

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54362; File No. SR-NYSE-2006-07)

August 25, 2006

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Granting Approval of Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 Thereto To Amend Exchange Rule 104 Regarding the Requirement that Specialists Obtain Floor Official Approval for Destabilizing Dealer Account Transactions that Match the National Best Bid or Offer

I. Introduction

On February 16, 2006, the New York Stock Exchange LLC (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change to amend NYSE Rule 104 (Dealings by Specialists) to permit specialists to effect destabilizing dealer account transactions when matching the national best bid or offer without requiring that they obtain Floor Official approval. On April 27, 2006, NYSE filed Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the Federal Register on May 16, 2006.<sup>3</sup> The Commission received one comment letter<sup>4</sup> and a letter from NYSE that responded to the issues raised by the commenter.<sup>5</sup> On August 17, 2006,

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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 Securities Exchange Act Release No. 53782 (May 10, 2006), 71 FR 28399.

<sup>4</sup> See e-mail from George Rutherford to the Commission, dated April 24, 2006 (“Rutherford Letter”).

<sup>5</sup> Letter to Nancy M. Morris, Secretary, Commission, from Mary Yeager, Assistant Secretary, NYSE, dated July 20, 2006 (“NYSE Response Letter”).

NYSE filed Amendment No. 2 to the proposed rule change.<sup>6</sup> This order approves the proposed rule change, as amended by Amendment No. 1. Simultaneously, the Commission is providing notice of filing of Amendment No. 2 and granting accelerated approval of Amendment No. 2.

## II. Description of the Proposal

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. 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 proposes to allow specialists to effect proprietary transactions on a destabilizing basis for their own account when such trades are effected at a price that matches the current national best bid or offer ("NBBO") displayed by another market center.

## III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

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<sup>6</sup> Amendment No. 2 clarifies that a specialist's ability to effect destabilizing dealer account transactions when matching the national best bid or offer applies when the national best bid or offer is established by another market center.

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 No. SR-NYSE-2006-07 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-2006-07. 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-2006-07 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

#### IV. Discussion

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>7</sup> and, in particular, the requirements of Section 6 of the Act.<sup>8</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>9</sup> which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and 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.

The commenter asserted that the proposed rule change is unnecessary because the current rules work well to protect the public and the integrity of the price discovery mechanism.<sup>10</sup> The commenter expressed concern that removing the requirement for Floor Official approval would diminish the check and balance system that ensures that a specialist matching an away bid or offer is appropriate under the circumstances. The

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<sup>7</sup> In approving this proposed rule change, as amended, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f.

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> See Rutherford Letter, supra note 4.

commenter also challenged the Exchange’s argument that the proposed rule change is consistent with certain current practices in which specialists are permitted to match away bids and offers, as with exchange traded funds (“ETFs”). The commenter argued that, because ETFs are derivatively and objectively priced and the Exchange is not the primary market or price setting mechanism for ETFs, as it is for equities, the proposed rule change would not be appropriate for equity securities.

In response to the commenter’s argument that Floor Official approval is a necessary safeguard against specialist over-reaching, the Exchange asserted that specialist transactions for their own account are still subject to certain Exchange Rules including “a specialist’s affirmative and negative obligations, a responsibility to maintain a two-sided market with quotations that are timely and accurately reflect market conditions, and a duty to ensure that a specialist’s principal transactions are designed to contribute to the maintenance of price continuity with reasonable depth.”<sup>11</sup> The Exchange argued that a Floor Official’s approval of a destabilizing transaction for a specialist’s proprietary account is only one part of the test to determine whether a specialist’s proprietary transaction is proper. The Exchange also stated that it would continue to surveil specialists’ proprietary transactions for compliance with the Exchange’s Rules.<sup>12</sup>

In addition, the Exchange believed that there is no basis for the commenter’s argument that that “[p]rices are not objectively determined . . .” with respect to transactions in non-ETF equity securities and that “most investors look to prices prevailing in the primary market, not nominal bids/offers in tertiary markets.”<sup>13</sup> The

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<sup>11</sup> See NYSE Response Letter, supra note 5, at 1.

<sup>12</sup> Id.

<sup>13</sup> Id.

Exchange argued that the Commission’s Order Protection Rule in Regulation NMS<sup>14</sup> undermines the validity of the commenter’s assertion.<sup>15</sup> Further, the Exchange believed that “investors and specialists will review pricing information from several sources and assign each source the weight they consider proper in making a trade or investing decision.”<sup>16</sup> The Exchange also believed that the proposed rule change to permit certain specialist trades at the NBBO price without requiring Floor Official approval gives the specialist increased flexibility to keep the Exchange’s market competitive.<sup>17</sup>

Amending NYSE Rules 104.10(5) and (6) to permit specialists to effect a destabilizing proprietary trade in an equity security at a price that matches the current NBBO should result in specialists following the market as set by the independent judgment of other market participants. The Commission believes that removing these restrictions should enhance the specialist’s ability to make competitive markets. The Commission agrees with the Exchange that the proposed rule change does not relieve specialists of their obligations under federal securities laws or NYSE Rules.<sup>18</sup> A specialist’s ability to effect proprietary transactions remains limited under the Act and NYSE Rules. The Commission notes that the Exchange is obligated to surveil its specialists to ensure their compliance with the Act and the Exchange’s Rules.

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<sup>14</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

<sup>15</sup> See NYSE Response Letter, supra note 5, at 2.

<sup>16</sup> Id. at 2.

<sup>17</sup> Id. at 2.

<sup>18</sup> Id. at 2.

Accelerated Approval of Amendment No. 2

The Commission finds good cause to approve Amendment No. 2 to the proposed rule change, as amended, prior to the thirtieth day after Amendment No. 2 is published for comment in the Federal Register pursuant to Section 19(b)(2) of the Act.<sup>19</sup> Amendment No. 2 clarifies that a specialist's ability to effect destabilizing dealer account transactions when matching the NBBO applies when the NBBO is established by another market center. The Commission finds that Amendment No. 2 provides clarification in the rule text as to the intent of the proposed rule filing. For these reasons, the Commission believes that good cause exists to accelerate approval of Amendment No. 2.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>20</sup> that the proposed rule change (File No. SR-NYSE-2006-07), as amended by Amendment No. 1 thereto, be, and hereby is, approved, and that Amendment No. 2 thereto, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>21</sup>

Nancy M. Morris  
Secretary

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<sup>19</sup> 15 U.S.C 78s(b)(2).

<sup>20</sup> 15 U.S.C. 78s(b)(2).

<sup>21</sup> 17 CFR 200.30-3(a)(12).