SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50586; File No. SR-NYSE-2004-13)

October 25, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. to Adopt Rule 405A ("Non-Managed Fee-Based Account Programs – Disclosure and Monitoring")

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on February 25, 2004, the New York Stock Exchange, Inc. ("NYSE" or the "Exchange") filed with the Securities and Exchange Commission ("SEC" or the "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On October 22, 2004, the NYSE filed Amendment No. 1 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Proposed new NYSE Rule 405A ("Non-Managed Fee-Based Account Programs – Disclosure and Monitoring") would prescribe certain requirements for members and member organizations that offer programs that charge customers a fixed fee or percentage of account value in lieu of commissions. The requirements include disclosure, appropriateness determination, monitoring of transactional activity, and a follow-up

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See letter from Mary Yeager to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated October 22, 2004.

system to contact customers. The text of the proposed new rule appears below. Proposed new language is in italics.

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Rule 405A ("Non-Managed Fee-Based Account Programs – Disclosure and Monitoring")

(1) General Disclosures Required

Each member or member organization shall provide each customer, prior to the opening of an account in a Non-Managed Fee-Based Account Program, and annually thereafter, a disclosure document describing the types of Non-Managed Fee-Based Account Programs available to such customer. The document shall disclose, for each such Program type, sufficient information for the customer to make a reasonably informed determination as to whether the Program is appropriate for them, including, at minimum: a description of the services provided, eligible assets, fees charged including projected customer costs, any conditions or restrictions imposed, and a summary of the Program's advantages and disadvantages.

(2) Opening of Accounts

Members and member organizations are required to make a determination, prior to opening an account in a Non-Managed Fee-Based Account Program, that such Program is appropriate for each customer taking into account the services provided, anticipated costs, and customer objectives.

(3) Monitoring of Accounts

Each member or member organization must establish and maintain systems and procedures adequate to monitor, on an ongoing basis, transactional activity by customers in Non-Managed Fee-Based Account Programs. Such systems and procedures must include specific transactional parameters or criteria for identifying levels of customer

account activity that may be inconsistent with the Program costs incurred by the customer.

(4) Review and Follow-Up

Each member or member organization must maintain written procedures for contacting and following-up with customers identified pursuant to Paragraph (3) of this rule, at minimum, every 12 months. More frequent contact is required should circumstances warrant. The means (e.g., letter or phone call) and general content of each follow-up customer contact must be documented and retained in an easily accessible place. At minimum, such contact must include notification that the level of account activity for a specified time-frame may be inconsistent with the Program costs incurred by the customer.

(5) Applicability of Rule

This rule shall not apply to accounts opened on behalf of "Qualified Investors" as that term is defined in Section 3(a)(54) of the Securities Exchange Act of 1934 (15 U.S.C. 78c) or to any member or member organization that does not offer Non-Managed Fee-Based Account Programs to its customers.

(6) Definition

For purposes of this rule, the term "Non-Managed Fee-Based Account Program" shall refer to arrangements in which no investment advisory services are provided by the member or member organization and in which customers are charged a fixed fee and/or a percentage of account value, rather than transaction-based commissions.

Supplementary Material:

.10 See also Rule 405(1) requirement that member organizations use due diligence to learn the essential facts relative to every customer and every cash or margin account, including accounts in Non-Managed Fee-Based Account Programs, accepted or carried by such member organization.

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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 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

Background

In keeping with evolving investors' sentiment and needs, members and member organizations have increasingly been offering a wider variety of account types beyond traditional brokerage accounts, including on-line accounts and fee-based programs such as "wrap" accounts, whereby all the services (investment advice, execution, and clearance) provided by a broker-dealer are bundled together for a fee. Members and member organizations are also increasingly offering Non-Managed Fee Based Account Programs ("NFBA Programs") to their customers.

NFBA Programs are agreements between a broker-dealer and a customer in which the customer is charged a fixed fee and/or a percentage of account value rather than transaction-based commissions. Unlike "wrap" accounts, NFBA Programs do not offer investment advisory services but are directed by the customer or by an agent of the customer pursuant to a separate agreement. The primary advantage of NFBA Programs is that they offer a "volume discount" from traditional transaction-based commission charges.

Proposal

Every member and member organization is required by NYSE Rule 405 ("Diligence as to Accounts") to "[u]se due diligence to learn the essential facts relative to every customer, every order, [and] every cash or margin account… ." Likewise, NYSE Rule 342 ("Offices – Approval, Supervision and Control") requires that each member and member organization exercise supervision and control over each business activity. While NFBA Programs are subject to the provisions of these and all other applicable NYSE rules, they present potential regulatory issues that warrant a specifically tailored approach. For instance, as a general matter, a fee-based approach may be considered appropriate for customers who engage in moderate to high levels of trading activity since the price per trade is reduced as the number of trades increases. However, such arrangements may not be appropriate for customers who engage in a lower level of trading activity, as substantially greater transaction cost savings might be realized in the context of a traditional pay-per-trade commission structure.

Various factors, including other services provided as part of the Program, must be considered to determine whether a given NFBA Program is an appropriate investment

vehicle for a particular customer. The NYSE is proposing NYSE Rule 405A to address regulatory concerns in this regard by requiring initial informational disclosure to customers, appropriateness determination prior to account opening, ongoing monitoring, and follow-up as appropriate. Accordingly, the proposed rule requires each member and member organization to provide each customer, prior to the opening of an NFBA Program account and annually thereafter, a disclosure document describing the types of NFBA Programs available to such customer. The document would include for each account type, at minimum, a description of the services provided, eligible assets, fees charged, including projected customer costs, any conditions or restrictions imposed, and a summary of the Program's advantages and disadvantages. Essentially, the document should provide a reasonable basis upon which a customer can make an informed decision with respect to available NFBA Program options.

The member or member organization must also make a determination, prior to opening an account in an NFBA Program, that such Program is appropriate for each customer taking into account the services provided, anticipated costs, and customer objectives. Cost is an important factor, but not the only one. For this reason, factors other than cost may properly be considered in determining whether an NFBA Program is appropriate for a particular customer. Members and member organizations must consider the overall needs and objectives of the customer when determining the benefits and costs of an NFBA Program for that customer, including the anticipated level of trading activity in the account and non-price factors, such as the importance that a customer places on aligning his or her interests with those of the broker.

Proposed Rule 405A also requires a member or member organization to establish and maintain systems and procedures adequate to monitor, on an ongoing basis, transactional activity by customers in NFBA Programs. Such systems and procedures must include specific transactional parameters or criteria for identifying customer account activity that may be inconsistent with the Program costs incurred by the customers. The proposed rule does not establish specific parameters or criteria since NYSE believes such determinations are best made by each member and member organization depending upon the specifics of the account Program(s) offered and customers' investment profiles.

Proposed Rule 405A also requires a member or member organization to maintain written procedures for contacting and following up, at minimum, every 12 months, with those customers whose level of activity in an NFBA Program over a specified period of time has been identified, pursuant to the member or member organization's transactional parameters or criteria, as possibly inconsistent with their incurred Program costs. The minimum 12-month standard reflects the fact that, due to any number of variables, an NFBA Program's appropriateness may not be determinable except over a relatively extended period of time. Such variables could include, among others, general economic or market conditions, variations in customer trading patterns, changes in customer investment objectives, or the types of services/benefits included in a given Program. However, as noted above, members and member organizations have an ongoing obligation to monitor NFBA Program activity and, accordingly, more frequent customer contact should be made if warranted by the circumstances. At minimum, all such contact must include notification that the level of account activity for a specified time-frame may be inconsistent with the Program costs incurred by the customer. The proposed rule does

not prescribe specific procedures for identifying, contacting, and following-up with customers since the variety of NFBA Programs, customer investment profiles, and member organization supervisory structures, allows for numerous effective alternate methods. However, the proposed rule does require that the means (e.g., letter or phone call) and general content of each follow-up customer contact must be documented and retained in an easily accessible place.

Because proposed Rule 405A is intended to protect the interests of retail customers, it contains an exception for accounts opened on behalf of "Qualified Investors" as that term is defined in Section 3(a)(54) of the Securities Exchange Act of 1934.[4] For example, excepted from the proposed rule's provisions are accounts of registered investment companies, banks, insurance companies, certain employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), any corporation, company or partnership that owns and invests on a discretionary basis not less than $25,000,000 in investments, or any natural person who owns and invests on a discretionary basis not less than $25,000,000 in investments. This exception is based on the assumption that such accounts are generally directed by persons that are financially sophisticated and thus better able to make informed decisions regarding the appropriateness of available NFBA Programs. The proposed rule would also not apply to any member or member organization that does not offer NFBA Programs to its customers.

As noted above, proposed Rule 405A would not apply to arrangements in which a fixed fee and/or a percentage of account value is charged as payment for investment advisory services. Most such accounts are subject to the Investment Advisers Act of

[4] 15 U.S.C. 78c(a)(54).

1940[5] and are thus subject to its regulatory scheme, as well as to existing NYSE and other self-regulatory organization sales practice rules.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the requirements of Section 6(b)(5)[6] of the Exchange Act, which requires that the rules of the Exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest in that it establishes requirements for appropriate disclosure, monitoring, and follow-up procedures for the protection of customers who utilize NFBA Programs.

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

The Exchange believes that the proposal does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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

Written comments were neither solicited nor received.

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

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5 15 U.S.C. 80b-1 et seq.

6 15 U.S.C. 78f(b)(5).

(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-2004-13.

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-2004-13. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the 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-2004-13 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.[7]

Jill M. Peterson
Assistant Secretary

[7] 17 CFR 200.30–3(a)(12).