MEMO# 11897

May 22, 2000

SEC APPROVES PROPOSAL TO RESCIND NYSE RULE 390

1 See Memorandum to Equity Markets Advisory Committee No. 9-00 and SEC Rules Committee No. 26-00, dated February 25, 2000). 2 Securities Exchange Act Release No. 42758 (May 9, 2000), 65 FR 30175 (May 10, 2000) ("Release"). 3 Securities Exchange Act Release No. 42450 (February 23, 2000), 65 FR 10577 (February 28, 2000). [11897] May 22, 2000 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 33-00 SEC RULES COMMITTEE No. 79-00 RE: SEC APPROVES PROPOSAL TO RESCIND NYSE RULE 390 ____ As we previously informed you, the Securities and Exchange Commission issued a proposed rule change filed by the New York Stock Exchange to rescind NYSE Rule 390.1 The SEC has issued a release approving the proposed rule change.2 NYSE Rule 390 generally prohibited NYSE members and their affiliates from effecting transactions in NYSE listed securities away from a national securities exchange. In its proposal to rescind Rule 390, the NYSE stated that the intended purpose of the rule was to maximize the opportunity for customer orders to interact with one another in agency auction markets and to be executed without the participation of a dealer. The NYSE also discussed its concerns that broker-dealer internalization practices and market fragmentation would increase after Rule 390's rescission. In order to address these concerns, the NYSE urged that the SEC, in approving the rescission of Rule 390, adopt a market-wide requirement that broker-dealers not be permitted to trade against their customer orders unless they provide a price to the order that is better than the national best bid or offer against which the order might otherwise be executed. The NYSE stated that such a requirement would assure that investors receive the fairest pricing of their internalized orders, and would eliminate broker- dealer conflicts of interest in trading against their own customer order flow to capture the spread. The SEC did not take any action on the NYSE's request in approving the rescission of Rule 390. The Release notes, however, that the SEC's concept release on market fragmentation3 sets forth the NYSE's proposal as one of the six potential options to address fragmentation on which comment is requested. In approving the proposed rule change, the SEC states that Rule 390 is overbroad as a tool to address market fragmentation, as it applies in many situations that do not promote investor order interaction. In addition, the SEC states that Rule 390 effectively restricts the competitive opportunities of ECNs and that to avoid the anticompetitive effect of Rule 390, some ECNs have indicated that they would even accept the regulatory responsibilities associated with registering as a national securities exchange. The SEC believes that the rescission of Rule 390 will eliminate these barriers to competition. The SEC also states that to the extent the rule promotes the interaction of investors' orders, it does so in an undesirable way, by attempting a direct restriction on competition. Finally, the Release states that several commenters believed that the SEC should not approve the rescission of Rule 390 until it had addressed market fragmentation

concerns. The SEC states, however, that it does not believe that the potential fragmentation of the listed market due to an increase in internalization and payment for order flow arrangements warrants a delay in approving the proposed rule change. The SEC notes that it already has begun its review of market fragmentation issues through the issuance of the market fragmentation concept release. In addition, the SEC states that it intends to monitor any significant changes in the order-routing practices of NYSE members as a result of the rescission of Rule 390, particularly decisions to internalize their customer order flow. Ari Burstein Assistant Counsel Attachment

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