The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
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NYSE PROPOSED RULE CHANGE RELATING TO PROCEDURES FOR GAPPING THE QUOTE

[17937] August 31, 2004 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 40-04 RE: NYSE PROPOSED RULE CHANGE RELATING TO PROCEDURES FOR GAPPING THE QUOTE The Securities and Exchange Commission has issued a notice of the filing and immediate effectiveness of a proposed rule change by the New York Stock Exchange updating the NYSE's procedures for "gapping" the quote.1 According to the NYSE, the purpose of the gapped quote procedures is to provide public dissemination of an order imbalance and to minimize short-term price dislocation associated with such an imbalance by allowing appropriate time for the entry of offsetting orders or the cancellation of orders on the side of the imbalance.2 When an imbalance exists, the gapped quote procedures provide that the specialist widen the spread between the bid and offer, a process known as "gapping." In such cases, the quote on the side of the imbalance must match ("touch") the prior sale price. Once a quotation has been gapped, it must remain in place for a reasonable time to allow interested parties to respond to the order imbalance. Prior to the proposed change in gapping procedures, the specialist was required to show the size associated with the gapped quotation as 100 x 100 and a senior-level NYSE Floor Official determined a reasonable period of time for the gapped quotation to be maintained (generally, not to exceed five minutes) to allow for adequate public disclosure and sufficient time to attract contra-side interest. The NYSE is updating the gapped quotation procedures to require that the specialist disseminate a quote size of 100 shares on only one side of the market. Size consistent with the order imbalance is to be shown on the other side, i.e., 100 x size or size x 100. The 100-share side represents the specialist's determination of the price at which the stock would trade if no contra-side interest develops or no cancellations occur as a result of the gapped quotation. The size side represents the extent of the order imbalance, which can represent orders in the crowd as well as SuperDot orders. The new procedures also shorten the 1 Securities Exchange Act Release No. 50237 (August 24, 2004), 69 FR 53123 (August 31, 2004) ("Release"). The NYSE's proposal can be found on the SEC's website at http://www.sec.gov/rules/sro/nyse/34-50237.pdf. 2 The Release states that an imbalance may occur when the specialist receives a sudden influx of orders on the same side of the market at the same time, or when there are one or more large-size orders and there is no offsetting interest. An imbalance also may occur when a member proposes to effect a one-sided block transaction at a significant premium or discount from the prevailing market. 2 reasonable period of time for the gapped quotation to remain in place in light of faster market conditions and technology.3 Ari Burstein Associate Counsel 3 The Release notes that proposed changes to the Exchange's Direct+ facility to facilitate the NYSE becoming a hybrid market may affect the updated gapping procedures but that until such

changes are approved and implemented, the procedures described in the proposed rule change will remain in place.