Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an e-mail to *rule-comments@sec.gov*. Please include File Number SR–NYSE–2006–104 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSE–2006–104. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSE–2006–104 and should be submitted on or before December 29, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[13]

Florence E. Harmon,

Deputy Secretary.

[FR Doc. E6–20885 Filed 12–7–06; 8:45 am]

BILLING CODE 8011–01–P

[13] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–54860; File No. SR NYSE–2006–76]

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing and Order Granting Accelerated Approval to Proposed Rule Change, as Amended, Relating to Exchange Rule 104.10 (''Dealings by Specialists'')

December 1, 2006.

I. Introduction

On September 22, 2006, the New York Stock Exchange LLC (''NYSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend specialist stabilization requirements set forth in NYSE Rule 104.10 (''Dealings by Specialists''). The proposed rule change was published for comment in the **Federal Register** on September 28, 2006.[3] The Commission received five comment letters[4] from one commenter and two comment response letters from NYSE.[5] On October 25, 2006, NYSE filed Amendment No. 1 to the proposed rule change.[6] This notice and order approves the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.[7]

II. Description of the Proposal

NYSE Rule 104 governs specialist dealings and includes, among other things, restrictions upon specialists' ability to trade as a dealer in the stocks in which he or she is registered. Under NYSE Rule 104(a), specialists are not permitted to effect transactions on the Exchange for their proprietary accounts 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 * * *'' This restriction is known as the ''negative obligation.'' In particular, NYSE Rules 104.10(5) and (6) expand upon the negative obligation with regard to specific types of proprietary transactions. These sections further define the instances when a specialist is restricted in his or her ability to trade in relation to the direction of the market.

A. Current Specialist Stabilization Rules

Specifically, current NYSE Rule 104.10(5)(i) provides that specialist proprietary transactions are to be effected in a reasonable and orderly manner in relation to the general market, the market in a particular stock, and the adequacy of the specialist's position to the immediate and reasonably anticipated needs of the market. The rule further provides that, unless it is to render the specialist's position in a stock adequate for current or reasonably anticipated needs of the market, a specialist should not effect a non-stabilizing transaction (*i.e.*, a transaction with the trend of price movement) for the specialist's account when acquiring or increasing a position. In this regard, the rule restricts specialists from purchasing stock at a price above the last sale (in the same trading session) and purchasing more than 50% of the stock offered on a ''zero plus tick,'' *i.e.*, at the same price as the last sale, when such last sale price was higher than the previous, differently priced sale in the stock on the Exchange. Specialists are, however, permitted to effect these types of transactions with Floor Official approval or in less active markets where such transactions are an essential part of a proper course of dealings and where the amount of stock involved and the price change, if any, are normal in relation to the market.

NYSE Rule 104.10(6) sets forth the specialist's stabilization requirements when liquidating or reducing a position. This rule provides that such trades should be effected in a reasonable and orderly manner in relation to the condition of the general market, the market in the particular security, and the adequacy of the specialist's position to meet the immediate and anticipated needs of the market in the security. Specialists are permitted to liquidate or reduce a position by selling stock on a ''direct minus tick,'' *i.e.*, selling stock at a price lower than the price of the last sale on the Exchange, or by purchasing stock on a ''direct plus tick,'' *i.e.*, at a price higher than the price of the last

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 54504 (September 26, 2006), 71 FR 57011 (''Stabilization Proposal'').

[4] *See* letters from George Rutherfurd to the Commission, dated October 11, 2006 (''Rutherfurd Letter I''); October 20, 2006 (''Rutherfurd Letter II''); October 26, 2006 (''Rutherfurd Letter III''); November 2, 2006 (''Rutherfurd Letter IV''); and November 14, 2006 (''Rutherfurd Letter V'').

[5] *See* letters from Mary Yeager, Assistant Secretary, NYSE, to Nancy M. Morris, Secretary, Commission, dated November 6, 2006 (''NYSE Letter I'') and November 29, 2006 (''NYSE Letter II'').

[6] For a description of Amendment No. 1, *see* Section II.D., *infra*.

[7] The proposed rule change, as amended by Amendment No. 1, was approved on a temporary, pilot basis in File No. SR–NYSE–2006–82. *See* Securities Exchange Release No. 54578 (October 5, 2006), 71 FR 60216 (October 12, 2006) (''Phase 3 Pilot'').

sale on the Exchange, if such transaction is reasonably necessary and the specialist has obtained Floor Official approval. After such direct tick liquidating transactions and after proprietary liquidating sales on ''zero minus ticks'' and proprietary liquidating purchases on ''zero plus ticks,'' specialists are required to re-enter the market on the opposite side in an appropriate amount, where the imbalance of supply and demand indicates that immediately succeeding transactions may result in lower (following specialist's sale) or higher (following specialist's purchase) prices.[8]

Pursuant to NYSE Rule 104.10(b)(7), specialists are permitted to effect proprietary transactions in investment company units and Trust issued receipts (securities commonly referred to as exchange-traded funds or ETFs) without Floor Official approval for the purpose of bringing the ETF price into parity with the underlying index value. These transactions, however, must be effected in a manner that is consistent with the maintenance of a fair and orderly market.

B. Proposed Specialist Stabilization Rules

NYSE proposes to retain the negative obligation in that specialist dealings must be reasonably necessary for the maintenance of a fair and orderly market and that transactions with the trend of the market be accompanied by appropriate re-entry on the opposite side of the market. NYSE proposes to amend its stabilization rules to reflect four types of specialist dealer transactions—''Neutral,'' ''Non-Conditional,'' ''Conditional,'' and ''Prohibited.''

1. Neutral Transactions [9]

NYSE proposes to define Neutral Transactions as purchases or sales by which a specialist liquidates or decreases a position. NYSE proposes that Neutral Transactions must be effected in a reasonable and orderly manner in relation to the condition of the general market, the market in the particular stock, and the adequacy of the specialist's position to the immediate and reasonably anticipated needs of the round-lot and odd-lot market. Neutral Transactions may be made without restriction as to price but must be reasonably necessary to render the specialist's position adequate to the market's needs. This is similar to what the current rule permits today,[10] but eliminates the requirement for Floor Official approval in situations where the transaction is a sale on a direct minus tick or a purchase on a direct plus tick. The specialist's obligation to maintain a fair and orderly market may require re-entry on the opposite side of the market after effecting one or more Neutral Transactions and should be in accordance with the immediate and anticipated needs of the market. Re-entry on the opposite side of the market is not required merely as a result of the specialist engaging in one or more Neutral Transactions, but may be necessary in order for the specialist to meet his or her affirmative obligation to maintain a fair and orderly market.

2. Non-Conditional Transactions [11]

Non-Conditional Transactions are defined as certain specialist bids or purchases and offers or sales that establish or increase the specialist's position other than reaching across the market to trade with the Exchange quote. Like Neutral Transactions, Non-Conditional Transactions must be effected in a reasonable and orderly manner in relation to the condition of the general market, the market in the particular stock, and the adequacy of the specialist's position to the immediate and reasonably anticipated needs of the round-lot and odd-lot market. Proposed NYSE Rule 104.10(5)(i)(a)(II)(b) sets forth seven types of Non-Conditional Transactions (items (i) through (vii)), which may be effected without restriction as to price or the need for Floor Official approval. The first two types of Non-Conditional Transactions (items (i) and (ii)) are allowed without restriction under the current rule and have not been changed.[12] The following is a list of Non-Conditional Transactions:

(i) Matching another market's better bid or offer;[13]

(ii) Bringing the price of a security into parity with an underlying or related security or asset; [14]

(iii) Adding size to an independently established bid or offer on the Exchange;

(iv) Purchasing at the published bid on the Exchange;

(v) Selling at the published offer on the Exchange;

(vi) Purchasing or selling at a price between the Exchange published bid and published offer; or

(vii) Purchasing below the published bid or selling above the published offer on the Exchange (*e.g.*, during a ''sweep'').

Re-entry on the opposite side of the market is not required as a result of the specialist engaging in one or more Non-Conditional Transactions, but may be required in order for the specialist to meet its affirmative obligation to maintain a fair and orderly market. Where such re-entry is necessary, it should be commensurate with the size of the specialist's Non-Conditional Transactions and the immediate and anticipated needs of the market.

3. Specialist Trades To Increase Its Position by Trading With the Exchange Quote [15]

Transactions in which the specialist is increasing or establishing a position in his or her registered securities by reaching across the market to trade with the Exchange bid or offer are governed by proposed NYSE Rule 104.10(5)(i)(b) for inactive securities and proposed NYSE Rule 104.10(6) for active securities. NYSE proposes to define Active Securities as: [16]

(a) Securities comprising the S&P 500® Stock Index;

(b) Securities trading on the Exchange during the first five trading days following their initial public offering; and

(c) Securities that have been designated as ''active'' by a Floor Official.[17]

''Inactive securities'' are securities that do not fall within the definition of ''Active'' securities.

[8] This rule provides that, during any period of volatile or unusual market conditions resulting in a significant price movement in the subject security, the specialist's transaction in reentering the market should reflect, at a minimum, the specialist's usual level of dealer participation. Further, any series of specialist destabilizing transactions during periods of volatile or unusual market conditions should be accompanied by the specialist's re-entry in the market and effecting transactions which reflect a significant degree of dealer participation. *See* NYSE Rule 104.10(6)(i)(B).

[9] Proposed NYSE Rule 104.10(5)(i)(a)(I).

[10] NYSE Rule 104.10(6)(i)(A).

[11] Proposed NYSE Rule 104.10(5)(i)(a)(II).

[12] NYSE Rules 104.10(5)(iv) and 104.10(7).

[13] *See* Securities Exchange Release No. 54362 (August 25, 2006), 71 FR 52201 (September 1, 2006) (SR–NYSE–2006–07).

[14] *See* Securities Exchange Release No. 37016 (March 22, 1996), 61 FR 14185 (March 29, 1996) (SR–NYSE–96–04).

[15] Proposed NYSE Rule 104.10(6).

[16] Proposed NYSE Rule 104.10(6)(i).

[17] A governing Floor Official may designate a security as ''active'' by determining, among other things, that the security in question has exhibited substantially greater than normal trading volume and is likely to continue to sustain such higher volume during the remainder of the trading session. The Floor Official's determination that a security should be considered ''active'' lasts only for the trading session on the particular day it is determined. While the security may be designated ''active'' on subsequent days, such determinations must be made based on its trading characteristics that day. Floor Officials would also be required to notify the Market Surveillance Division of New York Stock Exchange Regulation (''NYSER'') whenever he or she designates a security as ''active.'' Both the specialist and Floor Official would be required to create and maintain such documentation regarding the security as the Exchange may require.

a. Conditional Transactions in Active Securities

NYSE proposes a pilot program until June 30, 2007 (''Pilot'') that would allow Conditional Transactions, which are specialist trades in Active Securities that establish or increase a position by reaching across the market to trade with the Exchange's published bid (in the case of a specialist's sale) or offer (in the case of a specialist's purchase) when such bid (offer) is priced below (above) the last differently-priced trade and the last differently-priced published bid (offer) on the Exchange.

NYSE proposes to allow a specialist to execute Conditional Transactions without restriction as to price or Floor Official approval, provided that the specialist appropriately re-enters on the opposite side of the market in a size commensurate with the specialist's Conditional Transaction. NYSE proposes to issue guidelines that specialists should follow, called ''Price Participation Points'' (''PPPs''), that would identify the price at or before which a specialist is expected to re-enter the market after effecting one or more Conditional Transactions. The Exchange noted that PPPs are minimum guidelines only and compliance with them does not guarantee that a specialist is meeting its obligations.[18]

NYSE proposes that certain Conditional Transactions would require the specialist to immediately re-enter, or re-enter as the specialist's next available quoting or trading action, regardless of the PPP. For example, immediate re-entry may be required based on the price and/or volume of the specialist's Conditional Transaction(s) in reference to the market in the security at the time of such trading. The fact that there may have been one or more independent trades following the specialist's Conditional Transaction does not, by itself, eliminate the need for immediate re-entry, when otherwise appropriate. In addition, immediate re-entry is required after a Conditional Transaction: (a) Of 10,000 shares or more or a quantity of stock with a market value of $200,000 or more; and (b) which exceeds 50% of the published bid or offer size (as relevant).[19]

b. Inactive Securities

Specialist transactions in Inactive Securities that reach across the market to trade with the existing bid or offer when the specialist is establishing or increasing a position would continue to be governed by the requirements of current NYSE rules.[20] A specialist would not be permitted to establish or increase its position by reaching across the market to purchase the offer at a price that is above the last sale price on the Exchange or sell to the bid at a price below the last sale price on the Exchange, unless such specialist trade is reasonably necessary to render the specialist's position adequate to the immediate and reasonably anticipated needs of the market and approved by a Floor Official. Further, specialists would not be permitted to purchase more than 50% of the stock offered at a price that is equal to the last sale price when the last sale price was higher than the last differently priced regular way sale, unless such trade is approved by a Floor Official. Specialists must reenter the market when reasonably necessary after effecting such trades.

4. Prohibited Transactions [21]

NYSE proposes that, during the last ten minutes of trading, (1) A specialist with a long position in a security would be prohibited from making a purchase in such security that results in a new Exchange high for the day at the time of the specialist's transaction, and (2) a specialist with a short position in a security would be prohibited from making a sale in such security, including securities subject to the Regulation SHO Pilot,[22] that results in a new Exchange low for the day at the time of the specialist's transaction. However, the specialist would be permitted to effect such a transaction in order to match another market's better bid or offer or to bring the price of the security into parity with an underlying or related security or asset.

C. Other Changes

The Exchange proposes to delete current NYSE Rule 104.10(9). This rule states that if a specialist has sell orders on the limit order book (''Book'') at two or more different prices, the specialist should not, as a dealer, purchase all of the stock from the Book at the lowest limit price and then immediately purchase stock from the Book at a higher limit price. This rule currently requires the specialist to cross the entire amount of stock he or she is purchasing at one price. The same principle applies when a specialist sells to orders on the Book.

The Exchange also proposes to make conforming changes such as re-numbering certain provisions and other non-substantive language changes. For example, current NYSE Rule 104.10(6)(i)(D) which governs the ability of the crowd to prevent the specialist, when liquidating or decreasing a position, from trading on parity with the crowd during a manual transaction has been re-numbered NYSE Rule 104.10(5)(i)(a)(I)(d). NYSE Rules 70 and 123 have been amended to reflect this provision's new rule number.

D. Description of Amendment No. 1

In Amendment No. 1, the Exchange proposes to clarify that the transactions discussed in proposed NYSE Rule 104.10(5)(i)(b)(I) regarding transactions by a specialist for the specialist's account to establish or increase a position apply to transactions that reach across the market to trade with the Exchange bid or offer.

In addition, in the original filing, the Exchange proposed to rescind NYSE Rule 104.10(7), which provides that the requirement to obtain Floor Official approval for transactions for a specialist's own account contained in NYSE Rule 104.10 does not apply to transactions effected in ETFs when the specialist transactions are for the purpose of bringing the ETF into parity with the underlying index value. Amendment No. 1 proposes to retain NYSE Rule 104.10(7) and include that the provisions therein should not apply to streetTRACKS® Gold Shares, as the term is defined in NYSE Rule 1300 or Currency Trust Shares, as the term is defined in NYSE Rule 1301A.

In Amendment No. 1, the Exchange further requests that the Commission re-interpret the specialist's negative obligation to eliminate the requirement that each trade by the specialist for the dealer account meet a test of reasonable necessity. The Exchange believes that such an interpretation is appropriate in view of the development of the national market system over the past seventy years since the interpretation was initially issued.

According to the Exchange, the Commission has been granted specific authority by Congress to reinterpret the negative obligation. Specifically, in 1975, in connection with the 1975 amendments [23] to the Act, Congress eliminated the negative obligation clause from Section 11(b) of the Act and gave the Commission the flexibility to define dealer obligations for both exchange members and over-the-counter market makers. In making the changes,

[18] *See* proposed NYSE Rule 104.10(6)(iv)(a).

[19] *See* proposed NYSE Rule 104.10(6)(iv)(c)(I) and (II).

[20] The current requirements under NYSE Rule 104.10(5)(i) and NYSE Rule 104.10(6)(i) are reflected in proposed NYSE Rule 104.10(5)(i)(b)(I). *See also* Amendment No. 1.

[21] Proposed NYSE Rule 104.10(5)(i)(c).

[22] 17 CFR 240.202T.

[23] Securities Acts Amendments of 1975 (''1975 Amendments''), Pub. L. No. 94–29, 89 Stat. 97 (June 4, 1975).

Congress noted that changes in the marketplace might warrant changes in the scope of the dealer obligation.[24]

In Amendment No. 1, the Exchange stated that it believes that the conditions for change that were identified by Congress have largely come to pass and that, as a result, it is appropriate to redefine the scope of the specialist's negative obligation. For example, the Exchange argued that the institutionalization of the market, increased competition, and increased application of computer and communication technology has significantly diminished the time-and-place advantages of specialists. As a result, markets have seen increases in the average daily trading volume and the movement off the Floor of the decision making that affects the direction and extent of movements in the specialty stocks. The Exchange stated that there has also been a dramatic increase in transparency with respect to the specialist's Book through, among other things, Exchange initiatives like Exchange OPENBOOK.™ The Exchange stated that it believes that this increased transparency gives all market participants, both on and off the Floor, a greater ability to see and react to market changes.

The Exchange stated that there has also been a significant increase in competition in Exchange-listed securities. For example, unlike in previous years, Exchange specialists must now compete with upstairs liquidity providers and with multiple over-the-counter dealers, crossing networks and Alternative Trading Systems. As a result of unlisted trading privileges (''UTP'') and dual listings, the Exchange stated that specialists also face competition from other national and regional exchanges. For all of these reasons, the Exchange stated that it believes that it is appropriate for the Commission to reinterpret the negative obligation away from an emphasis on trade-by-trade necessity, and toward a more general evaluation of the reasonable necessity of trading activity in specialty securities for the dealer account.

The Exchange stated that NYSER has appropriate surveillance procedures in place to surveil for compliance with the negative obligation by specialists. For example, NYSER would monitor, on a patterns and practices basis, specialist activity that appears to cause or exacerbate an excessive price movement in the market, as such transactions would appear to be in violation of a specialist's negative obligation. Additionally, the Division of Market Surveillance of NYSER would monitor for all subsequent action taken by the specialist, or lack thereof, to cushion such price movement. As today, the Exchange would, in the context of price volatility alerts, monitor for excessive price movements that may involve a failure to comply with either the affirmative or negative obligation. The Exchange represented that, as it gains experience with its new market structure, it would enhance existing surveillances and/or create new surveillances where necessary and appropriate to monitor for compliance with the specialist negative obligation.

III. Comments

Commission received five comment letters from one commenter[25] and two letters from the Exchange responding to the commenter.[26] The commenter opposed NYSE's proposal. The commenter argued that the negative obligation and current stabilization rules support public order interaction and that the Exchange's proposal would result in the displacement of public orders by specialists. The commenter argued that, as a result, NYSE's proposal is inconsistent with Section 11A of the Act, which promotes the opportunity for investors' orders to be executed without the participation of a dealer.

A. Stabilization Rules

The commenter argued that NYSE's proposal to amend its Rule 104.10 to allow specialists to trade in a destabilizing manner was a ''de facto abandonment of the specialist's historic mandate to stabilize the market by trading counter to the price trend.''[27]

The commenter stated that the specialist's role is, in essence, to act as the ''trader of last resort'' and expressed concern that the proposed changes to the Exchange's stabilization rules allowing specialists to trade for their own account in instances in which they are currently not permitted would displace public orders that would otherwise be capable of execution.[28] The commenter argued that specialists would be unconstrained by whether a particular trade is ''necessary'' or not and whether the trade had an impact on the market's price direction.[29] The commenter argued that NYSE's proposal provides specialists with proprietary trading privileges that are unrelated to the specialist's market making function.[30]

The commenter stated that active stocks, in particular, trade well in terms of depth and liquidity without unnecessary dealer intervention. He also noted that the stocks in which specialists are least needed are the stocks in which they would be allowed to most freely effect non-stabilizing transactions. The commenter further argued that the maintenance of the stabilization requirements for inactive stocks is meaningless because they rarely, if ever, trade.

In addition, the commenter believed that the proposed PPPs would be ineffective in regulating specialists and, in fact, would allow a specialist to increase profits by trading on the opposite side of the market from its previous trade.[31] In the commenter's opinion, specialists would act as risk adverse intra-day ''flip traders'' who do not seek to hold positions. The Exchange disagreed with the commenter, and stated that it believed that its specialists would continue to assume risk by committing capital to cushion market volatility when other market participants are trading with the trend and destabilizing the price of the security.[32] The Exchange believed that, in order for specialists to continue in this role, they must have the appropriate tools to compete.

The Exchange argued that specialists are increasingly unable to compete in a tick-based rules environment given the significant changes in competitive forces, customer expectations, technology, and automation that have impacted the NYSE market in recent years and reduced the specialist's ability to direct or influence trading or control the quote. Notwithstanding the changes in the market place, NYSE's specialists will continue in the Hybrid Market to be required to commit capital and add liquidity in order to bridge gaps in supply and demand, reduce volatility,

[24] S. Rep. No. 94–75, at 100 (1975) (''It might well be that with active competition among market makers and the elimination of trading advantages specialists now enjoy, such a restriction on specialists' dealings would become unnecessary. Because trading patterns and market making behavior in the context of a national market system cannot now be predicted, it appears appropriate to expand the Commission's rulemaking authority in this area so that the Commission may define responsibilities and restrict activities of specialists in response to changing market conditions.'').

[25] *See supra* note 4.

[26] *See supra* note 5.

[27] *See* Rutherfurd Letter II. The commenter described NYSE's proposal as permitting ''direct and unnecessary specialist intervention in determining market price direction,'' which the commenter argued cannot serve the public interest, and would have an adverse impact on many public investor trading strategies.

[28] *Id.*

[29] *Id.*

[30] *See* Rutherfurd Letter IV.

[31] *See*Rutherfurd Letter II.

[32] *See*NYSE Letter I, *supra* note 5, at 9.

and encourage stable prices.[33] The Exchange believed that the current tick-based rules were ''appropriate for and worked well in a market where substantially all trading was conducted manually, at a pace that enabled individuals to discern 'tick' changes easily and which tolerated the time it took to call a Floor Official into the Crowd to approve a specialist's proposed destabilizing transaction.'' [34] The Exchange argued, however, that the current rules hinder the specialists from operating in the Hybrid Market, where trading is substantially electronic and the speed and frequency of executions and quote changes preclude individuals from being able to accurately track ''ticks'' or stop trading to allow for Floor Official involvement.[35] The Exchange, therefore, believes that keeping the current tick-based rule would be inconsistent with Section 11A(a)(i)(C)(ii) of the Act, which promotes fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets.

The Exchange also disagreed with the commenter's suggestion that specialists have a monopoly on algorithmic trading or have access to electronic trading that creates an ''unlevel competitive playing field.'' [36] The Exchange argued that its rules do not prevent market participants from employing algorithmic-based trading strategies in connection with round-lot trading and stated that, in fact, customers benefit from the use of e-Quotes and d-Quotes via their floor brokers and can create or purchase their own algorithmic systems to generate orders that can be entered via NYSE SuperDot®.[37] The Exchange stated that the Hybrid Market provides all market participants with the ability to trade electronically and that all orders entered on the Exchange would be executed, consistent with their instructions, in accordance with Exchange rules. The Exchange represented that no class of customers would be advantaged or disadvantaged by these rules because all market participants are afforded an opportunity to interact with published trading interest.[38]

While the Exchange acknowledged that specialists occupy a unique position in relation to other market participants, the Exchange disagreed with the commenter that specialists continue to enjoy a time and place advantage.[39] It noted that, for example, last sale prices and quotations are immediately available to all market participants and that the growth of internalization has allowed ''upstairs'' trading firms to have comparable informational advantages as the specialists but the firms are able to trade on their information instantaneously without restrictions.[40] Also, NYSE argued that, while the specialists' algorithms have a slight informational advantage by having knowledge of orders as they enter NYSE systems, such knowledge does not deny other market participants an opportunity to interact with incoming orders. NYSE further notes that specialists' algorithmic ability to trade with incoming marketable orders is limited to providing price improvement or matching a better price posted by another market center. These trading opportunities are subject to competition by floor brokers who have a similar opportunity to interact with incoming orders via d-Quotes.[41] NYSE also noted that marketable CAP–DI orders automatically convert and trade along with specialist principal transactions.[42] Accordingly, the Exchange argued that specialists' algorithms do not act as an impediment to competition among market participants. The Exchange, therefore, believes that the Stabilization Proposal and the amended interpretation of the negative obligations of specialists present an appropriately flexible approach that will allow specialists to continue to add value to the marketplace.

Moreover, the Exchange argued that the current marketplace is dominated by professional traders—program traders, hedge funds, day traders, and institutions—employing algorithmic trading and smart order routers.[43] Unlike in the past, NYSE specialists must now compete with upstairs liquidity providers, with multiple over-the-counter dealers, crossing networks, and ECNs, as well as with NYSE floor brokers empowered with new, more effective, electronic order types.[44] These market participants have the ability to trade on alternative systems while actively participating in trading on the Exchange. The Exchange stated that, unlike the Exchange specialists, none of these market participants have similar restrictions on their trading.

B. Negative Obligation

The commenter argued that the transaction-by-transaction approach to determining the reasonable necessity of a specialist's proprietary trade is the only consistent interpretation of the negative obligation. According to the commenter, the negative obligation limits a specialist's ability to trade to those situations when there is a disparity in supply and demand and the specialist is needed to ensure appropriate trade-to-trade price continuity. In these situations, the commenter argued that the specialist is not restricted by the negative obligation and, in fact, is required to trade pursuant to the affirmative obligation. The commenter argued that supply and demand assessments arise in each particular trade, and thus the trade-by-trade approach should be maintained in its current form.[45] The commenter believed that NYSE's proposal to reinterpret the negative obligation so that specialist trading is surveilled on a ''patterns and practices,'' rather than on a trade-by-trade basis, effectively results in a *de facto* rescission of the negative obligation.[46] The commenter disagreed with the Exchange's assertions that specialists' trading privileges have been reduced, and that increased competition and automation support a new interpretation of the negative obligation. The commenter believed that specialists will enjoy a time and place advantage in the Hybrid Market ''far in excess of any that the specialist may have enjoyed in the physical auction.'' [47] For example, the commenter stated that the specialist alone has knowledge of floor broker hidden public orders and can trade algorithmically to take advantage of material, non-public market information. For this reason, the commenter believed that the negative obligation in its current form will still be relevant and should be maintained. The NYSE responded that the specialists do not have the time and place advantage they once possessed. The Exchange argued that the dissemination of the consolidated quote and trade information and NYSE limit orders via OpenBook provide all investors with market information.[48] In

[33] *Id.*

[34] *Id. at 3–4.*

[35] *Id.* at 4.

[36] *Id.* at 11 (referencing Rutherfurd Letter II); *see also* Rutherfurd Letter III.

[37] *See* NYSE Letter I, *supra* note 5, at 11.

[38] *Id.*

[39] *Id.* at 8.

[40] *Id.*

[41] *Id.*

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] The commenter also argued that NYSE should propose to amend its Rule 104 and petition the Commission to amend Rule 11b–1 under the Act so that the rule text would clearly express NYSE's proposal.

[46] *See* Rutherfurd Letters I, II, III, IV, and V.

[47] *See* Rutherfurd Letters II and V.

[48] *See* NYSE Letter II, at 2.

addition, NYSE argued that the expansion of Direct+® and technology available to floor brokers have diminished the size and significance of the Crowd, and allows orders to be entered and executed at the best bid (offer) without human intervention.[49] Further, the Exchange noted that quoting in pennies had reduced concentration of volume and average trade size.[50] Finally, NYSE stated that the national market system order routing requirements have resulted in orders being executed on markets other than the market on which they were entered.[51]

The commenter also challenged the Exchange's arguments based on the legislative history of Section 11(b) of the Act.[52] The commenter stated that NYSE ''continues to be the dominant, primary market in its stocks by a huge measure'' and believed that the Exchange's competitive position is much stronger today than it was in 1975, when Congress and the Commission declined to act on specialists' negative obligations.[53] The NYSE disagreed with the commenter's argument. NYSE stated that competition has increased and that competition has, consequently, effected its market share.[54] NYSE argued that increased internalization, the existence of alternative trading venues, and the ability of floor brokers to compete directly with specialists has resulted in increased competition to the specialist.[55]

The commenter also expressed concern about how the negative obligations would be measured and enforced. Further, the commenter believed that, even in a fast-moving Hybrid Market, a specialist's algorithm could easily be programmed to conform to the current trade-by-trade negative obligation requirements. The commenter stated that NYSE's proposal to surveil compliance with the negative obligation on a patterns or practices basis is vague and questioned the effectiveness of looking at whether specialist trading causes or exacerbates excessive price movements. The commenter argued that a ''specialist cannot know whether subsequent trades that may be part of a 'pattern' are necessary because subsequent order flow will dictate pricing, market direction, and, on a case-by-case basis, whether specialist intervention is appropriate as to any particular trade.'' [56] According to the commenter, the ''problem with commingling 'necessity' and 'pattern' is that the broad pattern may arguably be okay if there is no unusual price movement, but many individual trades within the pattern may not be 'necessary' at all. * * *'' [57] In addition, the commenter believed that the ''patterns and practices'' surveillance standard was flawed in that each specialist would establish his or her own such standard, which the commenter believed could lead a specialist to trade more aggressively. The commenter also questioned NYSE's plan to monitor price movements as part of its surveillance of the negative obligation, because such examinations had historically been performed to measure the specialist's compliance with the affirmative obligation by looking at whether a specialist had failed to trade to counter the market trend.

The Exchange believes that the trade-by-trade interpretation established seventy years ago no longer addresses the realities of the modern market. The Exchange emphasized that it is not proposing to eliminate the negative obligation or its reasonable necessity test. The Exchange noted that it is, instead, proposing to reinterpret the negative obligation's reasonable necessity test to eliminate the requirement that each trade must meet the test of reasonable necessity.

The Exchange disagreed with the commenter's suggestion that a non-trade-by-trade approach is unworkable, and will ultimately lead to customer disadvantage because specialists would engage in ''in and out profit taking that interferes with direct public interaction.'' [58] The Exchange argued that such a pattern of trading would continue to violate the specialist's negative obligation, and that its revised approach will provide an appropriate regulatory check on specialists.[59]

C. Public Notice

The commenter argued that the proposed rule change, as amended by Amendment No. 1 regarding the reinterpretation of the negative obligation of specialists, should be republished and the public comment period should be reset.[60] In addition, the commenter urged the Commission to consider the proposal at a public hearing.[61]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the proposed rule change as modified by Amendment No. 1, including whether the proposal is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an e-mail to *rule-comments@sec.gov.* Please include File No. SR–NYSE–2006–76 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSE–2006–76. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSE–2006–76 and should be submitted on or before December 29, 2006.

[49] *Id.* at 3.

[50] *Id.*

[51] *Id.*

[52] *See* Rutherfurd Letter II (referring to NYSE's excerpt of a Senate Report in SR–NYSE–2006–82: ''It might well be that with active competition among market makers and the elimination of trading advantages specialists now enjoy, such a restriction on specialists' dealings would become unnecessary.'' S. Rep. No. 94–75, at 100 (1975)).

[53] *Id. See also* Rutherfurd Letters III and V.

[54] *See* NYSE Letter II, at 2

[55] *Id.* at 3.

[56] *See* Rutherfurd Letter II.

[57] *Id.*

[58] *See* NYSE Letter I, *supra* note 5, at 10 (citing Rutherfurd Letter II).

[59] *Id.*

[60] *See* Rutherfurd Letters I, II, III, IV, and V.

[61] *See* Rutherfurd Letters I, II, and III.

V. Discussion and Commission Findings

After careful consideration, the Commission finds 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 [62] and, in particular, the requirements of Section 6 of the Act.[63] Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[64] which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in securities, 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. Finally, the Commission believes that the proposal is consistent with the principles set forth in Section 11A of the Act and the requirements of Rule 11b–1 under the Act.[65]

Specialists' dealer activities are governed, in part, by the negative and affirmative trading obligations. Rule 11b–1 under the Act 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.[66] 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.[67] NYSE has adopted these obligations in its Rule 104.[68]

When debating the adoption of the Act, Congress considered barring the ability of exchange members to trade for their own accounts.[69] Instead, pursuant to Section 11(e) of the Act, Congress directed the Commission to make a study of the feasibility and advisability of the completely segregating the functions of brokers and dealers.[70] In 1935, soon after the adoption of the Act, the Commission recommended that the national securities exchanges adopt sixteen rules to regulate trading on exchanges in order to eliminate some of the undesirable consequences of dealer activities.[71] These rules were adopted by all the exchanges. The tenth rule (''Tenth Rule'') prohibited specialists from effecting purchases or sales for their registered securities unless such dealings were reasonably necessary to permit specialists to maintain a fair and orderly market.[72]

''This rule * * * represents an attempt to eliminate the dealer activities of specialists except insofar as such activities allegedly perform a useful service to the market. In view of the specialist's fiduciary obligation to buyers and sellers whose orders he has accepted for execution; in view of his special knowledge and superior bargaining power in trading for his own account; in view of his peculiar opportunities and motives for attracting public interest to the stock in which he specializes; and in view of the undesirable effect which his trading may exert upon the market; it was deemed essential by the Commission that the dealer functions of the specialist be subjected to stringent control. The rule was intended to allow him only sufficient latitude in his personal trading to enable him to maintain a fair and orderly market in the securities in which he is registered.'' [73]

In 1937, the Commission issued an interpretation (''Saperstein Interpretation'') to clarify various aspects of the Tenth Rule, which the exchanges believed to be unnecessary because of other, more general rules regarding specialists that the exchanges had already adopted.[74] In the interpretation, the Commission emphasized that ''a mere showing that a transaction by a specialist for his own account had no undesirable effect, or even no discernible effect, upon the market'' was not enough to evidence compliance with the rule.[75] The Saperstein Interpretation stated that the ''rule leaves no doubt that it prohibits all transactions for the account of a specialist, excepting only such transactions as are properly a part of a course of dealings reasonably necessary to permit the specialist to maintain a fair and orderly market * * *'' [76] The Saperstein Interpretation thereafter stated that *each transaction* by a specialist for his own account must meet the test of reasonable necessity.[77] The interpretation made clear that a specialist would be required to comply with the rule on a transaction-by-transaction basis.

The Saperstein Interpretation also provided the basis for some of the current stabilization rules. Specifically, in the Interpretation, the Commission noted that certain transactions effected by a specialist when increasing or establishing a position tend to have a detrimental effect on the market and therefore would be commonly unjustifiable. These transactions included: (1) A purchase above the last sale price; (2) the purchase of all or substantially all the stock offered on the book at the last sale price; (3) the supplying of all or substantially all the stock bid for on the book at the last sale price; and (4) transactions that clean up the market in a manner that is similar to cleaning up the book. The Saperstein Interpretation noted that these transactions may be justifiable ''but only when they are an essential part of a course of dealings designed to promote the continuity and stability of the market and effected in an orderly manner.'' [78]

NYSE has proposed to amend its rules that restrict the ability of specialists to

[62] In approving this proposed rule change, as amended, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[63] 15 U.S.C. 78f.

[64] 15 U.S.C. 78f(b)(5).

[65] 17 CFR 240.11b–1.

[66] 17 CFR 240.11b–1(a)(2)(iii).

[67] 17 CFR 240.11b–1(a)(2)(ii).

[68] 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 * * *''

[69] Report of the Committee on Banking and Currency, Stock Exchange Practices, S. Rep. No. 1455 (1934), reprinted in 5 J.S. Ellenberger and Ellen P. Mahar, Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934 (2001), at 19–30.

[70] Commission, Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker (June 20, 1936) (''Segregation Study'').

[71] The text of the recommended rules can be found at Appendix O–1 of the Segregation Study. *See also* Segregation Study at 60–64 for a summary of the rules.

[72] The Tenth Rule stated: ''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 the firm of which he is a partner, or any partner of such firm, is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market, or to act as an odd-lot dealer in such security.'' *See* Segregation Study Appendix O–1 at 169. *See also* NYSE Rule 104(a).

[73] *Id.* at 63.

[74] Securities Exchange Act Release No. 1117, 1937 SEC LEXIS 357 (March 30, 1937). The Saperstein Interpretation took the form of an interpretation by David Saperstein, then-Director of the Commission's Trading and Exchange Division, and was contained in a letter sent to the Presidents of the various exchanges having a specialist system, including NYSE and a predecessor to the American Stock Exchange.

[75] Saperstein Interpretation at 3–4.

[76] *Id.* at 4.

[77] *Id.*

[78] *Id.* at 5.

trade with the trend of the market. NYSE has also asked the Commission to reinterpret the negative obligation to eliminate the requirement that *each* trade be measured against the reasonable necessity test. NYSE believes that specialists are an integral part of its market structure and that they perform important functions in the marketplace. NYSE believes that specialists will continue to contribute vitally to the Hybrid Market by committing capital and adding liquidity in order to bridge gaps in supply and demand, which can help to keep the market fair and orderly and reduce volatility. However, NYSE argues that with the anticipated increase in the volume of orders and speed of market activity as a result of the Hybrid Market and the implementation of Regulation NMS, its current rules restricting the ability of specialists to trade for their own account based upon the tick in relation to the last sale on the Exchange, as set forth in NYSE Rules 104.10(5) and (6), are both unworkable and less relevant in determining whether a specialist's trading is consistent with the negative obligation. Instead, NYSE believes these rules may in fact hinder specialists' ability to maintain fair and orderly markets in the Hybrid environment.

In addition, NYSE argues that the time and place and informational advantages traditionally enjoyed by specialists have been diminished. Prior to the Hybrid Market, the majority of orders that were executed on the Exchange were handled by the specialist. Specialists would have unique knowledge at the point of sale as to the extent of interest available in the market for execution. Under the Hybrid Market, all investors have access to the depth of the NYSE Book and will be able to access NYSE liquidity without the involvement of a specialist. Floor brokers and their customers also will be able to interact with incoming orders directly without the involvement of the specialist. This increased transparency and access gives all market participants, both on and off the floor, a greater ability to see and react to market changes.

The Commission believes that these combined factors significantly change the market in which the NYSE specialist operates and justifies a new approach to regulating specialists' dealer trades so that they will be able to effectively perform their obligation to maintain a fair and orderly market. The Commission notes that specialists remain constrained by the negative obligation and that their proprietary trading must be limited to that reasonably necessary to maintain a fair and orderly market. Therefore, for the reasons discussed below, the Commission believes that NYSE's proposal to amend its stabilization rules is consistent with the Act. In addition, the Commission has decided to reinterpret the negative obligation to remove the obligation to measure each individual specialist trade against the test of reasonable necessity.

A. Negative Obligation

In Amendment No. 1, the Exchange requested that the Commission reinterpret the reasonable necessity test found in the negative obligation to eliminate the trade-by-trade analysis that measures whether a specialist's proprietary trade is consistent with the negative obligation. As noted above, 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.[79]

The commenter argued that the trade-by-trade requirement of the Saperstein Interpretation was the only consistent reading of reasonable necessity test. In addition, the commenter believed that, in the Hybrid Market, specialists will not experience a reduction in their advantages, but rather would enjoy advantages far in excess of those available to them in the floor-based auction environment.[80] NYSE disagrees with the commenter's assertion and argues that specialists do not have the informational advantages they once possessed. Specifically, NYSE argues that market information is ''ubiquitous, readily available to all market participants as a result of consolidated quote and trade streams'' and OpenBook.[81] NYSE also argued that ''the expansion of NYSE Direct+® and technology available to floor brokers has diminished the size and significance of the Crowd and enables orders entered into the Exchange system to execute at the best bid and offer without the need for human intervention.'' [82]

The Commission agrees with NYSE that the national market system has changed greatly in the nearly seventy years since the Saperstein Interpretation was issued. The Commission believes that the trade-by-trade standard that was established seventy years ago is unworkable in the current market environment. The high speed and volume of trading in today's market make impracticable a trade-by-trade determination by the specialist of whether a particular trade is reasonably necessary. Further, the Commission believes that the informational advantages that specialists once enjoyed have been diminished.

The Commission believes that eliminating the trade-by-trade standard with respect to the negative obligation should enhance the specialist's ability to fulfill its obligation to maintain a fair and orderly market. The Commission believes that increased automation and competition—both within the Hybrid Market and in the markets generally—are significant factors, among others, that affect the ability of specialists to make a trade-by-trade analysis regarding their negative obligations. The Commission finds that permitting specialists to consider the reasonable necessity of their transactions under the negative obligation without a transaction-by-transaction test, is appropriate and consistent with the Act.[83] The Commission emphasizes that it is not eliminating the negative obligation. Therefore, specialists must continue to assess their need to trade and limit their proprietary trades to those reasonably necessary to allow the specialist to maintain a fair and orderly market.

The commenter expressed concern that eliminating the trade-by-trade test could lead to more aggressive trading by specialists. The Commission notes that the new interpretation does not relieve specialists of their obligations under federal securities laws or NYSE Rules. A specialist's ability to effect proprietary transactions remains limited under the Act and NYSE Rules and a specialist must still determine whether their transactions are reasonably necessary. The Commission notes that the Exchange is obligated to surveil its specialists to ensure their compliance with the Act and the Exchange's Rules, and the Exchange has represented that it will conduct surveillance of specialist

[79] 17 CFR 240.11b–1(a)(2)(iii).

[80] The Commission notes that the commenter's assertion that specialists have the exclusive ability to trade with incoming marketable orders is incorrect. Floor brokers are permitted to execute against incoming marketable orders via d-Quotes. *See* NYSE Rule 70.25(b)(i). In addition, the commenter asserted that specialists have access to floor broker agency interest data. This statement is likewise inaccurate. Specialists' algorithms will not have access to such data. *See* NYSE Rule 104(c)(ii). Further, a floor broker may exclude its interest from aggregate floor broker interest that is disclosed to the specialist on the floor. *See* Rule 70.20(g).

[81] *See* NYSE Letter II, *supra* note 5.

[82] *Id.*

[83] The commenter believed that this ''reinterpretation'' of the Saperstein Interpretation should be done through a change to the text of NYSE Rules. The Commission believes this to be unnecessary, as the original Saperstein Interpretation, was communicated through a letter from then-Director Saperstein to the presidents of the various exchanges.

trading for compliance with the negative obligation.

B. Stabilization Rules

NYSE proposes to amend its rules that specifically restrict certain specialist transactions that are effected with the trend of the market. As noted above, these rules supplement the negative obligation.

1. Neutral Transactions

NYSE proposes to allow a specialist to liquidate or reduce a position regardless of the tick and without the need to receive Floor Official approval. Currently, NYSE rules are less restrictive regarding liquidating trades because these transactions do not create as great a potential conflict of interest for specialists. For example, if a specialist wanted to inappropriately influence the trend of the market in a security in which the specialist held a position, that specialist would have an incentive to increase the value of his or her position in the security by inflating the price. When liquidating a position, the specialist would not have a comparable incentive to cause the price to move downward. Importantly, however, specialists' liquidating trades remain subject to the negative obligation and, therefore, specialists remain constrained by reasonable necessity when engaging in liquidating transactions. Therefore, the Commission finds that it is consistent with the Act for NYSE to eliminate the need for specialists to obtain Floor Official approval when liquidating or reducing a position.

2. Non-Conditional Transactions

NYSE proposed to allow a specialist to increase or establish a position in transactions other than transactions that reach across the market to trade with the Exchange bid or offer, without the need for Floor Official approval and regardless of the tick. The Commission believes that these Non-Conditional Transactions do not create a significant potential conflict of interest for specialists. Non-Conditional Transactions reflect instances where an independent source establishes the price of the transaction, thereby addressing concerns that a specialist may be ''leading the market.'' In addition, the proposed rule would allow specialists to buy at the published bid or sell at the published offer without Floor Official approval. While in this circumstance the specialist may establish the bid/offer, the trade itself is initiated by other market participants and not the specialist.

NYSE argues that requiring Floor Official approval is impractical in the Hybrid Market, where trading is substantially electronic and the speed and frequency of executions and quote changes preclude specialists from being able to accurately track ticks or stop trading to allow for Floor Official involvement. The Commission also believes that the proposal to remove specific restrictions on Non-Conditional Transactions could enhance the specialist's ability to maintain fair and orderly markets. Finally, the Commission notes that Non-Conditional Transactions remain subject to the negative obligation. Accordingly, the Commission believes the proposed rule change regarding Non-Conditional Transactions is consistent with the Act.

3. Prohibited Transactions

NYSE has proposed to prohibit certain transactions during the last ten minutes of the trading day. The Commission finds that the proposed rules for Prohibited Transactions are consistent with the Act because they restrict trades that may inappropriately influence the price of a security to advantage a specialist's proprietary position. The Commission also believes exempting specialist transactions that match another market's better bid or offer or that bring the price of the security into parity with an underlying or related security asset is appropriate because in these situations, an independent party, not the specialist, has set the price.

4. Conditional Transactions in Active Securities

NYSE proposes to allow specialists to trade with the NYSE quote without the need for Floor Official approval and regardless of the tick when increasing or establishing a position in certain Active Securities.[84] As proposed, NYSE specialists will remain subject to the negative obligation and will be required to appropriately reenter the market after a Conditional Trade is executed. NYSE will issue guidelines known as PPPs to provide specialists with a price at which they should reenter. For certain Conditional Trades, specialist reentry must immediately follow the Conditional Trade.

The Commission believes that the provisions governing Conditional Transactions in Active Securities may reflect an appropriate balance between the needs of specialists and other market participants in today's fast moving markets. The Commission recognizes the potential conflicts of interest presented when a specialist engages in aggressive trading activity such as reaching across the market to trade with the NYSE Quote while increasing its position. The concern is lessened with Active Securities, however, because the specialist likely will be less able to unilaterally cause a price movement. Accordingly, the Commission is approving this proposed provision on a pilot basis until June 30, 2007. Before the Commission decides whether to extend the operation of this rule or to approve this rule on a permanent basis, NYSE must provide data and analysis on the impact of this rule change.

Specifically, during the Pilot, NYSE must provide to the Commission on a regular, ongoing basis, statistics relating to market quality and specialist trading activity under the Pilot. These statistics should include general market quality measures, in addition to specific measures aggregated up from a trade-by-trade analysis of market activity and specialist activity during periods immediately following a specialist's Conditional Trade. After the initiation of the Pilot, NYSE must continue to work with Commission staff to ensure that these statistics are sufficiently informative to allow NYSE and the Commission to evaluate (i) the degree to which the trading activity of specialists under the Pilot affects execution quality for orders arriving on the same side of the market immediately after Conditional Trades, (ii) whether specialist Conditional Trades tend to be immediately followed by market price movements in the same direction as the specialist Conditional Trades, and (iii) the extent to which specialists provide liquidity on the opposite side of the market immediately after a Conditional Trade. These statistics should reflect all relevant aspects of the specialist trading and quoting activity immediately following Conditional Trades, including the frequency and speed of re-entry, the re-entry price relative to the take-out price, and the size of the re-entry quote relative to the size taken.

The Commission recognizes that the national market system is changing in considerable ways. Technological advancements and market forces, as well as regulatory changes such as the

[84] Transactions that increase or establish a specialist's position in securities that do not satisfy the definition of Active Security would remain subject to the current NYSE rule, which requires that a specialist receive Floor Official approval before executing a transaction on a destabilizing tick. *See* proposed NYSE Rule 104.10(5)(i)(b). NYSE has proposed some clarifying changes to the rule text of this provision and the Commission finds that these changes better reflect the operation of this rule and therefore are consistent with the Act.

Commission's Regulation NMS, have spurred trading centers to become even more automated, with trading volume and intermarket competition expected to continue to increase. Although it is difficult to forecast at this time the precise effect of such changes on the Exchange generally and specialists in particular, the Commission believes that the Exchange has made a case for modifying the rules relating to Conditional Transactions in Active Securities in anticipation of such changes. At the same time, the Commission recognizes that the proposed rule change represents a significant shift in the roles and obligations of specialists at the Exchange. Therefore, the Commission has required that, for Conditional Transactions, the Exchange implement this proposed rule change only for Active Securities and only as a Pilot.

5. Other Changes

The Commission finds that the proposal to delete current NYSE Rule 104.10(9) is appropriate because it is no longer applicable given the proposed changes to the stabilization rules as described above. In addition, the Commission also believes that the deletion of section (9) is consistent with the proposed re-definition of a Sweep Transaction [85] and notes that NYSE Rule 104.10(6)(c)(III) makes clear that each specialist trade at a separate price in a Sweep is viewed as a transaction with the published bid or offer for the purposes of the transactions that require immediate re-entry pursuant to proposed NYSE Rule 104.10(6)(iv)(c).

Further, the Commission believes that retaining NYSE Rule 104.10(7) and including streetTRACKS® Gold Shares (as defined in NYSE Rule 1300) and Currency Trust Shares (as defined in NYSE Rule 1301A) are appropriate because these are derivative products in which there is limited risk for the specialist to assert price control.

C. Accelerated Approval of Amendment No. 1

The Commission finds good cause to approve Amendment No. 1 to the proposed rule change prior to the thirtieth day after Amendment No. 1 is published for comment in the **Federal Register** pursuant to Section 19(b)(2) of the Act.[86] The commenter requested that the Commission publish the Exchange's proposal as amended in Amendment No. 1 for public comment. The Commission has authority under Section 19(b)(2) of the Act to approve the proposed rule change prior to the thirtieth day after it is published for comment.[87] The Commission notes that the Exchange's request that the Commission issue a new interpretation of the negative obligation described in Amendment No. 1 was published for a 21-day comment period in an earlier proposed rule change.[88] In that order, the Commission specifically requested comment on NYSE's request to reinterpret the negative obligation. The Commission received comment letters from the commenter himself in response to that request, which were fully considered by the Commission. Therefore, the Commission believes that the public has had appropriate notice of the Exchange's request to re-interpret the negative obligation of specialists.

The remaining modifications in Amendment No. 1 were clarifications and/or technical corrections to the originally proposed rule change. For these reasons, the Commission believes that good cause exists to accelerate approval of the proposed rule change as amended by Amendment No. 1.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[89] that the proposed rule change (File No. SR–NYSE–2006–76), as modified by Amendment No. 1, be, and hereby is, approved, on an accelerated basis and the Pilot is approved on a temporary basis until June 30, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[90]

Florence E. Harmon,

Deputy Secretary.

[FR Doc. E6–20886 Filed 12–7–06; 8:45 am]

BILLING CODE 8011–01–P

[85] *See* Securities Exchange Act Release No. 54820 (November 27, 2006).

[86] 15 U.S.C 78s(b)(2).

[87] *Id.*

[88] *See* Securities Exchange Act Release No. 54578 (October 5, 2006), 71 FR 60216 (October 12, 2006). *See also* Securities Exchange Act Release No. 54685 (November 1, 2006), 71 FR 65559 (November 8, 2006).

[89] 15 U.S.C. 78s(b)(2).

[90] 17 CFR 200.30–3(a)(12).

DEPARTMENT OF STATE

[Public Notice 5635]

Bureau of Near Eastern Affairs; Notice of New Information Collection Under Emergency Review: Iran Democracy Program Grants Vetting; Form DS–4100, OMB Control Number 1405–xxxx

AGENCY: Department of State, Bureau of Near Eastern Affairs.

ACTION: Notice of request for Emergency OMB approval.

SUMMARY: The Department of State has submitted the following new information collection request to the Office of Management and Budget (OMB) for review and approval in accordance with the emergency review procedures of the Paperwork Reduction Act of 1995.

Type of Request: Emergency Review.

Originating Office: Bureau of Near Eastern Affairs, Middle East Partnership Initiative.

Title of Information Collection: Iran Democracy Program Grants Vetting.

Frequency: On occasion.

Form Number: DS–4100.

Respondents: Potential Grantees for Iran Democracy Program.

Estimated Number of Respondents: 200.

Average Hours per Response: 1 hour per response.

Total Estimated Burden: 200 hours.

The proposed information collection is published to obtain comments from the public and affected agencies. Emergency review and approval of this collection has been requested from OMB by December 8, 2006. If granted, the emergency approval is only valid for 180 days. Comments should be directed to Katherine Astrich, State Department Desk Officer, Office of Information and Regulatory Affairs, Office of Management and Budget (OMB), Washington, DC 20530, who may be reached on 202–395–4718.

During the first 60 days of this same period a regular review of this information collection is also being undertaken. Comments are encouraged and will be accepted until 60 days from the date that this notice is published in the **Federal Register**. The agency requests written comments and suggestions from the public and affected agencies concerning the proposed collection of information. Your comments are being solicited to permit the agency to:

- Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility.
- Evaluate the accuracy of the agency's estimate of the burden of the proposed collection, including the validity of the methodology and assumptions used.
- Enhance the quality, utility, and clarity of the information to be collected.
- Minimize the reporting burden on those who are to respond, including