

establish the need for QOMC review of a combination. Combinations below this figure do not usually have a significant impact on specialist operations in terms of capital or manpower. Combinations less than 2% will still require Market Performance Committee review and approval with respect to an assessment of the impact of the proposal on specialist performance and market quality. Requiring QOMC review for combinations greater than 2% is desirable initially to gauge the impact these have on specialist concentration. The Exchange may consider a different *de minimis* level after it gains experience with the 2% level.

The Exchange will explain how the *de minimis* provision of the Concentration Policy will be applied as part of the Information Memo that will be distributed to all members when the proposed rule change is made effective.

Combinations Not Approved

The QOMC has approved each of the proposed combinations presented to the Committee since the adoption of the Policy. The Market Performance Committee has approved all but one of the combinations it has reviewed.

Capital

The Policy currently requires units subject to Tier 1 reviews to maintain a minimum of 1½ times the Rule 104.20 position requirement for each stock that is included in the S&P 500 Stock Price Index ("S&P500"); units subject to Tier 2 reviews to maintain 2 times the position requirement for all S&P 500 stocks, and 1½ times the requirement for all other stocks; and units subject to Tier 3 reviews to maintain 2½ times the requirement for S&P 500 stocks, and 2 times the requirement for all other stocks. These requirements are proposed to be removed from the Policy in light of proposed amendments of other Exchange requirements.

In connection with maintaining more stringent capital requirements for the larger specialist organizations, the formula shown below was approved in changes to Exchange Rule 104.21.⁷ In addition, Exchange Rule 104.22 requires any new specialist entities that result from merger, acquisition, consolidation, or other combination of specialist assets to maintain net liquid assets (NLA) equivalent to the greater of either: (1) The aggregate of the NLA of the specialist entities prior to their combination, or (2) the capital requirement prescribed by Rule 104.

Below is a chart that shows the current NLA requirement.⁸

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|---|------------------------------------|
| Dow Jones Stocks | \$4.0 million per stock |
| S&P 100 Stocks | \$2.0 million per stock |
| S&P 500 Stocks | \$1.0 million per stock |
| Non-S&P Stocks | \$0.5 million per stock |
| Bond Funds | \$0.1 million per stock |
| Preferred Stocks and Structured Products | \$0.1 million per stock |
| Investment Company Units (Exchange-Traded Funds) ("ETFs") | \$0.5 million per ETF ⁹ |

The Exchange also proposes to require that a unit subject to a concentration review must agree that all required specialist unit capital be accounted for separately from any other capital, and be used solely for the specialist business.

Market Performance Committee Assessment

The Market Performance Committee ("MPC" or the "Committee") is charged with the responsibility of reviewing and approving, or disapproving in writing, a specialist combination to see what effect it will have on market quality.¹⁰ The MPC has reviewed specialist combinations since its inception. The Committee receives a summary of the proposal, letters from the specialist firms or individuals involved, information with respect to the stocks involved, historic and proposed capital of the combined units, capital requirements, personnel information, clearing arrangements and operational statistics of the units (e.g., SPEQ ratings, dealer participation rates, stabilization rates, etc.).¹¹ The proponents of a combination may be asked to appear before the MPC to answer any questions it may have. The MPC then utilizes its expertise and judgment to decide what effect a proposed combination will have on market quality in the stocks involved. If the MPC determines that a proposed combination will significantly erode market quality, it would be required to inform the units of its concerns. If the parties persist in their

plans, the MPC can inform them that some or all of the affected stocks will be put up for reallocation.

The MPC's assessment of the impact on market quality in the stocks would include a specific assessment of the performance of each specialist who will be designated to trade a component stock of the Dow Jones Industrial Average (DJIA), if a Tier 1 review; and any S&P 100 stock if a Tier 2 or Tier 3 review. The unit under review must discuss in particular the performance statistics for stocks it received through previous combinations or transfers of registration within the last two years.

Personnel

The Policy is proposed to be amended to require the proponents of the combined units to disclose whether the existing clerical support of the combined units will be maintained or increased. The Policy is also proposed to be amended to provide that specialist units involved in a Tier 2 or Tier 3 combination must have a separate corporate relations department fully staffed to maintain good relations with each listed company and major member organizations, and be capable of keeping listed company officials apprised of market developments on a daily basis. Each unit must show that they have satisfied the listed company and member firm contact requirements of Rule 106, and, if they have not, they must present an acceptable plan to the QOMC that provides specific, tangible steps to improve such contact.

Commitment to the Exchange

Section b(3) of the Policy is proposed to be amended to require that the QOMC assess each constituent unit's 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.

Management and Operations

As proposed, the Policy will require that the unit under review in a Tier 2 or Tier 3 review must discuss whether it will:

- Designate a senior specialist to be responsible for reviewing specialist performance data;
- Have procedures for correcting any deficiencies identified;
- Designate specific individuals to handle unusual situations on the Floor and, if so, the names of the individuals;
- Employ a "zone management" system on the Floor and, if so, who will be responsible for overseeing each

⁷ See Securities Exchange Act Release No. 43098 (July 31, 2000), 65 FR 49044 (August 10, 2000) (SR-NYSE-99-46).

⁸ The NYSE requested that the Commission insert this sentence for clarification. Telephone discussion between Jeff Rosenstock, Senior Special Counsel, NYSE and Mia C. Zur, Attorney, Division, Commission (March 5, 2003).

⁹ A unit registered in only one ETF would be subject to the \$1m minimum capital requirement of Rule 104.20. See SR-NYSE-2001-08 (approved in Securities Exchange Act Release No. 44616) (July 30, 2001), 66 FR 40761 (August 3, 2001).

¹⁰ In Amendment No. 1, the Exchange added rule language to require that disapprovals be made in writing. The NYSE requested that the Commission modify this sentence to indicate this change. Telephone discussion between Jeff Rosenstock, Senior Special Counsel, NYSE and Mia C. Zur, Attorney, Division, Commission (March 5, 2003).

¹¹ See Section 5 of the Policy.