

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51665; File No. SR-NYSE-2005-23)

May 6, 2005

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Seek Permanent Approval of the Pilot Relating to the Allocation Policy for Trading of Exchange-Traded Funds on an Unlisted Trading Privileges Basis (NYSE Rule 103B)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 29, 2005, the New York Stock Exchange, Inc. (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the NYSE. The proposed rule change has been filed by the NYSE as a “non-controversial” rule change under Rule 19b-4(f)(6) under the Act,<sup>3</sup> which renders the proposal effective upon filing with the Commission.<sup>4</sup> 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

The proposed rule change seeks to adopt on a permanent basis the pilot program relating to the allocation policy for trading certain Exchange-Traded Funds (“ETFs”), which has been codified in NYSE Rule 103B, Section VIII. This policy applies to ETFs which are traded on an Unlisted Trading Privileges Basis (“UTP”). The pilot is set to expire on May 8, 2005. For

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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> 17 CFR 240.19b-4(f)(6).

<sup>4</sup> Rule 19b-4(f)(6) under the Act requires the NYSE to provide the Commission with five business days notice of its intention to file a non-controversial proposed rule change. The NYSE did not provide such notice but requested that the Commission waive the notice requirement. The NYSE also requested that the Commission waive the 30-day operative delay. See Rule 19b-4(f)(6)(iii) under the Act. 17 CFR 240.19b-4(f)(6)(iii).

purposes of the allocation policy, ETFs include both Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual) and Trust Issued Receipts (as defined in Rule 1200). The text of the proposed rule change is below. Proposed new language is italicized.

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**Rule 103B Specialist Stock Allocation**

**I – VII. No changes**

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**VIII. Policy for Allocation of Exchange Traded Funds Admitted to Trading on the Exchange on an Unlisted Trading Privileges Basis**

Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual) and Trust Issued Receipts (as defined in Exchange Rule 1200) (collectively known as Exchange-Traded Funds) ("ETFs") admitted to trading on the Exchange on an unlisted trading privileges basis shall be allocated pursuant to this Policy rather than the Exchange's policy for allocating securities to be listed on the Exchange.

ETFs shall be allocated by a special committee consisting of the Chairman of the Allocation Committee, the three most senior Floor broker members of the Allocation Committee, and four members of the Exchange's senior management as designated by the Chief Executive Officer of the Exchange. This committee shall solicit allocation applications from interested specialist units, and shall review the same performance and disciplinary material with respect to specialist unit applicants as would be reviewed by the Allocation Committee in allocating listed stocks.

The committee shall reach its decisions by majority vote with any tie votes being decided by the Chief Executive Officer of the Exchange. Specialist unit applicants may appear before the committee.

### **Special Criteria**

In their allocation applications, specialist units must demonstrate:

- (a) an understanding of the trading characteristics of ETFs;
- (b) expertise in the trading of derivatively-priced instruments;
- (c) ability and willingness to engage in hedging activity as appropriate;
- (d) knowledge of other markets in which the ETF to be allocated trades;
- (e) willingness to provide financial and other support to Exchange marketing and educational initiatives with respect to the ETF to be allocated.

### **Allocation Freeze Policy**

The Allocation Freeze Policy as stated in the Allocation Policy for listed stocks shall apply.

### **Prohibition on Functioning as Specialist in ETF and Specialist in any Component Security of the ETF**

No specialist member organization may apply to be allocated an ETF if it is registered as specialist in any security which is a component of the ETF. A specialist member organization which is registered as specialist in a component stock of an ETF may establish a separate member organization which may apply to be the specialist in an ETF. The approved persons of such ETF specialist member organization must obtain an exemption from specified specialist rules pursuant to Rule 98.

If, subsequent to an ETF being allocated to a specialist member organization, a security in which the specialist member organization is registered as specialist becomes a component security of such ETF, the specialist organization must (i) withdraw its registration as specialist in the security which is a component of the ETF; (ii) withdraw its registration as specialist in the ETF; or (iii) establish a separate specialist member organization, which will be registered as specialist

in the ETF and whose approved persons have received an exemption from specified specialist rules pursuant to Rule 98.

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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 NYSE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposal. The text of these statements may be examined at the places specified in Item IV below. The 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

The Exchange seeks permanent approval for the pilot relating to the allocation policy for trading ETFs on a UTP basis, as codified in NYSE Rule 103B,<sup>5</sup> Section VIII. This proposed rule change was originally filed as a one-year pilot in SR-NYSE-2001-07<sup>6</sup> and Amendment No. 1

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<sup>5</sup> See Securities Exchange Act Release No. 46579 (October 1, 2002), 67 FR 63004 (October 9, 2002) (SR-NYSE-2002-31).

<sup>6</sup> See Securities Exchange Act Release No. 44272 (May 7, 2001), 66 FR 26898 (May 15, 2001) (SR-NYSE-2001-07).

thereto, and subsequently amended by SR-NYSE-2001-10<sup>7</sup> and SR-NYSE-2002-07<sup>8</sup>. The pilot was subsequently extended for an additional three years and is due to expire on May 8, 2005.<sup>9</sup>

#### Allocation Policy for ETFs Trading Under UTP

The purpose of the Exchange's current Allocation Policy and Procedures (the "Policy") is: (1) ensure that the allocation process is based on fairness and consistency and that all specialist units have a fair opportunity for allocations based on established criteria and procedures; (2) provide an incentive for ongoing enhancement of performance by specialist units; (3) provide the best possible match between specialist unit and security; and (4) contribute to the strength of the specialist system.

The Allocation Committee has sole responsibility for the allocation of securities to specialist units under this policy pursuant to authority delegated by the Board of Directors. The Allocation Committee renders decisions based on the allocation criteria specified in this policy.<sup>10</sup>

In deciding to trade ETFs on a UTP basis, the Exchange considered it appropriate to modify the listed equities allocation process to provide that such ETFs be allocated by a special committee, consisting of the Chairman of the Allocation Committee, the three most senior Floor broker members on the Allocation Committee, and four members of the Exchange's senior management as designated by the Chief Executive Officer of the Exchange. This permitted Exchange management, acting with designated members of the Allocation Committee, to

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<sup>7</sup> See Securities Exchange Act Release No. 44306 (May 15, 2001), 66 FR 28008 (May 21, 2001) (SR-NYSE-2001-10).

<sup>8</sup> See Securities Exchange Act Release No. 45729 (April 10, 2002), 67 FR 18970 (April 17, 2002) (SR-NYSE-2002-07).

<sup>9</sup> See Securities Exchange Act Release Nos. 45884 (May 6, 2002), 67 FR 32073 (May 13, 2002) (SR-NYSE-2002-17); 47690, 68 FR 20205 (April 24, 2003) (SR-NYSE-2003-07); and 49649 (May 4, 2004), 69 FR 26200 (May 11, 2004) (SR-NYSE-2004-21).

<sup>10</sup> See Securities Exchange Act Release No. 42746 (May 2, 2000), 65 FR 30171 (May 10, 2000) (SR-NYSE-99-34).

oversee directly the introduction of the UTP concept to the NYSE. For purposes of the Allocation Policy, ETFs collectively include Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual) and Trust Issued Receipts (as defined in Exchange Rule 1200).

Allocation applications for ETFs trading on a UTP basis are solicited by the Exchange, and this special committee reviews the same performance and disciplinary material as is reviewed by the Allocation Committee.<sup>11</sup> In addition, specialist unit applicants are required to demonstrate:

- (a) an understanding of the trading characteristics of ETFs;
- (b) expertise in the trading of derivatively-priced instruments;
- (c) ability and willingness to engage in hedging activity as appropriate;
- (d) knowledge of other markets in which the ETF which is to be allocated trades; and
- (e) willingness to provide financial and other support to relevant Exchange publicity and educational initiatives.

#### Proposal to Make the Policy Permanent

The Exchange believes that the ETF allocation process has worked well and should be made permanent.<sup>12</sup>

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<sup>11</sup> See NYSE Rule 103B, Section IV (“Allocation Criteria”) of the Allocation Policy and Procedures approved in Securities Exchange Act Release No. 42746 (May 2, 2000), 65 FR 30171 (May 10, 2000) (SR-NYSE-99-34) for details of the performance and disciplinary material available to the Allocation Committee.

<sup>12</sup> Neither the Exchange, nor the Commission received any comment letters in response to the solicitation of comments in SR-NYSE 2001-07, SR-NYSE 2002-17, SR-NYSE 2003-07, and NYSE 2004-21. Telephone conversation between Jeffrey Rosenstock, Principal Rule Counsel, NYSE, and Florence E. Harmon, Senior Special Counsel, Division of Market Regulation (“Division”), SEC, dated May 6, 2005

In this regard, since the inception of the Allocation Policy, 59<sup>13</sup> ETFs have been allocated and are trading on the Exchange. This includes 17 Merrill Lynch Holding Company Depositary Receipts (HOLDRs), a type of Trust Issued Receipt, nine types of Select Sector Standard & Poor's Depositary Receipts (SPDRs), one MidCap SPDR, 29 types of iShares, one Vanguard Index Participation Equity Recipient (VIPER) Shares, the Standard & Poor's 500 Index (symbol SPY), and the Dow Industrials DIAMONDS (symbol DIA).

Currently, the special committee reviews specialist unit applications and reaches its allocation decisions by majority vote. Any tie vote is decided by the Chief Executive Officer of the Exchange. The Exchange has determined that due to the unique aspects of certain ETF products, it may be helpful for the special committee to meet with and interview specialist units before making an allocation decision.

## 2. Statutory Basis

The Exchange believes that its proposed rule change is consistent with Section 6(b) of the Act,<sup>14</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>15</sup> in particular, in that it is designed to remove impediments to and perfect the mechanism for 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 NYSE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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<sup>13</sup> The NASDAQ 100 Trust (symbol QQQ) was allocated and began trading on the Exchange on July 31, 2001, but as of December 1, 2004, no longer trades on the Exchange. The iShares MSCI Emerging Markets Free (EEM) was allocated, but never traded on the Exchange.

<sup>14</sup> 15 U.S.C. 78f(b).

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

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

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

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

The proposed rule change has been filed by the Exchange as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act<sup>16</sup> and Rule 19b-4(f)(6), thereunder.<sup>17</sup> Because the forgoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days after the date of its filing, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, provided that the Exchange has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>18</sup> and Rule 19b-4(f)(6), thereunder.<sup>19</sup>

The Exchange requests that the Commission waive the five-day pre-filing notice requirement and the 30-day delayed operative date of Rule 19b-4(f)(6)(iii). Under Rule 19b-4(f)(6)(iii), a proposed “non-controversial” rule change does not become operative for 30 days after the date of filing, unless the Commission designates a shorter time.

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<sup>16</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>17</sup> 17 CFR 240.19b-4(f)(6).

<sup>18</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>19</sup> 17 CFR 240.19b-4(f)(6).



The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Acceleration of the operative date will allow for the continued operation of the Exchange's Policy for Allocation of Exchange-Traded Funds Admitted to Trading on the Exchange on an Unlisted Trading Privileges Basis, now codified in NYSE Rule 103B, Section VIII on the permanent basis without interruption.<sup>20</sup>

The Commission notes that it has not received any comments on previous proposed rule changes filed by NYSE for this pilot. For this reason, the Commission designates the proposed rule change to be effective and operative upon its filing with the Commission. The Commission also waives the five-business day pre-filing requirement. As 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.

#### 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](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2005-23 on the subject line.

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<sup>20</sup> For the purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rules impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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-2005-23. 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 at <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 Exchange. 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-2005-23 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

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

Margaret H. McFarland  
Deputy Secretary

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