilizing ticks or on any tick (depending on the broker's specific instructions to the specialist). The broker can also instruct that any elected portion of a CAP order is to be executed immediately in whole or in part, and that whatever is not immediately executed does not remain on the book as a limit order, but reverts to its status as an unelected percentage order for future election or conversion.

⁸ 15 U.S.C. 78k(a)(1)(G).

⁹ 17 CFR 240.11a-1(T).

by encouraging specialists to add depth and liquidity by initiating proprietary transactions on the Floor of the Exchange. Notably, however, the interpretation does not give specialists the unfettered ability to trade for their proprietary accounts, since, in effecting such transactions, they remain bound by the reasonable necessity considerations contained in NYSE Rule 104, and since their ability to trade on parity in any event always remains subject to the Crowd's objection.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)¹⁰ 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 believes that the proposed rule change would not 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 not solicited written comments on the proposed rule change. The Commission received two comment letters (both from the same commenter) in connection with filing SR-NYSE-2005-74. The Commission staff forwarded those comments to the Exchange and asked the Exchange to respond to them in this filing. The comment letters and the Exchange's response to them are summarized below.

¹⁰ 15 U.S.C. 78f(b)(5).

Comment letter from George Rutherford, dated October 30, 2005: This letter is non-substantive. It announces that Mr. Rutherford intends to file a more detailed letter regarding this filing, and urges the Commission not to take action until such time as Mr. Rutherford has had an opportunity to submit such a letter.

Comment letter from George Rutherford, dated November 1, 2005: This letter raises four principal objections: (i) The Exchange's interpretation of NYSE Rule 108(a) is at odds with the plain language of the Rule; (ii) the fact that the Exchange has filed its interpretation with the Commission "proves" that the interpretation is not reasonably and fairly implied by an existing rule and therefore is not eligible for immediate effectiveness; (iii) specialist parity trades, at least when they are establishing or increasing their positions, are contrary to the interests of public investors and should be prohibited; and (iv) Floor brokers cannot effectively protect their own or their customers' interests and therefore the specialists must be prevented from trading on parity when they are establishing or increasing their proprietary positions.

The Exchange strongly disagrees with the commenter's arguments. In its response to the comment letters, the Exchange argues that (i) its interpretation of NYSE Rule 108(a) is consistent with the plain language of the rule; (ii) the Exchange appropriately sought immediate effectiveness for the interpretation; (iii) the Exchange's interpretation is consistent with the history of NYSE Rule 108; (iv) Floor brokers can protect customers' interests by objecting where appropriate; and (v) Mr. Rutherford fails to explain why brokers cannot protect customers' interests. The Exchange concludes that the Exchange's interpretation of NYSE Rule 108(a) is consistent with customer protection, and that the proposed Information Memo will further clarify the procedures for trading consistent with the interpretation and documenting that trading

properly. A copy of the Exchange's response is attached to its filing with the Commission as part of Exhibit 2, and is also set forth below.

None of the commenter's arguments have merit, inasmuch as they rely on sweeping generalizations or incorrect assumptions, are unsupported by any verifiable legal or other authority, and consist largely of meritless accusations. Nevertheless, the Exchange addresses these objections below.

1. The Exchange's Interpretation of Rule 108(a) is Consistent with the Plain Language of the Rule

Although the commenter dismisses the Exchange's interpretation as "ridiculous word games," the fact is that statutory interpretation must, of necessity, start with the words of the rule or statute to be interpreted.¹¹ What's more, the words of a statute or rule should be given their plain meaning, wherever possible.¹²

At issue is whether NYSE Rule 108(a) on its face prohibits specialists from trading on parity when they are establishing or increasing their positions. It does not. As the commenter is well aware, the rule states simply that specialists are not "entitled" to trade on parity.

According to the commenter (without citations), "entitled" means "allowed to act"; he interprets that word, when coupled with the word "not," to mean "not allowed to act" or "prohibited." He then concludes that since the specialists are, in his formulation, "not allowed to

¹¹ See United States v. Kinzler, 55 F.3d 70, 72 (2d Cir. 1995) ("Statutory interpretation starts with the language of the statute itself . . .").

¹² See Perrin v. United States, 444 U.S. 37, 42 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning.") (emphasis added).

act” in parity situations, the Exchange’s interpretation must be intended to put one over on the Commission.

But perhaps the commenter should consult a dictionary before accusing others of being “intellectually overmatched.” The Exchange consulted two, the American Heritage Dictionary of the English Language¹³ and Black’s Law Dictionary,¹⁴ both of which confirmed the Exchange’s understanding of the meaning of the word, and did not support his. To wit, the American Heritage Dictionary defines “entitle” to mean “to furnish with a right or claim to something,” while Black’s Law Dictionary defines “entitle” as follows: “In its usual sense, to entitle is to give a right or legal title to.”

Applying these definitions, it’s clear that the Exchange’s interpretation is neither “ridiculous” nor “intellectually bankrupt.” It is merely a plain reading of the English language. Simply put, the rule says only that a member does not have an unfettered or automatic right to trade on parity when establishing or increasing his position. Tellingly, there is nothing in the plain language of the rule about a specialist being “prohibited” from trading in that situation.

The logic of this interpretation is further supported by the well-accepted canon of statutory construction that rule-writers are presumed in any rule to have said what they meant, and meant what they said.¹⁵ In particular, where Exchange rules mean to prescribe or proscribe specific conduct, the rules use terms such as “shall” or “must” or similar words of obligation.¹⁶

¹³ 4th Ed. (Houghton Mifflin 2000).

¹⁴ 6th Ed. (West 1991).

¹⁵ See Connecticut Nat’l Bank v. Germain, 503 U.S. 249, 253-54 (1992) (“Courts must presume that a legislature says in a statute what it means and means in a statute what it says there.”)

¹⁶ See, e.g., NYSE Rule 63 (“Bids and offers in securities admitted to dealings on a ‘when issued’ basis shall be made only ‘when issued’”); NYSE Rule 72(b) (“A member who is providing a better price to one side of the cross transaction must trade with all

Notably, NYSE Rule 108(a) does not use such obligatory language, but rather, uses the conditional term “entitled.” It would be illogical to conclude that the Exchange meant something other than what it said; if it had meant to categorically exclude specialists from trading on parity in situations in which they are establishing or increasing a position, the numerous rules where “shall” or “must” appear certainly demonstrate that the Exchange knew how to write such a rule. The fact that the rule is not written that way is evidence of the Exchange’s different intent with respect to the rule and its scope.

In the absence of a prohibition on specialist parity when establishing or increasing a position, it is entirely consistent with the rule, as well as Commission precedent, to state that even if they are not entitled, specialists nevertheless may trade on parity under certain circumstances.¹⁷ And what are these circumstances? Exactly the ones enunciated in the Information Memo that is the subject of the rule filing: the specialist may trade on parity while establishing or increasing his position as long as he or she clearly announces an intention to trade on parity, and no brokers in the Trading Crowd object.

other market interest having priority at that price before trading with any part of the cross transaction.”); NYSE Rule 78 (“An offer to sell coupled with an offer to buy back at the time or at an advanced price, or the reverse, is a prearranged trade and is prohibited.”).

¹⁷ See NASD Manual Section 2341 (“You are not entitled to an extension of time on a margin call. While an extension of time to meet margin requirements may be available to customers under certain conditions, a customer does not have a right to the extension.”) (Emphasis in original), approved by Securities Exchange Act Release No. 44223 (May 3, 2001), 66 FR 22274, 22276 (April 26, 2001) (NASD-00-55) (“Some investors believe they are automatically entitled to an extension of time to meet margin calls. While an extension of time to meet initial margin requirements may be available to the customer under certain conditions, it is only granted if the clearing firm chooses to request an extension from its Designated Examining Authority—the customer does not have a right to an automatic extension.”).

2. The Exchange Appropriately Sought Immediate Effectiveness for the Interpretation

The commenter further argues that the Exchange's filing is not properly designated for immediate effectiveness because it is not an "interpretation" that is "reasonably and fairly implied" by the rule text. But as described above, the Exchange's interpretation of NYSE Rule 108(a) is not, as the commenter contends, "absolutely at odds with the rule's plain language"; to the contrary, it is entirely consistent with that language. Nevertheless, the commenter claims that by filing the interpretation, the Exchange is "acknowledging the obvious," namely that the interpretation is not reasonably and fairly implied from the existing language. Otherwise, he reasons, why would the Exchange have filed it?

Section 19(b)(3)(A) of the Act¹⁸ provides that a "rule change may take effect upon filing with the Commission" if the proposed change constitutes a "stated policy, practice or interpretation" with respect to the meaning of an existing rule. As described more fully below, the Exchange has been interpreting NYSE 108(a) since its adoption as limiting, but not eliminating, the ability of specialists to trade on parity when establishing or increasing their positions. In response to inquiries from the Commission, the Exchange has now filed that interpretation pursuant to Section 19(b)(3)(A) under the Act. We fail to see how this is inconsistent with the underlying scheme of the Act, or how this in any way "proves" that the current practice is illegal; by the commenter's logic, all filings for immediate effectiveness would be either unnecessary or indicative of illegal conduct by the filing exchange. Surely this is not a proper reading of the statute.

In any event, the Exchange strongly disagrees with the commenter's claim. As noted above, we believe that the Exchange's interpretation of NYSE Rule 108(a) is reasonably and

¹⁸ 15 U.S.C. 78s(b)(3)(A).

fairly implied from the existing language of the rule, since the rule by its terms does not prohibit a specialist from trading on parity when he or she is establishing or increasing a position. At the same time, the Exchange recognizes that the rule does not give specialists carte blanche to trade on parity in those situations. Accordingly, the Information Memo reminds specialists that their proprietary trading must be consistent with maintaining a fair and orderly market, and reminds Floor Brokers that they have an obligation to object to specialist parity if not objecting would result in a less-than-best execution for their customers. We believe that this is also reasonably and fairly implied from the rule, since permission to be on parity could not logically come from anyone but the Floor Brokers who are, after all, representing the customers' interests.

3. The Exchange's Interpretation Is Consistent with the History of NYSE Rule 108

The commenter claims that the Exchange's interpretation of NYSE Rule 108(a) is inconsistent with the history underlying the rule. Again, the Exchange strongly disagrees.

Historically, NYSE Rule 108 was intended to prevent specialists, registered competitive market makers and competitive traders from unduly profiting from their "time-place" trading advantage over other market participants by reason of the members' physical presence on the Floor, which permitted them to respond to trading activity in a particular stock before the transaction appeared on the tape. The issue of the proper role of floor trading has been one of contention since the passage of the Act in 1934. At that time, there was significant pressure to ban floor trading altogether, but Congress tabled the issue and directed the newly-formed SEC to study it and make a recommendation as to appropriate action. The SEC's conclusion, reported in its Segregation Report in 1936,¹⁹ was that there was not a clear-cut case for eliminating all floor

¹⁹ "Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker," Securities and Exchange Commission (1936) ("Segregation Report").

trading. With respect particularly to specialists trading for their own accounts, the Segregation Report concluded that “[i]mmediate concern for the reduction of this activity is . . . not demanded” and recommended further study.²⁰

Over the next nine years, between 1936 and 1945, the Commission and the NYSE (among others) debated whether floor trading was harmful or beneficial to the goals of securities regulation. In January 1945, the SEC’s Trading and Exchange Division issued its “Report on Floor Trading” which reported on an extensive study of floor trading.²¹ The report recommended the elimination of floor trading by competitive traders altogether and by specialists except where such transactions were reasonably necessary to the maintenance of a fair and orderly market.

In August 1945, in response to the SEC’s recommendation, the Exchange adopted the predecessor to NYSE Rule 108. The Exchange’s action amounted to a compromise with the SEC, in that the Exchange agreed to restrict floor trading substantially in order to “remove . . . any conceivable advantage which the floor trader may be presumed to have over public customers of our member firms.”²² Significantly, the SEC did not adopt the Floor Trading Report’s recommendations,²³ and although the SEC revisited the issue of floor trading several times after 1945, the fundamental principles underlying NYSE Rule 108 have been preserved to date.

²⁰ Id. at 111.

²¹ See Securities Exchange Act Release No. 3640 (January 16, 1945).

²² Statement of NYSE President Emil Schram, August 28, 1945 (copy maintained in NYSE Archives).

²³ Securities Exchange Act Release No. 3727 (August 28, 1945).

Statements in a 1979 rule amendment filing, SR-NYSE-79-2,²⁴ reinforce the conclusion that the NYSE’s interpretation has not substantially changed over the years. That filing was made in response to implementation of Section 11(a)(1)(G) of Act,²⁵ and expressly entitled specialists to be on parity with members’ off-Floor proprietary orders (the so-called “G orders,” after the section number). In essence, the amendment permitted a specialist to trade on parity with G orders even if the entering member would have objected to parity.

Notably, the rule filing specifically limited the change to G order situations: “No changes are proposed with respect to priority, parity and precedence based on size vis-à-vis orders of public customers.” Also notable is the Exchange’s own description in the filing as to the scope of NYSE Rule 108, which is not inconsistent with the interpretation that is the subject of the Information Memo:

In varying degrees, Exchange Rules 108 and 112 restrict bids and offers of specialists . . . from having priority, parity or precedence based on size over orders initiated off the Floor . . . The restriction primarily applies when a member is establishing or increasing a position as opposed to liquidating a position.
(Emphasis added.)²⁶

The use of the terms “restrict” and “restriction” instead of “prohibit” and “prohibition” is significant, as it reinforces the interpretation that NYSE Rule 108 does not, and was not intended to, “prohibit” specialist parity, but merely to “restrict” it in certain situations – namely, where a broker objects to the specialist trading on parity.

²⁴ See Securities Exchange Act Release No. 15535 (January 29, 1979), 44 FR 6240 (January 31, 1979) (Notice of proposed rule change).

²⁵ 15 U.S.C. 78k(a)(1)(G).

²⁶ Securities Exchange Act Release No. 15535, supra note 24.

Subsequent interpretive guidance on NYSE Rule 108, such as statements contained in the Exchange's annually-published Floor Official Manual, is also not inconsistent with the Exchange's interpretation of NYSE Rule 108. For example, NYSE Floor Official Manuals as far back as 1991 state that specialists "must yield parity" to off-Floor orders when establishing or increasing positions, however, this merely reiterates that the right of specialists to trade on parity is not unfettered – that is, that if a broker objects to specialist parity when the specialist is establishing or increasing a position, then the specialist has no choice but defer to that order. In other words, in the face of an objection, the specialist "must yield" parity. But this language does not prohibit a specialist from being on parity when no broker objects. The specialist may not insert himself unilaterally, but can be given the right-of-way.

While NYSE Rule 108 in its current form preserves the restrictions on on-floor trading by stating that a member's order for his or its own account are not "entitled" to parity with a public order if the member is establishing or increasing a position, the rule does not, and was not meant to, completely eliminate parity trading by specialists when establishing or increasing a position. Instead, the rule was intended only to control it, in order to remove undue advantages that specialists had over the public customer.

Notably, the Exchange's subsequent interpretation of NYSE Rule 108(a) is entirely consistent with that aim, in that it prevents specialists from taking advantage of public customers by requiring them to refrain from trading on parity when any broker representing a public customer's order in that auction objects to the specialist's participation.

4. Objections by Floor Brokers Can Effectively Protect Their Customers' Interests Under Rule 108(a)

a. Brokers can protect customers' interests by objecting where appropriate

The commenter nakedly asserts that Floor brokers cannot be counted on to object to specialist parity trading because they are intimidated by the “retributive powers of specialists” and must “get along by going along.” His sweeping conclusion, however, is not supported by meaningful objective data, and the commenter thus leaves the Exchange with the impossible task of disproving an unproven factoid. We also note that this argument is illogical, since, in a competitive marketplace, brokers who failed to adequately execute orders as a result of specialists “bullying” them would quickly lose customer business.

In any event, the Exchange notes that as a result of the issuance of the Information Memo at issue, there should be no doubts among the Floor members either as to the duties of the specialists in potential parity trades or as to the obligations on the brokers to object, if an objection is called for. In addition, there should not be any doubt that the decision to permit the specialist to trade on parity or not is intimately connected with both the specialists' obligations under NYSE Rule 104, and the brokers' best execution obligations under NYSE Rules 13.20, 123A.41, 123A.42, and 123A.43, and will be evaluated by NYSE Regulation on that basis as well.

We also note that because brokers are required to inform their customers about specialist parity and about the brokers' practices in deciding whether to permit the specialists to trade on parity, customers may increase the instances in which they request, as a term of their orders, that the specialist not trade on parity. These notices, and the resulting public awareness of Floor trading practices regarding parity, are likely to increase members' vigilance to ensure that no one, either broker or specialist, trades on parity if it would be inappropriate to do so.

b. The commenter fails to explain why brokers cannot protect customers' interests

The commenter argues that the interpretation is unnecessary, as the Exchange's current rules could accommodate specialist "trade along" participation, and concludes as a result that the Exchange's true motivation in filing the interpretation must have been to provide specialists with additional opportunities to participate as dealer at the expense of customers. The Exchange disagrees with both his supposition and his conclusion.

We note that the commenter cites two examples in which, supposedly, the specialist could provide "trade along" participation without being on parity. Unfortunately, his examples do not comport with existing Exchange rules, approved by the SEC, regarding bidding and offering and therefore are inappropriate. Interestingly, however, they ably demonstrate how the newly-announced procedures in connection with NYSE Rule 108(a) protect the public customers' interests.

In his first example, the commenter poses a scenario in which there is a 2,000 share bid consisting of a single broker, Broker A, who bids for 1,000 shares, and the specialist also bidding for 1,000 shares (on parity) to establish or increase a position. Broker A's customer, Customer A, would prefer not to be 100% of the trading volume. Another broker, Broker B, enters the crowd to sell 1,000 shares to the bid.

Under the Exchange's interpretation, the specialist could trade on parity if Broker A did not object, and therefore the specialist and Broker A would each buy 500 shares, which would satisfy Customer A's preference not to be 100% of the volume. The commenter, however, suggests that instead, Broker A should buy 500 shares in a single trade, and then the specialist could provide "covering volume" in a second trade of 500 shares.

The commenter's example ignores the fact that Broker A has made a firm bid for 1,000 shares, and that as a result, if the specialist is not on parity in the first transaction, Broker A could not buy only 500 shares. Rather, he would be obligated under NYSE Rule 60 and Rule 11Ac1-1 under the Act to buy the entire 1,000 shares – the extent of his bid – from Broker B, who is willing to sell 1,000 shares. Significantly, the commenter also fails to explain how the Exchange's interpretation would permit the specialist to “‘elbow aside’ Broker A to the extent of 500 shares that should otherwise go to [Customer A].” Presumably, if Customer A simply wants someone – anyone – else on the trade with him, the specialist's participation on parity should not be problematic. If, on the other hand, Customer A would object to the specialist trading on parity, Customer A could instruct Broker A to object to specialist parity (meaning that Broker A would have to wait until another broker bid as well, in order to satisfy Customer A's concurrent desire not to be 100% of the volume on any trade), or in the absence of a specific parity instruction, Broker A could, in the reasonable exercise of his judgment, object on his own to the specialist trading on parity. In either event, the Exchange's interpretation and associated procedures result in no “elbowing aside,” and in fact actually safeguard Customer A's interests.

In the commenter's second example, he poses a situation in which there are four brokers (A through D) each bidding for 2,000 shares, and the specialist bidding for 2,000 shares as well. Another broker, Broker E, enters the crowd to sell 8,000 shares. If the specialist is not permitted to trade on parity, Brokers A, B, C and D would each buy 2,000 shares; if the specialist is permitted to trade on parity, the brokers and the specialist would each buy 1,600 shares. From this, the commenter concludes that Customers A, B, C and D must have been disadvantaged, since they did not get complete fills.

The commenter's proposed solution is, like the first scenario, inconsistent with how Floor trading rules operate – he suggests that the specialist should not participate in the transaction with Brokers A, B, C, and D, but could participate if any of the brokers did not “take an ‘equal split.’” But as noted before, given that each broker has bid 2,000 shares, and Broker E is selling 8,000 shares, there could never be an “unequal split” – the four brokers' bids would be hit by Broker E ($4 \times 2,000 = 8,000$), leaving nothing for the specialist.

His analysis, moreover, also ignores several possibilities that are positive for the customer, such as the possibility that the specialist is buying into a declining market, and that as a result of his trading on parity, Customers A, B, C and D might complete their purchases at one or more lower prices.

And again, ironically, the commenter's second example highlights the utility of the Exchange's interpretation of NYSE Rule 108(a) – if any of the four customers did not want the specialist to trade on parity, that customer or the broker representing that customer would be free to object, thus preventing the specialist from buying 1,600 shares, and getting the ability to complete his or its entire 2,000 share bid. Significantly, the commenter does not explain why this result could not come about, other than to reiterate his familiar canard that brokers are in thrall to the “all-powerful” specialist.

5. Conclusion

In sum, the Exchange's interpretation of NYSE Rule 108(a) is reasonably and fairly implied from the text of the rule and its history and from the history of regulation of floor trading, and therefore is appropriately filed for immediate effectiveness. Moreover, the Exchange believes that it is consistent with customer protection, and that the proposed

Information Memo will further clarify the procedures for trading consistent with the interpretation and documenting that trading properly.

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

The foregoing rule change, as amended, has become effective pursuant to Section 19(b)(3)(A)(i) of the Act²⁷ and subparagraph (f)(1) of Rule 19b-4 thereunder.²⁸ The proposed rule change is a stated policy, practice or interpretation with respect to the meaning, administration or enforcement of existing rules of the Exchange.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.²⁹

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

²⁷ 15 U.S.C. 78s(b)(3)(A)(i).

²⁸ 17 CFR 240.19b-4(f)(1).

²⁹ The effective date of the original proposed rule is December 13, 2005. The effective date of Amendment No. 1 is January 31, 2006. For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposed rule change under Section 19(b)(3)(C) of the Act, the Commission considers the period to commence on January 31, 2006, the date on which NYSE submitted Amendment No. 1. See 15 U.S.C. 78s(b)(3)(C).

- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-NYSE-2005-74 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSE-2005-74. 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-2005-74 and

should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁰

Nancy M. Morris
Secretary

³⁰ 17 CFR 200.30-3(a)(12).

Appendix

ATTENTION: FLOOR MEMBERS, SENIOR MANAGEMENT, GENERAL COUNSEL AND COMPLIANCE PERSONNEL

TO: ALL MEMBERS AND MEMBER ORGANIZATIONS

SUBJECT: SPECIALIST AND FLOOR BROKER OBLIGATIONS IN CONNECTION WITH SPECIALIST PARITY WITH ORDERS REPRESENTED IN THE CROWD UNDER RULE 108

The purpose of this Information Memo is to reiterate the New York Stock Exchange's (the "Exchange" or "NYSE") long-standing interpretation of NYSE Rule 108(a) regarding the specialist trading on parity with orders in the Crowd when the specialist is establishing or increasing his or her position.

The Exchange interprets NYSE Rule 108(a) as permitting a specialist to be on parity with orders in the Crowd when the specialist is establishing or increasing his or her position, provided that the brokers representing orders in the Crowd permit to the specialist trading along with them by not objecting to such participation. This is consistent with other rules that permit a specialist to trade on parity with the Crowd, such as NYSE Rule 123A.30, which expressly authorizes Floor brokers to permit a specialist to go along with brokers' convert-and-parity ("CAP") orders, regardless of the specialist's proprietary position.

NYSE Rule 108(a) provides that a specialist making a bid or offer on an order for his (or her) own account to establish or increase a position in a stock is not "entitled" to parity with a bid or offer that originates off the Floor. An exception is made for so-called "G" orders, which are orders that originate off the Floor and are executed pursuant to Section 11(a)(1)(G) of the Securities Exchange Act of 1934 (the "SEA") and SEA Rule 11a1-1(T) thereunder. But, because the rule only speaks to the specialist not being "entitled" (i.e., not having an unconditional right) to be on parity rather than flatly prohibiting him from being on parity, NYSE Rule 108(a), by its terms, does not preclude the specialist from trading on parity when establishing or increasing the specialist's position if the brokers in the Crowd raise no objection.

In connection with specialists trading on parity under NYSE Rule 108(a), members and member organizations should adhere to the following procedures:

1. Obligations of Specialists and Specialist Organizations

Specialists and specialist organizations are reminded that in order to ensure that brokers in the Crowd are making informed decisions when they permit a specialist who is establishing or increasing his or her position to trade along with the Crowd, the specialist must clearly announce his or her intention to trade on parity, and must give brokers representing orders in the Crowd a reasonable opportunity to object.¹ The obligation set out in this paragraph does not apply when specialists are handling CAP orders.

In the event that a Floor broker objects to the specialist trading on parity under NYSE Rule 108(a), the specialist must honor such request and refrain from trading on parity for that trade. Specialists and specialist organizations are also advised that notwithstanding the Exchange's interpretation, in determining whether to effect transactions under NYSE Rule 108(a), they remain bound by the reasonable necessity requirements of NYSE Rule 104. Thus, even if no Floor broker objects to the specialist trading on parity under NYSE Rule 108(a), such transactions by the specialist may nevertheless be inappropriate if the specialist's participation is not reasonably calculated to contribute to the maintenance of price continuity with reasonable depth, or to minimize the effects of temporary disparities between supply and demand that are immediate or reasonably anticipated.

2. Obligations of Floor Broker Members and Member Organizations

Floor brokers who object to the specialist trading on parity under NYSE Rule 108(a) with orders that they are representing must openly and audibly state such objections and document them.² If a Floor broker is making a continuing objection for all executions pertaining to the order he or she is representing, the objection should be stated (and subsequently documented as discussed below) when the Floor broker enters the Crowd. If a Floor broker is objecting only in specific auctions (but not for all executions pertaining to the order he or she is representing), the objection should be stated (and subsequently documented as discussed below) when the specialist announces, in connection with a particular auction, that he or she is seeking to trade on parity. Brokers who have not made a firm bid or offer in the particular auction where the specialist

¹ Pursuant to NYSE Rule 104.10(6)(i)(C), the specialist must similarly announce that he or she intends to trade on parity, and give brokers a meaningful opportunity to object. Please note that NYSE Rule 104.10(6)(i)(C) applies only when a specialist is liquidating or decreasing a position. Brokers who object to the specialist trading on parity must state as such and must record such objection using the procedures described in this memo in connection with NYSE Rule 108(a). Brokers are reminded that where a customer has specifically requested that the specialist not be on parity with the customer's order under NYSE Rule 104.10(6)(i)(C), such request is a condition of the order and must be documented pursuant to NYSE Rule 123(g).

² Upstairs firms must maintain records of customer disapprovals when such is provided.

expresses an intention to trade on parity would not have standing under NYSE Rule 108(a) to object to the specialist trading on parity in that auction.

The Exchange expects that when a Floor broker objects to the specialist trading on parity in connection with an order he or she is representing, the Floor broker must document his or her objection at the time the report of execution is issued in connection with such order. Floor broker members and member organizations must keep appropriate records of their objections pursuant to Securities Exchange Act Rule 17a-3 and NYSE Rule 440. The Exchange may from time to time revise or supplement the documentation requirements as necessary, and will notify members and member organizations accordingly.

Floor broker members and member organizations must disclose to customers that in executing orders on the Floor, the Floor broker may permit the specialist to trade on parity with the order for some or all of the executions associated with filling that order, where such permission would not be inconsistent with the broker's best execution obligations. Disclosures should be written and reasonably calculated to provide customers with sufficient notice of the Floor broker's practice in this regard. For example, such disclosure could be in the form of an affirmative written notice that is provided to customers in advance of trading.

In deciding whether to permit a specialist to trade on parity with orders that they are representing, Floor brokers must be mindful of their "best execution" obligations under the NYSE Rules 13.20, 123A.41, 123A.42 and 123A.44, including the obligation that they use due diligence to execute the order at the best price available to them under the published market procedures of the Exchange (subject to the customer's limit price, if the order is a limit order). Provided that they have made appropriate disclosures to their customers, Floor brokers are not required to obtain separate customer approval to permit the specialist to trade on parity under NYSE Rule 108(a) for each order or trade, but may rely on the disclosures to customers and any resulting guidance provided by their customers, as described above.

If a broker believes that a specialist has improperly traded on parity with his or her order, the broker should promptly alert any member of the On-Floor Surveillance Unit, located in the Extended Blue Room, or contact Pat Giraldi, Director of the unit, at (212) 656-6804.

3. All Members and Member Organizations

Members and member organizations should take steps to inform and educate management and associated persons regarding the information contained in this Information Memo, and are reminded that pursuant to Exchange Rule 342, they must have appropriate systems, procedures and controls for ensuring compliance with the above-referenced policies.

* * *

Questions regarding the above may be directed to Patrick Giraldi, Director, Market Surveillance, at (212) 656-6804, Gordon Brown, Manager, On-Floor Surveillance Unit, in the Extended Blue Room or at (212) 656-5321, or Daniel M. Labovitz, Director, Market Surveillance, at (212) 656-2081.

Robert A. Marchman
Executive Vice President
Market Surveillance