



January 18, 2011

Elizabeth Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: File Nos. SR-EDGA-2010-18/SR-EDGX-2010-17

Dear Ms. Murphy:

Direct Edge Holdings, LLC ("Direct Edge")¹, on behalf of EDGA and EDGX Exchanges, Inc., (the "Exchanges") appreciates the opportunity to respond to comments from NYSE Euronext ("NYSE")² on the proposed rule filings³ to amend the Exchanges' Rules 11.9(b)(1)(C) regarding the processing of Step-up orders through an auction (the "Auction Process"). In its proposed rule filings, Direct Edge seeks to create a mechanism that will allow its members to initiate a competitive auction among other members who have elected to receive such order information (each such member, an "Electing Member"). Such auction would take place for a 10 millisecond period (the "Auction Period") and allow Mid-Point Match ("MPM")⁴ order responses, which would provide for an execution at the mid-point between the National Best Bid and the National Best Offer (the "NBBO Midpoint").

Direct Edge limits its response to NYSE objections that are specific to the Auction Process, rather than the NYSE's restatement of its general objections to flash orders. Direct Edge has already addressed those concerns in its response⁵ to the Commission's proposing release on the Elimination of Flash Order Exception from Rule 602 of Regulation NMS (the "Release").⁶ Thus, our response is as follows:

I. Direct Edge's Auction Process comports with the Commission's Proposing Release on Rule 602

Direct Edge's offering comports with the Commission's preliminary guidance respecting Rule 602.⁷ In the Release, the Commission noted that a number of exchanges offer various price improvements auctions that would not be

¹ Direct Edge currently operates the third-largest stock exchange for the trading of U.S. equity securities, behind NYSE Euronext and NASDAQ OMX. More information about Direct Edge is available at <http://www.directedge.com>.

² See letter from Janet L. McGinness, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, SEC (Dec. 15, 2010), available at <http://www.sec.gov/comments/sr-edga-2010-18/edga201018-1.pdf>.

³ See Securities Exchange Act Release No. 63335 (Nov. 18, 2010), 75 FR 71783 (Nov. 24, 2010) and Amendment No. 2, which replaced the filing in its entirety – Securities Exchange Act Release No. 63572 (Dec. 17, 2010), 75 FR 80873 (Dec. 23, 2010) (SR-EDGA-2010-18); Securities Exchange Act Release No. 63336 (Nov. 18, 2010), 75 FR 71781 (Nov. 24, 2010) and Amendment No. 2, which replaced the filing in its entirety – Securities Exchange Act Release No. 63574 (Dec. 17, 2010), 75 FR 80876 (Dec. 23, 2010) (SR-EDGX-2010-17).

⁴ In SR-EDGA-2010-18, Amendment No. 2, proposed EDGA Rule 11.5(c)(7) defines a MPM as "an order with an instruction to execute it at the midpoint of the NBBO." EDGX Rule 11.5(c)(7) currently defines a MPM order the same way.

⁵ See letter from Eric W. Hess, General Counsel, Direct Edge to Elizabeth M. Murphy, Secretary, SEC (Nov. 20, 2009), available at <http://www.sec.gov/comments/s7-21-09/s72109-82.pdf>.

⁶ See Securities Act Release No. 60684, 74 FR 48632 (Sept. 23, 2009)(the "Release").

⁷ See *id.*

affected by the proposed amendment to Rule 602.⁸ The Commission characterized some of these mechanisms as follows:

[T]he Commission preliminarily believes that orders exposed as part of a competitive auction that provides an opportunity to obtain better prices than displayed quotations generally would not constitute bids and offers that must be provided to the consolidated quotation stream, nor would the responses to those orders if they were actionable only with respect to the exposed order.⁹

Contrary to the NYSE's assertion, Direct Edge is not offering an expansion of the flash order type, but rather an auction process that, in fact, has significant similarities to auction processes offered by the NYSE itself, including the benefits of facilitating price discovery and minimizing short-term price dislocation.¹⁰

The NYSE claims that the Auction Process introduces an artificial delay that increases the likelihood that the Step-up order will miss execution opportunities in other markets. The Auction Period would be the shortest in the securities markets, however, and substantially shorter than the NYSE Gap Quote auction which lasts for thirty seconds to two minutes. The Auction Period provides for near instantaneous execution while still ensuring a meaningful price improvement opportunity for members who *elect* to it. The short Auction Period responds to Commission concerns underlying Rule 602 respecting unnecessary routing delays¹¹ and is consistent with prior Commission approvals of similar proposals to reduce the duration of auctions.¹²

II. Direct Edge's Auction Process Encourages the Display of Trading Interest and Quote Competition

NYSE offers no data to support its assertion that the Auction Process causes missed price improvement opportunities. In contrast, the Auction Process creates meaningful price improvement opportunities for investors and help brokers to satisfy their best execution obligations.¹³ Further, markets with auction processes¹⁴ and multiple broker dealers¹⁵ have produced evidence of greater price improvement resulting from such processes.

⁸ See, e.g., BOX Rules, ch. V, sec. 18 (Price Improvement Mechanism); CBOE Rule 6.13A (Simple Auction Liaison); and ISE Rule 716(d) (Facilitation Mechanism).

⁹ See Release, *supra* note 6, at 48638.

¹⁰ For example, the NYSE operates auctions to solicit offsetting interest under its Gap Quote Policy and Rule 123C (its "Closing Procedures"). See NYSE IM-2010-08 (Feb. 16, 2010) and NYSE-IM-2010-11 (Feb. 26, 2010). Such auctions purport to "facilitate price discovery and minimize short-term price dislocation." See NYSE IM-2010-08 (Feb. 16, 2010). Absent such benefits, a fair and efficient single closing price process could not be achieved. See NYSE-IM-2010-11 (Feb. 26, 2010). Pursuant to its Closing Procedures, NYSE also publishes an order imbalance information data feed available to subscribers commencing at 3:45 p.m. and every five seconds thereafter until 4:00 p.m. Such information is designed to solicit actionable contra-side trading interest from feed recipients, make additional liquidity available to market participants, and reduce associated market impact.

¹¹ See Release, *supra* note 6, at 48637.

¹² See, e.g., Securities Exchange Act Release No. 58224 (July 25, 2008), 73 FR 44303 (July 30, 2008) (SR-ISE-2007-94) (reducing the duration of the auction from 3 seconds to 1 second); Securities Exchange Act Release No. 52711 (Nov. 1, 2005), 70 FR 67508 (Nov. 7, 2005) (SR-ISE-2004-04) (reducing the duration of the auction from 10 seconds to 3 seconds).

¹³ See Securities Exchange Act Release No. 51808 ("NMS Release"), 70 FR 37496, 37538 (June 29, 2005) ("[B]roker-dealers must take into account price improvement opportunities, and whether different markets may be more suitable for different types of orders or particular securities.")

¹⁴ See, e.g., letters to Elizabeth M. Murphy, Secretary, Commission, from William J. Brodsky, CEO, Chicago Board Options Exchange, Inc. (Aug. 9, 2010), available at <http://sec.gov/comments/s7-21-09/s72109-140.pdf>; Tony McCormick, Chief Executive

NYSE claims that the Auction Process will act as a disincentive to display limit orders. In fact, integrating the Auction Process with orders priced better but not outside the NBBO at the end of the Auction Period (such orders, “Eligible Book Orders”) will further enhance price competition and thus encourage all forms of market liquidity, as respondents to the Auction Process must compete with Eligible Book Orders. This allows a Step-up order to interact with the displayed market (the Eligible Book Order), a benefit the NYSE itself supports through its “Post No Preference Blind” (“PNP B”) order type.¹⁶ PNP B orders are not displayed on NYSE’s book but are designed to interact with it. In its rule filing for PNP B, NYSE lauded the benefits of such interaction, stating it would “remove impediments to and perfect the mechanism for a free and open market and a national market system.”¹⁷

The integrated competition that the Auction Process creates between aggressive and passive liquidity promotes, consistent with the principles of Regulation NMS, more efficient pricing of individual stocks and broadens the pool of available marketplace liquidity.¹⁸ As stated by the Commission in adopting Regulation NMS: “[T]he basic principle underlying Reg. NMS is to promote fair competition among markets, but within a system that also promotes interaction between **all** of the buyers and sellers in a particular NMS stock.”¹⁹ (emphasis added).

III. Integration of Eligible Book Orders and Mid-Point Match Orders Expands Member Choice

Expanding participation in the Auction Process to both Eligible Book Orders and MPM orders not only increases price competition but also expands member choice. As for Eligible Book Orders, such orders will be in no way disrupted or delayed due to their interaction with the respective books of the Exchanges and therefore, the order sender would be no more inclined to discriminate against such liquidity than any other liquidity in such books. Indeed, the Commission has consistently approved rule proposals that expand the participation to include the order books of exchanges in auctions on other markets.²⁰ As for the MPM order, such an order provides an

Officer, Boston Options Exchange (Nov. 23, 2009), available at <http://sec.gov/comments/s7-21-09/s72109-86.pdf>; Michael J. Simon, Secretary, International Securities Exchange, LLC (Nov. 23, 2009), available at <http://sec.gov/comments/s7-21-09/s72109-83.pdf>.

¹⁵ See, e.g., letters to Elizabeth M. Murphy, Secretary, Commission, from Jerry O’Connell, Chief Compliance Officer, Susquehanna International Group LLP (Aug. 23, 2010), available at <http://sec.gov/comments/s7-21-09/s72109-155.pdf>; John Nagel, Managing Director, Citadel LLC (Aug. 6, 2010), available at <http://sec.gov/comments/s7-21-09/s72109-144.pdf>; Christopher Nagy, Managing Director, TD Ameritrade Inc. (Nov. 23, 2009), available at <http://sec.gov/comments/s7-21-09/s72109-88.pdf>.

¹⁶ “The PNP B order is an undisplayed limit order priced at or through the Protected Best Bid and Offer (PBBO), with a tradable price set at the contra side of the PBBO. When the PBBO moves away from the price of the PNP B and the prices continue to overlap, the limit price of the PNP B will remain undisplayed and its tradable price will be adjusted to the contra side of the PBBO. When the PBBO moves away from the price of the PNP B and the prices no longer overlap, the PNP B shall convert to a displayed PNP limit order.” <http://www.nyse.com/equities/nysearcaequities/1157018931913.html>.

¹⁷ See Securities Exchange Act Release No. 56810 (November 19, 2007), 72 FR 66013 at 66015 (November 26, 2007) (SR-NYSEArca-2007-117).

¹⁸ See NMS Release, *supra* note 13, at 37498-99 (“Vigorous competition among markets promotes more efficient and innovative trading services, while integrated competition among orders promotes more efficient pricing of individual stocks for all types of orders, large and small. Together, they produce markets that offer the greatest benefits for investors and listed companies.”)

¹⁹ *Id.* at n. 442 and n. 795.

²⁰ See, e.g., Exchange Act Release No. 57937 (June 6, 2008), 73 FR 33865 (June 13, 2008) (SR-CBOE-2008-58); Securities Exchange Act Release No. 51666 (May 9, 2005), 70 FR 25631 (May 13, 2005) (SR-ISE-2003-07).

additional pricing mechanism for the respondent to offer price improvement where the respondent is unwilling to cross the NBBO spread to so.²¹

Conclusion

Direct Edge respectfully requests that the Auction Process Filings should be approved and allowed to be implemented under Commission oversight (as all exchange rules and products are). The Auction Process comports with the Commission's Release and encourages the display of trading interest and competition.

Direct Edge believes that the Auction Process improves investor choice and lowers transaction costs through price improvement, size improvement, lower exchange fees and reduced market impact. Rather than conflicting with Regulation NMS, the Auction Process promotes its underlying principles.²² The NYSE itself has acknowledged these benefits in selling its own products that access these forms of liquidity, stating they provide "increased potential for filling orders" and the "potential for price improvement."²³

Direct Edge would like to thank the Commission again for providing us with the opportunity to respond to comments on our Auction Process. We would welcome the opportunity to discuss our comments with the Commission.

Sincerely,



Eric W. Hess
General Counsel

²¹ See supra note 3.

²² NMS Release, supra note 13, at 37594.

²³ NYSE Arca to Provide Indication of Interest (IOI) Routing, March 12, 2008, available at http://www.nyse.com/pdfs/IOI_Routing.pdf. ("NYSE Arca IOI Routing Announcement.")