

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

- (a) New York Stock Exchange LLC (“NYSE” or the “Exchange”) proposes to amend Rule 98 and related rules to redefine specialist operations at the NYSE. The text of the proposed amendments to Rule 98 and related rules is attached as Exhibit 5.
- (b) The Exchange believes that the proposed amendments will not have any direct effect, or any significant indirect effect, on any other NYSE rule in effect at the time of the filing.
- (c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed filing has been made pursuant to authority delegated to the Exchange by the Board of the Exchange. No further action by the Board of Directors of the Exchange is required. Therefore, the Exchange's internal procedures with respect to the proposed change are complete.

The persons on the Exchange staff prepared to respond to questions and comments on the proposed rule change are:

Daniel M. Labovitz	Clare F. Saperstein
Vice President	Director
NYSE Regulation, Inc.	NYSE Regulation, Inc.
(212) 656-2081	(212) 656-2355

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

The NYSE is proposing to amend Rule 98 to reduce the regulatory burdens imposed by the rule and to provide flexibility to member organizations as to how they can structure their specialist operations and manage their risks. In particular, because of changes to the marketplace, including changes to the specialist’s role as a result of the increased use of electronic trading, the Hybrid Market®, and Regulation NMS, as well as technological advances in surveillance and internal controls, the NYSE believes that current Rule 98 imposes unnecessary restrictions on member organizations seeking to engage in specialist operations at the Exchange.

Accordingly, the NYSE proposes revising Rule 98 in its entirety to provide a framework for specialist operations that meet both the regulatory concerns of the current rule and the reality of today’s marketplace. In addition to changes to Rule 98, the NYSE proposes making conforming changes to other NYSE rules that rely

on Rule 98 exemptions for approved persons. As discussed in further detail below, the revisions to Rule 98 would include: (1) redefining the persons to whom Rule 98 would apply; (2) allowing specialist operations to be integrated into better capitalized member organizations; (3) permitting a specialist unit to share non-trading related services with its parent member organization or approved persons; and (4) providing flexibility to member organizations and their approved persons in how to conduct risk management of specialist operations.

To achieve these changes, the NYSE proposes shifting the paradigm of Rule 98 from one that assumes that the approved persons of a specialist member organization are subject to certain NYSE rules unless an exemption is provided to one where NYSE Regulation, Inc. (“NYSE Regulation”) reviews whether a trading unit that proposes to engage in specialist operations is sufficiently walled off from either its approved persons or parent member organization. Under the new paradigm, rules governing specialist operations, such as Rule 104, will apply only to the unit approved to engage in specialist operations at the NYSE.

As the NYSE market model continues to evolve, the NYSE believes that the proposed amendments to Rule 98 will provide a platform from which to further modernize specialist operations.

A. Background

The NYSE adopted Rule 98 in 1987 in response to consolidation in the securities industry, when NYSE specialist firms that had been independent member-owned entities increasingly became subsidiaries of larger, better capitalized broker-dealers. Because of the specialists’ unique position within the markets, and the restrictions on dealers under Section 11A of the Securities Exchange Act of 1934 (the “Act”),¹ the Exchange crafted a rule that governed how larger member organizations could be connected to specialist firms.

The rule establishes a functional separation between the specialist organization and the rest of the broker-dealer. The purpose of that separation was to eliminate or control conflicts of interest between the specialist’s actions as market maker in an issuer’s securities and other interactions among the specialist’s parent or sibling entities and the issuer.

In its current form, Rule 98 applies to specialist units and so-called “approved persons” of a specialist organization – that is, entities that are in a control relationship with a specialist organization, or share a common corporate parent with the specialist organization and are engaged in a kindred business.² Such entities are, by virtue of their association with the specialist organization, subject to the rules and restrictions applicable to specialists. These include, among other

¹ See 15 U.S.C. 78kA.

² See NYSE Rules 2(d) and 304(e).

things, restrictions on the approved persons' ability to trade in specialty stock options, restrictions on certain of their business transactions with issuers for whom the specialist organization is the registered specialist, and limits on the amount of securities of such issuers that the specialist and approved persons may own in the aggregate.

So as not to unreasonably hamstring a broker-dealer organization overall, Rule 98(b) provides that an approved person may seek Exchange approval to be exempted from most of those restrictions. To obtain a Rule 98(b) exemption, the approved person must establish policies and procedures that are consistent with the Guidelines for Approved Persons Associated with a Specialist's Member Organization ("Rule 98 Guidelines"). These guidelines set out in detail how approved persons and associated specialist organizations should structure and conduct their respective businesses in order to ensure complete separation between the specialist organization and the rest of the member organization.

Among other things, the Rule 98 Guidelines provide that the specialist member organization be housed in a separate corporate entity and broker-dealer from its approved persons. Further, to ensure that information does not flow improperly from the specialist organization to approved persons and that approved persons do not have undue influence over particular trading decisions by the specialist, the guidelines establish "functional regulations" that enforce the required separateness. These include requirements that the organizations maintain separate books and records, separate financial accounting, and separate required capital, and that each organization have in place procedures to safeguard confidential information derived from business interactions with the issuer or contained in draft research reports prepared by the approved person.

The assumption that all entities affiliated with a specialist are subject to specialist rules unless they have obtained a Rule 98(b) exemption creates a substantial administrative burden on specialist organizations and their approved persons: each approved person of a specialist organization must establish and continually update a separate exemption under Rule 98 if it wishes to engage in activity that would otherwise be restricted under applicable specialist rules. This burden creates a real and substantial barrier to entry for new broker-dealers who may want to establish specialist units.

In the face of significant structural changes to the NYSE and the equity markets, and in recognition of the vastly different competitive landscape compared to 1987, the Exchange believes that Rule 98 must be updated in order to provide both existing and prospective specialist firms with the necessary tools to remain competitive while at the same time meeting their obligations as specialists at the NYSE. The proposed changes to Rule 98 also address the Exchange's desire to ease the burdens of a new member organization seeking entry to supplement the six specialist firms currently trading on the Exchange, or the very real possibility of such a firm replacing one or more of the existing specialist firms if they withdraw from the market. Concerning the latter possibility, the NYSE notes that

this is not just a theoretical concern: within the past six months, two specialist firms have already withdrawn.

To address these very real concerns, the Exchange proposes to fundamentally amend Rule 98. The proposed rule is described in detail below, but at root, the amendment reverses the assumption that all affiliated entities of a specialist firm are automatically governed by the rules applicable to specialists, and shifts the focus of the rule onto the specialist unit rather than the approved person.

As part of this restructuring, the NYSE proposes to eliminate the prescriptive approach of the current rule and move towards a more principle-based approach. The NYSE believes that a principle-based rule closely overseen by NYSE Regulation can achieve the same goals as a rule that attempts to enumerate every possible situation that must be avoided. For that, the proposed rule still requires NYSE Regulation to review whether a specialist unit's policies and procedures are reasonably designed to protect confidential information. However, the rule provides sufficient flexibility so that as the type of information that needs to be protected and the manner in which such information can be protected evolves with changes to the trading environment, so too can the manner in which NYSE Regulation conducts its review.

The NYSE believes that the proposed changes to Rule 98 will minimize regulatory burdens and barriers to entry while at the same time provide the necessary level of regulatory scrutiny to ensure that confidential information continues to be protected. In addition, the proposed changes will reduce the regulatory burdens on existing specialist member organizations to enable them to continue such operations at lower cost.

B. Proposed Amendments to Rule 98

1. Applicability of Rule 98

Under the proposed rule, a member organization seeking to operate a specialist unit, either as its entire business or as one of its trading units, would need to apply for and be approved by NYSE Regulation before it can begin, or if applicable, continue operations as a specialist unit. As described in more detail below, NYSE Regulation will review whether a proposed specialist unit has: (1) adopted written policies and procedures governing the conduct and supervision of the business handled by the specialist unit; (2) established a process for regular review of such written policies and procedures; and (3) implemented controls and surveillances reasonably designed to prevent and detect violations of those policies and procedures. Among other things, these policies and procedures must be reasonably designed to protect specialist confidential information and non-public order information, as defined below.

Once approved, the NYSE specialist rules, as defined below, including Rule 104, would generally only be applicable to the approved specialist unit and not to its

approved persons or, if applicable, parent member organization. As discussed in more detail below, on a case-by-case basis, NYSE Regulation will assess whether an integrated proprietary aggregation unit that manages the risk for a specialist unit could be subject to the specialist rules if the integrated proprietary aggregation unit causes the specialist unit to violate its obligations.

The NYSE recognizes that despite the proposed rule changes, an existing specialist member organization may determine to either keep its current operational structure or wait before it implements changes to its operational structure, as permitted by the proposed amended rule. Because current Rule 98 would still be applicable to those specialist units that would not have yet sought the relief available under proposed Rule 98, the Exchange proposes keeping current Rule 98 in its rulebook as “Rule 98 (Former)” until such time as all specialist units are approved pursuant to proposed Rule 98(c). Any new entrant to become a specialist unit would be required to comply with proposed Rule 98; current Rule 98 procedures would not be available to new entrants to the specialist business. As proposed, current Rule 98(b) exemptive relief would be available only so long as the member organization and its approved persons have not materially changed their operational structure, internal controls, or compliance and audit procedures. In such case, the current Rule 98, i.e., Rule 98 (Former), would govern the specialist member organization and its approved persons.³ Any significant changes to the status quo after the effective date of the proposed new rule would require the member organization to apply for approval pursuant to the procedures described below.

The Exchange recognizes that an existing specialist member organization that does not implement structural changes to its operations that would require it to apply for approval under the proposed rule may still need certain relief available under the proposed version of the Rule. Accordingly, the Exchange proposes that a member organization operating pursuant to Rule 98 (Former) may apply for relief pursuant to proposed Rule 98(e), which concerns sharing non-trading related services, without first obtaining approval under other provisions of proposed Rule 98. In such situation, the specialist member organization would need to apply for approval from NYSE Regulation to share non-trading related services, as specified in proposed Rule 98(e). If approved, except for the sharing

³ As discussed in more detail below, in addition to amending Rule 98, the Exchange proposes to amend related rules that reference the current Rule 98 exemptions for approved persons. To ensure that member organizations operating pursuant to Rule 98 (Former) are subject to the appropriate rules, the Exchange proposes to maintain two forms of the related rules: the amended version and an otherwise unchanged version, except for the title “(Former)” added to the unamended version of the rule or, if applicable, the section affected by the proposed rule change. Once all member organizations are subject to the proposed Rule 98, the Exchange will file to delete any “Former” versions of Rule 98 and the related rules or sections.

of non-trading related services, such member organization and its approved persons would continue to be subject to Rule 98 (Former) as well as the “(Former)” versions of NYSE rules that reference exemptions from Rule 98 for approved persons, as discussed in more detail below.

Once approved pursuant to proposed Rule 98 to operate a specialist unit, share non-trading related services, or engage in risk management, any material changes in how a specialist unit operates its business would require the specialist unit to resubmit its revised written policies and procedures to NYSE Regulation for review. For example, if a specialist unit is approved to operate as a stand-alone aggregation unit and would like to change its business operations to include the specialist unit as part of a larger integrated proprietary aggregation unit, as permitted by proposed Rule 98(d), such change would require pre-approval.

2. Proposed Definitions

To ensure clarity, the proposed amendments include a number of defined terms that are applicable throughout the rule. These definitions are designed to provide a level of scalability to the rule so that as the NYSE market model evolves, the definitions used throughout the rule will have common meaning. Among the proposed definitions are:

- “Specialist unit” – this definition is intended to apply to any trading unit that is seeking approval to operate as a specialist at the Exchange. As proposed, a specialist unit could be a stand-alone member organization, an aggregation unit within a member organization, or a trading unit (or “desk”) within a larger aggregation unit. Regardless of which corporate structure a member organization chooses, the term “specialist unit” would refer to the unit that is responsible for specialist activities at the Exchange. If approved pursuant to proposed Rule 98(c), a specialist unit would be eligible for allocations under NYSE Rule 103B and be subject to specialist rules. For purposes of Exchange rules, the term “specialist unit” is synonymous with the term “specialist organization” or “specialist member organization.”
- “Specialist’s account” – this definition refers to any account through which a specialist unit trades at the Exchange. Sometimes referred to as a dealer account, this revised definition would encompass any of the variously-defined accounts that a specialist unit may use to trade at the Exchange.
- “Specialist rules” – this definition refers to those rules that govern specialist conduct or trading at the Exchange. Currently, the specialist rules include, among others, Rules 104, 105, and 113, but as the rules at the Exchange change, these rule designations may change. Accordingly, so that proposed Rule 98 evolves along with changes to other rules, this proposed definition does not identify specific rules.

- “Specialist confidential information” – this definition concerns the principal or proprietary trading activity of a specialist unit at the Exchange in the securities allocated to it pursuant to Rule 103B, including the unit’s positions in those securities, decisions relating to trading or quoting in those securities, and any algorithm or computer system that is responsible for such trading activity and that interface with Exchange systems, such as the specialist application protocol interface (the “specialist API”).⁴ The definition does not include information about non-public order information, as described below.
- “Non-public order” – this definition refers to any information relating to order flow at the Exchange, including verbal indications of interest made with an expectation of privacy, electronic order interest, e-quotes, reserve interest, or information about imbalances at the Exchange, that is not publicly-available on a real-time basis via an Exchange-provided datafeed, such as NYSE OpenBook®, or otherwise publicly-available. The definition also encompasses information regarding a reasonably imminent non-public transaction or series of transactions. For example, if in requesting information about the state of the Book, a Floor broker informs the specialist about an order that he or she has, such information would fall under the definition of “non-public order.” As defined, non-public orders include order information at the open, any re-openings, the close, when the security is trading in a slow mode (e.g., in a Gap quote or LRP situation), and any other information in the NYSE Display Book®⁵ that is not available via NYSE OpenBook®.⁶ As proposed, the linchpin to the definition of “non-public order” is that it is information not publicly available on a real-time basis. Currently, specialists have unique access to certain non-public order information. However, in its proposed new market model, the Exchange will be proposing to change the specialist’s access to such non-public order information. The proposed definition is

⁴ The specialist API is the electronic link between specialist trading algorithms and the NYSE Display Book®. Via this interface, specialist organization trading algorithms send quoting and trading messages to the Exchange for implementation in the NYSE Display Book®, and the Exchange transmits information necessary to acting as a specialist to specialist organizations.

⁵ The Display Book system is an order management and execution facility. The Display Book system receives and displays orders to the specialists, contains the Book, and provides a mechanism to execute and report transactions and publish results to the Consolidated Tape. The Display Book system is connected to a number of other Exchange systems for the purposes of comparison, surveillance, and reporting information to customers and other market data and national market systems.

⁶ NYSE OpenBook® provides aggregate limit-order volume that has been entered on the Exchange at price points for all NYSE-traded securities.

intended to take into consideration such future changes so that as the specialist's or specialist API's access to non-public order information changes, so will the specialist unit's responsibilities to protect that information change, but without having to revise Rule 98.

- “Investment banking department” and “Research department” – these definitions refer to the same departments that are defined as such in NYSE Rule 472 and NASD Rule 2711.
- “Customer-facing department” – this definition is intended to encompass any department, division, market-making desk, aggregation unit, or trading desk that receives, routes, or executes orders for customer execution or clearing accounts, regardless of whether such unit also engages in principal or proprietary trading. A hallmark of this definition is that a customer has an expectation of confidentiality and best execution on its behalf, which could include a customer that is another broker-dealer. Examples of trading desks that would meet this definition include a Nasdaq market-making desk and most block-trading desks. However, this definition is not intended to include an aggregation unit that solely conducts proprietary trading or proprietary market making (sometimes referred to as electronic market making).
- “Aggregation unit” – this definition adopts the standard of Rule 200(f) of Regulation SHO.⁷ The proposed rule uses this term throughout to refer to any department, division, unit, or trading desk that has been segregated pursuant to the requirements of Regulation SHO. The NYSE believes that the Regulation SHO requirements for establishing an aggregation unit, including any requirements for information barriers, would be sufficient for segregating a specialist unit's operations from the remainder of a member organization or its approved persons.
- “Non-trading related services” – this definition refers to the type of support services that a specialist unit may share with its parent member organization or approved person. The core of the proposed definition is that the type of services are not related to making decisions about the day-to-day trading of the specialist unit or provide trading support to such activity, such as by a trading assistant or specialist clerk. Examples of non-trading related services include stock loan (so long as consistent with Regulation SHO), clearing and settlement, controllers (for financial accounting purposes), technology support, and personnel who develop applications and algorithmic models.
- “Integrated proprietary aggregation unit” – this definition is intended to encompass any aggregation unit that has a trading objective to engage in proprietary trading, including proprietary market-making activities. As

⁷ See 17 CFR Part 242.200(f).

defined, an integrated proprietary aggregation unit must not include any activities that would be performed by an investment banking, research, or customer-facing department. Subject to proposed Rule 98(d), a specialist unit could be part of a member organization's integrated proprietary aggregation unit. Alternatively, an approved person or member organization could maintain an integrated proprietary aggregation unit separate from the specialist unit. In such case, the definition of an integrated proprietary aggregation unit becomes relevant in connection with proposed Rule 98(f)(3) and the ability of an approved person to engage in risk management activities on behalf of the specialist unit of an associated member organization.

- “Related products” – this definition refers to any derivative instrument that is related to a security allocated to a specialist unit. It can include options, warrants, hybrid securities, single-stock futures, security-based swap agreements, a forward contract, or any other contract that is exercisable into or whose price is based upon or derived from a security listed at the Exchange. The list referenced in the definition is not intended to be exhaustive and the definition is intended to cover any existing or future products that could be related to a security listed at the Exchange.

3. Proposed Rule 98(c): Approval to operate a specialist unit

Pursuant to proposed Rule 98(c), a member organization must obtain prior written approval from NYSE Regulation before it can operate a specialist unit. For approval, a specialist unit must demonstrate that it has: (i) adopted and implemented comprehensive written procedures and guidelines governing the conduct and supervision of business handled by the specialist unit; (ii) established a process for regular review of such written policies and procedures; and (iii) implemented controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines.

As proposed, these policies and procedures must be reasonably designed to provide that the specialist unit will maintain the confidentiality of both specialist confidential information and non-public orders. The proposed rule enumerates certain bright-line divisions that the specialist unit must maintain, including information barriers between the specialist unit and investment banking, research, and customer-facing departments and approved persons. Such information barriers should guarantee confidentiality two ways: the specialist unit cannot access material non-public information about securities allocated to that unit from either its approved persons or non-specialist operations of a parent member organization and vice versa.

With respect to a specialist unit's internal controls and surveillances, NYSE Regulation will be reviewing such surveillance plans to determine whether they are reasonably designed to protect information as required under the proposed rule. Where feasible, NYSE Regulation will expect specialist units to use

automated surveillances to check for breaches of the information barriers required by the proposed rule. As with the current rule, NYSE Regulation will also review whether a member organization has implemented internal audit procedures relating to compliance with the proposed Rule 98 policies and procedures.

In addition to the specific information barriers enumerated in the proposed rule, if a member organization proposes to operate a specialist unit as a stand-alone unit, the Exchange proposes importing the requirements of a Regulation SHO independent trading unit for specialist units. Accordingly, as required by Rule 200(f) of Regulation SHO,⁸ NYSE proposes requiring a specialist unit to have a written plan of organization that specifies its trading objectives and meet all of the other requirements of an independent trading unit under Regulation SHO. If a specialist unit seeks to avail itself of the exemption from NYSE Rule 105 under proposed Rule 98(f)(1), that written plan of organization would need to include its trading objectives for trading in related products.

As with the current rule, proposed Rule 98 would require the specialist unit to maintain net capital sufficient to meet the requirements of NYSE Rule 104.21. The NYSE believes that if a specialist unit is integrated within a larger member organization, the net capital requirement can be met by having the requisite capital amount allocated to the specialist unit by the member organization.

Despite the segregations required by the rule, the NYSE believes that senior managers who are not dedicated to the specialist unit and are associated with either an approved person or a member organization that runs a specialist unit should still be able to provide management oversight to the specialist unit. As proposed, the revised rule is not intended to be more restrictive than the current rule, which permits an approved person to provide general oversight over its associated specialist member organization. The proposed rule instead shifts from a detailed list of specific types of oversight that is permissible to a principle-based approach that focuses on protecting specialist confidential information and non-public order information. As with the current rule, as proposed, senior management oversight of a specialist unit should not conflict with or compromise in any way with the specialist unit's market-making obligations.

Proposed Rule 98(c)(2)(E) provides guidance on how a member organization or approved person should handle situations where a senior manager is called upon for risk management purposes and in connection with that role, gains access to specialist confidential information or non-public order information. The Exchange notes that non-public order information could become stale if the order is executed or cancelled without the specialist's knowledge. To ensure that there is no misuse of such information, whether material or not, the senior manager must not make (directly or indirectly) specialist confidential information or non-public order information available to the persons or systems responsible for making trading decisions in aggregation units, departments, divisions, or trading

⁸ See 17 CFR Part 242.200(f).

desks that are not part of the specialist unit, including the customer-facing departments. The senior manager also must not use such information to directly or indirectly influence the day-to-day trading decisions of the other aggregation units of the member organization or approved person with respect to the securities allocated to the specialist unit.

The NYSE believes that these restrictions on the use of specialist confidential information and non-public order information are similar to how broker-dealers currently handle situations where a senior manager has oversight over multiple aggregation units and in such capacity, becomes privy to confidential information of one aggregation unit. For such situations, broker-dealers have already developed procedures for protecting confidential information and the NYSE believes that such procedures should be reasonable for the oversight of a specialist unit as well.

The Exchange notes that although the proposed amendments to Rule 98 eliminate the exemption process under current Rule 98(b), the review that NYSE Regulation would conduct when approving a specialist unit would be as rigorous as the current review for obtaining an exemption, just simply a different focus of what is reviewed. As with the current Rule 98 exemption process, staff from both the Market Surveillance Division of NYSE Regulation as well as relevant staff from the Financial Industry Regulatory Authority, Inc. (“FINRA”) who are responsible for the routine examinations of specialist units would be involved in reviewing a specialist unit’s written policies and procedures and proposed automated surveillances and controls.⁹

For existing specialist firms, the initial approval process associated with any changes to how they operate may require upfront work to ensure that the specialist unit’s policies and procedures are reasonably designed to meet the requirements of the proposed rule. However, unlike the current rule, as proposed, specialist units would be relieved of the requirement to update any written statements to the Exchange for changes in approved persons or dually-affiliated employees. Once approved, NYSE Regulation and FINRA would examine whether a specialist unit’s policies and procedures continue to meet the rule requirements and whether the implemented controls and automated surveillances are functioning as designed. As part of such examination review, NYSE

⁹ In connection with the July 2007 transfer of certain member firm regulation functions from NYSE Regulation to FINRA, NYSE Regulation and FINRA entered into a regulatory services agreement (“RSA”) whereby FINRA agreed to provide NYSE Regulation with certain services relating to NYSE’s retained responsibilities to examine for compliance with NYSE rules that govern trading on or through the systems and facilities of the Exchange. In particular, pursuant to the RSA, FINRA participates in the current Rule 98(b) exemption process and examines specialist firms for compliances with that rule. As proposed, FINRA would continue to participate in the approval process under the proposed Rule 98 and examine specialist units for compliance with the rule.

Regulation and FINRA will conduct on-site reviews of a specialist unit to review for breaches of the controls or surveillances. And, as noted above, if the specialist unit proposes making any material changes to its operations, it would need to seek additional approval before it can change its operations.

4. Proposed Rule 98(d): Operating a Specialist Unit Within an Integrated Proprietary Unit

One of the goals of proposed Rule 98 is to provide a member organization with greater flexibility in how it manages the risk of a specialist unit. As discussed below, in proposed Rule 98(f), the NYSE proposes providing member organizations with an array of options of how to conduct risk management. The NYSE believes that the flexibility afforded by these options will meet the varying business models of the member organizations currently operating or seeking to operate a specialist unit at the Exchange.

As discussed in more detail below, one proposed risk management model would be to permit a member organization to integrate a specialist unit within a larger aggregation unit that meets the requirements of an integrated proprietary aggregation unit. Proposed Rule 98(d) sets forth the minimum requirements for how to structure such an integrated unit. While such a unit would be considered a single aggregation unit for Regulation SHO purposes, as proposed, the member organization would need to establish information barriers within the integrated proprietary aggregation unit to restrict access to non-public order information to the specialist unit only. And depending on the risk management model proposed by a specialist unit, a member organization or approved person may need to further segregate the flow of information within a specialist unit.

As proposed, the specialist unit that would operate within the integrated proprietary aggregation unit would need to meet the requirements of proposed Rule 98(c)(2)(A), (C), (D), and (E) of the rule, which concern the information barriers associated with the specialist unit and non-specialist unit operations, net capital requirements, and senior management oversight. Because an integrated proprietary aggregation unit that includes a specialist unit would likely already be subject to Rule 200(f) of Regulation SHO that it qualify as an independent trading unit, the specialist unit operating within the integrated proprietary aggregation unit would not need to separately meet the Rule 200(f) requirement for an independent trading unit. Accordingly, as proposed, a specialist unit that operates within an integrated proprietary aggregation unit would not need to meet the requirements of proposed Rule 98(c)(2)(B), which requires a specialist unit to separately comply with all of the Regulation SHO independent trading unit requirements.¹⁰

¹⁰ The Exchange recognizes that there may be some Regulation SHO issues in connection with how a member organization may choose to structure its specialist unit within an integrated proprietary aggregation unit or provide risk management

In addition to meeting certain requirements of proposed Rule 98(c), under proposed Rule 98(d)(2)(B), the specialist unit must restrict access to non-public order information or specialist confidential information from the rest of the integrated proprietary aggregation unit. Such information barriers must ensure that both individuals and systems that are not assigned to the specialist unit do not have access to non-public order information, or, unless otherwise provided for in proposed Rule 98(f), specialist confidential information.

The NYSE believes that as proposed, Rule 98(d)(2)(B) provides sufficient flexibility for how a member organization structures its operations to evolve as the NYSE market model changes. For example, the specialist API currently has access to limited non-public order information, but does not have access to information available in the NYSE Display Book. So long as the specialist API has access to that non-public order information, the Exchange believes that systems not dedicated to the specialist unit should not be integrated with the specialist API. Accordingly, the trading algorithms of the integrated proprietary aggregation unit that are not dedicated to the specialist unit would not have access to any non-public order information via the specialist API, or any other system.

Proposed Rule 98(d)(2)(B)(iii) addresses the situation of communications from the Floor of the Exchange to the rest of the integrated proprietary aggregation unit. Currently, specialist unit employees on the Floor of the Exchange have access to non-public order information, whether via access to information in the Display Book® or because of verbal representations of imminent orders. The NYSE believes that the best way to ensure that such information is not provided to individuals or systems not dedicated to the specialist unit is to restrict communications while the employee is still on the Floor of the Exchange.

Proposed Rule 98(d)(2)(B)(iv) considers the possibility that an individual who works on the Floor of the Exchange¹¹ may also, on an intra-day basis, move to an off-Floor location and engage in a non-specialist related role within the integrated proprietary aggregation unit pursuant to proposed Rule 98(d) or for an “upstairs” desk trading in related products within the specialist unit pursuant to proposed Rule 98(f)(1). In such case, the individual must not make any non-public order information or, unless specifically provided for, specialist confidential information, available to individuals or systems that are not dedicated to the specialist unit. Nor may that individual use such non-public information, or,

to the specialist unit pursuant to proposed Rule 98(f). In such case, approval to operate under proposed Rule 98 would not be provided until all Regulation SHO issues that may arise have been resolved.

¹¹ Note that NYSE rules define being on the Floor to include the trading Floor of the Exchange, and the premises immediately adjacent thereto, such as the various entrances and lobbies of 11 Wall Street, 18 New Street, 12 Broad Street, and 18 Broad Street, as well as the telephone lobby in the first basement of 11 Wall Street. See Rule 112(b).

except as provided for in the Rule, specialist confidential information, in any way in connection with responsibilities that are not related to Floor-based activities of the specialist unit. For purposes of proposed Rule 98(f)(1), once off the Floor, a specialist may not use non-public information to directly or indirectly trade in related products. However, nothing in the rule bars a specialist unit from moving personnel among different positions intraday, so long as the restrictions on information flow and use are followed. The NYSE believes that this would provide member organizations with sufficient flexibility to transfer its employees among various roles, including on the Floor of the Exchange and in a specialist unit upstairs location during a given trading day. For intra-day transfers, the Exchange will expect specialist units to have written policies and procedures reasonably designed to ensure that non-public order information and specialist confidential information (unless otherwise permitted) would not be used from an off-Floor location. The Exchange notes that in addition to the information barriers required by proposed Rule 98, specialists must continue to abide by Exchange rules that govern their access to and use of non-public order information.¹²

As noted above, an integrated proprietary aggregation unit would need to qualify as an aggregation unit, which for Regulation SHO purposes, requires the unit to net its positions. While the proposed rule would no longer require separate books and records for a specialist unit, to ensure that NYSE Regulation can review the trading activity by the specialist unit at the Exchange without having to parse through commingled records, under proposed Rule 98(d)(2)(C), in addition to meeting Regulation SHO requirements, an integrated proprietary aggregation unit must maintain records of its specialist's accounts in a manner that is separate from the accounts of the integrated proprietary aggregation unit.¹³

In addition to the above, the integrated proprietary aggregation unit must have written policies and procedures that address how it will ensure that the unit will not engage in any activities that could violate other Exchange rules or federal securities laws and regulations, including Regulation SHO. The policies and procedures must address, at a minimum, how the unit will ensure against front running, wash sales, and market manipulation.

In connection with wash sales, a potential concern for an integrated proprietary aggregation unit is the possibility that the specialist unit could be selling (buying) one of the securities registered to it and an individual or trading system of the integrated proprietary aggregation unit could at the same time be buying (selling) that same security at the Exchange. With the proper use of mnemonics associated with those orders, Exchange systems are capable of rejecting one side of those

¹² See, e.g., NYSE Rules 70.20(h)(ii), 104(b), 115, and 115A.

¹³ The Exchange is engaging in a separate discussion with Commission staff of the Regulation SHO implications of requiring a specialist unit to separately aggregate its trading positions for purposes of Exchange rules.

orders. Because the presumption would be in favor of the specialist unit trading, i.e., to meet its affirmative obligations at the Exchange, the NYSE proposes rejecting the order from the integrated proprietary aggregation unit.

The NYSE also proposes that to the extent an integrated proprietary aggregation unit directs its trading at the Exchange in any security that has been allocated to the specialist unit through the specialist unit, such trading would be subject to the specialist rules. In other words, while the specialist unit would be subject to certain market-making obligations while trading at the Exchange, the integrated proprietary aggregation unit's independent "upstairs" operations would be able to trade freely.

Finally, to ensure that NYSE Regulation can review the trading activities of the integrated proprietary aggregation unit, proposed Rule 98(d)(4) requires member organizations to maintain audit trail information for any trading by such unit, including trading at the Exchange and at other market centers. The NYSE proposes to amend NYSE Rule 132B to have the Order Tracking System ("OTS") requirements apply to trading by a specialist unit, and if applicable, an integrated proprietary aggregation unit. Member organizations must maintain sufficient records to reconstruct in a time-sequenced manner its trading in securities allocated to the specialist unit and any trading by the integrated proprietary aggregation unit in those securities in other market centers or trading in related products.

As with the approval process under proposed Rule 98(c), to obtain approval to operate a specialist unit within an integrated proprietary aggregation unit, a member organization would need to submit its written policies and procedures to NYSE Regulation for review of whether such policies and procedures are reasonably designed to meet the rule requirements. Once approved under proposed Rule 98(d), NYSE Regulation and FINRA would continue to examine whether a specialist unit's policies and procedures continue to meet the rule requirements and whether the implemented controls and surveillances plans are functioning as designed.

5. Proposed Rule 98(e): Sharing Non-Trading Related Services

One of the restrictions of current Rule 98 is the limit on a specialist member organization and its approved persons to share operational support personnel. In its current form, Rule 98(c) permits dual affiliation only if the specialist member organization and approved person provide the Exchange with a written statement of the duties of such person and why it is necessary for the individual to have a dual affiliation. Any changes to dual affiliations must be submitted to the Exchange for approval in advance of making such change.

The NYSE believes that current Rule 98(c) unnecessarily restricts the ability of a specialist member organization and its approved person to share non-trading related services, i.e., operational support services. Accordingly, the NYSE

proposes amending Rule 98 to permit the sharing of non-trading related services, subject to the approval of NYSE Regulation.

As with the approval process to become a specialist unit, the approval process for a specialist unit to share non-trading related services with its parent member organization or approved person would require the specialist unit to: (1) adopt written policies and procedures governing the sharing of non-trading related services; (2) establish a process for regular review of such written policies and procedures; and (3) implement controls and surveillances reasonably designed to prevent and detect violations of those policies and procedures. In accordance with the purpose of Rule 98, such policies and procedures must be reasonably designed to protect specialist confidential information and non-public order information.

The NYSE understands that personnel or systems that provide non-trading related services may have access to specialist confidential information or non-public order information. For example, clearance and settlement services would have knowledge of specialist positions in securities, and technological support personnel may have knowledge of how a specialist algorithm conducts its trading. However, access to such information should not be the basis for restricting the sharing of such personnel or systems. Rather, such personnel or systems can be shared so long as the specialist unit has controls reasonably designed to ensure that the individuals or systems who have access to specialist confidential information or non-public information neither provide nor make available that information to any individuals or systems not part of the specialist unit. In particular, under no circumstances should non-public order information or specialist confidential information be made available to the investment banking, research, or customer-facing departments.

Before a specialist unit can share non-trading related services, NYSE Regulation will review whether the specialist unit has adopted policies and procedures and controls and surveillances reasonably designed to protect specialist confidential information and non-public order information. Once approved, a specialist unit would no longer need to provide NYSE Regulation with a written statement of why a certain individual has a dual affiliation and update such written statements if the individual involved changes. On an ongoing basis, NYSE Regulation and FINRA will examine whether the specialist unit's policies and procedures and controls comply with the requirements of the rule.

6. Proposed Rule 98(f): Risk Management

Specialist member organizations and their approved persons are currently limited in their ability to manage the specialist member organization's trading risks: Rule 98 currently restricts an approved person from being involved in any trading decisions of an associated specialist member organization; Rule 105 currently restricts the specialist member organization's ability to trade in options and single-stock futures related to the securities allocated to the specialist member

organization. Together, these restrictions place specialist member organizations at a competitive disadvantage vis-à-vis other market-making or trading firms.

The NYSE believes that the changes to the marketplace that have occurred since 1987, when Rule 98 was adopted, call for an overhaul of how specialist units are permitted to manage their risk. For example, when Rule 98 was adopted, the NYSE enjoyed an approximately 85% market share in trading of NYSE-listed securities and specialists participated in approximately 12% of the transactions at the Exchange. Now, the NYSE's market share for listed securities hovers under 40%, and of that, specialist participation is in the range of two percent. These numbers are telling: because of automatic executions at the Exchange, specialists no longer have a unique advantage over other market participants. To the contrary, specialists are now at a disadvantage to other market participants because they must meet their affirmative and negative obligations to the Exchange, yet cannot participate in the type of hedging activities that other market participants may and can do.

Accordingly, the Exchange proposes providing specialist units with the ability to manage their risks by broadening the ability to trade in related products and expanding the universe of who may be involved in managing the risk of the specialist unit. Because there is no single correct model for risk management, the NYSE proposes providing specialist units with options of how to manage their risk, which they can choose to use in combination or alone. Regardless of which model a specialist unit proposes to adopt for risk management, at all times, the specialist unit will be ultimately responsible for its quoting or trading decisions at the Exchange.

a. Specialist Unit Risk Management

In order to provide a specialist unit with greater risk management tools, the NYSE proposes permitting specialist units to apply for an exemption from the Rule 105(b)-(d) restrictions on trading options and single-stock futures. In connection with this change, the NYSE proposes amending Rule 105 so that it applies only to a specialist unit, and not to any other departments or units of a member organization or approved person. If approved for an exemption from Rule 105, a specialist unit would be permitted to trade in related products, subject to proposed Rule 98(f)(1).¹⁴

¹⁴ The Exchange also proposes amending section (m) of the Rule 105 Guidelines to provide that a specialist unit is not permitted to engage in market-making activities in single-stock futures or options. However, if eligible for an exemption under Rule 105(b)-(d), nothing restricts a specialist unit from having a trading desk that trades in options or single-stock futures. Because an integrated proprietary aggregation unit that includes a specialist unit may engage in options market making, the Exchange proposes eliminating sections (m)(ii) and (iii) of the Rule 105 Guidelines.

As proposed, to obtain an exemption from Rule 105, the specialist unit must: (i) adopt and implement comprehensive written procedures and guidelines governing the conduct of trading in related products; (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines.

These policies and procedures must be reasonably designed to ensure that the individuals or systems responsible for trading related products do not have access to non-public order information, or, unless otherwise specifically provided for, specialist confidential information. In addition, individuals who work on the Floor of the Exchange would not be permitted to trade or direct trading in related products, nor would the specialist API be permitted to make any trading decisions in related products. Accordingly, any trading in related products by the specialist unit must be conducted by an off-Floor, i.e., “upstairs” office. All trading in related products must be conducted by individuals who are qualified and registered to trade in the marketplaces where such trading occurs. Moreover, the member organization that houses the specialist unit must be a member of FINRA or other self-regulatory organizations, as required by each marketplace where the specialist unit proposes to trade.

The NYSE believes that a specialist unit should have the flexibility to transfer its employees among different functions within the unit. Accordingly, the proposed rule does not expressly prohibit specialists from trading in related products; it only bars directly entering or executing trades in related products while on the Floor of the Exchange.¹⁵ As proposed, a specialist unit could transfer a specialist back and forth from the Floor of the Exchange to a specialist unit upstairs desk that trades in related products, so long as that specialist is registered and qualified to trade in related products and non-public order information is not used when trading in related products. In such case, however, a specialist unit must have policies and procedures reasonably designed to ensure that a specialist who moves off the Floor of the Exchange does not make available or use any non-public information or, unless otherwise specified, specialist confidential information, to which the specialist may have had access while on the Floor of the Exchange. As noted above, while off the Floor of the Exchange, specialists continue to be subject to other NYSE rules that govern their access to and use of non-public order information.

To ensure that the specialist unit upstairs desk that trades in related products can effectively hedge the specialist unit’s positions, the NYSE proposes that the specialist unit upstairs desk have electronic access to the trades by the specialist

¹⁵ The Exchange notes that a specialist unit that has not been approved for an exemption from Rule 105 under proposed Rule 98(f)(1) would still be permitted to enter orders in options or single-stock futures from the Floor, subject to the requirements of Rule 105.

unit at the Exchange in securities allocated to the specialist unit that have been printed to the Consolidated Tape.

Currently, senior managers of specialist member organizations can be privy to information about trading on the Floor of the Exchange as well as any hedging conducted by the specialist member organization, even though such hedging opportunities are limited. For example, currently, a specialist on the Floor can call his or her senior manager to discuss hedging strategies. Under the proposed exemption from Rule 105, the NYSE believes that specialist unit senior managers should be able to continue in that role and provide oversight of both Floor specialist operations and any specialist unit upstairs trading in related products. The NYSE believes that the oversight model that works for larger broker-dealers, whose senior managers have a role with respect to multiple aggregation units, should apply within a specialist unit as well.

Accordingly, the NYSE proposes Rule 98(f)(1)(v) to address how a senior manager of a specialist unit should handle situations where he or she has access to non-public order information in connection with his or her role as a senior manager. As with proposed Rule 98(c)(2)(E), when trading in related products, the specialist unit must have policies and procedures reasonably designed to ensure that the specialist unit senior manager who has access to non-public order information does not provide such information to the specialist unit upstairs trading desk responsible for trading related products or use such non-public information to directly or indirectly influence trading by that upstairs desk.

b. Integrated Proprietary Aggregation Unit Risk Management

Proposed Rule 98(f)(2) addresses how an integrated proprietary aggregation unit that has been approved pursuant to proposed Rule 98(d) to include a specialist unit could engage in risk management of the specialist unit's positions. At a minimum, an integrated proprietary aggregation unit must have policies and procedures that are reasonably designed to meet the protections enumerated in the rule, including how it trades in related products on behalf of a specialist unit and how it electronically accesses the specialist unit's trades at the Exchange in securities allocated to the specialist unit that have been printed to the Consolidated Tape.

In addition, proposed Rule 98(f)(2)(v) would permit an integrated proprietary aggregation unit to send appetites of trading or quoting direction to the specialist unit. In practice, this would permit a non-specialist unit "upstairs" risk management desk that has real-time access both to the specialist unit's positions in securities allocated to it and to the integrated proprietary aggregation unit's positions in related products and other securities to provide electronic direction to the specialist unit of whether to trade or quote in a certain direction. The Exchange believes that permitting an integrated proprietary aggregation unit to send quoting messages that are based on real-time positions of the unit as a whole will enable a specialist unit to better meet any quoting requirements at the

Exchange. In other words, the specialist unit will no longer need to operate in a vacuum when determining how or when to quote at the Exchange.

As proposed, the specialist unit would be ultimately responsible for whether to accept the electronic trading direction submitted by the integrated proprietary aggregation unit upstairs desk; a specialist unit must comply at all times with its market-marking obligations, including the specialist rules, notwithstanding any electronic trading directions received from that upstairs desk. Stated otherwise, the specialist unit would operate independently and be free to accept or reject the electronic trading directions sent by the integrated proprietary aggregation unit. However, to the extent an integrated proprietary aggregation unit causes a specialist unit to violate one or more of the specialist rules, the Exchange proposes that in such case, the integrated proprietary aggregation unit should also be held to those standards.

At this time, as noted above, because of access to non-public order information, the NYSE does not believe it would be feasible to permit communications, whether verbal or electronic, from the specialist or the specialist API to the individuals or systems responsible for trading in related products and other securities within the integrated proprietary aggregation unit, or, if applicable, to an upstairs desk within the specialist unit. However, as the NYSE market model evolves, the NYSE will continue to review how best to integrate a specialist unit within an integrated proprietary aggregation unit, including the possibility of fully integrating the trading systems that interact with the Exchange for the specialist unit and the trading systems that trade in related products and other securities. The NYSE believes that ultimately, a competitive trading model would permit full integration, including permitting two-way communications among trading desks.

c. Approved Person Risk Management

As proposed, another option available to firms to manage the risk of the specialist unit is to permit a separate integrated proprietary aggregation unit that is housed in either an approved person or a member organization that runs a specialist unit to provide the same level of risk management as proposed for an integrated proprietary aggregation unit that includes a specialist unit. This option would provide flexibility for broker-dealers that want to keep the specialist unit as a separate member organization or aggregation unit, yet still have an approved person or separate aggregation unit provide risk management services for the specialist unit.

As with proposed Rule 98(f)(2), proposed Rule 98(f)(3) would require that the approved person not have access to either specialist confidential information and non-public order information, except as provided for in that section of the rule. Specifically, an integrated proprietary aggregation unit of an approved person could have access to the trades by a specialist unit at the Exchange in securities allocated to that unit, so long as such trades have been printed to the Consolidated Tape.

And as with proposed Rule 98(f)(2), an approved person could send electronic appetites of how the specialist unit should trade or quote in its allocated securities. As discussed above, a specialist unit would be free to reject or accept such electronic directions as it sees fit to meet its market-making obligations at the Exchange.

The Exchange notes that an approved person that provides risk management under this proposed section may not itself be an NYSE member organization. In such case, the individuals at the approved person responsible for making risk management decisions on behalf of the specialist unit should be dually employed by the specialist unit that is part of an NYSE member organization and the approved person so that they are subject to the jurisdiction of NYSE Regulation.

7. Proposed Rule 98(g): Failure to Maintain Confidentiality, Reporting Obligations, and Breaches

The NYSE proposes to keep certain provisions of current Rule 98, but adjust them to reflect the changes to the rest of the rule. In particular, current Rule 98(i) has been amended and is included in proposed Rule 98(g); current Rule 98(j) has been amended and is included in proposed Rule 98(h); and, current Rule 98(k) has been amended and is included in proposed Rule 98(i).

Under proposed Rule 98(g), as with the current rule, if a specialist becomes aware of non-public material information from its approved person or parent member organization, such specialist may have to cease acting as a specialist in the security involved, which was formerly referred to as “giving up the Book.” The proposed rule does not change how such determinations would be made. However, the proposed rule updates the language of the rule and separates the rule into easier-to-read subsections.

Under proposed Rule 98(h), the NYSE proposes adding to the existing reporting obligations that a specialist unit must report any actual breaches or internal investigations of possible breaches of the information barriers required by the rule. The reporting obligation for internal investigations is intended to be similar in effect to the reporting obligation pursuant to NYSE Rules 351(e) and 342.21. In particular, under proposed Rule 98(h)(4), a specialist unit will be required to conduct an internal investigation into any trading activity that may be a result of a breach of the information barriers required by proposed Rules 98(c), (d), (e), and (f). On a quarterly basis, a specialist unit must report in writing to NYSE Regulation whether it has commenced such an internal investigation, the quarterly progress of any open investigations, what remedial measures, if any, were taken, and the completion of any internal investigation, including the methodology and results of such investigation, any internal disciplinary action taken, and any referral of the matter to the NYSE, another self-regulatory organization, or the Securities and Exchange Commission (the “Commission”).

Finally, as with the current rule, proposed Rule 98(i) provides that any breach of the proposed Rule could result in disciplinary action, including the withdrawal of one or more securities allocated to the specialist unit or withdrawal of approval to operate a specialist unit. The Exchange notes that as with the current rule, any trading by any person while in possession of material, non-public information received as a result of any breach of internal controls required by proposed Rule 98 may violate Rule 10b-5 of the Act,¹⁶ Rule 14e-3 of the Act,¹⁷ NYSE Rule 104, just and equitable principles of trade or one or more provisions of the Act, or regulations thereunder or rules of the Exchange. The Exchange intends to review carefully any such trading of which it becomes aware with a view towards determining whether any such violation has occurred.

C. Proposed Amendments to Related Rules

As noted above, because of the shift in paradigm away from approved persons, the NYSE proposes amending those NYSE rules that refer to approved persons and the need for an exemption from Rule 98.

1. Proposed Amendments to Rule 98A

NYSE Rule 98A requires approved persons to agree in writing not to cause a specialist or odd-lot dealer to violate rules applicable to the specialist or odd-lot dealer. The rule further requires that approved persons report to the Exchange any off-Floor orders for securities in which an associated specialist member organization specializes for any account in which the approved person has a direct or indirect interest.

Because of the proposed changes to Rule 98, and in particular, the recognition that an appropriately walled-off specialist unit ameliorates the need to scrutinize the trading by an approved person, the NYSE proposes eliminating those portions of Rule 98A that concern approved persons. However, the NYSE would keep the limitation on an issuer, or a partner or subsidiary thereof, from becoming an approved person of a specialist unit.

2. Proposed Amendments to Rules 99, 102, 103B, 104, and 113

In their current form, NYSE Rules 99, 103B, 104, and 113 specifically apply to approved persons, unless such approved person has obtained an exemption under Rule 98. To ensure consistency among NYSE rules, and in particular, to ensure that the revised paradigm of proposed Rule 98 is consistently applied, the NYSE

¹⁶ See 17 CFR Part 240.10b-5.

¹⁷ See 17 CFR Part 240.14e-3.

proposes to amend Rules 99, 103B, 104, and 113 to eliminate the references to approved persons.¹⁸

In addition, the Exchange proposes to delete Rule 102, which concerns trading in options by odd-lot dealers. Because the Exchange no longer has separate odd-lot dealers and all specialists are also responsible for odd-lot trading in securities in which they are registered, there is no need for a separate rule governing trading in related products by an odd-lot dealer. Accordingly, because Rule 102 is duplicative of the standards set forth in proposed Rules 98 and 105, the Exchange proposes deleting that rule.

3. Proposed Amendments to Rule 460

In addition to amending Rule 460 to ensure consistent application of proposed Rule 98 and making other non-substantive changes, the NYSE proposes eliminating Rule 460.20 that approved persons of specialist member organizations be held to any limits on beneficial ownership of any equity security in which an associated specialist unit is registered. Instead, as proposed, any limitations on beneficial ownership should apply only to the specialist unit that has been approved pursuant to proposed Rule 98, and not to any other aggregation unit or other department or division of the member organization.

With respect to the specialist unit's beneficial ownership of outstanding shares of securities allocated to such unit, the NYSE proposes to amend NYSE Rule 460.10 to require that a specialist unit report when its beneficial ownership of outstanding shares exceeds 5% and to update such report if the beneficial ownership either falls below 5% or exceeds 10%. The NYSE thus proposes to eliminate the requirement that a specialist unit seek NYSE Regulation approval before it may have more than 10% beneficial ownership of a listed security. The NYSE believes that because of the reduced market share of the NYSE and the limited impact of specialist trading on securities allocated to a specialist unit, the protections of the existing rule are no longer necessary. However, the NYSE proposes retaining the prohibition on a specialist unit having beneficial ownership of more than 25% of the outstanding shares in a security allocated to such unit. Because the changes to the marketplace are in effect now, the Exchange believes that the changes to Rule 460 should be implemented notwithstanding whether a specialist member organization continues to operate under Rule 98 (Former). Accordingly, the Exchange proposes having a single version of Rule 460 to reflect the proposed amendments.

¹⁸ For the period of time that the current Rule 98 stays in the NYSE Rules as "NYSE Rule 98 (Former)," each of NYSE Rules 99, 103B, 104, and 113 will have two forms: one to meet the requirements of NYSE Rule 98 (Former) and one to meet the requirements of proposed Rule 98. The version of the rules that relate to Rule 98 (Former) will be similarly designated with the "(Former)" title either for the entire rule, or for a section of a rule, as appropriate.

(c) Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)¹⁹ that an Exchange have rules that are designed to promote the 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.

3. Self-Regulatory Organization's Statement on the Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

The Exchange neither solicited nor received written comments on the proposed rule change.

6. Extension of Time Period for Commission Action

The Exchange does not consent at this time to an extension of any time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1 – Form of Notice of Proposed Rule Change for Federal Register

Exhibit 5 – Text of proposed changes to Rule 98 and related rules

¹⁹ 15 U.S.C. 78f(b)(5).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NYSE-2008-45)

[Date]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by New York Stock Exchange LLC Amending NYSE Rule 98 and Related Rules to Redefine Specialist Operations at the NYSE

Pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (the “Act”)² and Rule 19b-4 thereunder,³ notice is hereby given that, on June 11, 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, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Rule 98 and related rules to redefine specialist operations at the NYSE. The text of the proposed amendments to Rule 98 and related rules is attached as Exhibit 5.

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

¹ 15 U.S.C.78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The NYSE is proposing to amend Rule 98 to reduce the regulatory burdens imposed by the rule and to provide flexibility to member organizations as to how they can structure their specialist operations and manage their risks. In particular, because of changes to the marketplace, including changes to the specialist's role as a result of the increased use of electronic trading, the Hybrid Market®, and Regulation NMS, as well as technological advances in surveillance and internal controls, the NYSE believes that current Rule 98 imposes unnecessary restrictions on member organizations seeking to engage in specialist operations at the Exchange.

Accordingly, the NYSE proposes revising Rule 98 in its entirety to provide a framework for specialist operations that meet both the regulatory concerns of the current rule and the reality of today's marketplace. In addition to changes to Rule 98, the NYSE proposes making conforming changes to other NYSE rules that rely on Rule 98 exemptions for approved persons. As discussed in further detail below, the revisions to Rule 98 would include: (1) redefining the persons to whom Rule 98 would apply; (2) allowing specialist operations to be integrated into better capitalized member organizations; (3) permitting a specialist unit to share non-trading related services with its parent member organization or approved persons; and (4) providing flexibility to member

organizations and their approved persons in how to conduct risk management of specialist operations.

To achieve these changes, the NYSE proposes shifting the paradigm of Rule 98 from one that assumes that the approved persons of a specialist member organization are subject to certain NYSE rules unless an exemption is provided to one where NYSE Regulation, Inc. (“NYSE Regulation”) reviews whether a trading unit that proposes to engage in specialist operations is sufficiently walled off from either its approved persons or parent member organization. Under the new paradigm, rules governing specialist operations, such as Rule 104, will apply only to the unit approved to engage in specialist operations at the NYSE.

As the NYSE market model continues to evolve, the NYSE believes that the proposed amendments to Rule 98 will provide a platform from which to further modernize specialist operations.

A. Background

The NYSE adopted Rule 98 in 1987 in response to consolidation in the securities industry, when NYSE specialist firms that had been independent member-owned entities increasingly became subsidiaries of larger, better capitalized broker-dealers. Because of the specialists’ unique position within the markets, and the restrictions on dealers under Section 11A of the Securities Exchange Act of 1934 (the “Act”),⁴ the Exchange crafted a rule that governed how larger member organizations could be connected to specialist firms.

⁴ See 15 U.S.C. 78kA.

The rule establishes a functional separation between the specialist organization and the rest of the broker-dealer. The purpose of that separation was to eliminate or control conflicts of interest between the specialist's actions as market maker in an issuer's securities and other interactions among the specialist's parent or sibling entities and the issuer.

In its current form, Rule 98 applies to specialist units and so-called "approved persons" of a specialist organization – that is, entities that are in a control relationship with a specialist organization, or share a common corporate parent with the specialist organization and are engaged in a kindred business.⁵ Such entities are, by virtue of their association with the specialist organization, subject to the rules and restrictions applicable to specialists. These include, among other things, restrictions on the approved persons' ability to trade in specialty stock options, restrictions on certain of their business transactions with issuers for whom the specialist organization is the registered specialist, and limits on the amount of securities of such issuers that the specialist and approved persons may own in the aggregate.

So as not to unreasonably hamstring a broker-dealer organization overall, Rule 98(b) provides that an approved person may seek Exchange approval to be exempted from most of those restrictions. To obtain a Rule 98(b) exemption, the approved person must establish policies and procedures that are consistent with the Guidelines for Approved Persons Associated with a Specialist's Member Organization ("Rule 98 Guidelines"). These guidelines set out in detail how approved persons and associated specialist organizations should structure and conduct their respective businesses in order

⁵ See NYSE Rules 2(d) and 304(e).

to ensure complete separation between the specialist organization and the rest of the member organization.

Among other things, the Rule 98 Guidelines provide that the specialist member organization be housed in a separate corporate entity and broker-dealer from its approved persons. Further, to ensure that information does not flow improperly from the specialist organization to approved persons and that approved persons do not have undue influence over particular trading decisions by the specialist, the guidelines establish “functional regulations” that enforce the required separateness. These include requirements that the organizations maintain separate books and records, separate financial accounting, and separate required capital, and that each organization have in place procedures to safeguard confidential information derived from business interactions with the issuer or contained in draft research reports prepared by the approved person.

The assumption that all entities affiliated with a specialist are subject to specialist rules unless they have obtained a Rule 98(b) exemption creates a substantial administrative burden on specialist organizations and their approved persons: each approved person of a specialist organization must establish and continually update a separate exemption under Rule 98 if it wishes to engage in activity that would otherwise be restricted under applicable specialist rules. This burden creates a real and substantial barrier to entry for new broker-dealers who may want to establish specialist units.

In the face of significant structural changes to the NYSE and the equity markets, and in recognition of the vastly different competitive landscape compared to 1987, the Exchange believes that Rule 98 must be updated in order to provide both existing and prospective specialist firms with the necessary tools to remain competitive while at the

same time meeting their obligations as specialists at the NYSE. The proposed changes to Rule 98 also address the Exchange's desire to ease the burdens of a new member organization seeking entry to supplement the six specialist firms currently trading on the Exchange, or the very real possibility of such a firm replacing one or more of the existing specialist firms if they withdraw from the market. Concerning the latter possibility, the NYSE notes that this is not just a theoretical concern: within the past six months, two specialist firms have already withdrawn.

To address these very real concerns, the Exchange proposes to fundamentally amend Rule 98. The proposed rule is described in detail below, but at root, the amendment reverses the assumption that all affiliated entities of a specialist firm are automatically governed by the rules applicable to specialists, and shifts the focus of the rule onto the specialist unit rather than the approved person.

As part of this restructuring, the NYSE proposes to eliminate the prescriptive approach of the current rule and move towards a more principle-based approach. The NYSE believes that a principle-based rule closely overseen by NYSE Regulation can achieve the same goals as a rule that attempts to enumerate every possible situation that must be avoided. For that, the proposed rule still requires NYSE Regulation to review whether a specialist unit's policies and procedures are reasonably designed to protect confidential information. However, the rule provides sufficient flexibility so that as the type of information that needs to be protected and the manner in which such information can be protected evolves with changes to the trading environment, so too can the manner in which NYSE Regulation conducts its review.

The NYSE believes that the proposed changes to Rule 98 will minimize regulatory burdens and barriers to entry while at the same time provide the necessary level of regulatory scrutiny to ensure that confidential information continues to be protected. In addition, the proposed changes will reduce the regulatory burdens on existing specialist member organizations to enable them to continue such operations at lower cost.

B. Proposed Amendments to Rule 98

1. Applicability of Rule 98

Under the proposed rule, a member organization seeking to operate a specialist unit, either as its entire business or as one of its trading units, would need to apply for and be approved by NYSE Regulation before it can begin, or if applicable, continue operations as a specialist unit. As described in more detail below, NYSE Regulation will review whether a proposed specialist unit has: (1) adopted written policies and procedures governing the conduct and supervision of the business handled by the specialist unit; (2) established a process for regular review of such written policies and procedures; and (3) implemented controls and surveillances reasonably designed to prevent and detect violations of those policies and procedures. Among other things, these policies and procedures must be reasonably designed to protect specialist confidential information and non-public order information, as defined below.

Once approved, the NYSE specialist rules, as defined below, including Rule 104, would generally only be applicable to the approved specialist unit and not to its approved persons or, if applicable, parent member organization. As discussed in more detail below, on a case-by-case basis, NYSE Regulation will assess whether an integrated

proprietary aggregation unit that manages the risk for a specialist unit could be subject to the specialist rules if the integrated proprietary aggregation unit causes the specialist unit to violate its obligations.

The NYSE recognizes that despite the proposed rule changes, an existing specialist member organization may determine to either keep its current operational structure or wait before it implements changes to its operational structure, as permitted by the proposed amended rule. Because current Rule 98 would still be applicable to those specialist units that would not have yet sought the relief available under proposed Rule 98, the Exchange proposes keeping current Rule 98 in its rulebook as “Rule 98 (Former)” until such time as all specialist units are approved pursuant to proposed Rule 98(c). Any new entrant to become a specialist unit would be required to comply with proposed Rule 98; current Rule 98 procedures would not be available to new entrants to the specialist business. As proposed, current Rule 98(b) exemptive relief would be available only so long as the member organization and its approved persons have not materially changed their operational structure, internal controls, or compliance and audit procedures. In such case, the current Rule 98, i.e., Rule 98 (Former), would govern the specialist member organization and its approved persons.⁶ Any significant changes to the status quo after

⁶ As discussed in more detail below, in addition to amending Rule 98, the Exchange proposes to amend related rules that reference the current Rule 98 exemptions for approved persons. To ensure that member organizations operating pursuant to Rule 98 (Former) are subject to the appropriate rules, the Exchange proposes to maintain two forms of the related rules: the amended version and an otherwise unchanged version, except for the title “(Former)” added to the unamended version of the rule or, if applicable, the section affected by the proposed rule change. Once all member organizations are subject to the proposed Rule 98, the Exchange will file to delete any “Former” versions of Rule 98 and the related rules or sections.

the effective date of the proposed new rule would require the member organization to apply for approval pursuant to the procedures described below.

The Exchange recognizes that an existing specialist member organization that does not implement structural changes to its operations that would require it to apply for approval under the proposed rule may still need certain relief available under the proposed version of the Rule. Accordingly, the Exchange proposes that a member organization operating pursuant to Rule 98 (Former) may apply for relief pursuant to proposed Rule 98(e), which concerns sharing non-trading related services, without first obtaining approval under other provisions of proposed Rule 98. In such situation, the specialist member organization would need to apply for approval from NYSE Regulation to share non-trading related services, as specified in proposed Rule 98(e). If approved, except for the sharing of non-trading related services, such member organization and its approved persons would continue to be subject to Rule 98 (Former) as well as the “(Former)” versions of NYSE rules that reference exemptions from Rule 98 for approved persons, as discussed in more detail below.

Once approved pursuant to proposed Rule 98 to operate a specialist unit, share non-trading related services, or engage in risk management, any material changes in how a specialist unit operates its business would require the specialist unit to resubmit its revised written policies and procedures to NYSE Regulation for review. For example, if a specialist unit is approved to operate as a stand-alone aggregation unit and would like to change its business operations to include the specialist unit as part of a larger integrated proprietary aggregation unit, as permitted by proposed Rule 98(d), such change would require pre-approval.

2. Proposed Definitions

To ensure clarity, the proposed amendments include a number of defined terms that are applicable throughout the rule. These definitions are designed to provide a level of scalability to the rule so that as the NYSE market model evolves, the definitions used throughout the rule will have common meaning. Among the proposed definitions are:

- “Specialist unit” – this definition is intended to apply to any trading unit that is seeking approval to operate as a specialist at the Exchange. As proposed, a specialist unit could be a stand-alone member organization, an aggregation unit within a member organization, or a trading unit (or “desk”) within a larger aggregation unit. Regardless of which corporate structure a member organization chooses, the term “specialist unit” would refer to the unit that is responsible for specialist activities at the Exchange. If approved pursuant to proposed Rule 98(c), a specialist unit would be eligible for allocations under NYSE Rule 103B and be subject to specialist rules. For purposes of Exchange rules, the term “specialist unit” is synonymous with the term “specialist organization” or “specialist member organization.”
- “Specialist’s account” – this definition refers to any account through which a specialist unit trades at the Exchange. Sometimes referred to as a dealer account, this revised definition would encompass any of the variously-defined accounts that a specialist unit may use to trade at the Exchange.
- “Specialist rules” – this definition refers to those rules that govern specialist conduct or trading at the Exchange. Currently, the specialist rules include, among others, Rules 104, 105, and 113, but as the rules at the Exchange change, these rule designations may change. Accordingly, so that proposed Rule 98 evolves along with changes to other rules, this proposed definition does not identify specific rules.
- “Specialist confidential information” – this definition concerns the principal or proprietary trading activity of a specialist unit at the Exchange in the securities allocated to it pursuant to Rule 103B, including the unit’s positions in those securities, decisions relating to trading or quoting in those securities, and any algorithm or computer system that is responsible for such trading activity and that interface with Exchange systems, such as the specialist application protocol interface (the “specialist API”).⁷ The definition does not include information about non-public order information, as described below.

⁷ The specialist API is the electronic link between specialist trading algorithms and the NYSE Display Book®. Via this interface, specialist organization trading algorithms send quoting and trading messages to the Exchange for

- “Non-public order” – this definition refers to any information relating to order flow at the Exchange, including verbal indications of interest made with an expectation of privacy, electronic order interest, e-quotes, reserve interest, or information about imbalances at the Exchange, that is not publicly-available on a real-time basis via an Exchange-provided datafeed, such as NYSE OpenBook®, or otherwise publicly-available. The definition also encompasses information regarding a reasonably imminent non-public transaction or series of transactions. For example, if in requesting information about the state of the Book, a Floor broker informs the specialist about an order that he or she has, such information would fall under the definition of “non-public order.” As defined, non-public orders include order information at the open, any re-openings, the close, when the security is trading in a slow mode (e.g., in a Gap quote or LRP situation), and any other information in the NYSE Display Book⁸ that is not available via NYSE OpenBook⁹. As proposed, the linchpin to the definition of “non-public order” is that it is information not publicly available on a real-time basis. Currently, specialists have unique access to certain non-public order information. However, in its proposed new market model, the Exchange will be proposing to change the specialist’s access to such non-public order information. The proposed definition is intended to take into consideration such future changes so that as the specialist’s or specialist API’s access to non-public order information changes, so will the specialist unit’s responsibilities to protect that information change, but without having to revise Rule 98.
- “Investment banking department” and “Research department” – these definitions refer to the same departments that are defined as such in NYSE Rule 472 and NASD Rule 2711.
- “Customer-facing department” – this definition is intended to encompass any department, division, market-making desk, aggregation unit, or trading desk that receives, routes, or executes orders for customer execution or clearing accounts, regardless of whether such unit also engages in principal or proprietary trading. A hallmark of this definition is that a customer has an expectation of confidentiality

implementation in the NYSE Display Book®, and the Exchange transmits information necessary to acting as a specialist to specialist organizations.

⁸ The Display Book system is an order management and execution facility. The Display Book system receives and displays orders to the specialists, contains the Book, and provides a mechanism to execute and report transactions and publish results to the Consolidated Tape. The Display Book system is connected to a number of other Exchange systems for the purposes of comparison, surveillance, and reporting information to customers and other market data and national market systems.

⁹ NYSE OpenBook® provides aggregate limit-order volume that has been entered on the Exchange at price points for all NYSE-traded securities.

and best execution on its behalf, which could include a customer that is another broker-dealer. Examples of trading desks that would meet this definition include a Nasdaq market-making desk and most block-trading desks. However, this definition is not intended to include an aggregation unit that solely conducts proprietary trading or proprietary market making (sometimes referred to as electronic market making).

- “Aggregation unit” – this definition adopts the standard of Rule 200(f) of Regulation SHO.¹⁰ The proposed rule uses this term throughout to refer to any department, division, unit, or trading desk that has been segregated pursuant to the requirements of Regulation SHO. The NYSE believes that the Regulation SHO requirements for establishing an aggregation unit, including any requirements for information barriers, would be sufficient for segregating a specialist unit’s operations from the remainder of a member organization or its approved persons.
- “Non-trading related services” – this definition refers to the type of support services that a specialist unit may share with its parent member organization or approved person. The core of the proposed definition is that the type of services are not related to making decisions about the day-to-day trading of the specialist unit or provide trading support to such activity, such as by a trading assistant or specialist clerk. Examples of non-trading related services include stock loan (so long as consistent with Regulation SHO), clearing and settlement, controllers (for financial accounting purposes), technology support, and personnel who develop applications and algorithmic models.
- “Integrated proprietary aggregation unit” – this definition is intended to encompass any aggregation unit that has a trading objective to engage in proprietary trading, including proprietary market-making activities. As defined, an integrated proprietary aggregation unit must not include any activities that would be performed by an investment banking, research, or customer-facing department. Subject to proposed Rule 98(d), a specialist unit could be part of a member organization’s integrated proprietary aggregation unit. Alternatively, an approved person or member organization could maintain an integrated proprietary aggregation unit separate from the specialist unit. In such case, the definition of an integrated proprietary aggregation unit becomes relevant in connection with proposed Rule 98(f)(3) and the ability of an approved person to engage in risk management activities on behalf of the specialist unit of an associated member organization.
- “Related products” – this definition refers to any derivative instrument that is related to a security allocated to a specialist unit. It can include options, warrants, hybrid securities, single-stock futures, security-based swap agreements, a forward contract, or any other contract that is exercisable into or whose price is based upon or derived from a security listed at the Exchange. The list referenced in the

¹⁰ See 17 CFR Part 242.200(f).

definition is not intended to be exhaustive and the definition is intended to cover any existing or future products that could be related to a security listed at the Exchange.

3. Proposed Rule 98(c): Approval to operate a specialist unit

Pursuant to proposed Rule 98(c), a member organization must obtain prior written approval from NYSE Regulation before it can operate a specialist unit. For approval, a specialist unit must demonstrate that it has: (i) adopted and implemented comprehensive written procedures and guidelines governing the conduct and supervision of business handled by the specialist unit; (ii) established a process for regular review of such written policies and procedures; and (iii) implemented controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines.

As proposed, these policies and procedures must be reasonably designed to provide that the specialist unit will maintain the confidentiality of both specialist confidential information and non-public orders. The proposed rule enumerates certain bright-line divisions that the specialist unit must maintain, including information barriers between the specialist unit and investment banking, research, and customer-facing departments and approved persons. Such information barriers should guarantee confidentiality two ways: the specialist unit cannot access material non-public information about securities allocated to that unit from either its approved persons or non-specialist operations of a parent member organization and vice versa.

With respect to a specialist unit's internal controls and surveillances, NYSE Regulation will be reviewing such surveillance plans to determine whether they are reasonably designed to protect information as required under the proposed rule. Where feasible, NYSE Regulation will expect specialist units to use automated surveillances to

check for breaches of the information barriers required by the proposed rule. As with the current rule, NYSE Regulation will also review whether a member organization has implemented internal audit procedures relating to compliance with the proposed Rule 98 policies and procedures.

In addition to the specific information barriers enumerated in the proposed rule, if a member organization proposes to operate a specialist unit as a stand-alone unit, the Exchange proposes importing the requirements of a Regulation SHO independent trading unit for specialist units. Accordingly, as required by Rule 200(f) of Regulation SHO,¹¹ NYSE proposes requiring a specialist unit to have a written plan of organization that specifies its trading objectives and meet all of the other requirements of an independent trading unit under Regulation SHO. If a specialist unit seeks to avail itself of the exemption from NYSE Rule 105 under proposed Rule 98(f)(1), that written plan of organization would need to include its trading objectives for trading in related products.

As with the current rule, proposed Rule 98 would require the specialist unit to maintain net capital sufficient to meet the requirements of NYSE Rule 104.21. The NYSE believes that if a specialist unit is integrated within a larger member organization, the net capital requirement can be met by having the requisite capital amount allocated to the specialist unit by the member organization.

Despite the segregations required by the rule, the NYSE believes that senior managers who are not dedicated to the specialist unit and are associated with either an approved person or a member organization that runs a specialist unit should still be able to provide management oversight to the specialist unit. As proposed, the revised rule is

¹¹ See 17 CFR Part 242.200(f).

not intended to be more restrictive than the current rule, which permits an approved person to provide general oversight over its associated specialist member organization. The proposed rule instead shifts from a detailed list of specific types of oversight that is permissible to a principle-based approach that focuses on protecting specialist confidential information and non-public order information. As with the current rule, as proposed, senior management oversight of a specialist unit should not conflict with or compromise in any way with the specialist unit's market-making obligations.

Proposed Rule 98(c)(2)(E) provides guidance on how a member organization or approved person should handle situations where a senior manager is called upon for risk management purposes and in connection with that role, gains access to specialist confidential information or non-public order information. The Exchange notes that non-public order information could become stale if the order is executed or cancelled without the specialist's knowledge. To ensure that there is no misuse of such information, whether material or not, the senior manager must not make (directly or indirectly) specialist confidential information or non-public order information available to the persons or systems responsible for making trading decisions in aggregation units, departments, divisions, or trading desks that are not part of the specialist unit, including the customer-facing departments. The senior manager also must not use such information to directly or indirectly influence the day-to-day trading decisions of the other aggregation units of the member organization or approved person with respect to the securities allocated to the specialist unit.

The NYSE believes that these restrictions on the use of specialist confidential information and non-public order information are similar to how broker-dealers currently

handle situations where a senior manager has oversight over multiple aggregation units and in such capacity, becomes privy to confidential information of one aggregation unit. For such situations, broker-dealers have already developed procedures for protecting confidential information and the NYSE believes that such procedures should be reasonable for the oversight of a specialist unit as well.

The Exchange notes that although the proposed amendments to Rule 98 eliminate the exemption process under current Rule 98(b), the review that NYSE Regulation would conduct when approving a specialist unit would be as rigorous as the current review for obtaining an exemption, just simply a different focus of what is reviewed. As with the current Rule 98 exemption process, staff from both the Market Surveillance Division of NYSE Regulation as well as relevant staff from the Financial Industry Regulatory Authority, Inc. (“FINRA”) who are responsible for the routine examinations of specialist units would be involved in reviewing a specialist unit’s written policies and procedures and proposed automated surveillances and controls.¹²

For existing specialist firms, the initial approval process associated with any changes to how they operate may require upfront work to ensure that the specialist unit’s policies and procedures are reasonably designed to meet the requirements of the proposed rule. However, unlike the current rule, as proposed, specialist units would be relieved of

¹² In connection with the July 2007 transfer of certain member firm regulation functions from NYSE Regulation to FINRA, NYSE Regulation and FINRA entered into a regulatory services agreement (“RSA”) whereby FINRA agreed to provide NYSE Regulation with certain services relating to NYSE’s retained responsibilities to examine for compliance with NYSE rules that govern trading on or through the systems and facilities of the Exchange. In particular, pursuant to the RSA, FINRA participates in the current Rule 98(b) exemption process and examines specialist firms for compliances with that rule. As proposed, FINRA would continue to participate in the approval process under the proposed Rule 98 and examine specialist units for compliance with the rule.

the requirement to update any written statements to the Exchange for changes in approved persons or dually-affiliated employees. Once approved, NYSE Regulation and FINRA would examine whether a specialist unit's policies and procedures continue to meet the rule requirements and whether the implemented controls and automated surveillances are functioning as designed. As part of such examination review, NYSE Regulation and FINRA will conduct on-site reviews of a specialist unit to review for breaches of the controls or surveillances. And, as noted above, if the specialist unit proposes making any material changes to its operations, it would need to seek additional approval before it can change its operations.

4. Proposed Rule 98(d): Operating a Specialist Unit Within an Integrated Proprietary Unit

One of the goals of proposed Rule 98 is to provide a member organization with greater flexibility in how it manages the risk of a specialist unit. As discussed below, in proposed Rule 98(f), the NYSE proposes providing member organizations with an array of options of how to conduct risk management. The NYSE believes that the flexibility afforded by these options will meet the varying business models of the member organizations currently operating or seeking to operate a specialist unit at the Exchange.

As discussed in more detail below, one proposed risk management model would be to permit a member organization to integrate a specialist unit within a larger aggregation unit that meets the requirements of an integrated proprietary aggregation unit. Proposed Rule 98(d) sets forth the minimum requirements for how to structure such an integrated unit. While such a unit would be considered a single aggregation unit for Regulation SHO purposes, as proposed, the member organization would need to establish information barriers within the integrated proprietary aggregation unit to restrict access to

non-public order information to the specialist unit only. And depending on the risk management model proposed by a specialist unit, a member organization or approved person may need to further segregate the flow of information within a specialist unit.

As proposed, the specialist unit that would operate within the integrated proprietary aggregation unit would need to meet the requirements of proposed Rule 98(c)(2)(A), (C), (D), and (E) of the rule, which concern the information barriers associated with the specialist unit and non-specialist unit operations, net capital requirements, and senior management oversight. Because an integrated proprietary aggregation unit that includes a specialist unit would likely already be subject to Rule 200(f) of Regulation SHO that it qualify as an independent trading unit, the specialist unit operating within the integrated proprietary aggregation unit would not need to separately meet the Rule 200(f) requirement for an independent trading unit. Accordingly, as proposed, a specialist unit that operates within an integrated proprietary aggregation unit would not need to meet the requirements of proposed Rule 98(c)(2)(B), which requires a specialist unit to separately comply with all of the Regulation SHO independent trading unit requirements.¹³

In addition to meeting certain requirements of proposed Rule 98(c), under proposed Rule 98(d)(2)(B), the specialist unit must restrict access to non-public order information or specialist confidential information from the rest of the integrated proprietary aggregation unit. Such information barriers must ensure that both individuals

¹³ The Exchange recognizes that there may be some Regulation SHO issues in connection with how a member organization may choose to structure its specialist unit within an integrated proprietary aggregation unit or provide risk management to the specialist unit pursuant to proposed Rule 98(f). In such case, approval to operate under proposed Rule 98 would not be provided until all Regulation SHO issues that may arise have been resolved.

and systems that are not assigned to the specialist unit do not have access to non-public order information, or, unless otherwise provided for in proposed Rule 98(f), specialist confidential information.

The NYSE believes that as proposed, Rule 98(d)(2)(B) provides sufficient flexibility for how a member organization structures its operations to evolve as the NYSE market model changes. For example, the specialist API currently has access to limited non-public order information, but does not have access to information available in the NYSE Display Book. So long as the specialist API has access to that non-public order information, the Exchange believes that systems not dedicated to the specialist unit should not be integrated with the specialist API. Accordingly, the trading algorithms of the integrated proprietary aggregation unit that are not dedicated to the specialist unit would not have access to any non-public order information via the specialist API, or any other system.

Proposed Rule 98(d)(2)(B)(iii) addresses the situation of communications from the Floor of the Exchange to the rest of the integrated proprietary aggregation unit. Currently, specialist unit employees on the Floor of the Exchange have access to non-public order information, whether via access to information in the Display Book® or because of verbal representations of imminent orders. The NYSE believes that the best way to ensure that such information is not provided to individuals or systems not dedicated to the specialist unit is to restrict communications while the employee is still on the Floor of the Exchange.

Proposed Rule 98(d)(2)(B)(iv) considers the possibility that an individual who works on the Floor of the Exchange¹⁴ may also, on an intra-day basis, move to an off-Floor location and engage in a non-specialist related role within the integrated proprietary aggregation unit pursuant to proposed Rule 98(d) or for an “upstairs” desk trading in related products within the specialist unit pursuant to proposed Rule 98(f)(1). In such case, the individual must not make any non-public order information or, unless specifically provided for, specialist confidential information, available to individuals or systems that are not dedicated to the specialist unit. Nor may that individual use such non-public information, or, except as provided for in the Rule, specialist confidential information, in any way in connection with responsibilities that are not related to Floor-based activities of the specialist unit. For purposes of proposed Rule 98(f)(1), once off the Floor, a specialist may not use non-public information to directly or indirectly trade in related products. However, nothing in the rule bars a specialist unit from moving personnel among different positions intraday, so long as the restrictions on information flow and use are followed. The NYSE believes that this would provide member organizations with sufficient flexibility to transfer its employees among various roles, including on the Floor of the Exchange and in a specialist unit upstairs location during a given trading day. For intra-day transfers, the Exchange will expect specialist units to have written policies and procedures reasonably designed to ensure that non-public order information and specialist confidential information (unless otherwise permitted) would

¹⁴ Note that NYSE rules define being on the Floor to include the trading Floor of the Exchange, and the premises immediately adjacent thereto, such as the various entrances and lobbies of 11 Wall Street, 18 New Street, 12 Broad Street, and 18 Broad Street, as well as the telephone lobby in the first basement of 11 Wall Street. See Rule 112(b).

not be used from an off-Floor location. The Exchange notes that in addition to the information barriers required by proposed Rule 98, specialists must continue to abide by Exchange rules that govern their access to and use of non-public order information.¹⁵

As noted above, an integrated proprietary aggregation unit would need to qualify as an aggregation unit, which for Regulation SHO purposes, requires the unit to net its positions. While the proposed rule would no longer require separate books and records for a specialist unit, to ensure that NYSE Regulation can review the trading activity by the specialist unit at the Exchange without having to parse through commingled records, under proposed Rule 98(d)(2)(C), in addition to meeting Regulation SHO requirements, an integrated proprietary aggregation unit must maintain records of its specialist's accounts in a manner that is separate from the accounts of the integrated proprietary aggregation unit.¹⁶

In addition to the above, the integrated proprietary aggregation unit must have written policies and procedures that address how it will ensure that the unit will not engage in any activities that could violate other Exchange rules or federal securities laws and regulations, including Regulation SHO. The policies and procedures must address, at a minimum, how the unit will ensure against front running, wash sales, and market manipulation.

In connection with wash sales, a potential concern for an integrated proprietary aggregation unit is the possibility that the specialist unit could be selling (buying) one of the securities registered to it and an individual or trading system of the integrated

¹⁵ See, e.g., NYSE Rules 70.20(h)(ii), 104(b), 115, and 115A.

¹⁶ The Exchange is engaging in a separate discussion with Commission staff of the Regulation SHO implications of requiring a specialist unit to separately aggregate its trading positions for purposes of Exchange rules.

proprietary aggregation unit could at the same time be buying (selling) that same security at the Exchange. With the proper use of mnemonics associated with those orders, Exchange systems are capable of rejecting one side of those orders. Because the presumption would be in favor of the specialist unit trading, i.e., to meet its affirmative obligations at the Exchange, the NYSE proposes rejecting the order from the integrated proprietary aggregation unit.

The NYSE also proposes that to the extent an integrated proprietary aggregation unit directs its trading at the Exchange in any security that has been allocated to the specialist unit through the specialist unit, such trading would be subject to the specialist rules. In other words, while the specialist unit would be subject to certain market-making obligations while trading at the Exchange, the integrated proprietary aggregation unit's independent "upstairs" operations would be able to trade freely.

Finally, to ensure that NYSE Regulation can review the trading activities of the integrated proprietary aggregation unit, proposed Rule 98(d)(4) requires member organizations to maintain audit trail information for any trading by such unit, including trading at the Exchange and at other market centers. The NYSE proposes to amend NYSE Rule 132B to have the Order Tracking System ("OTS") requirements apply to trading by a specialist unit, and if applicable, an integrated proprietary aggregation unit. Member organizations must maintain sufficient records to reconstruct in a time-sequenced manner its trading in securities allocated to the specialist unit and any trading by the integrated proprietary aggregation unit in those securities in other market centers or trading in related products.

As with the approval process under proposed Rule 98(c), to obtain approval to operate a specialist unit within an integrated proprietary aggregation unit, a member organization would need to submit its written policies and procedures to NYSE Regulation for review of whether such policies and procedures are reasonably designed to meet the rule requirements. Once approved under proposed Rule 98(d), NYSE Regulation and FINRA would continue to examine whether a specialist unit's policies and procedures continue to meet the rule requirements and whether the implemented controls and surveillances plans are functioning as designed.

5. Proposed Rule 98(e): Sharing Non-Trading Related Services

One of the restrictions of current Rule 98 is the limit on a specialist member organization and its approved persons to share operational support personnel. In its current form, Rule 98(c) permits dual affiliation only if the specialist member organization and approved person provide the Exchange with a written statement of the duties of such person and why it is necessary for the individual to have a dual affiliation. Any changes to dual affiliations must be submitted to the Exchange for approval in advance of making such change.

The NYSE believes that current Rule 98(c) unnecessarily restricts the ability of a specialist member organization and its approved person to share non-trading related services, i.e., operational support services. Accordingly, the NYSE proposes amending Rule 98 to permit the sharing of non-trading related services, subject to the approval of NYSE Regulation.

As with the approval process to become a specialist unit, the approval process for a specialist unit to share non-trading related services with its parent member organization

or approved person would require the specialist unit to: (1) adopt written policies and procedures governing the sharing or non-trading related services; (2) establish a process for regular review of such written policies and procedures; and (3) implement controls and surveillances reasonably designed to prevent and detect violations of those policies and procedures. In accordance with the purpose of Rule 98, such policies and procedures must be reasonably designed to protect specialist confidential information and non-public order information.

The NYSE understands that personnel or systems that provide non-trading related services may have access to specialist confidential information or non-public order information. For example, clearance and settlement services would have knowledge of specialist positions in securities, and technological support personnel may have knowledge of how a specialist algorithm conducts its trading. However, access to such information should not be the basis for restricting the sharing of such personnel or systems. Rather, such personnel or systems can be shared so long as the specialist unit has controls reasonably designed to ensure that the individuals or systems who have access to specialist confidential information or non-public information neither provide nor make available that information to any individuals or systems not part of the specialist unit. In particular, under no circumstances should non-public order information or specialist confidential information be made available to the investment banking, research, or customer-facing departments.

Before a specialist unit can share non-trading related services, NYSE Regulation will review whether the specialist unit has adopted policies and procedures and controls and surveillances reasonably designed to protect specialist confidential information and

non-public order information. Once approved, a specialist unit would no longer need to provide NYSE Regulation with a written statement of why a certain individual has a dual affiliation and update such written statements if the individual involved changes. On an ongoing basis, NYSE Regulation and FINRA will examine whether the specialist unit's policies and procedures and controls comply with the requirements of the rule.

6. Proposed Rule 98(f): Risk Management

Specialist member organizations and their approved persons are currently limited in their ability to manage the specialist member organization's trading risks: Rule 98 currently restricts an approved person from being involved in any trading decisions of an associated specialist member organization; Rule 105 currently restricts the specialist member organization's ability to trade in options and single-stock futures related to the securities allocated to the specialist member organization. Together, these restrictions place specialist member organizations at a competitive disadvantage vis-à-vis other market-making or trading firms.

The NYSE believes that the changes to the marketplace that have occurred since 1987, when Rule 98 was adopted, call for an overhaul of how specialist units are permitted to manage their risk. For example, when Rule 98 was adopted, the NYSE enjoyed an approximately 85% market share in trading of NYSE-listed securities and specialists participated in approximately 12% of the transactions at the Exchange. Now, the NYSE's market share for listed securities hovers under 40%, and of that, specialist participation is in the range of two percent. These numbers are telling: because of automatic executions at the Exchange, specialists no longer have a unique advantage over other market participants. To the contrary, specialists are now at a disadvantage to other

market participants because they must meet their affirmative and negative obligations to the Exchange, yet cannot participate in the type of hedging activities that other market participants may and can do.

Accordingly, the Exchange proposes providing specialist units with the ability to manage their risks by broadening the ability to trade in related products and expanding the universe of who may be involved in managing the risk of the specialist unit. Because there is no single correct model for risk management, the NYSE proposes providing specialist units with options of how to manage their risk, which they can choose to use in combination or alone. Regardless of which model a specialist unit proposes to adopt for risk management, at all times, the specialist unit will be ultimately responsible for its quoting or trading decisions at the Exchange.

a. Specialist Unit Risk Management

In order to provide a specialist unit with greater risk management tools, the NYSE proposes permitting specialist units to apply for an exemption from the Rule 105(b)-(d) restrictions on trading options and single-stock futures. In connection with this change, the NYSE proposes amending Rule 105 so that it applies only to a specialist unit, and not to any other departments or units of a member organization or approved person. If approved for an exemption from Rule 105, a specialist unit would be permitted to trade in related products, subject to proposed Rule 98(f)(1).¹⁷

¹⁷ The Exchange also proposes amending section (m) of the Rule 105 Guidelines to provide that a specialist unit is not permitted to engage in market-making activities in single-stock futures or options. However, if eligible for an exemption under Rule 105(b)-(d), nothing restricts a specialist unit from having a trading desk that trades in options or single-stock futures. Because an integrated proprietary aggregation unit that includes a specialist unit may engage in options market making, the Exchange proposes eliminating sections (m)(ii) and (iii) of the

As proposed, to obtain an exemption from Rule 105, the specialist unit must: (i) adopt and implement comprehensive written procedures and guidelines governing the conduct of trading in related products; (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines.

These policies and procedures must be reasonably designed to ensure that the individuals or systems responsible for trading related products do not have access to non-public order information, or, unless otherwise specifically provided for, specialist confidential information. In addition, individuals who work on the Floor of the Exchange would not be permitted to trade or direct trading in related products, nor would the specialist API be permitted to make any trading decisions in related products.

Accordingly, any trading in related products by the specialist unit must be conducted by an off-Floor, i.e., “upstairs” office. All trading in related products must be conducted by individuals who are qualified and registered to trade in the marketplaces where such trading occurs. Moreover, the member organization that houses the specialist unit must be a member of FINRA or other self-regulatory organizations, as required by each marketplace where the specialist unit proposes to trade.

The NYSE believes that a specialist unit should have the flexibility to transfer its employees among different functions within the unit. Accordingly, the proposed rule does not expressly prohibit specialists from trading in related products; it only bars directly entering or executing trades in related products while on the Floor of the

Exchange.¹⁸ As proposed, a specialist unit could transfer a specialist back and forth from the Floor of the Exchange to a specialist unit upstairs desk that trades in related products, so long as that specialist is registered and qualified to trade in related products and non-public order information is not used when trading in related products. In such case, however, a specialist unit must have policies and procedures reasonably designed to ensure that a specialist who moves off the Floor of the Exchange does not make available or use any non-public information or, unless otherwise specified, specialist confidential information, to which the specialist may have had access while on the Floor of the Exchange. As noted above, while off the Floor of the Exchange, specialists continue to be subject to other NYSE rules that govern their access to and use of non-public order information.

To ensure that the specialist unit upstairs desk that trades in related products can effectively hedge the specialist unit's positions, the NYSE proposes that the specialist unit upstairs desk have electronic access to the trades by the specialist unit at the Exchange in securities allocated to the specialist unit that have been printed to the Consolidated Tape.

Currently, senior managers of specialist member organizations can be privy to information about trading on the Floor of the Exchange as well as any hedging conducted by the specialist member organization, even though such hedging opportunities are limited. For example, currently, a specialist on the Floor can call his or her senior manager to discuss hedging strategies. Under the proposed exemption from Rule 105,

¹⁸ The Exchange notes that a specialist unit that has not been approved for an exemption from Rule 105 under proposed Rule 98(f)(1) would still be permitted to enter orders in options or single-stock futures from the Floor, subject to the requirements of Rule 105.

the NYSE believes that specialist unit senior managers should be able to continue in that role and provide oversight of both Floor specialist operations and any specialist unit upstairs trading in related products. The NYSE believes that the oversight model that works for larger broker-dealers, whose senior managers have a role with respect to multiple aggregation units, should apply within a specialist unit as well.

Accordingly, the NYSE proposes Rule 98(f)(1)(v) to address how a senior manager of a specialist unit should handle situations where he or she has access to non-public order information in connection with his or her role as a senior manager. As with proposed Rule 98(c)(2)(E), when trading in related products, the specialist unit must have policies and procedures reasonably designed to ensure that the specialist unit senior manager who has access to non-public order information does not provide such information to the specialist unit upstairs trading desk responsible for trading related products or use such non-public information to directly or indirectly influence trading by that upstairs desk.

b. Integrated Proprietary Aggregation Unit Risk Management

Proposed Rule 98(f)(2) addresses how an integrated proprietary aggregation unit that has been approved pursuant to proposed Rule 98(d) to include a specialist unit could engage in risk management of the specialist unit's positions. At a minimum, an integrated proprietary aggregation unit must have policies and procedures that are reasonably designed to meet the protections enumerated in the rule, including how it trades in related products on behalf of a specialist unit and how it electronically accesses the specialist unit's trades at the Exchange in securities allocated to the specialist unit that have been printed to the Consolidated Tape.

In addition, proposed Rule 98(f)(2)(v) would permit an integrated proprietary aggregation unit to send appetites of trading or quoting direction to the specialist unit. In practice, this would permit a non-specialist unit “upstairs” risk management desk that has real-time access both to the specialist unit’s positions in securities allocated to it and to the integrated proprietary aggregation unit’s positions in related products and other securities to provide electronic direction to the specialist unit of whether to trade or quote in a certain direction. The Exchange believes that permitting an integrated proprietary aggregation unit to send quoting messages that are based on real-time positions of the unit as a whole will enable a specialist unit to better meet any quoting requirements at the Exchange. In other words, the specialist unit will no longer need to operate in a vacuum when determining how or when to quote at the Exchange.

As proposed, the specialist unit would be ultimately responsible for whether to accept the electronic trading direction submitted by the integrated proprietary aggregation unit upstairs desk; a specialist unit must comply at all times with its market-marking obligations, including the specialist rules, notwithstanding any electronic trading directions received from that upstairs desk. Stated otherwise, the specialist unit would operate independently and be free to accept or reject the electronic trading directions sent by the integrated proprietary aggregation unit. However, to the extent an integrated proprietary aggregation unit causes a specialist unit to violate one or more of the specialist rules, the Exchange proposes that in such case, the integrated proprietary aggregation unit should also be held to those standards.

At this time, as noted above, because of access to non-public order information, the NYSE does not believe it would be feasible to permit communications, whether

verbal or electronic, from the specialist or the specialist API to the individuals or systems responsible for trading in related products and other securities within the integrated proprietary aggregation unit, or, if applicable, to an upstairs desk within the specialist unit. However, as the NYSE market model evolves, the NYSE will continue to review how best to integrate a specialist unit within an integrated proprietary aggregation unit, including the possibility of fully integrating the trading systems that interact with the Exchange for the specialist unit and the trading systems that trade in related products and other securities. The NYSE believes that ultimately, a competitive trading model would permit full integration, including permitting two-way communications among trading desks.

c. Approved Person Risk Management

As proposed, another option available to firms to manage the risk of the specialist unit is to permit a separate integrated proprietary aggregation unit that is housed in either an approved person or a member organization that runs a specialist unit to provide the same level of risk management as proposed for an integrated proprietary aggregation unit that includes a specialist unit. This option would provide flexibility for broker-dealers that want to keep the specialist unit as a separate member organization or aggregation unit, yet still have an approved person or separate aggregation unit provide risk management services for the specialist unit.

As with proposed Rule 98(f)(2), proposed Rule 98(f)(3) would require that the approved person not have access to either specialist confidential information and non-public order information, except as provided for in that section of the rule. Specifically, an integrated proprietary aggregation unit of an approved person could have access to the

trades by a specialist unit at the Exchange in securities allocated to that unit, so long as such trades have been printed to the Consolidated Tape.

And as with proposed Rule 98(f)(2), an approved person could send electronic appetites of how the specialist unit should trade or quote in its allocated securities. As discussed above, a specialist unit would be free to reject or accept such electronic directions as it sees fit to meet its market-making obligations at the Exchange.

The Exchange notes that an approved person that provides risk management under this proposed section may not itself be an NYSE member organization. In such case, the individuals at the approved person responsible for making risk management decisions on behalf of the specialist unit should be dually employed by the specialist unit that is part of an NYSE member organization and the approved person so that they are subject to the jurisdiction of NYSE Regulation.

7. Proposed Rule 98(g): Failure to Maintain Confidentiality, Reporting Obligations, and Breaches

The NYSE proposes to keep certain provisions of current Rule 98, but adjust them to reflect the changes to the rest of the rule. In particular, current Rule 98(i) has been amended and is included in proposed Rule 98(g); current Rule 98(j) has been amended and is included in proposed Rule 98(h); and, current Rule 98(k) has been amended and is included in proposed Rule 98(i).

Under proposed Rule 98(g), as with the current rule, if a specialist becomes aware of non-public material information from its approved person or parent member organization, such specialist may have to cease acting as a specialist in the security involved, which was formerly referred to as “giving up the Book.” The proposed rule

does not change how such determinations would be made. However, the proposed rule updates the language of the rule and separates the rule into easier-to-read subsections.

Under proposed Rule 98(h), the NYSE proposes adding to the existing reporting obligations that a specialist unit must report any actual breaches or internal investigations of possible breaches of the information barriers required by the rule. The reporting obligation for internal investigations is intended to be similar in effect to the reporting obligation pursuant to NYSE Rules 351(e) and 342.21. In particular, under proposed Rule 98(h)(4), a specialist unit will be required to conduct an internal investigation into any trading activity that may be a result of a breach of the information barriers required by proposed Rules 98(c), (d), (e), and (f). On a quarterly basis, a specialist unit must report in writing to NYSE Regulation whether it has commenced such an internal investigation, the quarterly progress of any open investigations, what remedial measures, if any, were taken, and the completion of any internal investigation, including the methodology and results of such investigation, any internal disciplinary action taken, and any referral of the matter to the NYSE, another self-regulatory organization, or the Commission.

Finally, as with the current rule, proposed Rule 98(i) provides that any breach of the proposed Rule could result in disciplinary action, including the withdrawal of one or more securities allocated to the specialist unit or withdrawal of approval to operate a specialist unit. The Exchange notes that as with the current rule, any trading by any person while in possession of material, non-public information received as a result of any breach of internal controls required by proposed Rule 98 may violate Rule 10b-5 of the

Act,¹⁹ Rule 14e-3 of the Act,²⁰ NYSE Rule 104, just and equitable principles of trade or one or more provisions of the Act, or regulations thereunder or rules of the Exchange. The Exchange intends to review carefully any such trading of which it becomes aware with a view towards determining whether any such violation has occurred.

C. Proposed Amendments to Related Rules

As noted above, because of the shift in paradigm away from approved persons, the NYSE proposes amending those NYSE rules that refer to approved persons and the need for an exemption from Rule 98.

1. Proposed Amendments to Rule 98A

NYSE Rule 98A requires approved persons to agree in writing not to cause a specialist or odd-lot dealer to violate rules applicable to the specialist or odd-lot dealer. The rule further requires that approved persons report to the Exchange any off-Floor orders for securities in which an associated specialist member organization specializes for any account in which the approved person has a direct or indirect interest.

Because of the proposed changes to Rule 98, and in particular, the recognition that an appropriately walled-off specialist unit ameliorates the need to scrutinize the trading by an approved person, the NYSE proposes eliminating those portions of Rule 98A that concern approved persons. However, the NYSE would keep the limitation on an issuer, or a partner or subsidiary thereof, from becoming an approved person of a specialist unit.

¹⁹ See 17 CFR Part 240.10b-5.

²⁰ See 17 CFR Part 240.14e-3.

2. Proposed Amendments to Rules 99, 102, 103B, 104, and 113

In their current form, NYSE Rules 99, 103B, 104, and 113 specifically apply to approved persons, unless such approved person has obtained an exemption under Rule 98. To ensure consistency among NYSE rules, and in particular, to ensure that the revised paradigm of proposed Rule 98 is consistently applied, the NYSE proposes to amend Rules 99, 103B, 104, and 113 to eliminate the references to approved persons.²¹

In addition, the Exchange proposes to delete Rule 102, which concerns trading in options by odd-lot dealers. Because the Exchange no longer has separate odd-lot dealers and all specialists are also responsible for odd-lot trading in securities in which they are registered, there is no need for a separate rule governing trading in related products by an odd-lot dealer. Accordingly, because Rule 102 is duplicative of the standards set forth in proposed Rules 98 and 105, the Exchange proposes deleting that rule.

3. Proposed Amendments to Rule 460

In addition to amending Rule 460 to ensure consistent application of proposed Rule 98 and making other non-substantive changes, the NYSE proposes eliminating Rule 460.20 that approved persons of specialist member organizations be held to any limits on beneficial ownership of any equity security in which an associated specialist unit is registered. Instead, as proposed, any limitations on beneficial ownership should apply only to the specialist unit that has been approved pursuant to proposed Rule 98, and not to any other aggregation unit or other department or division of the member organization.

²¹ For the period of time that the current Rule 98 stays in the NYSE Rules as “NYSE Rule 98 (Former),” each of NYSE Rules 99, 103B, 104, and 113 will have two forms: one to meet the requirements of NYSE Rule 98 (Former) and one to meet the requirements of proposed Rule 98. The version of the rules that relate to Rule 98 (Former) will be similarly designated with the “(Former)” title either for the entire rule, or for a section of a rule, as appropriate.

With respect to the specialist unit's beneficial ownership of outstanding shares of securities allocated to such unit, the NYSE proposes to amend NYSE Rule 460.10 to require that a specialist unit report when its beneficial ownership of outstanding shares exceeds 5% and to update such report if the beneficial ownership either falls below 5% or exceeds 10%. The NYSE thus proposes to eliminate the requirement that a specialist unit seek NYSE Regulation approval before it may have more than 10% beneficial ownership of a listed security. The NYSE believes that because of the reduced market share of the NYSE and the limited impact of specialist trading on securities allocated to a specialist unit, the protections of the existing rule are no longer necessary. However, the NYSE proposes retaining the prohibition on a specialist unit having beneficial ownership of more than 25% of the outstanding shares in a security allocated to such unit. Because the changes to the marketplace are in effect now, the Exchange believes that the changes to Rule 460 should be implemented notwithstanding whether a specialist member organization continues to operate under Rule 98 (Former). Accordingly, the Exchange proposes having a single version of Rule 460 to reflect the proposed amendments.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with and furthers the objectives of Section 6(b)(5) of the Act,²² in that it is designed to prevent fraudulent and manipulative acts and practices, 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.

²² 15 U.S.C. 78f(b)(5).

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

II. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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 Number SR-NYSE-2008-45 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSE-2008-45. 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 Section, 100 F Street, NE, Washington, DC 20549-1090. Copies of the filing will also be available for inspection and copying at the NYSE's principal office and on its Internet Web site at www.nyse.com. 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-2008-45 and should be submitted on or before [insert date 21 days from publication in the Federal Register

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²³

Florence E. Harmon
Acting Secretary

²³ 17 CFR 200.30-3(a)(12).

Additions: Underscored

Deletions: [Bracketed]

Rule 98 – Operation of a Specialist Unit

(a) Applicability

- (1) Unless a member organization and its approved persons are subject to Rule 98 (Former), the provisions of this rule shall apply to all member organizations seeking to operate a specialist unit at the Exchange.

(b) Definitions

For purposes of this Rule, the following terms shall be defined as provided.

- (1) “Specialist” means any individual qualified to act as a specialist on the Floor of the Exchange, as defined in Rule 103.
- (2) “Specialist unit” means any member organization, aggregation unit within a member organization, or division or department within an integrated proprietary aggregation unit of a member organization that (i) has been approved by NYSE Regulation pursuant to section (c) of this Rule, (ii) is eligible for allocations under Rule 103B as a specialist in a security listed on the Exchange, and (iii) has met all registration and qualification requirements for specialists assigned to such unit. For purposes of Exchange rules and notwithstanding the foregoing, the term “specialist unit” shall be interchangeable with the terms “specialist organization” or “specialist member organization.”
- (3) “Specialist API” refers to any algorithmic system used by a specialist unit to generate quoting or trading messages for the specialist’s account that are delivered to the Exchange-provided trading platform, commonly referred to as “Display Book®” via an external quote application programmed interface (“API”) pursuant to Rule 104.
- (4) “Specialist’s account” means any account through which a specialist unit quotes or trades at the Exchange in securities allocated to it pursuant to Rule 103B.
- (5) “Specialist rules” means any rules that govern specialist conduct or trading.
- (6) “Specialist confidential information” means any non-public information relating to a specialist unit’s trading or quoting in securities allocated to that

specialist pursuant to Rule 103B, including positions or any other indication of a specialist's trading or quoting interest in securities allocated to such specialist, the specialist API, or any other non-public information relating to a specialist's interactions with a security allocated to such specialist, but not including non-public order information.

- (7) “Non-public order” means any order, whether expressed electronically or verbally, or any information regarding a reasonably imminent non-public transaction or series of transactions entered or intended for entry or execution on the Exchange and which is not publicly available on a real-time basis via an Exchange-provided datafeed, such as NYSE OpenBook® or otherwise not publicly available. Non-public orders include order information at the opening, re-openings, the close, when the security is trading in slow mode, and order information in the NYSE Display Book® that is not available via NYSE OpenBook®.
- (8) “Investment banking department” means any department or division, whether or not specifically identified as such, that performs any investment banking services on behalf of a member organization.
- (9) “Research department” means any department or division, whether or not specifically identified as such, that is responsible for preparing the substance of a research report on behalf of a member organization.
- (10) “Customer-facing department” means any trading or market-making department, division, aggregation unit, or desk that receives, routes, or executes orders for its own customers or customers of another broker-dealer or clearing accounts.
- (11) “Aggregation unit” means any trading or market-making department, division, or desk that meets the requirements of the definition of an “independent trading unit” pursuant to Rule 200 of Regulation SHO, 17 CFR Part 242.200(f).
- (12) “Approved person” means any person who controls a member organization, or who engages in a securities or kindred business and is controlled by or under common control with a member organization but is not a member or allied member or an employee of a member organization, as defined in Rule 304.
- (13) “Non-trading related services” means those persons or systems that provide support services to a trading or market-making department, division, aggregation unit, or desk, including a specialist unit, but that are not involved with day-to-day trading decisions.
- (14) “Integrated proprietary aggregation unit” means an aggregation unit of a member organization or approved person with a trading objective to engage in proprietary trading, including market-making activities. An integrated

proprietary aggregation unit must be separate from any department or division that engages in the activities of an investment banking, research, or customer-facing department. Subject to section (d) of this Rule, a specialist unit may be part of an integrated proprietary aggregation unit.

- (15) “Related products” means any derivative instrument that is related to a security allocated to a specialist unit, including options, warrants, hybrid securities, single-stock futures, security-based swap agreement, a forward contract, or any other instrument that is exercisable into or whose price is based upon or derived from a security listed at the Exchange.

(c) Approval to operate a specialist unit.

- (1) A member organization will be permitted to operate a specialist unit provided that the member organization has obtained prior written approval from NYSE Regulation, Inc. (“NYSE Regulation”).
- (2) A member organization seeking approval to operate a specialist unit pursuant to this Rule must (i) adopt and implement comprehensive written procedures and guidelines governing the conduct and supervision of business handled by such unit; (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines. At a minimum, such policies and procedures shall be reasonably designed in accordance with the following.
- (A) Unless otherwise specified in this Rule, the specialist unit shall maintain the confidentiality of both specialist confidential information and non-public orders.
- (i) A member organization’s departments, divisions, or aggregation units not part of the specialist unit, including investment banking, research, and customer-facing departments, shall not have access to specialist confidential information or non-public order information.
- (ii) Approved persons shall not have access to specialist confidential information or non-public order information. Notwithstanding this restriction, a specialist may make available to a Floor broker associated or affiliated with an approved person or member organization any information that the specialist would be permitted to provide under Exchange rules to an unaffiliated Floor broker.
- (B) Except as provided in paragraph (d) of this Rule, the specialist unit shall comply with all of the requirements of an aggregation unit.
- (C) The specialist unit shall not have access to material non-public information that is in the possession of aggregation units of the member organization or the approved person that do not include the specialist

unit and that is related to a security allocated to the specialist unit, including (i) information relating to investment banking or research activity by the member organization or approved person; (ii) information relating to trading by customer-facing departments; and (iii) information relating to positions held by aggregation units that do not include the specialist unit.

- (D) The specialist unit shall maintain or have allocated to it net capital sufficient to meet the requirements of Rule 104.21.
- (E) Senior managers of the member organization or approved person who are not assigned solely to the specialist unit may provide management oversight of the specialist unit provided that any such management oversight does not conflict with or compromise in any way the specialist unit from complying with the specialist rules.

(i) For purposes of risk management, senior managers of a member organization or approved person who are not assigned to the specialist unit may have access to specialist confidential information or non-public orders provided that upon receipt of such information, the senior manager (1) does not make such information available to the individuals or systems responsible for the day-to-day trading decisions of other aggregation units at the member organization or approved person, and (2) does not use such information to directly or indirectly influence the day-to-day trading decisions of the other aggregation units of the member organization or approved person with respect to the securities allocated to the specialist unit for which the senior manager has specialist confidential information or non-public order information.

(ii) Except as provided for in this Rule, no specialist may be directly supervised or controlled by an individual associated with an approved person or the member organization who is assigned to any investment banking, research, or customer-facing departments.

- (3) If a member organization is approved to operate a specialist unit under this Rule, the specialist rules will apply only to trading at the Exchange by the specialist unit in the securities allocated to the specialist unit.

(d) Approval to operate a specialist unit within an integrated proprietary aggregation unit.

(1) Notwithstanding any provision of this Rule to the contrary, a member organization will be permitted to operate a specialist unit within an integrated proprietary aggregation unit, provided that the member organization has obtained prior written approval from NYSE Regulation.

(2) A member organization seeking approval to operate a specialist unit within an integrated proprietary aggregation unit pursuant to this Rule must (i) adopt

and implement comprehensive written procedures and guidelines governing the conduct and supervision of business handled by such unit; (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines. At a minimum, such policies and procedures shall be reasonably designed in accordance with the following.

- (A) Unless otherwise provided in this Rule, the specialist unit shall meet the requirements set forth in section (c)(2)(A), (C), (D), and (E) of this Rule.
 - (B) The specialist unit shall restrict access to non-public order information by other areas of the integrated proprietary aggregation unit as follows.
 - (i) Except as provided for in section (c)(2)(E) of this Rule, individuals not assigned to the specialist unit shall not have access to non-public order information.
 - (ii) Systems, including computer algorithms, not assigned to the specialist unit shall not have access to non-public order information.
 - (iii) While on the Floor of the Exchange, individuals assigned to the specialist unit, including specialists, shall not communicate with individuals or systems responsible for making trading decisions for the integrated proprietary aggregation unit.
 - (iv) When an individual assigned to a specialist unit moves to a location off of the Floor of the Exchange, he or she shall not (1) make any non-public order information or specialist confidential information available to individuals or systems responsible for making trading decisions for the integrated proprietary aggregation unit, or (2) use any non-public order information or, except as provided for in section (f) of this Rule, specialist confidential information in connection with making trading decisions for the integrated proprietary aggregation unit.
 - (C) The integrated proprietary aggregation unit shall maintain records of its specialist accounts independent of the accounts of the integrated proprietary aggregation unit.
 - (D) The integrated proprietary aggregation unit may not engage in any activities that violate other Exchange rules or federal securities laws or regulations, including prohibitions on frontrunning, wash sales, and manipulation.
- (3) If a member organization is approved to operate a specialist unit within an integrated proprietary aggregation unit under this Rule, the specialist rules will apply to any trading on or through the systems and facilities of the

Exchange by the integrated proprietary aggregation unit through the specialist unit in the securities that are allocated to the specialist unit. The specialist rules will also apply to the integrated proprietary aggregation unit if the integrated proprietary aggregation unit causes the specialist unit to violate the specialist rules.

- (4) An integrated proprietary aggregation unit shall maintain order audit trail information consistent with the following:
- (A) The order tracking requirements of NYSE Rule 132B shall apply to the integrated proprietary aggregation unit's trading on or through the systems and facilities of the Exchange in securities allocated to the specialist unit, including trading by the specialist unit.
 - (B) The integrated proprietary aggregation unit must meet the order audit trail requirements of the exchanges or marketplaces where it trades or quotes.
 - (C) Member organizations must maintain records sufficient to reconstruct in a time-sequenced manner both the entry and execution of trading by the independent proprietary aggregation unit, including records sufficient to compare the entry and execution of trading by such unit to records maintained by the Exchange concerning trading or quoting on or through the systems and facilities of the Exchange by the specialist unit in the securities allocated to it.

(e) Sharing Non-Trading Related Services

- (1) Subject to approval by NYSE Regulation, a specialist unit may share non-trading related services with its member organization or approved persons.
- (2) To obtain approval to share non-trading related services, the specialist unit must (i) adopt and implement comprehensive written procedures and guidelines governing the sharing of non-trading related services; (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines. At a minimum, such policies and procedures shall be reasonably designed in accordance with the following.
 - (A) The specialist unit and member organization or approved person shall maintain the confidentiality of specialist confidential information and non-public orders.
 - (i) Individuals who provide non-trading related services to the specialist unit and who have access to either specialist confidential information or non-public order information shall not, either directly or indirectly, provide such information or otherwise use such information in such a

way that it could be made available to individuals or systems that are not part of the specialist unit, except to the extent that such information is needed for the purpose of providing non-trading related services to the specialist unit. Under no circumstances shall non-public order information or specialist confidential information be made available to investment banking, research, or customer-facing departments.

- (ii) Systems, including computer algorithms, that provide non-trading related services to the specialist unit and that have access to either specialist confidential information or non-public order information shall be configured in such a way to ensure that such information is not made available to individuals or systems that are not assigned to the specialist unit, except to the extent that such information is needed for the purpose of providing non-trading related services to the specialist unit. Under no circumstances shall non-public order information or specialist confidential information be made available to investment banking, research, or customer-facing departments.

(f) Risk Management

- (1) Subject to the approval of NYSE Regulation, a specialist unit that has been approved pursuant to section (c) of this Rule is eligible for an exemption from the requirements of Rule 105(b)-(d) and the Guidelines for Specialists' Specialty Stock Option and Single Stock Futures Transactions Pursuant to Rule 105 for the purpose of conducting risk management trading.
- (A) To obtain an exemption from Rule 105(b)-(d) and the guidelines thereunder, the specialist unit must (i) adopt and implement comprehensive written procedures and guidelines governing the conduct of trading in related products, (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines. At a minimum, such policies and procedures shall be reasonably designed to provide that:
 - (i) The individuals or systems, including computer algorithms, responsible for trading in related products shall not have access to non-public order information or, except as provided for in sections (f)(1)(A)(v) and (vi) of this Rule, specialist confidential information.
 - (ii) While on the Floor of the Exchange, individuals assigned solely to the specialist unit, including specialists, shall not directly enter or execute any trades in related products.
 - (iii) When an individual assigned to a specialist unit moves off of the Floor of the Exchange, he or she shall not (1) make any non-public order

information or specialist confidential information available to individuals or systems responsible for making trading decisions for related products, or (2) use any non-public order information or, except as provided in section (f)(1)(A)(v) of this Rule, specialist confidential information, in connection with making trading decisions for trading in related products.

- (iv) The specialist API shall not make any trading decisions for any related products.
- (v) The individuals or systems, including computer algorithms, responsible for making trading decisions in related products may have electronic access to the specialist unit's trades at the Exchange in securities allocated to the specialist unit, provided that such trades have been printed to the Consolidated Tape.
- (vi) Except as provided for in section (c)(2)(E) of this Rule, when providing risk management oversight over trading in securities allocated to the specialist unit and other trading within the specialist unit, senior managers of the specialist unit who have access to non-public order information or specialist confidential information shall not (1) make such information available to the individuals or systems responsible for the day-to-day trading decisions of either trading in related products within the specialist unit, or, if applicable, the integrated proprietary aggregation unit that provides risk management to the specialist unit pursuant to sections (f)(2) or (f)(3) of this Rule, or (2) use such information to directly or indirectly influence the day-to-day trading decisions of either trading in related products within the specialist unit or, if applicable, the integrated proprietary aggregation unit of the member organization or approved person with respect to the securities allocated to the specialist unit for which the senior manager has non-public order information.

(2) Subject to the approval of NYSE Regulation, an integrated proprietary aggregation unit approved pursuant to section (d) of this Rule to operate a specialist unit may conduct risk management trading related to the specialist unit's trading, including trading in related products, provided that:

- (A) In addition to meeting the requirements of sections (d) and (f)(1)(A)(i) through (v) of this Rule, the integrated proprietary aggregation unit must (i) adopt and implement comprehensive written procedures and guidelines governing the conduct of risk management of the specialist unit, (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines.

- (i) The individuals or systems, including computer algorithms, responsible for managing the risk of the specialist unit may electronically direct the specialist unit's trading or quoting at the Exchange in securities that are allocated to the specialist unit, provided, however, that the specialist unit must comply at all times with its market-making obligations, including the specialist rules, notwithstanding any electronic trading directions received from the integrated proprietary aggregation unit.
- (3) Subject to the approval of NYSE Regulation, an approved person or member organization associated with a specialist unit may conduct risk management trading related to the specialist unit's trading, including trading in related products, provided that:

 - (A) The specialist unit maintains the confidentiality of specialist confidential information and non-public order information, as required by section (c) of this Rule.
 - (B) Individuals employed by the approved person who are responsible for making risk-management decisions on behalf of the specialist unit shall be dually employed with the specialist unit's member organization.
 - (C) The approved person or member organization must (i) adopt and implement comprehensive written procedures and guidelines governing the conduct of risk management of the specialist unit, (ii) establish a process for regular review of such written procedures and guidelines; and (iii) implement controls and surveillances reasonably designed to prevent and detect violations of these procedures and guidelines. At a minimum, such policies and procedures shall be reasonably designed to provide that:

 - (i) The individuals or systems, including computer algorithms, responsible for managing the risk of the specialist unit shall be assigned to an integrated proprietary aggregation unit.
 - (ii) The individuals or systems, including computer algorithms, responsible for managing the risk of the specialist unit shall not have access to non-public order information or, except as provided for in sections (f)(3)(C)(iii) and (iv) of this Rule, specialist confidential information.
 - (iii) The individuals or systems, including computer algorithms, responsible for managing the risk of the specialist unit may have electronic access to the specialist unit's trades at the Exchange in securities allocated to the specialist unit, provided that such trades have been printed to the Consolidated Tape.

- (iv) The individuals or systems, including computer algorithms, responsible for managing the risk of the specialist unit may electronically direct the specialist unit's trading or quoting at the Exchange in securities that are allocated to the specialist unit, provided, however, that the specialist unit must comply at all times with its market making obligations, including the specialist rules, notwithstanding any electronic trading directions received from the member organization or approved person.

(g) Failure to Maintain Confidentiality

- (1) In the event that a specialist unit receives from the member organization or approved person non-public information about a security that is allocated to the specialist, that specialist shall promptly communicate that fact to the person responsible for compliance with the securities laws and regulations within the specialist unit (compliance officer) and shall seek a determination from such compliance officer as to whether the specialist should cease acting as a specialist in the security involved.
 - (A) If the compliance officer determines that the specialist should temporarily cease acting as a specialist in the security:
 - (i) The specialist shall transfer the responsibility to act as a specialist in such security to another member who is registered as a specialist and who is not in possession of the information so received;
 - (ii) The compliance officer shall immediately notify NYSE Regulation Division of Market Surveillance when (1) a determination is made that another specialist should act as a specialist in such security, and (2) when the compliance officer determines that the specialist who regularly handles the security can resume acting as a specialist for that security.
 - (iii) The compliance officer shall be responsible for determining when it is appropriate for the specialist to resume acting as specialist in the security involved.
 - (iv) The compliance officer shall take such actions as may be necessary to ensure that the transfer of the security to another member who is registered as a specialist is conducted in a "neutral" manner so that there is no communication of the information that had been received by the specialist who, as a consequence of receiving such information, was required to cease acting as a specialist for that security.
 - (v) The compliance officer shall maintain a written record of each request from a specialist for a determination of whether to cease acting as a specialist in a security. Such record shall include a description of the information received by the specialist, an indication when and from

whom the information was received, when the compliance officer was consulted on the matter, when the compliance officer made a determination on the matter, the determination of whether to cease acting as a specialist in a security, the basis for such determination, the time at which the specialist resumed acting as a specialist in the security involved, and such other information as the Exchange may from time to time require.

(h) Reporting Obligations

- (1) The member organization or approved person associated with a specialist unit shall report to NYSE Regulation, on a monthly “after the fact” basis and on such form and in such specific detail as NYSE Regulation may prescribe, information regarding material investment banking activities in which it has been engaged (e.g., underwriting, tender offers, mergers, acquisitions, recapitalizations, etc.), and material research reports, recommendations, etc., pertaining to any security that has been allocated to a specialist unit pursuant to Rule 103B.
- (2) A specialist unit shall report to NYSE Regulation on a monthly “after the fact” basis and on such form and in such specific detail as NYSE Regulation may prescribe, information regarding determinations pursuant to section (g)(1) of this Rule by a compliance officer that a specialist shall not be required to cease acting as a specialist in a security.
- (3) A specialist unit shall promptly report to NYSE Regulation any failure to maintain the confidentiality of specialist confidential information or non-public order information, as required by sections (c), (d), (e), and (f) of this Rule.
- (4) In the event a specialist unit, member organization, or approved person becomes aware of any trading activity that may be a result of a breach of (i) the specialist unit’s internal controls or surveillances as required by sections (c), (d), (e), and (f) of this Rule, or (ii) the requirement to maintain the confidentiality of specialist confidential information or non-public order information, as required by sections (c), (d), (e), and (f) of this Rule, the specialist unit, member organization, or approved person shall:
 - (A) Promptly conduct an internal investigation into any such actual or potential breach to determine whether such breach occurred and if there was a breach, how such breach occurred;
 - (B) Promptly take any and all necessary remedial measures to prevent and detect such breaches from recurring; and
 - (C) On a quarterly basis, for any ongoing internal investigation required by section (h)(4)(A) of this Rule, report in writing to NYSE Regulation:

- (i) The commencement of the internal investigation;
- (ii) The quarterly progress of each open investigation (report by the 15th day of the month following the quarter); and
- (iii) The completion of the investigation, including the methodology and results of the investigation, remedial actions taken, any internal disciplinary action taken, and any referral of the matter to the Exchange, another self-regulatory organization, the Securities and Exchange Commission or another Federal agency.

(i) Breach

Any failure by the specialist unit to maintain confidentiality of specialist confidential information or non-public order information or any breach of any internal controls established to protect such information, may result in the imposition of appropriate regulatory sanctions, including a withdrawal of the registration of one or more securities of the specialist unit or the withdrawal of approval to operate a specialist unit.

* * * * *

Rule 98 (Former). Restrictions on Approved Person Associated with a Specialist's Member Organization

This Rule is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under this Rule before [effective date of proposed Rule 98] and have not been approved to operate as a specialist unit under Rule 98. This Rule is not available for new entrants to become a specialist unit at the Exchange.

(a) (No Change)

(b) (No Change)

(c) (No Change)

Guidelines for Approved Persons Associated with a Specialist's Member Organization

(a) An "approved person" is a person (other than a member, allied member, or employee of a member organization) who controls a member organization, or is engaged in a securities or kindred business and is controlled by or under common control with a member organization (the term "approved person" is defined in Rule 2. The term "engaged in a securities or kindred business" is defined in Rule 2.). The term "control" is defined in Rule 2 to mean the power to direct, or cause the direction of, the management or policies of a person, whether through ownership of securities, by contract or otherwise. Under the definition, a person is presumed to control another person if such person, directly or indirectly, has the right to vote 25% or more of the voting securities, or is entitled to receive 25% or more of the net profits, or is a director, general partner or principal executive officer (or a person occupying a similar status or performing similar functions), of the other person. In these Guidelines, a member organization having one or more employees, partners or officers who are members registered with the Exchange as specialists is referred to as a "specialist member organization" and the approved person of a specialist member organization is sometimes referred to as being "associated" with the member organization.

The Exchange Rules listed below impose certain restrictions on an approved person who is associated with the specialist member organization:

- *Rule 104(a) (Former)* provides that a specialist may not effect any purchase or sale of a security in which he is registered for the account of an approved person associated with his organization, unless such transaction is reasonably necessary to permit the specialist to maintain fair and orderly markets.
- *Rule 104.13(Footer)* provides that any transaction for the benefit of an approved person associated with a specialist member organization, in any

stock in which a specialist in the specialist member organization is registered, must be for investment purposes and effected in a stabilizing manner, and precludes an approved person from originating an order in such stock for any account over which such approved person exercises investment discretion.

- *Rule 105(b) (Former)* provides that an approved person associated with a specialist member organization may trade in options or single stock futures overlying a specialty stock for hedging purposes only.

The restrictions discussed above were adopted to ensure that approved persons of specialist member organizations would not be placed in a more advantageous position vis-a-vis other market participants because of their association with a specialist member organization and their possible access to confidential information concerning the specialist's book or the specialist's trading activities. The restrictions are also designed to minimize potential conflicts of interest that may arise when a specialist handles an order for the account of an associated approved person while also handling public orders and orders for other members, or when the approved person is trading in a specialty stock. The restriction against "popularizing" is specifically addressed to concerns about conflicts of interest and the potential for market manipulation that may arise when the approved person makes recommendations, solicits orders, etc. in a stock in which an associated specialist is registered.

The objective of these Guidelines is to provide an exemption from the restrictions discussed above where an approved person and an associated specialist member organization organize their respective operations in such a way that the activities of each entity are clearly separate and distinct. Rule 98 (*Former*) and these Guidelines contemplate "functional regulation" whereby restrictions that are appropriately imposed on the activities of a specialist member organization are not also imposed on the activities of an associated person which maintains an "arm's length" relationship with the specialist member organization. "Functional regulation" is intended to provide member organizations with greater flexibility for conducting business operations, while at the same time not compromising legitimate regulatory objectives.

It is not mandatory that an approved person associated with a specialist member organization seek exemptive relief. If the approved person chooses to do so in a manner that is acceptable to the Exchange under these Guidelines, it gains an exemption from the restrictions discussed above as provided in Rule 98 (*Former*). If the approved person chooses not to do so, it remains subject to those restrictions.

(b) The "functional regulation" contemplated by these Guidelines essentially calls for the establishment of procedures that are sufficient to restrict the flow of privileged information between the approved person and the associated specialist member organization. Such procedures shall be expected to preclude the

possibility that such privileged information, as discussed in the subparagraph below, will be made available to be used in any way to influence a particular trading decision by a specialist in the associated specialist member organization, or vice versa. Generally, in order to obtain the exemptions from the Rules discussed in paragraph (a) above, the approved person and the specialist member organization that is to be associated with such approved person, should establish their respective operational structures along the lines discussed below.

(i) *Organizational Separation* The approved person and the associated specialist member organization should be organized as separate and distinct organizations. The specialist member organization must function as an entirely freestanding, separate entity responsible for its own trading decisions, and may not function in any manner as a "downstairs" extension of the "upstairs" trading desk. If a prospective specialist firm is not a separate and distinct organization from its proposed approved person, the Exchange may temporarily exempt such prospective specialist firm from this section of the Guidelines. Such temporary exemption is contingent on the prospective specialist firm satisfying sections (b)(ii) through (b)(x) of these Guidelines, including specifically satisfying the Exchange that adequate information barriers will be maintained notwithstanding the fact that separate entities are not employed.

(ii) *Management Influence* The respective management structures of the approved person and the associated specialist member organization should be organized in such a way that the approved person, through any of its officers, directors, partners or employees, does not exert any influence on particular trading decisions of the associated specialist member organization or any specialist therein. The approved person would not necessarily be precluded, however, from playing a general oversight role as to the management of an associated specialist member organization. The approved person would not necessarily be precluded for example, from setting general profitability targets, overall market strategy (as opposed to strategy on particular trades), and basic trading philosophy for the associated specialist member organization, would not necessarily be precluded from conducting periodic financial reviews to monitor fulfillment of profitability targets or from participating in personnel selection matters relating to the associated specialist member organization, and would not necessarily be precluded from engaging in other appropriate managerial responsibility activities, provided that any such general managerial oversight does not conflict with or compromise in any way the market-making responsibilities of the specialists in the associated specialist member organization as stated in Rule 104 or any other Rule or policy of the Exchange.

(iii) *Confidentiality of Trading Information and Information Derived from Clearing and Margin Financing Arrangements Pertaining to Specialist Member Organization* The approved person and the associated specialist member organization should establish procedures to ensure that any information pertaining to stock positions and trading activities of the associated specialist member

organization, and information derived from any clearing and margin financing arrangements between the approved person and the associated specialist member organization, may be made available only to those (other than employees actually performing clearing and margin financing activity) in senior management positions at the approved person who are involved in exercising general managerial oversight over the specialist member organization. Generally, such information may be made available only to the approved person's chief executive officer, chief operational officer, chief financial officer, and senior officer responsible for managerial oversight of the associated specialist member organization, and only for the purpose of exercising permitted managerial oversight. Such information may not be made available to anyone actually engaged in making day-to-day trading decisions for the approved person, or in making recommendations to the customers or potential customers of the approved person. Any margin financing arrangements must be sufficiently flexible so as not to limit the ability of any specialist in the specialist member organization to meet market-making or other obligations under Exchange Rules.

(iv) Confidentiality of Trading Information and Information Derived from Clearing Arrangements Retaining to Approved Person The approved person and the specialist member organization should establish procedures to ensure that any information pertaining to stock positions and trading activities of the approved person may be made available only to those in senior management positions at the specialist member organization who are involved in exercising general managerial oversight over the approved person, in such capacities as indicated in subparagraph (iii) above. If the specialist member organization clears any trades of the approved person, it shall establish procedures to maintain the confidentiality of such information in accordance with the principles stated in subparagraph (iii) above.

(v) Separate Books and Records Generally The approved person and the associated specialist member organization should maintain separate and distinct books, records, and accounts as to their respective business operations.

(vi) Separate Financial Accounting The approved person should avoid commingling its fund or securities with funds or securities of the associated specialist member organization for any purpose, other than as may be specifically approved by the Exchange. Any transfers of funds between the approved person and the associated specialist member organization should be properly recorded in accordance with generally accepted accounting principles.

(vii) Capital Requirements Met Separately If the approved person is a member organization of the Exchange, such approved person should at all times meet all applicable financial requirements imposed by the Exchange or the Securities and Exchange Commission separately from the associated specialist member organization. If the approved person is not a member organization of the Exchange, but is a broker-dealer, such approved person should at all times meet all

applicable financial requirements imposed by Securities and Exchange Commission Rule 15c3-1 separately from the associated specialist member organization. Each specialist associated with such specialist member organization should at all times meet all applicable financial requirements imposed by any Exchange Rule separately from the approved person. The specialist member organization's capital must be dedicated exclusively to specializing activities, and must not be at risk for any liabilities of the approved person. This paragraph shall not apply to a specialist member organization that is registered as a specialist solely in Investment Company Units (as defined in paragraph 703.16 of the Listed Company Manual) or a Trust Issued Receipt (as defined in Rule 1200). However, such specialist member organization will remain subject to the minimum capital requirements specified in Rule 104.20.

(viii) *Confidentiality of Specialist's "Book"* The approved person and the associated specialist member organization should establish procedures to ensure that information pertaining to orders in a specialty stock left with any specialist member of the specialist member organization shall be kept confidential, and shall not be made available, either directly or indirectly, to any officer, director, partner, or employee of the approved person, except as provided in Rule 115 or in any other Rule of the Exchange.

(ix) *Confidentiality of Information Derived from Business Transactions With Issuer* Where, as permitted by Rule 460, the approved person engages in a business transaction with a company in any of whose securities a specialist member of the associated specialist member organization is registered, the approved person should establish procedures to ensure that any material, non-public information derived from such issuer in the course of such business transaction is kept confidential and is not made available, either directly or indirectly, to the associated specialist member organization or to any member, partner, director, officer, or employee thereof.

(x) *Confidentiality of Proposed Research Reports, Recommendations, Etc* Where, as permitted by and in accordance with Rule 113.20, an approved person associated with a specialist member organization purposes to issue to its customers any material research report, recommendation, etc., either written or oral, about any individual security in which a specialist member of the specialist member organization, is registered, the approved person should establish procedures to ensure that no information pertaining to such research report, recommendation, etc. is made available, either directly or indirectly, to the associated specialist member organization or to any member, partner, director, officer, or employee thereof, in such a way as to permit such associated specialist member organization, or any member, partner, director, officer, or employee thereof, to take undue advantage of any information pertaining to such research report, recommendation, etc.

(c) In order to obtain the exemptions provided by Rule 98 (Former), the approved person and the specialist member organization with which such approved person is associated shall submit to the Exchange a written statement detailing the internal controls each of them intends to adopt to satisfy each of the conditions stated in subparagraphs (b)(i) through (b)(x) of these Guidelines, and the compliance and audit procedures it proposes to implement to ensure that the internal controls are maintained. If the Exchange determines that the organizational structure and the compliance and audit procedures proposed by the approved person and such specialist member organization, are acceptable under the Guidelines, the Exchange shall so inform the approved person and such specialist member organization, in writing at which point the exemptions provided by Rule 98(a) shall be granted. Absent such prior written approval, the exemptions provided by Rule 98 shall not be available. The written statement should identify the individuals in senior management positions (and their titles/levels of responsibility) of the approved person to whom information concerning the specialist member organization's trading activities and stock positions, and information concerning clearing and margin financing arrangements, is to be made available, the purposes for which it is to be made available, the frequency with which the information is to be made available, and format in which the information is to be made available. If any partner, director, officer, or employee of the approved person intends to serve in any such capacity with the associated specialist member organization, or vice versa, the written statement must include a statement of the duties of the particular individual at both entities, and why it is necessary for such individual to be a partner, director, officer, or employee of both entities. The Exchange will grant approval for service at both entities only if the dual affiliation is for overall management control purposes. Dual affiliation will not be permitted for an individual who intends to be active in the day-to-day business operations of both entities. Nothing in the foregoing, however, shall preclude an employee of one entity who performs strictly operational functions from performing similar functions on behalf of the other entity, provided that such individual is clearly identified, and the functions performed on behalf of each entity are specified, in the written statement described above, and all requirements in paragraph (b) above as to maintaining the confidentiality of information are met. Notwithstanding the above, a specialist member organization and approved persons approved for an exemption pursuant to paragraph (b) of this Rule may apply for approval pursuant to Rule 98(e) to share non-trading related services, as specified in that rule.

(d) If the person and the associated specialist member organization determine that any condition stated in paragraph (b) is not applicable, they shall so state in the written statement to the Exchange. If, subsequent to obtaining the written approval discussed in paragraph (c) above, the approved person and the associated specialist member organization determine that any such condition which had formerly been inapplicable shall become applicable, the approved person and the associated specialist member organization shall seek and obtain written approval of their proposed compliance with such condition before proceeding. For example, assume that prior written approval of functional separation has been obtained, but the

initial written statement had provided that the approved person would not clear proprietary trades of its associated specialist member organization. If it is subsequently determined that the approved person shall clear proprietary trades of the associated specialist member organization, the written approval of the Exchange must first be obtained. Whenever any statement made in any written statement submitted to and approved by the Exchange becomes inaccurate or incomplete, a corrected supplemental written statement shall be promptly submitted by the approved person and its associated specialist member organization to the Exchange for its approval.

(e) The Exchange shall not approve any joint account between a specialist member organization that is associated with an approved person entitled to the exemptions provided by Rule 98 (Former) and any other specialist member organization unless and until such other specialist member organization and such approved person have agreed to comply with each of the conditions set forth in subparagraph (b)(i) through (b)(x) in a manner that is acceptable to the Exchange.

(f) Pursuant to the requirements of Rule 113(b) (Former), all proprietary orders for the account of an approved person given to a specialist in an associated specialist member organization must indicate the account for which it is entered.

(g) The specialist member organization may make available to a broker affiliated with an associated approved person only the market information that it would make available in the normal course of its specializing activity, to any other broker, and in the same manner that it would make such information available to any other broker. The specialist member organization may make any such information available to a broker affiliated with an associated approved person only pursuant to a request by such broker for such information, and may not, on its own initiative, provide such broker with such information. A broker affiliated with an associated approved person may make available to the specialist member organization only the market information that he would make available to an unaffiliated specialist member organization in the normal course of his trading and market "probing" activities.

(h) No individual associated with an approved person may trade as a Competitive Trader or Registered Competitive Market-Maker in any stock in which any specialist in its associated specialist member organization is registered.

(i) Subparagraph (b), (b)(iv), (b)(ix) and (b)(x) of these Guidelines require the establishment of procedures designed to prohibit the flow of certain market sensitive information from an approved person to its associated specialist member organization or to any member, partner, director, or employee thereof. In the event that, as a result of any breach of these procedures, any specialist in the associated specialist member organization becomes aware of the fact that he has received, either directly or indirectly, any such information relating to any of his specialty stocks from his organization's associated approved person, the specialist shall

promptly communicate that fact and disclose the information so received to the person responsible for compliance with securities laws and regulations within his member organization (the compliance officer) and shall seek determination from the compliance officer as to whether he should, as a consequence of his receipt of such information, give up the book in the specialty stock involved. If the compliance officer determines that the specialist should give up the book, the specialist shall give it up to another member who is registered as a specialist in the stock and who is not in possession of the information so received. In any event, the compliance officer shall determine when it is appropriate for the specialist to recover the book and resume acting as specialist in the specialty stock involved. In any case where the compliance officer determines that the book should be given up to another specialist, he shall immediately so notify the Exchange. The compliance officer shall take such actions as may be necessary to ensure that the book is transferred in a "neutral" manner so that there is no communication of the information that had been received by the specialist who, as a consequence of receiving such information, is required to give up the book. The compliance officer shall immediately notify the Exchange when he makes a determination that the book may be given back to the specialist who regularly handles it.

The compliance officer shall keep a written record of each request received from a specialist for a determination as referred to above. Such record shall include a description of the information received by the specialist, and shall indicate when and from whom the information was received, when the compliance officer was consulted on the matter, when the compliance officer made a determination on the matter, the determination and the basis thereof, and such other information as the Exchange may from time to time require. If the book is given up, the record shall also set forth the time at which the specialist reacquired the book and the basis upon which the compliance officer determined that such reacquisition was appropriated.

Members and member organizations are cautioned that any trading by any person while in possession of material, non-public information received as a result of any breach of the internal controls required by the Guidelines may violate Rule 10b-5, Rule 14e-3, Exchange Rule 104, just and equitable principles of trade or one or more other provisions of the 1934 Act, or regulations thereunder or rules of the Exchange. The Exchange intends to review carefully any such trading of which it becomes aware with a view towards determining whether any such violation has occurred.

(j) An approved person associated with a specialist member organization shall report to the Exchange, on a monthly "after the fact" basis and on such form and in such specific detail as the Exchange may prescribe, information regarding material investment banking activities in which it has been engaged (e.g., underwriting, tender offers, mergers, acquisitions, recapitalizations, etc.), and material research reports, recommendations, etc., pertaining to any security in which a specialist member of an associated specialist member organization is registered. A specialist

member organization associated with an approved person shall report to the Exchange on a monthly "after the fact" basis and on such form and in such specific detail as the Exchange may prescribe, information regarding determinations by a compliance officer, made pursuant to paragraph (i) above that a specialist shall not be required to give up the book.

(k) Any failure, by either the approved person or its associated specialist member organization, to maintain confidentiality or privileged market information, any breach of the internal controls established by any such approved person or specialist member organization, and any violation of these Guidelines, or of the written statement submitted to the Exchange for its approval, may result in the imposition of appropriate regulatory sanctions, including a withdrawal of the registration of one or more stocks of the associated specialist member organization, or the withdrawal of one or more of the exemptions provided by Rule 98 (Former).

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Rule 98A. Restrictions on Persons or Parties Affiliated with A Specialist Unit

No issuer, or partner or subsidiary thereof, may become an approved person of a specialist unit that is registered in a stock of that issuer.

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Rule 98A (Former) Restrictions on Persons or Parties Affiliated with Specialist and Odd-Lot Dealer Member Organizations

This Rule is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This Rule is not available for new entrants to become a specialist unit at the Exchange.

* * * * *

(No Change)

Rule 99. Round-Lot Transactions of Odd-Lot Dealer

No odd-lot dealer shall effect while on the Floor of the Exchange purchases or sales of any security in which such odd-lot dealer is registered, for any account in which such odd-lot dealer or his or her specialist unit or any other member, or allied member in such organization is directly or indirectly interested, unless such dealings are reasonably necessary to permit the odd-lot dealer to act as such in such security, or, if also registered as a specialist in such security, to act as a specialist.

* * * * *

Rule 99 (Former). Round-Lot Transactions of Odd-Lot Dealer and Broker

This Rule is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This Rule is not available for new entrants to become a specialist unit at the Exchange.

* * * * *

(No Change)

[Rule 102. Options of Odd-Lot Dealers

No odd-lot dealer or his member organization and no other member, allied member, or approved person, in such organization shall acquire, hold, or grant, directly or indirectly, any interest in any put, call, straddle or option in any stock in which such odd-lot dealer is registered.]

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Rule 103B. Specialist Stock Allocation

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Prohibition on Functioning as Specialist in ETF and Specialist in any Component Security of the ETF (Former)

This section is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This section is not available for new entrants to become a specialist unit at the Exchange.

(No Change)

Prohibition on Functioning as Specialist in ETF and Specialist in any Component Security of the ETF

No specialist unit may apply to be allocated an ETF if it is registered as specialist in any security that is a component of the ETF unless, prior to such allocation, such specialist unit demonstrates to the satisfaction of the Exchange that all information regarding the activities of such specialist unit with regard to its trading of registered ETFs is effectively separated from all persons within such specialist unit trading component securities of such ETF, and conversely that all information regarding the activities of such specialist unit in its registered securities is effectively separated from all persons trading its registered ETFs. A specialist unit that is registered as specialist in a component stock of an ETF may in the alternative establish a separate member organization that may apply to be the specialist in an ETF. An ETF specialist unit must meet the requirements of Rule 98 to operate a specialist unit.

If, subsequent to an ETF being allocated to a specialist unit, a security in which the specialist unit is registered as specialist becomes a component security of such ETF, the specialist unit must (i) withdraw its registration as specialist in the security which is a component of the ETF; or (ii) withdraw its registration as specialist in the ETF; or (iii) demonstrate to the satisfaction of the Exchange the existence of physical and procedural information barriers to assure the effective separation of information regarding trading in ETFs and in its component securities; or (iv) establish a separate specialist unit that must meet the requirements of Rule 98 and will be registered as specialist in the ETF.

* * * * *

Rule 104. Dealings by Specialists

(a)(Former)

This section is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This section is not available for new entrants to become a specialist unit at the Exchange.

(No Change)

* * * * *

(a) 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, his specialist unit or any other member or allied member in such unit or officer or employee thereof 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.

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• • • *Supplementary Material:* -----

Functions of Specialists

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.13 Investment Transactions (Former). —

This section is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This section is not available for new entrants to become a specialist unit at the Exchange.

(No Change)

* * * * *

.13 Investment Transactions

(a) Any transactions effected for the benefit of any of the following persons in stocks in which a specialist is registered must be for investment purposes:

(i) any member, allied member, officer, employee or person or party active in the business of the specialist; or

(ii) the spouse and children of any of the above-named persons or parties who reside in the same household as such person or party.

(b) Any transaction included within paragraph (a) may only be made as follows:

(i) acquisitions at prices below the last different price—on "minus" or "zero minus" ticks; and

(ii) liquidations at prices above the last different price—on "plus" or "zero plus" ticks—except with the prior approval of the Exchange.

(c) All off-Floor orders entered for any of the above-named accounts must be identified so that such orders will not be executed prior to any agency order received by the specialist at the same price even though such agency order may be received subsequent to the identified order.

(d) No specialist, and no member or allied member affiliated with such specialist, officer, employee or person active in the business of the specialist shall originate orders in stocks in which such specialist is registered for any account over which they exercise investment discretion.

(e) Transactions in a stock in which a specialist is registered effected for trust accounts, including "blind" accounts, for the benefit of such specialist or any person specified in paragraph (a) shall be subject to the provisions of this rule. Transactions in a fund which invests broadly in securities and which may from to time invest in a security in which a specialist is registered, shall not be subject to this rule.

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Rule 105. Specialists' Interest in Pools, Options, and Single Stock Futures

(a)(Former)

This section is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This section is not available for new entrants to become a specialist unit at the Exchange.

(No Change)

* * * * *

(a) No member acting as a specialist or his or her member organization or any other member, allied member or approved person in such organization or officer or employee thereof shall be directly or indirectly interested in a pool dealing or trading in a stock in which such member is registered as a specialist.

(b) (Former)

This section is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This section is not available for new entrants to become a specialist unit at the Exchange.

(No Change)

* * * * *

(b) No member acting as a specialist or his or her specialist unit or any other member, or allied member or officer or employee thereof, shall directly or indirectly, hold, acquire, grant or have an interest in any option to purchase or sell or to receive or deliver shares of a stock in which such member is registered as a specialist, or in any security future of a stock in which such member is registered as specialist, except as provided in this Rule. The term "listed option" as used herein shall mean an option issued by the Options Clearing Corporation and traded on a national securities exchange. The term "security future" shall have the meaning given that term in section 3(a)(55) of the Securities Exchange Act of 1934. A security future of a single stock is hereinafter referred to as a "single stock future".

* * * * *

(d) (Former)

This section is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This section is not available for new entrants to become a specialist unit at the Exchange.

(No Change)

* * * * *

(d) A specialist unit and any officer or employee of such specialist unit that has a position in any specialty stock of such specialist in any account (other than the specialist's account) may grant or have an interest in listed options or single stock futures to purchase or sell or to receive or deliver shares of such specialty stock but only to the extent and in the manner that the "Guidelines", as promulgated by the Exchange and as may be amended from time to time, would permit the specialist to use listed options or single stock futures as to transactions for the specialist's account.

* * * * *

GUIDELINES FOR SPECIALISTS' SPECIALTY STOCK OPTION AND SINGLE STOCK FUTURES TRANSACTIONS PURSUANT TO RULE 105

* * * * *

(m) Specialist Shall Not Be Options or Single Stock Futures Market-Maker (Former)

This section is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This section is not available for new entrants to become a specialist unit at the Exchange.

(No Change)

* * * * *

(m) Specialist Shall Not Be Options or Single Stock Futures Market-Maker

No specialist unit or officer or employee thereof shall act as an options market-maker or option specialist, or function in any capacity involving market-making responsibilities, in any option as to which the underlying security is a stock in which the specialist is registered as such, nor shall any such persons function in

any market making capacity with respect to any single stock futures contract of a security in which such specialist is registered as such.

* * * * *

Rule 113 (Former). Specialists' Public Customers

This Rule is applicable only to those specialist member organizations and associated approved persons that have been approved for an exemption under Rule 98 (Former) and have not been approved to operate as a specialist unit under Rule 98. This Rule is not available for new entrants to become a specialist unit at the Exchange.

(No Change)

* * * * *

Rule 113. Specialists' Public Customers

(a) No specialist or the specialist unit with which he or she is associated shall accept an order for the purchase or sale of any stock in which he or she is registered as a specialist directly (1) from the company issuing such stock; (2) from any officer, director or 10% stockholder of that company; (3) from any pension or profit-sharing fund; (4) from any institution, such as a bank, trust company, insurance company, or investment company.

(b) No order given to a specialist for the purchase or sale of a security in which he or she is registered as a specialist shall indicate in any way the account for which it is entered except for orders received by the specialist by means other than any Exchange automated order routing system for accounts in which any of the below-named persons or parties has a direct or indirect interest:

(i) The specialist himself or herself;

(ii) any member, allied member, officer, employee or person or party active in the business of such specialist; and

(iii) the spouse and children of any of the above-named persons or parties who reside in the same household as such person or party.

(c) Every specialist shall report to the Exchange on a monthly basis, on such form and in such format as the Exchange may prescribe, a record of all purchases and sales effected in stocks in which such specialist is registered for any customer account not prohibited under section (a) which:

(1) is carried by the specialist's unit; or

(2) is serviced by such specialist or the specialist's unit; or

(3) is introduced by such specialist or the specialist's unit to another member organization on a disclosed basis.

• • • *Supplementary Material:* -----

.20"Popularizing" specialty stocks.— It is contrary to good business practice for a specialist or his or her specialist unit or any other member, or allied member in such organization or any officer or employee thereof to "popularize", either orally or in writing, any security in which he is registered. An approved person or member organization associated with the specialist unit may popularize a security in which such specialist is registered, provided that it makes the following disclosures:

(i) It is associated with a specialist who makes a market in the security:

(ii) At any given time, the associated specialist may have an inventory position, either "long" or "short", in the security; and

(iii) As a result of the associated specialist's function as a market maker, such specialist may be on the opposite side of orders executed on the Floor of the Exchange in the security.

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Rule 132B. Order Tracking Requirements

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[(f) The provisions of this Rule shall not apply to members effecting on the Floor proprietary transactions when they are acting in the capacity of a specialist, a Registered Competitive Market Maker, or a Competitive Trader.]

* * * * *

Rule 460. Specialists Participating in Contests

(a) No specialist member or his or her specialist unit [member organization] or any other member, allied member, [or approved person] or officer or employee of [the] such specialist unit [member organization] shall participate in a proxy contest [or] of a company if such specialist member is registered [specializes] in the stock of that company.

Specialists as Directors

(b) No specialist member or his or her specialist unit [member organization] or any other member, allied member, [or approved person in such member organization or] officer or employee of [the member organization] such specialist unit shall be a director of a company if such specialist member [specializes] is registered in the stock of that company.

••• *Supplementary Material:* -----

.10Control relationships—Business transactions—Finder's Fees.—

(a)(1) [No specialist or his member organization or any other member, allied member or approved person in such member organization or officer or employee thereof, individually or in the aggregate, shall acquire, directly or indirectly,] A specialist unit shall report the beneficial ownership of more than 5% [10%] of the outstanding shares of any equity security [in which the specialist is registered.] that is allocated to that unit. A specialist unit shall update any report if its beneficial ownership is reduced below 5% or exceeds 10% of the outstanding shares of any equity security that is allocated to that unit.

(2) The [prohibition] reporting obligation in (a)(1) shall not apply if the security is:

(i) a convertible or derivative security, American Depositary Receipt, Global Depositary Receipt, or similar instrument, unless the conversion or redemption of such security would directly or indirectly cause the specialist unit to have a position in any security allocated to the specialist unit that is in excess of the limits set forth in section (a)(1) of this Rule [the conversion of which into common stock of the issuer would not result in a position in the common stock exceeding the 10% threshold];

(ii) an investment company unit or Trust Issued Receipt, unless the conversion or redemption of such security would directly or indirectly cause the specialist unit to have a position in any security allocated to the specialist unit that is in excess of the limits set forth in section (a)(1) of this Rule [the redemption of which would not result in a position, directly or indirectly, in any equity security in which the specialist is registered exceeding the 10% threshold]; or

(iii) a security, such as a currency warrant, that trades in relationship to the value of that underlying currency, or a security, such as an index warrant, that trades in relationship to the value of that underlying index.

(3) With respect to the securities specified in (a)(2)(iii), the specialist unit [must obtain the permission of the Exchange to exceed the 10% threshold, and] may not in any event acquire directly or indirectly the beneficial ownership of more than 25% of the issue. This provision applies regardless of whether the beneficial ownership is acquired for investment, trading, or any other purpose.

[(4) Whenever any or all of the persons described in (a)(1) above shall acquire, directly or indirectly, beneficial ownership of 5% or more of the outstanding shares of any such equity security, the specialist or his organization shall promptly report this fact to the Market Surveillance Division. Thereafter, any person described in (a)(1) above shall, at the request of the Market Surveillance Division, promptly take appropriate action either to dispose of such beneficial ownership or reduce or eliminate his interest in the specialist organization, as may be acceptable to the Exchange.]

(b)(1) No specialist unit [or his member organization] or any other member, allied member, [or approved person in such member organization or] officer or employee thereof shall engage in any business transaction (including loans, etc.) with any company in whose stock the specialist is registered, or accept a finder's fee from such company, except as provided below.

(2) Notwithstanding the provision in (b)(1) above, a specialist registered in a security issued by an investment company may purchase and redeem the listed security, or securities that can be subdivided or converted into the listed security, from the issuer as appropriate to facilitate the maintenance of a fair and orderly market in the subject security.

(3) The provisions of (b)(1) shall not apply to the receipt of routine business services, goods, materials, or insurance, on terms that would be generally available.

.11 Definition of an Investment Company Unit.—The term "Investment Company Unit" in paragraph .10 above shall be the same as that in Section 703.16 of the Listed Company Manual.

.12 Definition of a Trust Issued Receipt.—The term "Trust Issued Receipt" in paragraph .10 above shall be the same as that in Rule 1200.

[.20 (a) The restrictions in paragraphs 460(a) and 460.10(a) above shall apply to an approved person of a specialist organization entitled to an exemption from this Rule pursuant to Rule 98 in the manner described below.

(1) The restriction on the acquisition of beneficial ownership of 10% or more of the outstanding shares of any equity security in which such specialist is registered, as provided in Rule 460.10, shall apply to such approved person separate and distinct from the restriction as applied to any or all other persons specified in Rule 460.10, and

(2) the positions of the approved person shall not be aggregated with the positions of any one or more other persons specified in Rule 460.10. The same principle applies with respect to the reporting of positions specified in Rule 460.10.

(b) An approved person entitled to an exemption from this Rule may engage in business transactions with a company in whose stock an associated specialist is registered, may accept a finder's fee from such company, and may act as an underwriter in any capacity for a distribution of securities issued by such company.]

[.25],20 The restrictions in paragraph .10 above relating to business transactions between a specialist or his or her specialist unit [member organization] or any other member, allied member, [or approved person in such member organization or] officer or employee thereof shall not apply to Investment Company Units (as defined in paragraph 703.16 of the Exchange's Listed Company Manual), Trust Issued Receipts (defined in NYSE Rule 1200), and derivative instruments based on one or more securities, currencies or commodities (collectively referred to as Exchange-Traded Funds or "ETFs"), if the following conditions are met:

(i) the specialist or his or her specialist unit [member organization] or any other member, allied member, [or approved person in such member organization or] officer or employee thereof only enters into the business transaction with the sponsor of the ETF and the sponsor is not involved in the day-to-day administration of the ETF; and

(ii) any fee or other compensation in connection with the business transaction paid to the specialist or his or her specialist unit [member organization] or any other member, allied member, [or approved person in such member organization or] officer or employee thereof must not be dependent on the trading price or daily trading volume of the ETF; and

(iii) the specialist or his or her specialist unit [member organization] or any other member, allied member, [or approved person in such member organization or] officer or employee thereof must notify and provide a full description to the Exchange of any business transaction or relationship, except those of a routine and generally available nature as described in paragraph .10 above, it may have with any sponsor of an ETF that he or it is registered as specialist in.

.30

(a) An approved person or member organization associated with a specialist unit [member organization] ("Affiliated Specialist") [that is entitled to an exemption from certain Exchange rules pursuant to Exchange Rule 98] shall notify the Exchange of its participation in any distribution or tender or exchange offer of any security covered by paragraph (b) of this rule, in such form and within such time frame as may be prescribed by the Exchange and shall provide the information required below:

1. name of security

2. symbol
3. type of security
4. symbol of reference security or securities (if different from security being distributed)
5. description of distribution or tender or exchange offer
6. distribution price or terms of tender or exchange offer
7. date of pricing
8. time of pricing
9. pricing basis (e.g., NYSE or Consolidated close)
10. beginning and ending dates of restricted period under Regulation M (if applicable) or, for a tender or exchange offer, the date the offer is publicly announced and its expiration date
11. firm submitting notification
12. name and title of individual submitting notification
13. telephone number
14. such other information as the Exchange may from time to time require

(b) The notification requirements of this rule are applicable to any security in which the Affiliated Specialist is registered where such security is either:

(i) the subject of a tender or exchange offer (or any other security which is immediately convertible into or exchangeable for such security) for purposes of Rule 10b-13 under the Securities Exchange Act of 1934; or

(ii) a covered security as defined in Rule 100 of Regulation M.

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