

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-58278; File No. SR-NYSE-2008-61)

July 31, 2008

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change by New York Stock Exchange LLC Amending NYSE Rule 104(e) (Dealings by Specialists) to Modify the Conditions Governing the Specialists' Use of the Price Improvement Trading Message Pursuant to NYSE Rule 104(b)(i)(H)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on July 25, 2008, New York Stock Exchange LLC ("NYSE" or the "Exchange") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. 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 Exchange proposes to amend Exchange Rule 104(e) (Dealings by Specialists) to modify the conditions governing the specialists' use of the price improvement trading message pursuant to Rule 104(b)(i)(H). The text of the proposed rule change is available at NYSE, [www.nyse.com](http://www.nyse.com), and the Commission's Public Reference Room.

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 self-regulatory organization 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 those statements may be examined at the places

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts 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 to modify the conditions that govern the ability of specialists to provide price improvement pursuant to Rule 104 (Dealings by Specialists). Specifically, the Exchange proposes to amend Exchange Rule 104(e) to remove the requirement that specialists be represented in the quote in a “meaningful amount” before they can send a trading message that will provide price improvement to arriving marketable orders (i.e., those orders capable of trading in the current market upon arrival).

Pursuant to Exchange Rule 104(b)(i), a specialist’s algorithm may generate and transmit quoting and trading messages in a number of specific situations detailed in the rule. Under Rule 104(b)(i)(H), one of the permitted algorithmic trading messages allows the specialist to provide price improvement to an order subject to the provisions of Rule 104(e). Rule 104(e)(i) calls for the specialist to be represented in the quote for a “meaningful amount” in order to provide price improvement to an arriving order.<sup>3</sup> A “meaningful amount” is defined in Rule 104(e)(ii) as at least ten round lots (usually 1,000 shares) for the 100 most active securities (based on average daily volume) on the Exchange, and at least five round lots (usually 500 shares) for all other securities on the Exchange.

The price improvement message capability was designed to provide trading opportunities for which the specialist’s algorithm could interact with orders electronically, supplying capital

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<sup>3</sup> Under Rule 104(e)(i), for an incoming buy order, the specialist must be represented in the offer, and for an incoming sell order, the specialist must be represented in the bid. The price improvement offered must be at least one cent.

and liquidity to the Hybrid Market<sup>SM</sup> as they did in the Exchange's auction market. Part of this ability is to be able to offer price improvement to other market participants on the Exchange. As originally approved in the Exchange's Hybrid Market<sup>SM</sup> filing,<sup>4</sup> the amount of price improvement to be supplied was also subject to minimums based on the quotation spread in the security at the time of the proposed trade with the incoming order.<sup>5</sup> However, in SR-NYSE-2007-81, the Exchange removed the minimum price improvement amount based on the Exchange's belief that these required minimums were a contributing factor to the decline in the level of price improvement offered by specialists.<sup>6</sup>

The removal of the required price parameters for specialist price improvement has not resulted in an appreciable rise in the level of specialist participation in price improvement trading. The Exchange believes that this is as a result of the "meaningful amount" minimum display requirement in Rule 104(e)(ii). As quote sizes continue to drop on the Exchange,<sup>7</sup> the Exchange believes that requiring the ten and five round lot minimums serve as a deterrent to price improvement participation by specialists since the required minimums potentially represent

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<sup>4</sup> See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006) (SR-NYSE 2004-05) (approving, among others, NYSE Rules 104(b)(i)(H) and 104(e)).

<sup>5</sup> As first approved in SR-NYSE-2004-05, Rule 104(e) required that the price improvement provided by the specialist be (a) at least three cents where the quotation spread is more than five cents, (b) at least two cents where the quotation spread is three, four or five cents, or (c) one cent where the quotation spread is two cents.

<sup>6</sup> In SR-NYSE-2007-81, the Exchange stated that the rate of price improvement offered by specialists had dropped from 1.47% in July 2006 to .03% in July 2007.

<sup>7</sup> For example, the average quote size for the top 100 equity securities traded on the Exchange in November 2006 was 18,907 shares on the bid side, and 20,375 shares on the offer side. By November 2007 these values were 3,645 shares and 3,230 shares respectively. As of May 2008, they are 5,462 shares bid and 4,875 shares offered. For securities beyond the top 100, the averages of bid and offer sizes for bids have also declined, but are slightly higher on the offer side. As of the end of November 2007, the averages were approximately 900 shares bid and 661 shares offered. As of the end of May 2008 the averages are 736 shares bid and 678 shares offered.

a significant portion of the current average size of bids and offers. Consequently, the Exchange proposes to remove these minimums in an effort to provide an incentive to specialists to participate more fully in the price improvement mechanism.

The Exchange notes that Floor brokers have the ability to include discretionary instructions with e-Quotes that they have entered (“d-Quotes”) pursuant to Rule 70.25. One of the features of d-Quotes is that the Floor broker can offer a range in which this interest will trade. By using such discretionary instructions, Floor brokers are able to systemically trade with incoming marketable orders and offer price improvement in a like manner to the specialist algorithm. There are, however, no minimum size requirements placed on Floor brokers’ d-Quotes. Thus, removing the minimum size requirements for specialists’ price improvement trading messages will increase competition and ultimately lead to increased opportunities for price improvement for Exchange market participants.

## 2. Statutory Basis

The basis under the Act for this proposed rule change are the requirements under Section 6(b)(5)<sup>8</sup> that the rules of an exchange be designed to promote just and equitable principles of trade, 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 Exchange believes that the instant proposal to remove the requirement that a specialist be represented in the NYSE quote in order to provide price improvement to an incoming order is consistent with the above principles in that it encourages specialists to additionally enhance the liquidity in the market and fosters increased competition among Exchange market participants, thus providing Exchange customers with additional opportunities for price improvement.

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<sup>8</sup> 15 U.S.C. 78f(b)(5).

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

The Exchange 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.

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

No written comments were solicited or received with respect to the proposed rule change.

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 self-regulatory organization 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](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2008-61 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSE-2008-61. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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 publicly available. All submissions should refer to File Number SR-NYSE-2008-61 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>9</sup>

Florence E. Harmon  
Acting Secretary

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<sup>9</sup> 17 CFR 200.30-3(a)(12).