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Self-Regulatory Organizations: New York Stock Exchange, Inc.; Order Granting Accelerated Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change Relating to Amendments to 460.20

August 1, 1995.

I. Introduction

On May 26, 1995, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") 1 and Rule 19b-4 thereunder,² a proposed rule change to amend Exchange Rule 460.20 to require an associated specialist of an approved person acting as an underwriter in a distribution of a security in which the associated specialist is registered to 'give up the book" if the associated specialist and approved person do not have an exemption from Rule 10b-6 or Rule 10b-13.

The proposed rule change was published for comment in Securities Exchange Act Release No. 35929 (June 30, 1995), 60 FR 35759 (July 11, 1995). No comments were received on the proposal. On July 27, 1995, the Exchange submitted Amendment No. 1 to the proposed rule change.³ This order approves the proposed rule change, including Amendment No. 1, on an accelerated basis.

II. Description of Proposal

Rule 10b–6 under the Act requires a specialist organization to withdraw from the market when an affiliated entity is participating in a distribution of a security in which the specialist organization is registered commencing with the applicable cooling off period specified in Rule 10b-6 until the affiliate has completed its participation in the distribution.⁴ Currently, to ensure

³ See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Glen Barrentine, Senior Counsel, SEC, dated July 26, 1995. In Amendment No. 1, the Exchange amended the NYSE rule to reflect more accurately the requirements under Rules 10b–6 and 10b–13 for specialists to give up the book if the specialists and their approved persons do not have an exemption from such rules. See infra note 10 and accompanying text.

⁴ Rule 10b–6 is an anti-manipulation rule that, subject to certain exceptions, prohibits persons engaged in a distribution of securities from bidding for or purchasing, or inducing others to purchase,

compliance with Rule 10b-6, NYSE Rule 460.20 requires a specialist organization to "give up the book" (i.e. suspend its specialist activities) to a specialist organization unaffiliated with any distribution participant, which then assumes all specialist responsibilities under NYSE rules until the approved person (affiliate) has completed its participating in the distribution.⁵ At the conclusion of the approved person's participation, the regular specialist organization regains the "book" and resumes its specialist activities.

The Exchange has filed a request with the Division of Market Regulation ("Division"), separately from this proposed rule change, for exemptive relief from certain provisions of Rules 10b-6 and 10b-13⁶ ("Petition for Exemptive Relief").7 This request was based on competitive concerns in light

⁵ Exchange Rule 460.10 prohibits an approved person of a specialist organization from engaging in any business transaction with any company whose stock the specialist is registered or accept a finder's fee from such company. See NYSE Rule 460. NYSE Rule 98, however, affords exemptive relief for approved persons of a specialist organization from restrictions found in various NYSE rules, including certain provisions of rule 460, that would otherwise be applicable to such approved persons transactions in NYSE securities in which the specialist organization is registered or to business transactions with the issuers of such securities. See NYSE Rule 98, infra note 9. Therefore, an approved person of a specialist organization must be entitled to an exemption from Rule 460.10 pursuant to Rule 98 to act as an underwriter in any capacity for a distribution of securities in which an associated specialist is registered.

⁶ Rule 10b-13 under the Act, among other things, prohibits a person making a tender offer or exchange offer for any equity security from, directly or indirectly, purchasing or making any arrangement to purchase any such security (or any security that is immediately convertible or exchangeable for such security), otherwise than pursuant to the offer, from the time the offer is publicly announced until its expiration, including any extension thereof. Rule 10b-13 also applies to the dealer-manager of a tender offer because the dealer-manager acts as the agent of the bidder to facilitate the bidder's objectives. See 17 CFR 240.10b-13.

The Exchange is seeking relief from Rule 10b-13 to allow affiliated specialists to continue their market making functions in their respective specialty securities in connection with certain mergers or tender or exchange offers in which an affiliated broker-dealer is participating.

7 See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Jonathan G. Katz, Secretary, SEC, dated April 28, 1995.

of the amendments to Rule 10b-6 and new Rule 10b-6A that permit NASD market makers to continue to make markets in a stock while participating in an underwriting of that stock, subject to several restrictions on their level of market making activity ("passive market making").⁸ In this regard, the Exchange believed that the failure to provide some type of exemptive relief from Rule 10b-6 for NYSE specialist units affiliated with underwriting firms may have a detrimental effect on the Exchange's ability to compete for issuer listings and on the willingness of large firms to invest capital in the specialist business. The Exchange further believed that the Commissions's passive market making restrictions could not be extended appropriately to Exchange specialists, who are subject to an affirmative obligation to deal when necessary to maintain a fair and orderly market. The Exchange believed, however, that exemptive relief was appropriate in light of the restrictions on the flow of information between the affiliated specialists and its approved person contained in Exchange Rule 98⁹ along with the additional safeguards specified in its Petition for Exemptive Relief.

Under this proposal, the Exchange proposes to replace the current "give up the book" provision with one that would make NYSE Rule 460.20 compatible with the Exchange's Petition for Exemptive Relief. The proposed rule change would allow an affiliated specialist to continue to make a market in the securities in which the affiliated

⁹ Pursuant to Rule 98 and the guidelines promulgated thereunder, the specialist organization and affiliated entities must be operated as separate and distinct organizations, and "information barriers" must be established that place substantial limits on access to, and communications of, trading information, including positions and strategies between the two organizations. Rule 98 exemptive relief is conditioned on the organizations receiving prior written approval from the NYSE, which conducts an annual review of each firm to ensure that all conditions for the exemption are being met.

¹15 U.S.C. 78s(b)(1) (1988).

²¹⁷ CFR 240.19b-4 (1994).

such securities, any security of the same class and series as those securities, or any right to purchase any such security ("related securities") until they have completed their participation in a distribution. The provisions of Rule 10b-6 apply to issuers, selling shareholders, underwriters, prospective underwriters, dealers, brokers, and other persons who have agreed to participate or are participating in the distribution, as defined in Rule 10b-6(c)(5), and their "affiliated purchasers," as defined in Rule 10b-6(c)(6), including broker-dealer affiliates. The applicable cooling off period is described in (xi) and (xii) of Rule 10b-6(a)(4). See 17 CFR 240.10b-6.

⁸ See Securities Exchange Act Release No. 32117 (Apr. 8, 1993), 58 FR 19528. In general, Rule 10b-6A permits "passive market making" in connection with the distributions of certain securities quoted on the Nasdaq Stock Market during the Rule 10b-6 cooling-off period, the period when the rule's provisions otherwise would prohibit such transactions. A passive market maker's bids and purchases, however, are limited to the highest current independent bid i.e., a bid of a market maker who is not participating in the distribution and is not an affiliated purchaser of a participating market maker. Furthermore, Rule 10b-6A contains certain eligibility criteria, volume limitations on purchases, and notification and disclosure requirements. See Rule 10b-6A(c)(2) (Level of Bid), (c)(3) (Requirements to Lower the Bid), (c)(4)(Purchase Limitation), (c)(5) (Limitation on Displayed Size), (c)(6) (Identification of a Passive Market Making Bid), (c)(7) (Notification and Reporting to the NASD). See 17 CFR 240.10b-6A(c)(2) through (c)(6).