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Elizabeth M. Murphy
Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549

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File No. SR-NSX-2013-02

Madam Secretary,

Thank you for the opportunity to comment on the National Stock Exchange, Inc.(NSX); Notice of Filing of a Proposed Rule Change to Adopt a New Order Type Called the “Auto-Ex Only” Order.

I have been an active investment professional for over 35 years, working in many different aspects of trading, from floor trader to buy-side trader, and participating on numerous industry committees and organizations. These comments are my personal comments and should in no way be construed as the comments of any other group nor my employer.

It would seem that the folks at the National Stock Exchange have not heard the recent discussion regarding the complexity of the current market structure. At recent SEC roundtables and recent industry conferences many participants have bemoaned the over complexity of the current market structure, recommending simplification where possible. This proposed order type takes market structure in exactly the opposite direction. While this order type is designed to allow NSX users to bypass order delivery indications, it is not clear what happens to unfilled portions of orders that were only partially displayed.

As an example, the NSX is quoting stock A 10 x 10.10, bidding for 1000 shares. The 1000 share bid is comprised of 400 shares firm on the book and 600 shares bid for by an order delivery firm. An order arrives at the NSX to sell 1000 shares of stock A at 10, “Auto Ex Only”. The incoming order would fill the 400 shares bid for on the book, and 600 shares would be cancelled back even though there is still a National Market System (NMS) protected bid being displayed at 10 for 600 shares. That just defies logic, wasn’t an expressed goal of Reg NMS to encourage interaction with protected quotations between market venues?

Alternatively, assume that the 400 shares displayed firm on the book is part of a larger order in the book the balance of which is not displayed, would the incoming order attempting to interact with the 10 bid on an “Auto Ex Only” basis be entitled to more than the 400 shares as Reg NMS expressly contemplates?

Or would the undesired order delivery displayed bid preclude further interaction? As one can see this order type adds another layer of complexity to an already over complex market structure, but this is not a comment on order types & the complexity they bring to the market.

This is a comment on whether or not the current market structure needs an order delivery function at all and if so are the current criteria under which order delivery functionality operate appropriate.

In NSX's December 10, 2012 filing (Release No. SR-NSX-2012-25), where NSX seeks to impose an order delivery notification fee on ECNs using the order delivery mode in an attempt to "recover ongoing operational costs, excluding the costs of regulation, of order delivery mode", says that the "order delivery mode is a unique market structure that costs more to operate and regulate than if the exchange offered only automatic executions." In this filing the NSX justifies bearing the added costs of operating and regulating the order delivery mode by wrapping itself in the flag of competition, saying that the exchange is "fostering competition between markets" and providing " ECNs with a mechanism to grow within the National Market System." Indeed, REG ATS was promulgated to do just that, provide competition for exchanges by incubating ECNs and other technological advances. I whole heartedly agreed with the intentions of Reg ATS when it was adopted and it has proved to be an amazing success! But that was nearly 20 years ago; we now have a robust, highly competitive National Market System composed of 12 exchange choices, none of which trades more than 25% of daily volume and 40+ alternative trading systems. We are now faced with abundant competition for order flow and confronting a glaring omission in Reg ATS: How do we encourage these ATSs that we've incubated and nurtured along for the better part of 20 years to mature and become stronger market participants who can help defray operational costs and bear some of the market regulation burden of a very decentralized market structure. I for one do not believe that asking the two ECNs involved in the order delivery mode to provide firm quotes to the National Market System and doing away with order delivery entirely is too onerous of a first step.

Haven't we made enough progress promoting competition in our market structure over the last 20 years that we can now forgo tailoring SRO rules intended to delicately side step tertiary market participant's indications of interest? The notion that an ECN needs extra time to determine whether or not their quote has already been executed on their own book is ludicrous in this day and age. Every broker/dealer that provides automated routing algorithms provides the ability to break parent orders into smaller orders that are then sent to various venues for representation and execution. Wouldn't it be more appropriate to require the two small ECNs that avail themselves of the order delivery mode at the NSX to invest in such technology so that they could send firm executable quotes to the NSX? The NMS should not have to tip toe around archaic market micro structure, the micro structure should be brought in line with the NMS.

During the NMS debates in ‘04~ the strongest argument for an all fast NMS was the desire to eliminate the “free option” that the NYSE specialist was enjoying via the Intermarket Trading System (ITS) system. Under the ITS plan the recipient of an ITS message had up to 30 seconds to decide whether to fill the incoming order or cancel it. Trading was not measured in sub-second intervals then, but 30 seconds or 30 average exchange time increments was considered an objectionable amount of time. Now we trade in nanoseconds and order delivery firms are required to be able to respond to an order delivery notification in 100 milliseconds. However, order delivery firms are allowed to delay an execution by up to 300 milliseconds effectively giving order delivery firms an option to fill or cancel an order for 300,000,000 average exchange time increments. Even if we slow the market down to trading in milliseconds and look at this issue we see the order delivery firms receiving free options for 300,000 average exchange time increments. This is most certainly not the automated and immediately executable quote required by Reg. NMS.

In the SEC Division of Market Regulation responses to frequently asked questions concerning Rule 611 and Rule 610 of regulation NMS, the very document that authorized the NSX’s creation of the shadowy order delivery mode, clearly states that “The SRO trading facility must be capable of providing a response to incoming orders that does not significantly vary between orders handled entirely within the SRO trading facility and orders delivered to the ECN.” The current NSX rule filing states “An incoming marketable order would be executed immediately against contra-side orders entered via Auto-Ex mode resting in the NSX Book. However, that same incoming marketable order may experience a delay if matched against an order resting on the NSX Book that was entered by an Order Delivery Participant via Order Delivery mode. The potential delays are due to [sic] Exchange sending an Order Delivery Notification to the Order Delivery Participant that posted the order requiring them to execute a potential match.” By the NSXs own admission there has clearly been a deviation between the authorized order delivery system and the program that is currently being administered.

While this filing is the exchange’s reaction to the ECNs low quote to fill ratio, a more telling statistic is the NSX’s low fill rate on IOC orders sent to the exchange to fulfill Reg NMS responsibilities. Are the majority of the cancellations a result of order delivery firms backing away from their displayed quotes? This should be fairly easy data for the SEC to collect and analyze. If in fact its empirical evidence the Commission needs to abolish this archaic piece of market structure, the Commission should have little trouble finding it.

I would also encourage the commission to investigate if the low fill ratios that investors experience at the NSX are due to the order delivery participants violating the rule interpretation set forth at question 2.05 in the Division of Market Regulation responses to frequently asked questions concerning Rule 611 and Rule 610 of regulation NMS which prohibits the simultaneous display of the same quotation on multiple automated trading centers. The inferior fill rate investors experience at the NSX is a significant source of frustration that has a deleterious effect on investor confidence at a time when investor confidence can afford little more deterioration. We need to make sure that all quotes in the National Market System are executable automatically and immediately, no ifs ands or buts.

Further I would encourage the commission to evaluate whether the NSX has fulfilled its SRO responsibility to monitor their systems in real time and “immediately identify its quotations as manual whenever it has reason to believe it is not capable of displaying automated quotations. The definition of automated quotation requires, among other things, that a trading center provide an immediate response to incoming immediate-or-cancel ("IOC") orders and immediately update its quotations.” In the current filing the NSX has identified the potential delays in executing orders, but it has failed to identify any of those problematic quotes as manual as required. It does not appear that the NSX has the appropriate policies and procedures in place to fulfill its obligations under Reg NMS.

The order delivery mode has operated for six years and failed to find any significant following with only two participants using it and the total volumes attributable to those participants hovering around one percent of average daily volume each. It appears to be frustrating its operator and deviating from the original rules that allowed its development. The program is a source of frustration for other market participants and seems difficult to regulate and expensive. I would urge the Commission to deny this rulemaking petition, find the empirical data the Commission desires and shutter the whole archaic order delivery function. May it rest in peace?

Sincerely,

Peter J. Driscoll
Investment Professional