

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, NW., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of Nasdaq.

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-NASDAQ-2008-081 and should be submitted on or before November 19, 2008.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>11</sup>

**Florence Harmon,**  
*Acting Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-58845; File No. SR-NYSE-2008-46]

### **Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment Nos. 2 and 3 and Order Granting Accelerated Approval to a Proposed Rule Change, as Modified by Amendment Nos. 1, 2, and 3, To Create a New NYSE Market Model, With Certain Components To Operate as a One-Year Pilot, That Would Alter NYSE's Priority and Parity Rules, Phase Out Specialists by Creating a Designated Market Maker, and Provide Market Participants With Additional Abilities To Post Hidden Liquidity**

October 24, 2008.

#### **I. Introduction**

On June 12, 2008, the New York Stock Exchange LLC<sup>1</sup> ("NYSE" or "Exchange") filed with the Securities

and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> a proposed rule change to establish a new market model ("New Model"). The New Model would implement significant changes in NYSE's market structure, including, most notably: (i) The phasing out of the specialist system and adopting a Designated Market Maker ("DMM") structure; (ii) the alteration of NYSE's priority and parity rules, most significantly to allow DMMs to trade on parity with orders on NYSE's Display Book<sup>®</sup> ("Display Book"); and (iii) the introduction of new order functionality, including the DMM Capital Commitment Schedule ("CCS") and hidden orders.<sup>4</sup>

On July 15, 2008, the Exchange filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for public comment in the **Federal Register** on July 23, 2008.<sup>5</sup> The Exchange filed Amendment No. 2 to the proposed rule change on August 29, 2008. The Exchange filed Amendment No. 3 to the proposed rule change on October 7, 2008. The Commission received no comment letters regarding proposed rule change. This order provides notice of filing of Amendment Nos. 2 and 3 to the proposed rule change, and grants accelerated approval to the proposed rule change, as modified by Amendment Nos. 1, 2 and 3.

#### **II. Description of the Proposal**

##### *A. Background: NYSE's Hybrid Market and the Evolution of Electronic Trading*

Section 11(b) of the Act<sup>6</sup> allows the rules of a national securities exchange to permit a member to be registered as a specialist and act as both a broker and a dealer. Historically, the NYSE specialist was responsible for overseeing the execution of all orders coming into the Exchange, for conducting auctions on the Floor, and for maintaining an orderly market in assigned securities. Specialists' dealer activities are governed, in part, by the negative and affirmative trading obligations. Rule 11b-1 under the Act<sup>7</sup> requires exchanges that permit members to register as specialists to have rules

governing specialists' dealer transactions so that their proprietary trades conform to the negative and affirmative obligations. The negative obligation as set forth in Rule 11b-1 under the Act requires that a specialist's dealings be restricted, so far as practicable, to those reasonably necessary to permit the specialist to maintain a fair and orderly market.<sup>8</sup> The affirmative obligation as set forth in Rule 11b-1 under the Act requires a specialist to engage in a course of dealings for its own account to assist in the maintenance, so far as practicable, of a fair and orderly market.<sup>9</sup> NYSE has adopted these obligations in its current Rule 104.<sup>10</sup> In 2006, the Exchange began implementation of its NYSE HYBRID MARKET<sup>SM</sup> ("Hybrid Market"),<sup>11</sup> under which Exchange systems assumed the function of matching and executing electronically-entered orders. As part of the Hybrid Market, the Exchange programmed its systems to provide specialists with an order-by-order advance "look" at incoming orders.

The rise of the electronic Hybrid Market has fundamentally altered NYSE's trading environment. Traditionally, price discovery on the Exchange took place almost exclusively on the Floor in the form of face-to-face interactions among brokers and specialists. These interactions have diminished as electronic trading has become more important on the Exchange.

In addition, information that once was exclusive to the Floor, such as the most up-to-date quotes and last sale prices, is now widely available off the Floor through electronic means. At the same time, the Exchange believes that it is no longer the dominant trading market for many NYSE-listed securities, as competition from other market centers has increased.

The increase in electronic executions on the Exchange as well as the increase in the use of smart routing engines by market participants of all types has reduced the advantages once enjoyed by Floor brokers and specialists. Indeed, NYSE has argued that the informational advantage has shifted "upstairs" where

<sup>8</sup> 17 CFR 240.11b-1(a)(2)(iii).

<sup>9</sup> 17 CFR 240.11b-1(a)(2)(ii).

<sup>10</sup> NYSE Rule 104(a) reflects NYSE's adoption of the negative obligation and states that "no specialist shall effect on the Exchange purchases or sales of any security in which such specialist is registered, for any account in which he or his member organization \* \* \* is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market \* \* \*."

<sup>11</sup> See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006) (SR-NYSE-2004-05).

<sup>2</sup> 15 U.S.C. 78s(b)(1).

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> Currently, specialists must yield to customer orders on the Display Book. See NYSE Rule 92(a).

<sup>5</sup> Securities Exchange Act Release No. 58184 (Jul. 17, 2008), 73 FR 42853 ("Notice").

<sup>6</sup> 15 U.S.C. 78k(b).

<sup>7</sup> 17 CFR 240.11b-1.

<sup>11</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> Formerly known as the New York Stock Exchange, Inc.

orders are now first “shopped” within a firm and then to others before being sent to the Floor for execution and, even then, orders are likely to be sent in pieces to multiple markets.<sup>12</sup>

Because of these changes, NYSE is proposing to adopt its New Model, which the Exchange believes would provide a more robust trading model on the Floor while preserving the existing framework for trading and some of the key responsibilities of its market participants that NYSE believes make it unique. The Exchange believes that the proposed changes would improve market quality in the form of tighter spreads, greater liquidity, and opportunities for price improvement.

### B. Proposed Changes to Exchange Systems

#### 1. Overview of NYSE’s Proposed New Model

The Exchange proposes to eliminate the “specialist” category of market participants and create a new category of market participants, DMMs.<sup>13</sup> The Exchange intends to implement the New Model in two phases: Phase 1, beginning as of the date of this order (“Approval Date”) and ending no more than five weeks after the Approval Date, and Phase 2, beginning upon completion of the Phase 1 implementation and ending no more than ten weeks after the Approval Date.<sup>14</sup> Though DMMs would still be “specialists” during Phase 1, once Phase 1 has been fully implemented and Phase 2 begins, DMMs would no longer be “specialists” under the Act. Once Phase 2 has been implemented, DMMs would no longer serve on the Exchange in the capacity of responsible broker-dealer for orders on NYSE’s book, and DMM trading activity on the Exchange would be limited to proprietary trading.<sup>15</sup> In addition, during Phase 2, the Exchange will eliminate the order-by-order advance “look” specialists currently receive. Because, with the implementation of Phase 2, they would no longer be specialists, DMMs would

not be subject to a specialist’s negative obligation not to trade for its own account unless reasonably necessary to the maintenance of a fair and orderly market.<sup>16</sup> The Exchange believes this would give the DMM greater freedom to manage the trading risks associated with their reduced responsibilities to the NYSE market. Like specialists today, DMMs would be able to generate orders through an algorithm that interacts directly with the Display Book. In addition, in the New Model, DMMs would be able to commit additional liquidity in advance to fill incoming orders via the Capital Commitment Schedule or CCS. The CCS is a liquidity schedule setting forth various price points where the DMM is willing to interact with incoming orders.

As part of the redesign of its market, NYSE proposes to amend the rules governing allocation of shares among the participants in a trade with an incoming order.<sup>17</sup> First, NYSE’s proposal would amend the Exchange’s priority rules relating to displayed interest that establishes the Exchange’s best bid or best offer (collectively “Exchange BBO”<sup>18</sup>), most notably by providing such priority interest with the first 15% of any execution and by allowing such interest to maintain priority until it is exhausted.<sup>19</sup> Second, in the proposed New Model, all market participants would receive executions on an equal basis (“parity”) with other interest available at that price.<sup>20</sup> Similar to the NYSE’s current market model, the Exchange would classify each individual Floor broker and the DMM registered in a security as separate market participants, while all off-Floor orders entered in Exchange systems for such security would together constitute a single market participant (“Off-Floor Participant”) for the purpose of share allocation. The Exchange’s proposed parity rule represents a significant change from its current requirement that

specialists yield to all off-Floor orders on the Display Book.

The Exchange also proposes to provide all market participants with the ability to maintain non-displayed “hidden interest”—*i.e.*, reserve interest without a minimum display requirement.<sup>21</sup> Along with the DMM’s CCS interest, the Exchange believes this ability of market participants to maintain hidden interest on NYSE’s book will contribute to the Exchange’s liquidity and depth of market.

#### 2. Updating the Roles of the Various Exchange Market Participants

As indicated above, the New Model proposal includes proposed changes to the roles of the Exchange’s various market participant groups to reflect new patterns of trading and new obligations. These include the phasing out of NYSE’s specialist system and the adoption of a Designated Market Maker structure. In addition, the Exchange is making changes to the role of, and tools available to, Floor brokers, and is giving new tools to off-Floor participants that will enable them to participate in the market more directly. These changes are described in more detail below.

##### (a) Designated Market Makers

###### (1) Overview

The Exchange believes that its new market model requires a new type of market maker<sup>22</sup>—the Designated Market Maker—with the ability (and affirmative obligation) to contribute liquidity in a security by trading competitively for its dealer account. The Exchange therefore proposes to phase out the existing specialist system and to replace specialists with Designated Market Makers who would be employees of Designated Market Maker Units (“DMM Units”).<sup>23</sup>

As described in further detail below, the Exchange proposes to give DMM Units tools and opportunities that are not available to specialists currently, along with modified obligations, that the Exchange believes are more commensurate with trading in electronic markets. At the same time, the Exchange would preserve several aspects of the specialist system that it believes are beneficial to the market and the investing public.

<sup>21</sup> See *infra* Section II.B.3.(a) for a more detailed description of the Exchange’s proposal regarding reserve interest.

<sup>22</sup> The term “market maker” shall have the same meaning as that term in Section (3)(a)(38) of the Act.

<sup>23</sup> As of the implementation of Phase 2, pursuant to proposed Rule 104(f)(iv), DMMs will be designated as “market makers” on the Exchange for purposes of the Act.

<sup>12</sup> See Notice, *supra* note 5, at 42861.

<sup>13</sup> See *infra* Section II.B.2.(a) for a more detailed description of the Exchange’s proposal regarding DMMs.

<sup>14</sup> The Exchange proposes to roll out each phase of the New Model initially in three or four securities, with progressive implementation of the New Model rules for additional securities over the duration of each phase. Certain provisions of the proposed rules for the New Model would be implemented on a one-year pilot basis. See *infra* Section II.B.5 for a more detailed description of the implementation of the proposed New Model.

<sup>15</sup> The DMM would also be responsible for effecting manual executions in certain circumstances on the Exchange. See *infra* notes 38–39 and accompanying text.

<sup>16</sup> See *supra*, notes 8–10 and accompanying text. The Exchange has determined to impose certain affirmative obligations on DMMs (including an obligation to provide quotes at the National Best Bid or Offer (“NBBO”) a minimum percentage of the trading day).

<sup>17</sup> Proposed NYSE Rule 72 (Priority of Bids and Offers and Allocation of Executions).

<sup>18</sup> The term “Exchange BBO” refers to the best bid or the best offer on NYSE. It should not be confused with the defined terms “national best bid” and “national best offer” as defined in Rule 600(b)(42) of Regulation NMS Rule 242.600(b)(42) under the Act.

<sup>19</sup> See *infra* Section II.B.3.(b) for a more detailed description of the Exchange’s proposal regarding priority.

<sup>20</sup> See *infra* Section II.B.3.(b) for a more detailed description of the Exchange’s proposal regarding parity.

Current NYSE Rule 104, relating to specialist dealings, will be amended and renamed 104T and will be operative and effective through the end of Phase 1. The Exchange also proposes a new Rule 104 that will be implemented during Phase 2.<sup>24</sup>

#### (2) DMMs and DMM Units Approved by the Exchange

The Exchange proposes to require that member organizations who want to operate a DMM Unit file an application in writing and be approved by NYSE Regulation prior to operating a DMM Unit. The application and approval requirement would be waived for existing NYSE specialist firms that decide to create a DMM Unit.<sup>25</sup> In deciding whether to approve an application, NYSE Regulation will consider, among other things, the member organization's market making ability, the capital that the member is willing or able to make available for market making and such other factors as NYSE Regulation deems appropriate.<sup>26</sup>

DMMs employed by DMM Units to work on the Floor of the Exchange will be required to be approved and registered with the Exchange. In order to obtain such approval, applicants will need to submit an application to NYSE Regulation, Inc., which will assess an applicant's regulatory fitness, and successfully complete a qualifications examination prescribed by the Exchange.<sup>27</sup>

#### (3) DMMs Not Responsible Broker-Dealer

The Exchange proposes to amend the provision in Exchange rules that makes specialists the "responsible broker-dealer" for purposes of Limit Order Display and other obligations under both the Act and regulations promulgated thereunder. Under NYSE Rule 60, specialists are currently solely responsible for quoting the highest bids and lowest offers on the Exchange for all reported securities.

The Exchange is of the view that this rule is appropriate in a manual trading environment, where the specialist post is the primary locus for trading in securities and where the specialist oversees the reporting of all executions. The Exchange believes this rule makes less sense in an automated market.

Market participants who are not specialists post their interest electronically in the form of DOT orders or e-Quotes (broker agency interest files), and Exchange systems process and publish that interest automatically. The Exchange's quote today now includes the Floor broker's agency interest, specialist interest, and electronically entered interest of off-Floor participants, and all interest included in the Exchange's quote is identifiable by the Exchange's systems.

Given the automated processing of participant orders, quotations, and executions, the Exchange believes that the notion that the specialist is the sole responsible broker-dealer is obsolete. And, because various obligations may attach based on whether a participant is designated as the responsible broker-dealer, the Exchange believes that designating the DMM as the "responsible broker-dealer" could place these obligations on a nominal participant while relieving the logically responsible participant of that same obligation. To address these limitations, NYSE is proposing to amend NYSE Rule 60 to reflect that the member or member organization entering a bid or offer in a security is the "responsible broker-dealer" to the extent of such bid or offer.<sup>28</sup>

#### (4) DMMs' Affirmative Obligation

Although the Exchange does not propose to require DMMs to act as "responsible broker-dealers," the Exchange does propose to impose on each DMM affirmative obligations with respect to the quality of the markets in securities assigned to it. The Exchange's proposed Rule 104 sets forth the DMMs' affirmative obligation as follows:

The function of a member acting as a DMM on the Floor of the Exchange includes the maintenance, in so far as reasonably practicable, of a fair and orderly market on the Exchange in the stocks in which he or she is so acting. The maintenance of a fair and orderly market implies the maintenance of price continuity with reasonable depth, to the extent possible consistent with the ability of participants to use reserve orders, and the minimizing of the effects of temporary disparity between supply and demand. In connection with the maintenance of a fair and orderly market, it is commonly desirable that a member acting as DMM engage to a reasonable degree under existing circumstances in dealings for the DMM's own account when lack of price continuity, lack of depth, or disparity between supply and demand exists or is reasonably to be anticipated.<sup>29</sup>

In addition, DMM Units would be required to maintain adequate minimum capital<sup>30</sup> based on their registered securities, and would be required to use their capital to engage in a course of dealings for their own accounts to assist in the maintenance, so far as practicable, of a fair and orderly market. Transactions on the Exchange by a DMM for the DMM Unit's account are to be effected in a reasonable and orderly manner in relation to the condition of the general market and the market in the particular stock.<sup>31</sup> To support this requirement, the Exchange would continue to provide depth guidelines<sup>32</sup> for each security, and NYSE Regulation would continue to surveil for and enforce DMM compliance with the guidelines.<sup>33</sup>

DMMs would further be required to maintain a bid or offer at the National Best Bid or National Best Offer ("inside") for securities in which the DMM is registered for a certain percentage of the trading day based on the average daily volume of the security. For securities that have a consolidated average daily volume of less than one million shares per calendar month, a DMM Unit must maintain a bid or an offer at the NBBO for at least 10% of the trading day (calculated as an average over the course of a calendar month). For securities that have a consolidated average daily volume of equal to or greater than one million shares per calendar month, a DMM Unit must maintain a bid or an offer at the NBBO for at least 5% or more of the trading day (calculated as an average over the course of a calendar month). Reserve or

<sup>30</sup> The proposed capital requirements for DMMs are identical to the current capital requirements computed for specialists in accordance with Rule 15c3-1 and current NYSE Rule 104. The Exchange proposes to move the placement of these requirements into proposed NYSE Rule 103.

<sup>31</sup> See Proposed NYSE Rule 104(g)(i).

<sup>32</sup> Currently, the Exchange provides each security with a daily depth guideline and depth sequence size that reflects its individual trading characteristics including intra-day price volatility. Depth sequence sizes over which depth is calculated and the depth guidelines against which the calculated depth movements are compared are dynamically updated each day for each symbol based on the symbol's recent trading characteristics. These characteristics include: its previous NYSE closing price; its NYSE adjusted volume; and its intra-day consolidated high/low range. Systemic calculations of these values occur each day and are used in the creation of a formulaic individualized depth guideline and depth sequence size that is unique for each security. The Exchange proposes to provide DMMs with the same information pursuant to proposed NYSE Rule 104(f)(iii).

<sup>33</sup> Specialist compliance with the depth guidelines is reviewed by the Market Surveillance division of NYSE Regulation on a patterns and practices basis. A specialist's failure to comply with the guidelines may result in referral to NYSE Regulation's Enforcement division for investigation and possible disciplinary action.

<sup>24</sup> See *infra* Section II.B.5 for a more detailed description of the phased implementation of the proposed New Model.

<sup>25</sup> See Proposed NYSE Rule 103(b)(ii).

<sup>26</sup> See Proposed NYSE Rule 103(b)(i).

<sup>27</sup> For a full discussion of the DMM registration and approval process, including provisions for Relief DMMs and Temporary DMMs, see Notice, *supra* note 5, at 42862.

<sup>28</sup> See 17 CFR § 240.602(b)(i).

<sup>29</sup> See Proposed NYSE Rule 104(f)(ii).

other hidden orders entered by the DMM would not be included in the inside quote calculations.<sup>34</sup>

The Exchange further proposes that DMMs retain the re-entry requirements currently imposed on specialists contained in NYSE Rule 104. As such, DMMs effecting Neutral, Non-Conditional and Conditional transactions would still be required to re-enter liquidity on the opposite side of the market depending on the type of transaction executed by the DMM.<sup>35</sup>

#### (5) DMMs and Order Information

Once Phase 2 has been implemented, DMMs would not receive an order-by-order advance “look” at incoming orders.<sup>36</sup> The DMM Unit’s trading algorithms would have access to information with respect to orders entered on the Exchange, Floor broker agency interest files, or reserve interest to the extent such information is made publicly available. DMM unit algorithms would receive the same information that is disseminated to the public by the Exchange, at the same time that it is available to other market participants, with respect to orders entered on the Exchange, Floor broker agency interest files, or reserve interest.<sup>37</sup>

Although the DMM would no longer receive order by order information, there are certain times during which the Exchange believes human interaction is essential to market quality and maintaining a fair and orderly market; specifically, during opening and re-

opening transactions, closing transactions, block transactions, gap quote situations, and when trading reaches liquidity replenishment points (“LRPs”) that would lock or cross the market.<sup>38</sup> During these specific situations, DMMs would be responsible for determining the price<sup>39</sup> and effecting executions of orders at that price.

#### (6) DMMs Would Not Retain the Specialists’ Negative Obligation

The Exchange believes that due to the transformation of the equities markets in the United States, the specialists’ negative obligation no longer makes sense and should be eliminated. Historically, in a manual, floor-based market, specialists often had a significant informational advantage from being at the center of substantially all of the exchange’s activity in a given security. Similarly, in the Hybrid Market, the specialist’s advance “look” at incoming orders provided the specialist with a unique and potentially significant informational advantage over other market participants.

Given the real-time availability of market information and resultant increase in market transparency in today’s markets and the Exchange’s proposed elimination of the advance “look” at incoming orders by the DMM, the Exchange believes that the imposition of a negative obligation on DMMs is unnecessary. Accordingly, the Exchange is proposing that, beginning with the implementation of Phase 2, DMMs would no longer be deemed to be “specialists” or to be subject to the negative obligation.

DMMs, however, would continue to facilitate manual transactions on the Exchange. When DMMs are facilitating manual transactions, Exchange systems would provide DMMs the total volume of all orders eligible to participate<sup>40</sup> in the transaction. All eligible orders would be aggregated by the Exchange system and shown to DMMs as interest available to participate in the manual

execution. With this tool, DMMs would have the necessary information to appropriately price opening, re-opening, and closing transactions and to trade out of gap quote and certain LRP situations. DMMs would not have access to such information on an order-by-order basis, as Exchange specialists do today.<sup>41</sup>

#### (7) DMMs Interest for Quoting and Trading

Although DMMs would no longer be restricted by a negative obligation, DMMs would have an affirmative obligation to contribute to the maintenance of a fair and orderly market by committing capital in order to add liquidity to the market when there is little or no liquidity, and bridge the gaps in supply and demand by trading for their own account. To assist DMMs in meeting these market making responsibilities, DMMs would be permitted to maintain systems that employ algorithms to make trading and quoting decisions (“DMM Interest”) on behalf of each DMM.

DMM Interest would be permitted to: (i) Supplement the size of the existing Exchange BBO; (ii) maintain displayed and non-displayed DMM Interest, as described more fully below;<sup>42</sup> (iii) layer interest at varying prices outside the Exchange BBO; (iv) partially or completely fill an order at the Exchange BBO or at a sweep price; (v) trade at and through the Exchange BBO; (vi) trade in a sweep transaction; (vii) provide price improvement; and (viii) match better bids and offers published by other market centers where automatic executions are immediately available. Exchange systems would prevent DMM Interest from executing against itself (*i.e.*, executing wash trades).

#### (8) DMM Capital Commitment Schedule

In addition to DMM Interest, DMMs would be permitted to transmit to the Display Book a Capital Commitment Schedule (“CCS”) setting forth additional liquidity that the DMM would be willing to provide at specific price points. The CCS would inform the Display Book of the amount of shares that the DMM is willing to trade at price points outside, at, and inside the Exchange BBO. The CCS is separate and distinct from the DMM Interest. DMM algorithms would send the Exchange this schedule of additional non-displayed trading interest.

CCS interest would be accessed by the Exchange’s systems in two ways,

<sup>34</sup> For a more detailed discussion of how DMM compliance with the quoting requirement is measured and an example of a quoting requirement calculation, *see* Notice, *supra* note 5, at 42863–4.

<sup>35</sup> Pursuant to proposed NYSE Rule 104(g)(i)(A), DMMs would be subject to the same requirements currently imposed on specialists in current NYSE Rule 104.10(5)–(6). Currently Conditional Transactions operate as a separate pilot; through this filing the Exchange seeks to incorporate those provisions into the New Model Pilot through proposed NYSE Rule 104(g)(i)(A).

<sup>36</sup> In SR-NYSE-2008-67, the Exchange modified the order flow sent to the Specialist Application Programmed Interface, or “SAPI.” Commencing with two securities (to ultimately apply to all Exchange securities), the Exchange’s systems will send only copies of the following types of orders to the Specialist Algorithm: (i) market orders; (ii) buy limit orders priced at the NYSE bid price or sell limit orders priced at the NYSE offer price; (iii) limit orders priced in between the NYSE bid price and the NYSE offer price; and (iv) limit orders that are priced at or through the opposite side quote (*i.e.*, below the bid in the case of an order to sell or at or above the offer in the case of an order to buy). *See* Securities Exchange Act Release No. 58628 (July 30, 2008), 73 FR 46122 (August 7, 2008).

<sup>37</sup> The Exchange notes that the DMM algorithm would receive “Book State” information, which is the same information that is available to other market participants that subscribe to NYSE market data feeds, and shows aggregated displayed interest at various price points.

<sup>38</sup> *See* Proposed NYSE Rule 104(a)(2)–(5).

<sup>39</sup> In an opening and reopening trade, Display Book would verify that all interest that must be executed in the opening or reopening can be executed at the price chosen by the DMM. If all the interest that must be executed in the transaction cannot be executed at that price, the Display Book would block the execution. In addition, when executing blocks (10,000 shares or more or value of \$200,000 or more), trading out of a gap quote situation or an LRP that locks or crossed the market, the Display Book may adjust the execution price if there is enough interest on the Display Book to complete the transaction at a better price.

<sup>40</sup> This information would not include customers’ Non-Displayed Reserve Orders and Floor broker agency interest that is designated “Do Not Display.” *See infra* Section II.B.3.(a).(2).

<sup>41</sup> Odd-lot orders are a temporary exception to this principle, due to limitations of the Exchange’s systems that process odd-lot orders. *See infra* notes 57–60 and accompanying text.

<sup>42</sup> *See infra* Section II.B.3.(a).

depending on whether an incoming order is inside, at, or through the NYSE BBO. When an order is received that would trade at or through the NYSE BBO, the Exchange's system would review all the liquidity available on the Display Book, including CCS interest, and determine the price at which the full size of the order can be satisfied (the "completion price"). When determining the completion price, Exchange systems would take into account all eligible displayed and non-displayed interest available in the Display Book (inside, at, and through the NYSE BBO); any protected bids or offers on markets other than the Exchange ("away interest"); and the DMM's CCS interest at a particular price. Exchange systems would then compare the amount of liquidity required from the DMM's CCS at the completion price with the number of CCS shares offered at the next price that is one minimum price variation ("MPV")<sup>43</sup> or more higher (in the case of an order to sell) or lower (in the case of an order to buy) (the "better price").

If the number of shares that would be allocated to the CCS interest at the better price is greater than the number of shares that would be allocated to the CCS interest at the completion price, then the CCS interest would participate at the better price (with CCS interest yielding to any other interest in Exchange systems at that price). Any remaining balance of the incoming order would be executed at the completion price against displayable and non-displayable interest pursuant to NYSE Rule 72.<sup>44</sup> If the number of shares that would be allocated to the CCS interest at the completion price is equal to or greater than the number of shares that would be allocated to the CCS interest at the better price, the CCS interest will participate at the completion price (with CCS interest yielding to any other interest in Exchange systems at that price).<sup>45</sup>

A DMM's CCS interest inside the Exchange BBO would be accessed by Exchange systems to provide price improvement to incoming orders and to match better-priced bids and offers if available on away market centers.

<sup>43</sup> Pursuant to NYSE Rule 62, the MPV is currently one cent (\$0.01) except that, with respect to equity securities trading on the Exchange at a price of \$100,000 or greater, the minimum price variation shall be ten cents (\$0.10).

<sup>44</sup> A DMM's CCS interest may only participate once in the execution of an incoming order. As such, CCS interest that may exist at the completion price is ineligible to trade with any remaining balance of the incoming order if the DMM's CCS interest was included in the execution of any portion of such order at the better price.

<sup>45</sup> For examples of the CCS, see Notice, *supra* note 5, at 42866-67.

DMMs would not be required to be represented in the bid or the offer in order to provide CCS interest inside the Exchange BBO.

Pursuant to proposed NYSE Rule 1000(e), CCS interest priced inside the Exchange BBO could trade with interest arriving in the Exchange market that: (i) Is eligible to trade at or through the Exchange BBO; (ii) is eligible to trade at the price of non-displayable reserve interest of Reserve Orders and Floor broker agency interest files reserve interest ("hidden interest"); or (iii) is eligible to route to away market interest for execution, if the total volume of CCS interest, d-Quote interest in Floor broker agency interest files, and any other hidden interest would be sufficient to fully execute the incoming order at a price inside the Exchange BBO. The Display Book would determine the price point inside the Exchange BBO at which the maximum volume of CCS interest would trade, taking into account the available d-Quotes and hidden interest. The CCS interest would then participate at that price, on parity with all other interest at that price (i.e., d-Quotes and non-displayable reserve interest). Any reserve interest of the DMM that is also eligible to trade at the price inside the Exchange BBO at which the CCS interest would participate would be aggregated with the DMM's CCS interest at that price when the trade execution is allocated. In this manner, an incoming order may be executed at multiple price points inside the Exchange BBO against d-quotes, non-displayable reserve interest of all participants, and CCS interest. However, CCS interest may only participate once if more than one execution is required to fill the order.

#### (b) Floor Brokers

##### (1) Elimination of Percentage Orders

The Exchange proposes to amend NYSE Rule 13 and to delete NYSE Rules 70.25(d)(i)(A), 123A.30 and 1000(d)(2)(D) to eliminate percentage orders. As a result of these proposed amendments, Floor brokers would no longer be permitted to enter CAP-DI orders. In place of this order type, the Exchange intends to provide Floor brokers access to algorithmic technology that would replicate the trading strategy achieved by the use of CAP-DI orders through the Floor broker's handheld electronic device.

The Exchange believes that this change is necessary to improve the efficiency of the Display Book. CAP-DI orders require the system to monitor and calculate many variables, and passively converted CAP-DI orders

impede the specialist's ability to function efficiently in an automated market because the specialist must manually complete the passive conversion.<sup>46</sup>

##### (2) d-Quote Trading With Non-Marketable IOC Orders and at the Open and Close

The Exchange further proposes to amend NYSE Rule 70 to enhance the functionality of the Floor broker d-Quote to increase the liquidity available for executions on the Exchange. Specifically, the Exchange proposes to allow d-Quotes to partially or completely fill a non-marketable immediate or cancel order ("IOC"), which includes NYSE IOC, Reg NMS IOC, and Intermarket Sweep Orders,<sup>47</sup> that are within the d-Quote's discretionary range.<sup>48</sup> In allowing the d-Quote to interact with a non-marketable IOC, the Exchange seeks to provide the IOC an opportunity to receive a partial or complete execution with price improvement. In instances where the d-Quote only partially completes the order, the remaining portion of the non-marketable IOC will be automatically and immediately cancelled.

To further increase the liquidity available at the opening and closing transaction, the Exchange proposes to amend NYSE Rule 70.25(a)(ii) to allow d-Quotes to be active in the opening and closing transactions.

##### (3) Floor Broker Interest Published to OpenBook

The Exchange proposes to have Floor broker interest published in the OpenBook system at every price point (unless designated "Do Not Display" or "DND"). The displayable portions of Floor broker interest that is designated DND will only be published in OpenBook when such interest is at the Exchange BBO. Floor broker agency interest employing Non-Displayed Reserve functionality, as described further below,<sup>49</sup> will not be published in OpenBook.

#### 3. Changes to NYSE Order Types and Order Processing

##### (a) Additional Undisplayed Liquidity

Floor brokers, off-Floor participants, and DMMs would continue to have the

<sup>46</sup> For additional discussion regarding the Exchange's proposed elimination of CAP-DI orders, see Notice, *supra* note 5, at 42868.

<sup>47</sup> See NYSE Rule 13. By their definition, these order types are never quoted but must be automatically executed. Any remaining unfilled portion is immediately and automatically cancelled. Non-marketable IOC orders are immediately and automatically cancelled.

<sup>48</sup> See Proposed NYSE Rule 70.25(d)(ix).

<sup>49</sup> See *infra* Section II.B.3.(a).(2).

ability to maintain reserve liquidity on the Exchange; however, NYSE proposes to modify each market participant's ability to provide reserve interest. As a threshold matter, the Exchange proposes to amend NYSE Rule 13 to label all undisplayed off-Floor interest "Reserve Orders." Within that category, the Exchange proposes to create two types of reserve interest, "Minimum Display" and "Non-Displayed Reserve."

#### (1) Minimum Display Orders

Under the proposed rule change, "Minimum Display Orders" require that a minimum of one round lot of the order be designated for display. The Exchange proposes to make permanent NYSE Rule 13 governing Reserve Orders, and also proposes to provide Floor brokers and DMMs with equivalent functionality via a conforming amendment to proposed NYSE Rules 70(e) and 104. Collectively, this minimum display reserve functionality is referred to as "Minimum Display Interest." Each time a Minimum Display Order is replenished from reserve interest, a new time-stamp is created for the replenished portion of that Minimum Display Order, while the remaining reserve interest retains the time-stamp of its original entry. Minimum Display Interest would be eligible to participate in manual executions, but would not be identifiable to the DMM on an order-by-order basis. Exchange systems would include all Minimum Display Interest in the aggregate order information available for execution at a price point when the DMM facilitates a manual transaction.

The Exchange further proposes that the aggregate of Minimum Display Interest be included in the aggregate interest available to be seen by the DMM in order to provide information about orders available in Exchange systems for response to a Floor broker's market probe request pursuant to NYSE Rule 115. Currently, during a manual execution, Floor broker DND reserve interest that has a displayed quantity and Reserve Orders pursuant to NYSE Rule 13 are included in the aggregated order information displayed to the specialist only during manual executions (e.g., the opening and closing trade on the Exchange, resuming trades after a LRP is reached, or during a gap quote situation). Pursuant to Exchange Rule 70.20(h), access to the Display Book system for information on reserve interest is only for the purpose of effecting transactions that are reasonably imminent.<sup>50</sup> The Exchange

proposes to amend NYSE Rules 13, 70.20 and 115 to specifically state that the aggregated Minimum Display Interest will be included in the information disseminated in response to a Floor broker's market probe request pursuant to NYSE Rule 115.

Pursuant to NYSE Rule 115(iii) a specialist may provide information about orders contained in the Display Book, referred to also as a market probe, to provide information about buying or selling interest in the market. This information can include aggregated buying or selling interest contained in Floor broker agency interest files other than interest the broker has chosen to exclude from the aggregated buying and selling interest in response to an inquiry from a member conducting a market probe in the normal course of business.

The Exchange further proposes to amend NYSE Rule 70.20(h)(ii) to remove the prohibition against specialist's ability to provide information about Floor broker reserve interest. The Exchange proposes that all Floor broker interest not designated DND be included in the information eligible for dissemination pursuant to NYSE Rule 115.

#### (2) Non-Displayed Reserve Orders

In addition to Minimum Display Interest, the Exchange further proposes to provide all market participants with the ability to maintain non-displayed interest. This proposed type of reserve interest would not require any of the order to be designated for display and would be available to all market participants. The Exchange proposes to create the "Non-Displayed Reserve Order" for off-Floor participants and provide Floor brokers and DMMs with equivalent functionality. Non-Displayed Reserve Orders of off-Floor customers would not be included in the information available to the DMM for manual execution.

Floor brokers would also be able to utilize non-displayed reserve functionality to enter reserve interest. If the Floor broker uses this functionality, there is no interest displayed in the published quotation, but the interest will be eligible for manual executions because the DMM has the ability to view the Floor broker agency interest in the aggregate. Floor broker agency interest file reserve interest may also be designated as Do Not Display or "DND,"

are prohibited from using the Display Book system to access information about Floor broker agency interest excluded from the aggregated agency interest other than for the purpose of effecting transactions that are reasonably imminent where such Floor broker agency interest information is necessary to effect such transaction."

meaning such interest will not be available to the DMM for manual executions. As such, Non-Displayed Reserve Orders and Floor broker non-displayed reserve interest that is designated DND would not participate at the open or the close, during a gap quote situation, or when a manual execution is required to trade out of an LRP that locks or crosses the market. Therefore, these types of interest may be executed at an inferior price, and will not be protected in any manual trade—at the choice of the customer. DMM interest employing Non-Displayed Reserve functionality would, however, be eligible to participate in a manual transaction.

Off-Floor participants that want to have non-displayed liquidity participate in a manual transaction would be required to send a Minimum Display Order. Similarly, Floor brokers that choose to have non-displayed liquidity participate in a manual transaction must not designate such interest DND.

#### (b) Execution of Bids and Offers

The Exchange proposes to amend NYSE Rule 72 to provide to all market participants the ability to receive executions on an equal basis with other interest available at that price. As with NYSE's current parity rules, individual Floor brokers and the DMM registered in the security would each constitute a single market participant, but all orders received by the Display Book directly from off-Floor participants would together constitute a single market participant, the Off-Floor Participant, for the purpose of share allocation. However, unlike specialist interest, which under current NYSE rules must yield to all off-Floor interest residing on the Display Book, DMM Interest would be on parity and would not be required to yield to any off-Floor interest.

#### (1) Priority and Parity for Setting Interest

Proposed NYSE Rule 72 would modify the concept of priority to provide that, where there is more than one bidder (offerer) participating in an execution and one of the bids (offers) was established as the first at a particular price and such bid or offer is the only interest when such price is or becomes the best bid or offer published by the Exchange (the "Setting Interest"), the displayed portion of such Setting Interest is entitled to priority. In order to qualify as Setting Interest, it must have been the only<sup>51</sup> interest quoted at

<sup>50</sup> NYSE Rule 70.20(h)(ii) provides, "Specialists, trading assistant and anyone acting on their behalf

<sup>51</sup> If, at the time of quoting, Non-Displayed Reserve Orders, Floor broker interest or DMM interest employing Non-Displayed Reserve

a price. Only the quoted (*i.e.*, displayed) portion of the Setting Interest is entitled to priority ("Priority Interest").

Exchange systems would allocate the first 15% of any execution (subject to a minimum of one round lot)<sup>52</sup> at that price to the Priority Interest. For the remainder of that execution, Setting Interest would receive executions on parity with other interest available at that price. Exchange systems would repeat the allocation logic for the Setting Interest until the Priority Interest is completely executed. Any remaining non Priority Interest of the Setting Interest would be executed on parity.

The Exchange proposes to have Priority Interest retain its standing even if the Exchange BBO moves away from the price point. In this case, if the Exchange BBO returns to that price point later in the same trading session, the remaining portion of the Priority Interest would again enjoy priority until it is executed or cancelled, trading in the stock is halted, the trading session ends, or the BBO moves away again.

Partial cancellations would count first against the non-Priority Interest of any Setting Interest. All allocations to the Setting Interest would be decremented from the Priority Interest first whether the allocation is based on priority or parity. Setting Interest may be executed on parity with no priority allocation if the quote moves to a better price point and thereafter an incoming order exceeds the shares available for execution at the newly established Exchange BBO. In those instances, the Setting Interest will be executed on parity and the Priority Interest will be decremented first.

## (2) Priority and Parity in the Absence of Setting Interest

Where there is no Setting Interest, Exchange systems would divide the size of the executing order by the number of participants. The total number of shares to be allocated to each participant (*i.e.*, the single Off-Floor Participant, the DMM, and each Floor broker) would be distributed equally among the market participants, subject to the need to allocate in round lots. Within the single

Off-Floor Participant, shares executed would be allocated in order of time priority of receipt of orders from off-Floor customers into Exchange systems. Executions would be allocated in round lots. In the event the number of shares to be executed at the price point is insufficient to allocate round lots to all the participants eligible to receive an execution at the price point, the Exchange systems would create an allocation wheel of the eligible participants at the price point and the available shares would be distributed to the participants in turn.

On each trading day, the allocation wheel for each security would be set to begin with the participant whose interest is entered or retained first on a time basis. Thereafter, participants would be added to the wheel as their interest joins existing interest at a particular price point. If a participant cancels its interest and then rejoins, that participant would join as the last position on the wheel at that time.

Non-displayed interest at price points within the Exchange BBO would also trade on parity at each price point. Thus, non-displayed interest that is priced within the Exchange BBO would be eligible to be executed on parity at each price point against incoming orders.

The Exchange further proposes to modify its overall allocation logic to require that, for all executions at or through the Exchange BBO, displayable interest trades ahead of non-displayable interest available for execution at the same price point. Once all displayable interest has been satisfied at a given price point, the remainder of the incoming order would execute against non-displayable interest at that price point. All categories of non-displayable interest would trade on parity, with the exception of the DMM's CCS interest, which yields to all other interest at the same price.

## 4. Additional Proposed Rule Changes

In addition to the proposed rule changes discussed above, the Exchange has proposed numerous minor substantive changes and conforming changes throughout the Exchange's rule book in order to conform NYSE's rules to the proposed New Model.<sup>53</sup>

## 5. Implementation Schedule

The proposed amendments herein require the Exchange to make significant modifications to Exchange systems. The Exchange therefore proposes that the

proposed rule change be implemented in stages pursuant to the schedule outlined below.

### (a) Non-Pilot Rules

The Exchange proposes that the amendments to NYSE Rule 13 regarding the establishment of Reserve Order types and the elimination of CAP orders would be implemented upon Commission approval as permanent changes to the NYSE rulebook. Similarly, all conforming changes to other Exchange rules to enable Floor brokers and DMMs to use equivalent reserve order functionality would be implemented upon Commission approval as permanent changes to the NYSE rulebook. In addition, the Exchange proposes that amendments to NYSE Rules 2 and 103 establishing the DMMs and DMM units also would be implemented upon Commission approval as permanent changes to the NYSE rulebook.

The Exchange further proposes that the proposed amendments to NYSE Rule 70 that: (i) Allow for the publication of Floor broker interest to OpenBook; (ii) allow d-Quote instructions to be active during the open and close; and (iii) allow d-Quotes to trade with non-marketable IOC orders would be implemented upon Commission approval as a permanent change to the NYSE rulebook.

### (b) Pilot Rules

The Exchange further proposes to implement certain provisions of the New Model proposal on a pilot basis ("New Model Pilot") upon Commission approval of the proposed rule change. The New Model Pilot would operate until October 1, 2009.

During Phase 1 of the New Model Pilot, the Exchange would implement proposed NYSE Rule 72 and proposed NYSE Rule 104T.<sup>54</sup> During the operation of Phase 1, pursuant to proposed Rule 72, all market participants, including DMMs, would have the ability to receive executions on parity with other interest available at that price. In addition, during Phase 1, DMMs would still receive the order-by-order "look" that the specialists currently receive. During this period, DMMs would still be considered "specialists" under the Act, subject to applicable affirmative and negative obligations.

With the implementation of Phase 2, NYSE Rule 104T would cease operation and new NYSE Rule 104 would supersede it. Beginning in Phase 2, the

Functionality exist at the price point along with a single order or quote that has a published quantity, the single order would be deemed to be a setting order even if the Hidden Reserve Orders and Floor broker and DMM interest employing Hidden Reserve Functionality arrived first. In addition, if prior to quoting, there are two orders at the price point and one of those orders cancels, the remaining order that is the only interest quoted at the price would be considered the Setting Interest. See Proposed Rule 72(a)(ii).

<sup>52</sup> All allocations will be done on a round lot basis. If 15% would result in the Priority Interest receiving a mixed lot, Exchange systems will round up to the nearest round lot.

<sup>53</sup> For a full discussion of these additional proposed rule changes, see the Notice, *supra* note 5, at 42870-1.

<sup>54</sup> Proposed NYSE Rule 104T is a temporary rule that would operate through the end of Phase 1 and cease operation with the implementation of Phase 2.

DMM would no longer receive any order-by-order information. In addition, under proposed Rule 104, DMMs would no longer be subject to a negative obligation. Also as of that date, the portion of Rule 1000 relating to the DMM's CCS interest would be implemented.

During the operation of the New Model Pilot, the Exchange has committed to provide the Commission's Division of Trading and Markets and Office of Economic Analysis with statistics related to market quality, trading activity, and sample statistics as requested by the Commission.

### C. Amendment No. 2

In Amendment No. 2 to the proposed rule change, the Exchange proposes to: (i) Clarify how odd-lot information will be transmitted to the DMM Unit algorithm prior to the opening; (ii) retain and expand the restriction, currently applicable to specialists, trading assistants, and anyone acting on their behalf from accessing certain Exchange systems and apply it to DMMs, trading assistants, and anyone acting on their behalf; (iii) make technical amendments to NYSE Rules 13, 52, 72, 299A, and 1000; (iv) reconcile the rule language of NYSE Rules 98, 98A, 99, 104T, 105, 113 and 460 with amendments approved by the Commission pursuant to filing SR-NYSE-2008-45 ("2008-45 Amendments");<sup>55</sup> (v) reconcile the rule language of NYSE Rule 104T with the NYSE's immediate effectiveness filing SR-NYSE-2008-73 ("2008-73 Amendments");<sup>56</sup> and (vi) describe the data that the Exchange will provide the Commission to monitor the New Model Pilot.

Specifically, Amendment No. 2 proposes to clarify that, while the individual DMM would have access only to aggregate order information as it pertains to round-lot and odd-lot orders, the DMM Unit algorithm would receive odd-lot information on an order-by-order basis prior to the opening. Odd-lot orders on the Exchange are processed in a separate system from the Exchange systems that execute round-lot orders. Odd-lots are executed systemically by Exchange systems designated solely for odd-lot orders (the "odd-lot System").<sup>57</sup> The odd-lot System executes all odd-lot

orders against the specialist<sup>58</sup> as the contra party. In order for the DMM Unit algorithm to effectively facilitate an opening transaction, the DMM Unit algorithm would also be provided odd-lot information prior to the opening. Constraints inherent in the odd-lot System require that odd-lot information be transmitted to the DMM Unit algorithm on an order-by-order basis prior to the opening.<sup>59</sup> As such, prior to the opening, Exchange systems will transmit to the DMM Unit algorithm odd-lot order information excluding e-Quote odd-lots, odd-lot cancellations, Stop odd-lot orders and Good 'til Cancel odd-lot orders.<sup>60</sup> Once the security is opened, Exchange systems would not provide any order-by-order odd-lot information to the DMM Unit algorithm.

In addition, Amendment No. 2 proposes to clarify that the Exchange seeks to retain and expand the restriction, currently applicable to specialists, trading assistants, and anyone acting on their behalf from accessing certain Exchange systems other than for the purpose of effecting transactions that are reasonably imminent, and apply it to DMMs, trading assistants, and anyone acting on their behalf.<sup>61</sup> In addition, the Exchange seeks to add information pertaining to Minimum Display Reserve Orders to the restriction and move the restriction from NYSE Rule 70 to the rules governing DMM requirements.<sup>62</sup> The proposed rule would prohibit DMMs, trading assistants, and anyone acting on their behalf from using the Display Book system to access information about Floor broker agency interest excluded from the aggregated agency interest and Minimum Display Reserve Order information other than for the purpose of effecting transactions that are reasonably imminent, and where such Floor broker agency and Minimum Display Reserve Order interest

information is necessary to effect such transaction.

Amendment No. 2 also proposes technical corrections to the rule text. Specifically, the Exchange proposes to change the word "specialist" to "DMM" in NYSE Rule 13 because during the editing process the word specialist was inadvertently left in this rule. The Exchange further amended their proposal to remove previously proposed changes to NYSE Rule 52 that the Exchange instead intends to be the subject of a separate future filing. Also, rule language designating proposed Rule 72 as operating in the New Model Pilot was inadvertently not underscored. The Exchange proposes to add the required underscoring to designate that text as new language pursuant to this filing. In addition, Amendment 2 reflects the Exchange's proposal to delete subparagraph (b)(2) of the Supplemental Material .10 of NYSE Rule 299A because, similarly to specialists under the current NYSE market model, DMMs will not be allowed to "stop" stock. Further, in order to correct lettering errors in NYSE Rule 1000, the Exchange proposes to move the language denoting the Rule as operating in the New Model Pilot to directly after the name of the rule and retain the original lettering.

On August 7, 2008, the Commission approved the 2008-45 Amendments which, among other things, modified the rule text of NYSE Rules 98, 98A, 99, 104T, 105, 113 and 460. Through Amendment No. 2, the Exchange seeks to change the term "specialist" to DMM in NYSE Rules 98 and 98A to reflect the new language approved in the 2008-45 Amendments.

In addition, on August 13, 2008, the Exchange filed with the Commission for immediate effectiveness a proposal to amend NYSE Rule 104(b) to provide for an automated opening message that is effectuated through the specialist Application Programmed Interface to allow specialists to automatically open a security on a transaction. Through Amendment No. 2, the Exchange proposes to amend Rule 104T(b)(ii) to incorporate the rule language from the 2008-73 Amendments.

Finally, during the operation of the New Model Pilot, the Exchange is committed to providing the Commission's Division of Trading and Markets and the Office of Economic Analysis with statistics related to market quality, trading activity, and sample statistics. The metrics discussed below, along with any other metrics the Exchange may choose to provide, will be transmitted to the Commission on a monthly basis. The Exchange will maintain average measures for each

<sup>55</sup> See Securities Exchange Act Release No. 58328 (August 7, 2008), 73 FR 48260 (August 18, 2008) (SR-NYSE-2008-45).

<sup>56</sup> See Securities Exchange Act Release No. 58351 (August 13, 2008), 73 FR 48416 (August 19, 2008) (SR-NYSE-2008-73).

<sup>57</sup> See NYSE Rule 124(a).

<sup>58</sup> Odd-lot orders will continue to be executed against the DMM as the contra. See proposed NYSE Rules 104(e) and 124(a).

<sup>59</sup> The Exchange is currently working on modifications to its odd-lot system that would allow for the transmission of aggregate odd-lot information to DMM unit algorithms in the third quarter of 2009 so that order-by-order transmission would no longer be required.

<sup>60</sup> See proposed NYSE Rule 104 Supplementary Material .05.

<sup>61</sup> Specifically, NYSE Rule 70.20(h)(ii) provides in pertinent part that: "Specialists, trading assistants and anyone acting on their behalf are prohibited from using the Display Book® system to access information about Floor broker agency interest excluded from the aggregated agency interest other than for the purpose of effecting transactions that are reasonably imminent where such Floor broker agency interest information is necessary to effect such transaction."

<sup>62</sup> See proposed NYSE Rules 104T(j) and 104(a)(6).

trading day during a particular month<sup>63</sup> in order to provide such information to the Commission upon request.

On or before the 20th day of the second calendar month following the Approval Date,<sup>64</sup> the Exchange will provide the Commission with the data described below, which will include data for all the trades in the two months prior to the commencement of the New Model Pilot. The data to be provided on such date will include the following:

1. The specialist time at the NBBO by security.

2. The effective spread by security.

3. The specialist volume broken out by "specialist interest type" (e.g., s-Quote and s-Quote employing reserve functionality). The Exchange will further provide the total shares traded expressed in twice total volume ("TTV") where both the buy and sell shares are counted for each trade to allow the Commission to track the direction of the overall specialist participation rate over time.

4. The average depth at the NBBO for specialists.

On the 20th day of the month following the initial provision of data, the Exchange will provide the Commission with the data described below, which will include data for all the trade dates in the months directly following the Approval Date through the last trade date of the previous month. On the same date, the Exchange will additionally provide data related to the average depth at the NBBO for Floor brokers and orders represented in the Display Book for the two months prior to the commencement of the New Model Pilot.<sup>65</sup> Thereafter the Exchange will provide the data described below on the 20th day<sup>66</sup> of each calendar month until the end of the New Model Pilot. The data will reflect the trading activity of the prior calendar month. The specific data to be provided until the end of the New Model Pilot is as follows:

1. The DMM time at the NBBO by security.

2. The effective spread by security.

3. The DMM volume broken out by "DMM interest type" (e.g., CCS, s-Quote). The Exchange will further provide the total shares traded expressed in TTV where both the buy

and sell shares are counted for each trade to allow the Commission to track the direction of the overall DMM participation rate over time.

4. The average depth at the NBBO by market participant (DMMs, Floor brokers, and orders represented in the Display Book).

5. The ratio of (i) shares not executed on the Display Book due to DMM execution to (ii) the shares executed by the DMM.

6. Effective spread for: (a) orders that involve DMM liquidity provision and (b) orders that are executed without DMM liquidity (for similar order size categories).

#### D. Amendment No. 3

In Amendment No. 3 to the proposed rule change, the Exchange proposes to: (i) Modify the dates that the Exchange is required to provide data to the Commission; (ii) amend the operative dates of certain rules; (iii) clarify the implementation schedule of the New Model Pilot; and (iv) make technical amendments to NYSE Rules 98 and 98 Former (e.g., changing the term "specialty stocks" to "registered security").

In Amendment No. 3, the Exchange clarified that the implementation of the New Model Pilot would occur in two phases, Phase 1 and Phase 2. Each phase of the New Model Pilot would commence initially in three or four securities. The Exchange proposes that after a period of monitoring the system operation, NYSE would progressively implement each phase of the New Model Pilot in additional securities until that phase is operative in all securities traded on the Floor. The rules applicable to each phase of the New Model Pilot would apply to trading in securities as they are added to each phase. Implementation of Phase 1 will be completed no later than five weeks after the Approval Date, and implementation of Phase 2 will be completed no later than ten weeks after the Approval Date.

### III. Discussion and Commission Findings

After careful review, we find 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. In particular, we find that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act<sup>67</sup> which requires, among other things, an exchange to 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 a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.<sup>68</sup> The Commission also finds that the proposed rule change is consistent with Section 6(b)(8) of the Act,<sup>69</sup> which requires that the rules of an exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

#### A. Redefinition of the Role of the Specialist; Designated Market Makers

One major element of NYSE's New Model is the elimination of specialists and the introduction of Designated Market Makers. DMMs would be assigned affirmative obligations, some of which are similar to those currently imposed on specialists. Specifically, DMMs would have an obligation to use the firm's own capital to contribute to the maintenance of a fair and orderly market on the Exchange in its assigned securities, would be subject to depth guidelines,<sup>70</sup> and would have an obligation to maintain a bid or an offer at the National Best Bid or National Best Offer for a certain percentage of the trading day.<sup>71</sup> In addition, DMMs would be required to facilitate transactions in their assigned securities during certain specified periods, namely for opening and re-opening transactions, closing transactions, block transactions, gap quote situations and when trading reaches LRP that would lock or cross the market. DMMs would be responsible for choosing the price and for the executions of the orders at that price during those specific situations. The Exchange has also proposed to eliminate for DMMs the advance "look" at incoming orders that NYSE specialists currently receive during Phase 2 of the implementation, which will be

<sup>68</sup> In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>69</sup> 15 U.S.C. 78f(b)(8).

<sup>70</sup> For more information regarding depth guidelines, see Notice, *supra* note 5, at 42863, n. 115.

<sup>71</sup> For securities that have a consolidated average daily volume of less than one million shares per calendar month, a DMM Unit would be required to maintain a bid or an offer at the NBBO for at least 10% of the trading day (calculated as an average over the course of a calendar month). For securities that have a consolidated average daily volume of equal to or greater than one million shares per calendar month, a DMM Unit would be required to maintain a bid or an offer at the NBBO for at least 5% or more of the trading day (calculated as an average over the course of a calendar month). See *supra* note 34 and accompanying discussion.

<sup>63</sup> The average per security may be provided across volume deciles.

<sup>64</sup> The timing of the provision of the market quality, trading activity, and other statistics to the Commission was set forth in Amendment No. 3.

<sup>65</sup> The Exchange represents that it is unable to provide this data in the requested format prior to this date.

<sup>66</sup> In the event the 20th day of the calendar month is a non-business day, the Exchange would provide the data on the next business day following the 20th day of that month.

<sup>67</sup> 15 U.S.C. 78f(b)(5).

completed within ten weeks of the Approval Date.<sup>72</sup>

In exchange for these obligations, NYSE has proposed that DMMs be permitted to freely trade for their own account on parity with other market participants (*i.e.*, the negative obligation and the requirement to yield to public customer orders on the Display Book, imposed on specialists under NYSE's current market model, would be eliminated).<sup>73</sup> The Exchange would no longer consider DMMs to be the "responsible broker-dealer" with respect to executions on the Exchange. In addition, a DMM would be permitted to transmit to the Display Book a Capital Commitment Schedule for its assigned securities setting forth additional liquidity that the DMM commits to provide at specific price points.<sup>74</sup> This proposed functionality would permit a DMM to participate in executions against incoming orders that would execute at or through the NYSE BBO, and allow the DMM to participate at the incoming order's completion price (or at the price one minimum price variation better, depending upon the circumstances). CCS interest priced inside the Exchange BBO could also be accessed by Exchange systems to provide price improvement to incoming orders and to match better-priced bids and offers available on away market centers.

Section 6(b)(5) of the Act requires that the rules of a national securities exchange protect investors and the public interest.<sup>75</sup> In addition, the Act requires that such rules promote just and equitable principles of trade and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.<sup>76</sup> Likewise, Section 11A of the Act emphasizes that the national market system should promote the public interest, the protection of investors, and the maintenance of fair and orderly markets.<sup>77</sup> In considering the proposed rules of a national securities exchange, we must therefore take into account their effect not only on the participants of the given market, but their impact on

investors and the public interest generally.

We recognize that the participation of market makers in exchange markets may benefit public customers by promoting more liquid and efficient trading, and that an exchange may legitimately confer benefits on market participants willing to accept substantial responsibilities to contribute to market quality.<sup>78</sup> However, while the rules of an exchange may confer special or unique benefits to certain types of participants, they must ensure, among other things, that investors and the public interest are protected.<sup>79</sup>

We carefully review trading rule proposals that seek to offer special advantages to market makers. Although an exchange may reward such participants for the benefits they provide to the exchange's market, such rewards must not be disproportionate to the services provided.<sup>80</sup> In considering NYSE's New Model provisions relating to DMMs, we have assessed whether the rewards granted to DMMs—including granting DMMs parity with respect to orders from off-Floor participants and giving DMMs unique hidden interest functionality via the proposed CCS—are commensurate with their obligations under the New Model.

Under NYSE's current market model, specialists are designated as the "responsible broker-dealer" for orders resting on the Display Book. NYSE specialists, by virtue of their advance "look" at incoming orders and their position on the trading floor, also have an informational advantage over other market participants which, if unchecked, could permit them to adjust their trading interest to the disadvantage of orders residing on the book. Because of this, specialists are required to yield to all off-Floor participant orders on the Display Book and are subject to the negative obligation not to trade for their own account in any security in which the specialist is registered "unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market."<sup>81</sup>

In support of its proposal to eliminate the negative obligation and allow the specialists' successors, DMMs, to trade on parity with public customer orders,

NYSE argues that the negative obligation is "an outmoded vestige of trading in a wholly different market environment and is unnecessary."<sup>82</sup> The Exchange believes that advances in technology, including electronic trading and the availability of real-time market information, make it difficult, if not impossible, for any single market participant, including a specialist, to have a time-and-place advantage over other market participants. In addition, the Exchange believes that the fragmentation of liquidity in the marketplace has lessened the importance of the specialist's influence over its registered securities. Moreover, NYSE proposes to eliminate for DMMs, during Phase 2 of the implementation, the advance "look" at incoming orders that specialists currently receive under the Exchange's current rules.

We generally agree that, given the widespread adoption of electronic, automated trading, the ability of market participants to avail themselves of robust real-time market information, and the reduction in NYSE's market share in recent years, the historic time-and-place advantage of specialists has been reduced in today's market environment, though we do not believe that such advantage has been completely eliminated.<sup>83</sup> The Exchange has proposed to fully eliminate the advance "look" specialists currently receive during Phase 2 of the implementation. In doing so, the Exchange has represented that, other than for odd-lot orders,<sup>84</sup> a DMM Unit's algorithm would receive the same information with respect to orders entered on the Exchange, Floor broker agency interest files, or reserve interest as is disseminated to the public by the Exchange, and would receive such information no sooner than it is available to other market participants.

We believe that the proposed elimination of the specialist's "look"—when viewed in conjunction with the obligations imposed upon DMMs, including a general affirmative obligation on the DMM to use its capital to contribute to the maintenance of a fair and orderly market in its assigned securities; an obligation to quote at the

<sup>72</sup> For so long as DMMs retain the "look" for particular securities, they would still be considered "specialists" under the Act in such securities, subject to applicable affirmative and negative obligations.

<sup>73</sup> In addition, the proposed parity and allocation rules would provide DMMs with preferential allocations to the extent that there are multiple orders of off-Floor customers in the Display Book at the execution price. See *infra* Part III.B.

<sup>74</sup> See *supra* Part II.B.2.a.(8).

<sup>75</sup> 15 U.S.C. 78f(b)(5).

<sup>76</sup> *Id.*

<sup>77</sup> 15 U.S.C. 78k-1(a)(2).

<sup>78</sup> See Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008) at 40148.

<sup>79</sup> 15 U.S.C. 78f(b)(5).

<sup>80</sup> See Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008) at 40148 ("Market makers can play an important role in providing liquidity to the market, and an exchange can appropriately reward them for that as well as the services they provide to the exchange's market, so long as the rewards are not disproportionate to the services provided.") (citation omitted).

<sup>81</sup> See current Rule 104(a).

<sup>82</sup> See Notice, *supra* note 5, at 42865.

<sup>83</sup> The Commission notes that, while NYSE's overall market share in NYSE-listed securities has fallen dramatically in recent years, it continues to execute a higher percentage of the volume in certain of these securities than any other single exchange. In addition, while the move to largely electronic trading has substantially reduced the information advantage gained from a presence on the Exchange Floor, DMMs retain some informational advantage to the extent there continue to be manual negotiations and executions on the Floor.

<sup>84</sup> See *supra* Part II.C.

National Best Bid or National Best Offer for a certain percentage of time; an obligation to facilitate transactions during specified periods; and depth guidelines<sup>85</sup>—reflects an appropriate balance of DMM obligations against the benefits provided to DMMs under this proposal, including providing DMMs parity with other market participants (and preferential allocations to the extent there are multiple orders of off-Floor participants in the Display Book at the execution price) and providing DMMs unique functionality through the CCS. However, given the significant advantage DMMs would receive by being on parity with market participants (discussed below in Part III.B), we are seeking further evidence that the benefits proposed for DMMs are not disproportionate to their obligations.<sup>86</sup>

In addition, while we believe that the proposed operation of the DMM's unique CCS functionality is designed to provide a slightly better execution price for a portion of a large incoming order because that portion of the order could receive an execution price of a penny better than it would have received absent the CCS interest, we note that the CCS would provide DMMs the opportunity to obtain its CCS execution at an advantageous price with minimal risk, and with no contribution to the visible depth of the market.

Accordingly, we are approving the proposal's provisions with regard to the elimination of specialists and the creation of DMMs, but we are approving certain key provisions on a pilot basis until October 1, 2009, as discussed more fully below in Part III.D.

### B. Order Allocation

NYSE proposes to revise the order allocation methodology of Rule 72 to provide that: (i) All market participants would receive executions on parity; (ii)

“Setting Interest” that establishes the Exchange BBO would be entitled to priority and would receive the first 15% of any incoming order (subject to a minimum of one round lot) in advance of the regular allocation of such order; and (iii) for executions occurring outside the Exchange BBO, all displayable interest would be executed before any non-displayable interest.

One of the most significant changes in the Exchange's proposal is the elimination of the requirement currently imposed upon specialists to yield to off-Floor participant orders on the Display Book. Once the specialist's advance “look” at incoming orders is fully eliminated, and DMMs are no longer subject to the specialist's agency responsibilities with respect to orders on the Display Book, we agree that it would no longer be necessary to require DMMs to yield to off-Floor participant orders on the Display Book. However, the Exchange's proposal does not merely eliminate the requirement to yield to off-Floor participants, but rather provides DMMs with a substantial advantage over off-Floor orders sent to the Display Book. As the Exchange stated in its proposal, it is amending its Rule 72 “to provide to all market participants the ability to receive executions on an equal basis (‘parity’) with other interest available at that price.”<sup>87</sup> The Exchange's concept of parity hinges on its definition of “market participant.” According to the Exchange's definition, the DMM registered in a given security and each individual Floor broker representing orders in such a security would each constitute a single market participant. In contrast to the Exchange's DMM and Floor brokers, all off-Floor orders would be aggregated together to constitute a single market participant, the Off-Floor Participant.<sup>88</sup> Because of the aggregated nature of the Off-Floor Participant, in many cases a DMM's interest would be assured of receiving some execution while the Off-Floor Participant, even if composed of multiple Display Book orders and even if such orders constituted a large volume of shares, would receive an allocation equal to that received by the DMM. Particularly in instances when there is more than one off-Floor order resting in the Display Book at a particular price point at the time of execution, the result would likely be that some orders in the Display Book would remain unexecuted, despite potentially having been entered into the Display Book prior

to the DMM's interest having been submitted.

In addition, NYSE's proposal would permit an interim period—from the approval of this proposed rule change through completion of Phase 2—when DMMs would have parity with other market participants (*i.e.*, including off-Floor orders) while retaining the current specialists' advance “look.”<sup>89</sup> This period, albeit short, would provide DMMs with a significant informational advantage over other market participants, while also providing them parity in executing their interest.

For these reasons, we are concerned about the effects the proposed parity rule may have on market quality, book depth, and the execution rates of public customer orders posted to Display Book. Therefore, we have determined to approve proposed Rule 72 on a pilot basis, as discussed more fully below in Part III.D.

With respect to the priority provisions for Setting Interest under proposed Rule 72(a), in addition to the proposed 15% priority allocation, the Setting Interest would also participate on parity with other market participants (as it would even if it were not the Setting Interest) in the allocation of the remaining 85% of an incoming order.<sup>90</sup> Moreover, the Setting Interest maintains its priority status until the interest is completely executed. Thus, proposed Rule 72(a) is designed to reward aggressive quoting by market participants—which contributes to market quality—by allowing the price setter to take the first portion of an execution at that price. We believe that the proposed priority rule constitutes an appropriate approach, consistent with the Act, for incentivizing and rewarding market participants who quote aggressively to set the Exchange BBO.

Finally, we believe that the proposed provisions designed to ensure that all

<sup>85</sup> The Commission notes that the proposed obligations of DMMs would also differ significantly from those imposed on specialists currently on the Exchange in that DMMs would no longer be the “responsible broker-dealer” for orders resting on the Display Book and the specialists' negative obligation would be eliminated. We note that the DMM's duties in connection with order executions on Hybrid are substantially reduced under the proposed rules. Whereas Rule 60 currently requires the specialist, as “responsible broker-dealer,” to collect, process, and publish quotations, in fact in the current automated market, virtually all orders submitted to the Display Book are processed, published, and executed automatically, with no handling by the specialist. Given the substantially reduced duties of the DMM in connection with order executions, the Commission believes it is appropriate for the Exchange to no longer consider the DMM to be the “responsible broker-dealer” for orders on the Display Book, and instead consider the broker-dealer that submitted the order to the Exchange to be in such a position.

<sup>86</sup> For a description of the metrics the Exchange has agreed to provide, see *supra* Part II.C.

<sup>87</sup> See Notice, *supra* note 5, at 42869.

<sup>88</sup> See *id.*; see also proposed Rule 72(c)(ii).

<sup>89</sup> The Exchange will eliminate the “look” for a particular security upon implementation of Phase 2 for such security. Amendment No. 3 to the proposed rule change establishes a deadline of ten weeks after the Approval Date for completion of Phase 2. Any extension of this deadline would require NYSE to file a proposed rule change under Section 19(b) of the Exchange Act for Commission review.

<sup>90</sup> The Commission also notes that there is a requirement that the Setting Interest receive a minimum of one round lot, typically 100 shares. See proposed NYSE Rule 72(c)(iii). Given the reduction in average execution sizes on the Exchange recently, the Commission notes that the Setting Interest would likely often receive more than 15% because of the round lot minimum requirement. See, e.g., Securities Exchange Act Release No. 56599 (October 2, 2007), 72 FR 57622 (October 10, 2007) (SR-NYSE-2007-93) at fn. 6 (noting that average execution size had declined from 334 shares in November 2006 to 254 shares in August 2007).

displayable interest trades ahead of any non-displayable interest for executions occurring outside the Exchange BBO are consistent with the Act. Currently, NYSE rules are designed to ensure that all displayed interest at the Exchange BBO is fully executed prior to any execution of undisplayed interest at the Exchange BBO. We believe that these proposed amendments to Rule 72, which are designed to ensure that the same requirement is applied to executions outside the Exchange BBO, are consistent with the Act, since preferencing interest that is displayed or designated for display over hidden interest should contribute to price discovery, and thus is consistent with the requirements of Section 6(b)(5) of the Act that exchange rules be designed to perfect the mechanism of a free and open market and the national market system and not be unfairly discriminatory.

### C. Reserve Order Functionality

In April 2008, the Exchange implemented a pilot program that provides reserve order functionality for orders with a minimum display quantity of one round lot, now proposed to be called Minimum Display Reserve Orders, to off-Floor market participants.<sup>91</sup> Minimum Display Reserve Orders give off-Floor participants a reserve functionality substantially similar to the reserve functionality of Floor brokers' d-Quote and specialists' s-Quotes. The Exchange now proposes to make this pilot program permanent. In addition, the Exchange proposes to create hidden interest functionality (*i.e.*, with no minimum display requirement), known as Non-Displayed Reserve Orders, for off-Floor participants. This functionality would also be available to Floor brokers and DMMs.

We believe that extending the hidden interest functionality of Minimum Display and Non-Displayed Reserve Orders to all market participants would help level the playing field among NYSE members on and off the Floor, and is consistent with the Section 6(b)(5) of the Act, because it is designed to promote just and equitable principles of trade among Exchange customers and members and is not unfairly discriminatory. In addition, we agree that these additional order types, by expanding the opportunities for market participants to post different types of liquidity on the exchange, should result in deeper liquidity and thus may

contribute to overall market quality. We note that the rules of other national securities exchanges also provide for similar order functionality.<sup>92</sup>

However, the Exchange's proposed treatment of hidden interest is not identical among market participants, particularly with respect to manual executions.<sup>93</sup> While all Minimum Display interest is included in the manual execution template, the same is not true of hidden interest. A DMM's hidden interest would be eligible to participate in manual transactions since this interest would always be known to the DMM. In contrast, Non-Displayed Reserve Orders of off-Floor participants, which would be fully hidden from the DMM, would never be eligible for participation in manual transactions. Finally, Floor brokers' hidden interest would be included in the manual execution template and eligible to participate in manual transactions unless the Floor broker, at his or her option, marked the order "Do Not Display."<sup>94</sup>

Though these functionality differences exist in the proposed implementation of hidden interest among different market participants, we note that all participants have the ability to ensure that their interest participates in manual transactions if they so choose. Floor brokers could do so by not designating their hidden interest as "Do Not Display," while off-Floor participants could instead send their interest to the Exchange as a Minimum Display Reserve Order, which requires the display of one round lot and is eligible to participate in its entirety in manual transactions. Accordingly, we

<sup>92</sup> See NYSE Rule 13. See also, *e.g.*, Nasdaq Rules 4756(c)(3) and 4757; NYSE Arca Equities Rule 7.31(h)(3); and ISE Rule 715(g)(1).

<sup>93</sup> In the New Model, DMMs would continue to facilitate manual transactions on the Exchange in a limited number of situations. See *supra*, Part III.A. Orders eligible for manual execution are aggregated by Exchange systems and shown to the DMM in the Display Book's manual execution template.

<sup>94</sup> In Amendment No. 2, the Exchange proposed to prohibit DMMs, their trading assistants, and others acting on their behalf from using Display Book to access information about Floor broker agency interest excluded from the aggregated agency interest and Minimum Display Reserve Order information other than for the purpose of effecting transactions that are reasonably imminent where such information is necessary to effect the transaction. Because this restriction is designed to prevent DMMs from gleaned an informational advantage from access to ordinarily hidden information on the Display Book that is not necessary to the performance of their obligations, we find that the retention and expansion of this provision is consistent with the Act, including Section 6(b)(5) thereunder, which requires that proposed rules promote just and equitable principles of trade, and not be designed to permit unfair discrimination between customers, issuers, brokers, and dealers.

believe that NYSE's proposed rules regarding reserve functionality are not unfairly discriminatory and otherwise are consistent with the Act.

### D. New Model Pilot Program

As discussed in Part II.B.5.(b) above, several key provisions of the Exchange's New Model proposal are being approved today on a pilot basis (collectively, the "Pilot provisions"). The New Model Pilot will include: (i) The changes to NYSE's priority and order allocation structure under proposed Rule 72; (ii) the dealings and responsibilities of DMMs, including the affirmative obligation to market quality, the quoting obligation, the re-entry requirements following certain transactions for the DMM's own account, and, implicitly, the elimination of the negative obligation, set forth in proposed Rule 104; and (iii) the provisions related to DMM CCS interest set forth in proposed Rule 1000.

As discussed above, we have concerns regarding certain aspects of the Exchange's proposal and are therefore approving the provisions described above on a pilot basis for a period ending October 1, 2009. Before we decide what action to take on any NYSE proposal to extend the operation of the Pilot provisions or to establish the Pilot provisions on a permanent basis, we believe that NYSE must provide data and analysis on the impact of the Pilot provisions. Specifically, we believe that to be able to take any further action on an NYSE proposal with regard to the Pilot, NYSE must provide to us on a regular, ongoing basis, statistics relating to market quality and trading activity.<sup>95</sup> The Exchange has committed to providing us with these metrics on a monthly basis. The Exchange has also represented that it will maintain average measures for each trading day during a particular month in order to provide such information to us upon request.<sup>96</sup> Analysis of the requested statistics will assist the Commission, among other things, in evaluating the effects of the Pilot provisions on NYSE's market quality, and in determining whether the New Model Pilot should be permanently approved, if so requested by the Exchange, with or without adjustments, consistent with the Act.

The Commission intends to closely examine these statistics and other information relating to the impact of the Pilot provisions on investors and other market participants. If the Commission

<sup>95</sup> For a description of the metrics the Exchange has agreed to provide, see *supra* Part II.C.

<sup>96</sup> The average per security may be provided across volume deciles.

<sup>91</sup> See Securities Exchange Act Release No. 57688 (April 18, 2008), 73 FR 22194 (April 24, 2008) (SR-NYSE-2008-30).

determines, upon expiration of the Pilot period or at any earlier time, that implementation of the New Model Pilot is having a detrimental effect on investors or other market participants, the Commission will consider what action it should take to address any detrimental effect.

#### *E. Other Proposed Changes*

Several of NYSE's proposed changes, such as the approval procedures for DMMs and DMM Units, elimination of Floor broker percentage orders, changes to the handling of Floor broker d-Quotes, and inclusion of additional Floor broker interest in OpenBook, raise policy issues that we have considered previously, and resolve such policy issues in a manner consistent with our prior approvals. The remainder of NYSE's proposed changes are technical, non-substantive changes intended, for example, to update the terminology of NYSE's existing rules to conform them to the proposed New Model, or to delete archaic rule provisions or provisions that have sunset according to their terms. We believe that these proposed changes are consistent with the Act.

#### **IV. Accelerated Approval**

We find good cause, pursuant to Section 19(b)(2) of the Act,<sup>97</sup> for approving the proposed rule change, as modified by Amendment Nos. 1, 2 and 3, prior to the thirtieth day after publication of notice of filing of Amendment Nos. 2 and 3 in the **Federal Register**.

In Amendment No. 2, the Exchange proposes to clarify how odd-lot information will be transmitted to the DMM Unit algorithm prior to the opening. The Exchange has represented that current technical constraints in its odd-lot System require that odd-lot information be transmitted to the DMM Unit algorithm on an order-by-order basis prior to the opening. The Exchange has represented that it is currently working on modifications to its systems that would allow the transmission of odd-lot order information on an aggregated basis prior to the open. The Exchange has stated that these system changes will be effective by the third quarter of 2009, at which time odd-lot information on an order-by-order basis would no longer be required for the DMM Unit algorithm to effectively facilitate the opening. We find that the clarification with respect to

the way in which odd-lot information would be transmitted to the DMM Unit algorithm is consistent with the Act<sup>98</sup> and note that the Exchange has committed to implement the necessary technical changes to its system that will obviate the need for the sending of order-by-order odd-lot information to the DMM Unit algorithm.

In Amendment No. 2, the Exchange has also proposed to retain the restriction currently applicable to specialists prohibiting them, their trading assistants, and others acting on their behalf from using the Display Book system to access information about Floor broker agency interest excluded from the aggregated agency interest other than for the purpose of effecting transactions that are reasonably imminent where such Floor broker agency interest information is necessary to effect such transaction. The Exchange's proposal would apply this restriction to DMMs and include information pertaining to Minimum Display Reserve Orders within the restriction. Because this restriction is designed to prevent DMMs from gleaning an informational advantage from their access to ordinarily hidden information on the Display Book that is not necessary to the performance of their obligations, we find that the retention and expansion of this provision is consistent with the Act, including Section 6(b)(5) thereunder, which requires that proposed rules promote just and equitable principles of trade, and not be designed to permit unfair discrimination between customers, issuers, brokers, and dealers.

In this amendment, the Exchange has made minor edits to its rule text (in particular, in NYSE Rules 13, 52, 72, 299A and 1000) that are technical or clarifying in nature. Finally, in Amendment No. 2, the Exchange has committed to provide us with specific metrics on an ongoing basis that relate to market quality and certain of its rules that are subject to the New Model Pilot. We believe that this data will be important in helping the Commission analyze the impact of the New Model Pilot, and in determining whether to permanently approve or modify it, if so requested by the Exchange. Therefore, we find that these proposed changes are consistent with the Act.

In Amendment No. 3, the Exchange modified the dates that the Exchange is required to provide data to the Commission, amended the implementation dates of certain rules, and clarified the implementation schedule of the New Model Pilot.

Finally, in Amendment No. 3, the Exchange proposed technical changes to Rule 98 and 98 Former to replace the term "specialty stocks" with "registered security."

The Exchange has requested that the proposed rule change, as modified by Amendment Nos. 1, 2, and 3, be approved prior to the 30th day after publication of notice of filing of Amendment Nos. 2 and 3 in the **Federal Register**. The changes proposed in Amendment Nos. 2 and 3, discussed above, are either technical in nature, raise policy issues that we have considered previously (and address them in a manner consistent with our prior approvals), do not differ substantively from the changes proposed in the original filing as modified by Amendment No. 1, notice of which was published for public comment in the **Federal Register** on July 23, 2008, or strengthen the proposal.

For example, NYSE's commitment in Amendment No. 2 to provide certain data to enable us to evaluate the effects of the Pilot provisions strengthens the proposal by specifying what data the Exchange must provide and when it must be provided. Clarification of the Exchange's implementation schedule for the New Model Pilot in Amendment No. 3 strengthens the proposal by setting a deadline of ten weeks following the date of this order by which the Exchange will fully implement the Pilot provisions, and thus eliminate the DMM's advance "look" at incoming orders.

Accordingly, we find that good cause exists, consistent with Sections 6(b)(5) of the Act,<sup>99</sup> and Section 19(b) of the Act<sup>100</sup> to approve the proposed rule change, as modified by Amendment Nos. 1, 2, and 3 on an accelerated basis.

#### **V. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether Amendment Nos. 2 and 3 are 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-2008-46 on the subject line.

<sup>97</sup> 15 U.S.C. 78s(b)(2). Pursuant to Section 19(b)(2) of the Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing.

<sup>98</sup> 15 U.S.C. 78f(b)(5).

<sup>99</sup> 15 U.S.C. 78f(b)(5).

<sup>100</sup> 15 U.S.C. 78s(b).

### 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-2008-46. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the SEC'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 us, and all written communications relating to the proposed rule change between us 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 SEC's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 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; we do 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-2008-46 and should be submitted on or before November 19, 2008.

### VI. Conclusion

For the foregoing reasons, we find that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>101</sup> that the proposed rule change (SR-NYSE-2008-46), as modified by Amendment Nos. 1, 2, and 3 be, and it hereby is, approved on an accelerated basis.

By the Commission.

**Florence E. Harmon,**

*Acting Secretary.*

[FR Doc. E8-25797 Filed 10-28-08; 8:45 am]

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### SECURITIES AND EXCHANGE COMMISSION

**Release No. 34-58834; File No. SR-NYSE-2008-93]**

#### **Self-Regulatory Organizations; The New York Stock Exchange LLC; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Temporarily Suspend the Operation of NYSE Rule 123D(3) to Respond to Market Conditions for Thornburg Mortgage, Inc. (TMA) on September 29, 2008**

October 23, 2008.

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (the "Act")<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that, on October 10, 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 and II below, which Items have been prepared by the self-regulatory organization. This order provides notice of the proposed rule change and approves the proposed rule change on an accelerated basis.

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

The Exchange proposes to temporarily suspend the operation of NYSE Rule 123D(3) to respond to market conditions for Thornburg Mortgage, Inc. (TMA) on September 29, 2008.

The text of the proposed rule change is available at the Exchange, <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 specified in Item III 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 is proposing to temporarily suspend the operation of NYSE Rule 123D(3) with respect to the opening transactions on September 29, 2008, in the common stock and preferred Series E of Thornburg Mortgage, Inc. ("Thornburg"), a NYSE-listed company (TMA).

##### *Background*

Thornburg is a single-family residential mortgage lender that originates, acquires, and retains investments in adjustable-rate and variable-rate mortgage assets. On September 26, 2008, the common stock of TMA underwent a one-for-10 reverse stock split pursuant to which every ten shares of common stock were combined into one share of new common stock. As part of the stock split, TMA issued new stock certificates representing the new issue.<sup>4</sup> Generally, reverse stock splits are intended to increase the value of the common stock of a company.

Because Thornburg issued new stock certificates, the Exchange considers the trading of TMA on September 29, 2008 to be a new issue, notwithstanding prior trading in the stock.<sup>5</sup> Accordingly, in anticipation of TMA trading at the Exchange on September 29, 2008, the Exchange received multiple orders for TMA to participate in the opening transaction.

To ensure a fair and orderly market, and in particular, to ensure that orders in TMA that have been submitted to the Exchange get executed, the Exchange is proposing to suspend the operation of NYSE Rule 123D(3) on September 29, 2008 for Thornburg's common stock and the Preferred Series E ("TMA securities")<sup>6</sup> that would open at a price of \$1.05 or less. This proposed suspension relates only to the opening transactions of TMA securities on September 29, 2008. Immediately following the opening of such securities, the Exchange intends to halt trading of TMA securities pursuant to NYSE Rule 123D(3) and invoke a Sub-penny trading condition.

<sup>4</sup> See Thornburg Mortgage, Inc., Form 8-K (Sept. 26, 2008).

<sup>5</sup> TMA has been the subject of a Sub-penny trading condition at the Exchange and closed Friday, September 26, 2008 at \$0.28 in away markets.

<sup>6</sup> See TMA and TMA-PE.

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

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b-4.

<sup>101</sup> 15 U.S.C. 78f(b)(2).