MEMO# 22253

February 20, 2008

NYSE Amends Specialists' Requirements to Yield Proprietary Trades to Later-Arriving Systems Orders

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 8-08 RE: NYSE AMENDS SPECIALIST REQUIREMENT TO YIELD PROPRIETARY TRADES TO LATER-ARRIVING SYSTEMS ORDERS

The Securities and Exchange Commission has approved a proposed rule change, as amended, filed by the NYSE to require a specialist to yield to a marketable order that arrives on the book before the reporting of the specialist's trade as principal is complete.*

On December 13, 2004, the NYSE filed a proposal to require a specialist to yield proprietary trades to later-arriving systems orders. In response to comments and changes in the Exchange marketplace, the NYSE amended the proposal five times, including, most recently, February 8, 2008. As approved, the proposal amends NYSE Rule 104 Supplementary Material .10 to add new section (10). The new section specifically provides that when a specialist has completed but not yet reported a transaction as principal with an order in the book or in the crowd, the specialist must yield to any order received through SuperDot that could take the specialist's place in the unreported principal transaction. The proposal also provides that where the specialist is required to yield, the customer whose order entered the book would be reported as the contra party for the trade instead of the specialist.

The proposal includes six exceptions to the requirement to yield, including: (1) correction of a bona fide specialist error in a previously reported transactions; (2) trading in satisfaction of the specialist’s obligation to give up a trade to an agency order; (3) report of non-regular-way principal to customer transactions; (4) principal participation in CAP order electing transactions; (5) principal participation in connection with a CAP order executed as part of the opening of trading; and (6) closing transactions to offset market-at-the-close and/or limit-at-the-close order imbalances.

The Order states that the Commission received five comment letters on the proposal – all from a single commenter opposing the proposal. Among other concerns, the commenter argued that the proposal “attempts to codify a truly bizarre notion” whereby “an order must participate in trade even though the order was not even in the marketplace when the trade took place.” The commenter also suggested that the proposal conflicted with existing NYSE rules and that it would not allow for the possibility of price improvement for an order to which the specialist yielded.

The Order concludes that the NYSE’s responses to the commenter are appropriately within the Exchange’s discretion and are reasonable interpretations. The Order specifically states that the proposal should help ensure that system orders entered into the display book through SuperDot “receive executions in the Exchange market to the greatest extent possible, and should help to minimize the risk of improper trading ahead of SuperDot orders by the specialist.” In addition, the Order finds that the exceptions to the proposal are sufficiently limited.

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