

units' past conduct. For example, the Committee shall assess each constituent unit's:

(a) Participation upon request in the Exchange's FACTS program, in its marketing seminars, in sales calls and in other of its marketing initiatives seeking to attract order flow and new listings.

(b) Acceptance of innovations in order-routing and other trade-support systems and willingness to make optimal use of the systems once they become fully operational.

(c) Willingness to apply for a *broad range of new listings and for allocations of stocks that are less lucrative from the standpoint of profitability to the specialist.*

(d) Assistance to other units by providing capital and personnel in unusual market situations, such as "breakouts" and difficult openings.

(e) Efforts at customer relations with both listed companies and order providers, as evidenced by personal contact, return of telephone calls, prompt resolution of complaints, assessment of customer needs and anticipation of customer problems.

(f) Efforts to streamline the efficiency of its own operations and its competitive posture.

.20 Guidelines for Applying Consideration (c)(1)(a)(iv)

Consideration (c)(1)(a)(iv) requires review of whether a proposed combination is in the public interest. For example, the Committee may consider the unit's efforts to enhance market quality, its capabilities for maintaining ongoing communications with its listed companies and customers in compliance with Rule 106, and its commitment to applying for new listings and other activities.

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 Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these 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 aspects of such statements.

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

1. Purpose

The purpose of this filing is to amend the Policy, which was formally codified as NYSE Rule 123E.⁴ It has been previously filed with, and approved by, the Commission pursuant to Rule 19b-4.⁵

The Policy requires Exchange approval of proposed specialist unit combinations exceeding five, ten, or fifteen percent of any one of four concentration measures.⁶ The Policy provides that the Quality of Markets Committee ("QOMC") review proposed combinations which, by virtue of the size of the resulting unit (as defined by the four concentration measures), may raise concerns as to: (1) Overall concentration in the specialist community and reduced competition among specialist units as an incentive for allocations of newly-listed stocks; (2) the maintenance of market quality in the unit's stocks; and (3) the maintenance of the financial stability of the specialist system.

The QOMC has conducted 40 concentration reviews under the Policy since its adoption in 1987. This includes 24 Tier 1 reviews (any concentration measure exceeding 5%, but less than or equal to 10%), eight Tier 2 reviews (any concentration measure exceeding 10%, but less than or equal to 15%) and eight Tier 3 review (any concentration measure exceeding 15%). 32 of the 40 reviews (and seven of the eight Tier 2 reviews) occurred after 1993. In the concentration reviews, the QOMC examined the proposals on their own merits, and focused principally on whether the combinations would adversely impact market quality (with input from the Market Performance Committee) and the prospects for financial and operational success of the combined entities.

The NYSE believes that the environmental factors that prompted the adoption of the Policy in December 1986 are even more significant today. The Exchange faces increasing

competitive pressures in several areas. In addition, market volatility has increased substantially in the last half dozen years. Daily movements in the S&P 500 Stock Price Index of two percent or more are now as frequent as one percent movements were in 1993. This has required specialists to maintain more capital to cushion price movements and to contribute to the maintenance of fair and orderly markets. The Exchange believes that there is general agreement on the need for a policy to review specialist combinations which, on the one hand, enhances competition among specialists, maximizes the quality of Exchange markets and the services provided by specialists, and minimizes the risk of financial failure, while on the other hand, contributes to improved operational efficiencies, enhances risk management capabilities, and ensures that the specialist units are adequately capitalized and staffed to be better equipped to handle active and volatile markets. To this end, the Exchange believes that the current Policy has worked well, and that the combinations reviewed by the QOMC have enhanced the performance of the specialist organizations and the market quality in the stocks involved. However, the Exchange is continuing to evolve toward a smaller community of specialists. Therefore, it is important that the Policy contain specific guidelines to assist the QOMC in determining whether future combinations will strengthen the Exchange market and specialist system.

The Exchange proposes the following amendments to the Policy.

Scope of Quality of Markets Committee Reviews

De Minimis Increase in Concentration Measure

The filing proposes that when a combination of specialist firms results in an increase in any concentration measure of less than two points within a tier level, no review by the QOMC would be required. A review by the QOMC would still be required if a percentage change of less than two points nonetheless resulted in a unit moving into a higher tier classification (e.g., from Tier 1 to Tier 2). If a combination results in a specialist firm's percentage in any of the concentration measures moving from below 5% (where no QOMC review is required) to over 5% (e.g., moving from 4.5% to 6.3%), a QOMC review will be required, regardless of whether the percentage increase is above or below two points.

The Exchange believes that a 2% or more increase is an acceptable level to

⁴ See Securities Exchange Act Release No. 46579 (October 1, 2002), 67 FR 63004 (October 9, 2002) (SR-NYSE-2002-31).

⁵ It was last approved in Securities Exchange Act Release No. 35343 (February 8, 1995), 60 FR 8437 (February 14, 1995) (SR-NYSE-94-46).

⁶ The concentration measures include a specialist unit's share of: (1) common stocks listed on the Exchange; (2) the 250 most active listed common stocks for the last 12 months; (3) total listed common stock share volume for the last 12 months; and (4) total listed common stock dollar volume for the last 12 months.