

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55804; File No. SR-NYSE-2007-21)

May 23, 2007

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Rule 92 (Limitations on Members' Trading Because of Customers' Orders)

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 February 23, 2007, New York Stock Exchange LLC ("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 substantially prepared by NYSE. On May 22, 2007, NYSE submitted Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

NYSE proposes to amend Rule 92 to permit, among other things, members or member organizations to trade ahead of a customer order if the purpose of the proprietary order is to execute, on a riskless principal basis, another order from a customer and to expand the consent provisions for trading along under Rule 92(b). The text of the proposed rule change is available at NYSE, the Commission's Public Reference Room, and www.nyse.com.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaced and superseded the original filing in its entirety.

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 had 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

The Exchange proposes to amend NYSE Rule 92 in order to permit member organizations to combine multiple orders into a single order and to route the order to the Display Book® for execution on a riskless principal basis via Exchange execution systems. In addition, the Exchange proposes to change the notification and consent provision of Rule 92(b) to permit customers to provide affirmative blanket consent, subject to certain requirements, rather than the current requirement that members and member organizations obtain and document consent for members to trade along with customer orders on an order-by-order basis. Finally, the Exchange proposes adding an additional exemption to Rule 92 to permit a member organization in certain situations to enter Regulation NMS ("Reg. NMS") intermarket sweep orders at the Exchange, subject to certain conditions, including that the firm yield its principal executions to any open customer orders that are required to be protected by Rule 92. The Exchange proposes these changes to harmonize Rule 92 with similar rules of the NASD and to address the changes to the marketplace because of the implementation of NYSE's Hybrid Market and Reg. NMS.

Riskless Principal Transactions

NYSE Rule 92 generally prohibits members or member organizations from trading on a proprietary basis ahead of, or along with, customer orders that are executable at the same price as the proprietary order.⁴ The rule contains several exceptions that make it permissible for a member or member organization to enter a proprietary order while representing a customer order that could be executed at the same price, so long as it is not for an account of an individual investor and the customer has provided express permission (referred to herein as a “Rule 92(b) proprietary order”).⁵

The Exchange’s proposed amendment would add a new subsection to Rule 92 that would permit riskless transactions for the purpose of facilitating the execution, on a riskless principal basis, of one or more customer orders. The proposed rule defines a riskless principal transaction as one in which a member or member organization, after having received one or more orders to buy (sell) a security, purchases (sells) the security as principal at the same price to satisfy the order(s) to buy (sell). Under the rule, the member would be required to give the customer the same price it received, exclusive of any markup or markdown, commission or commission equivalent, or other fee.

The proposed amendment seeks to harmonize the rules of NYSE with similar rules of the NASD, in particular, the NASD’s so-called Manning Rule, which permits riskless principal orders as an exception to the rule prohibiting trading ahead of customer market and limit orders

⁴ For the purposes of this rule filing and NYSE Rule 92, the terms proprietary order and principal order have the same meaning.

⁵ In general, these are transactions in which the member or member organization is: (1) liquidating a position held in a proprietary facilitation account and the customer’s order is for 10,000 shares or more; (2) creating a bona fide hedge; (3) modifying an existing hedge; or (4) engaging in a bona fide arbitrage or risk arbitrage transaction.

on the NASDAQ market.⁶ The Manning Rule is an interpretation of NASD customer protection rules, which, like NYSE Rule 92, generally prohibit firms from executing proprietary orders ahead of customer orders that could be executed at the same price. The Exchange states that the Manning exception was adopted to permit NASD broker/dealers to manage their order flow more efficiently; instead of executing a group of like customer orders individually, the rule permits market makers to aggregate like customer orders, execute a single trade as principal in the market in place of those orders, and then allocate shares back to the customers within 60 seconds of receiving a report on the riskless principal trade and at the same price as the riskless principal trade, exclusive of any markup or markdown, commission or commission equivalent, or other fee. Currently, NYSE has no equivalent exception to Rule 92 to permit more efficient riskless principal trading on NYSE. The proposed amendment adapts the riskless principal requirements of the Manning Rule described above, and integrates those requirements into the existing requirements of NYSE Rule 92, as follows.

The Exchange proposes adopting the underlying order requirements of the Manning Rule for riskless principal transactions at the Exchange. Accordingly, the Exchange proposes that a riskless principal transaction can be effected on behalf of any customer order, regardless of whether from an institutional account or an individual investor. The Exchange believes that adopting the riskless principal transaction requirements of the Manning Rule will ensure that the marketplace will run efficiently and will enable member organizations to both comply with their Reg. NMS requirements and meet best execution requirements for customers.

Further requirements for proposed riskless principal transactions include that the receipt

⁶ See NASD Rule 2111 and IM-2110-2.

time reference for the underlying order would have to be before the execution report time reference of the riskless principal transaction. Within 60 seconds of receiving an execution report from NYSE on the riskless principal transaction, members or member organizations would be required to allocate to the accounts represented in the riskless principal transaction the same price at which the order was executed on NYSE, exclusive of any markup or markdown, commission equivalent, or other fee.

In addition, under the proposed amendment, firms would be permitted to aggregate only orders whose order types and instructions (including tick restrictions) permit such aggregation. The Exchange believes that such aggregating meets the standards set forth in the Commission's July 18, 2005 letter to the Securities Industry Association ("SIA"),⁷ in which the Commission granted a riskless principal exemption from Rule 10a-1 under the Act to permit a broker-dealer to fill customer orders without complying with the "tick" provisions of the Rule, in certain situations and subject to certain conditions, as set forth in the letter.

Firms would need to disclose to customers the method by which the firm would allocate the shares bought or sold in the riskless principal transaction (e.g., strict time priority, precedence based on size, etc.), and would be required to allocate shares in accordance with that method. Such method must be fair and reasonable, be consistently applied, and not unfairly discriminate against any particular class of accounts or types of orders. The Exchange would not require a specific allocation methodology, but would require that the chosen method be adequately disclosed to customers and be consistent with rules governing parity of orders.

⁷ See letter to Ira Hammerman, Senior Vice President and General Counsel, SIA, from James A. Brigagliano, Assistant Director, Division of Market Regulation ("Division"), Commission, dated July 18, 2005 (available at www.sec.gov/divisions/marketreg/mr-noaction/sia071805.htm).

The Exchange would require member organizations to keep certain books and records in connection with riskless principal transactions. In particular, when executing riskless principal transactions, firms would be required to submit order execution reports to the Exchange's Front End Systemic Capture database linking the execution of the riskless principal order on the Exchange to the specific underlying orders. The information that will be provided must be sufficient for both member firms and the Exchange to reconstruct in a time-sequenced manner all orders, including allocations to the underlying orders, with respect to which a member organization is claiming the riskless principal exception.

As with the Manning Rule, in allocating riskless principal transactions, if the riskless principal transaction includes Rule 92(b) proprietary orders, orders from customers that have consented to trade along with Rule 92(b) proprietary orders, and orders from customers that either have not or cannot consent (for example, an individual investor with an order of less than 10,000 shares) to the member firm trading along with those orders, the Rule 92(b) proprietary orders and any customer orders that have consented to trading along with such proprietary orders must yield to the non-consenting customer orders.

Customer Consent Under Rule 92(b)

The Exchange further proposes amending the requirements surrounding the obtaining of customer consent to trade along with customer not-held orders. Under current Rule 92(b), the Exchange requires that a customer provide express permission, including an understanding of the relative price and size of allocated execution reports, before permitting execution of one of the specified proprietary orders under that rule that could be executed at the same price as the customer's order. The Exchange has interpreted this provision to require that consent to trade

along be obtained and documented on an order-by-order basis.

As the Exchange has transitioned to the Hybrid Market, with its greater prevalence of automated executions and rapid pace of order execution, and with the implementation of Reg. NMS, the Exchange has concluded that the current order-by-order consent rule and attendant documentation requirements have become outmoded and can operate to impede market efficiencies. Moreover, the order-by-order consent requirement for trading along in Rule 92 is inconsistent with other similar situations where firms are permitted to obtain a general or “blanket” approval to trade along with not-held customer orders, provided they are accompanied by appropriate disclosures.⁸

The Exchange accordingly is proposing to modify the consent requirement of NYSE Rule 92(b) to eliminate the order-by-order consent and instead provide that customers may give “blanket” affirmative written consent for a member firm to trade along provided that: (i) the customer has received adequate prior affirmative notice of the fact that the member or member organization may trade along with its orders, including a disclosure of the method by which the member organization will allocate shares to the customer’s order and a disclosure relating to the allocation methodology for riskless principal transactions that include both a Rule 92(b) proprietary order and an order from a customer that has not consented to trade along with a Rule 92(b) proprietary order; (ii) the customer affirmatively consents prior to such trading by the member or member organization; and (iii) the member or member organization’s trading along is

⁸ See, e.g., Information Memo 05-52 (requiring member firms to provide periodic affirmative notice regarding their practice in trading for their proprietary accounts while in possession of customer VWAP orders); see also Information Memo 05-81 (deeming customers to consent to their Floor brokers’ decision to permit a specialist to trade on parity with their orders, provided that the Floor broker has adequately disclosed to the customer as to the broker’s regular practice in this regard).

permitted under one of the exceptions contained in NYSE Rule 92.

The Exchange believes that this proposed consent requirement would provide the same level of investor protection as the current consent requirement because both standards require disclosures and consent before a member organization can enter a Rule 92(b) proprietary order. However, by eliminating the order-by-order consent, the Exchange believes that the proposed consent requirement would reduce the burden associated with obtaining consent in advance of each transaction, thus permitting member organizations to trade in the faster environment of today's marketplace without having to pause before each trade to obtain consent.

The Exchange proposes that member organizations can document such affirmative consent either by (i) a signed writing from the customer that acknowledges the disclosures, including that a customer can opt-out on an order-by-order basis, and provides consent; or (ii) documenting consent that was provided orally, provided that written disclosures were provided to the customer before obtaining the oral consent and the member organization provides written notice to the customer documenting that oral consent. Once a customer has provided affirmative written consent and so long as firms continue to provide written disclosures on a periodic basis, member organizations will not need to renew such affirmative consent.

The Exchange further proposes expanding the class of investors that may consent to a Rule 92(b) proprietary order. Under the Manning Rule, the NASD permits customers that meet the NASD's definition of an institutional account and individual customers with orders of 10,000 shares or more, unless such orders are less than \$100,000 in value, to consent to trade along with a member's proprietary order. In contrast, the current Rule 92 bars both individual investors and institutional investors with orders of less than 10,000 shares from consenting to a member or

member organization from trading along with their orders. To harmonize this portion of the rules, the Exchange proposes amending the class of investors that can consent to a member or member organization trading along with a customer order to include all institutional investors, regardless of the size of the order, and individual investors with orders of 10,000 shares or more, unless such orders are less than \$100,000 in value. To ensure consistency, the Exchange proposes to incorporate, for purposes of Rule 92 only, NASD's definition of an "institutional account,"⁹ and therefore proposes adding that definition to the supplementary material to Rule 92.

Customers would retain the ability to "opt-out" on a trade-by-trade basis or to modify the instructions obtained under blanket consent, since the customer always has the option to submit an order with an instruction that the member or member organization not trade along or alter the terms for trading along with the order. The Exchange would require members and member organizations to periodically disclose this to customers as well.

Once a customer provides such "blanket" consent, a member or member organization may trade on a proprietary basis along with a customer order that is executable at the same price as a proprietary order that meets the exceptions set forth in Rule 92(b). A member or member organization may seek to include a Rule 92(b) proprietary order with a proposed Rule 92(c) riskless principal order. In such case, even though a single order is transmitted to the Exchange, the order would include both riskless and risk elements, and therefore would no longer be a pure riskless principal transaction. For purposes of parity, Exchange systems will recognize the riskless principal order as an agency order, regardless of whether the order includes any Rule

⁹ See NASD Rule 3110(c)(4).

92(b) proprietary orders. However, when allocating the underlying orders, Rule 92(b) proprietary orders and any customer orders that have consented to the Rule 92(b) proprietary orders must yield to customer orders that have not or cannot consent to a Rule 92(b) proprietary order. This allocation methodology must be disclosed to customers that consent to trade along with Rule 92(b) proprietary orders. If the riskless principal transaction represents only agency orders and does not include any proprietary orders, regular allocation of the underlying orders would apply.

Exemption for Reg. NMS-Compliant Intermarket Sweep Orders

The Exchange also proposes amending Rule 92 to add an exemption so that, when facilitating a customer order that would otherwise require the firm to either violate Rule 92 or trade through protected quotations, member organizations can comply with their Reg. NMS obligation without also violating Rule 92. Under the current rule, if a member organization is required to route intermarket sweep orders as principal to execute against the full displayed size of any protected quotation in a security (“ISO”), for example, when facilitating a customer order at a price inferior to the national best bid or offer or other protected quotations and in compliance with Rules 600(b)(30)(ii) and 611(b)(6) of Reg. NMS,¹⁰ the ISO could violate Rule 92 by trading ahead of or along with open customer orders.

The proposed exemption provides that when routing ISOs, the member organization must yield its principal executions to any open customer orders that are required to be protected by Rule 92 and capable of accepting the fill. As defined in Rule 92(a), customer orders that are required to be protected are those open customer orders that are known to the member

¹⁰ 17 CFR 242.600(b)(30)(ii) and 17 CFR 242.611(b)(6).

organization before entry of the ISO. In addition, the proposed exemption would require that if a firm executes an ISO to facilitate a customer order at a price inferior to one or more protected quotations, that customer must consent to not receiving the better price obtained by the ISO(s) or the firm must yield its principal execution to that customer.¹¹ For purposes of this amendment, the Exchange further proposes adopting the definitions of Reg. NMS in connection with the terms “protected quotation” and “intermarket sweep order.”¹²

2. Statutory Basis

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

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

The Exchange does not believe that the proposed rule change will result in 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.

¹¹ Telephone conversation between Clare F. Saperstein, Principal Rule Counsel, Market Surveillance, NYSE, and Theodore S. Venuti, Attorney, Division, Commission, on May 23, 2007.

¹² See 17 CFR 242.600(b)(7) and (30).

¹³ 15 U.S.C. 78f(b)(5).

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 NYSE 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 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. Please include File Number SR-NYSE-2007-21 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-2007-21. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all

comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of 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 publicly available. All submissions should refer to File Number SR-NYSE-2007-21 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Florence E. Harmon
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).