November 16, 2006

Dear SEC:

I am writing to address the NYSE's attempts to respond to comments on 2006-65.

As is the case with all its attempts to "respond" to criticism, the NYSE has offered meaningless truisms and platitudes, distorted the substance of the actual criticisms being made, and ignored the actual substance of the critique.

Specialist Trading Against Elected Stop Orders

In its proposal, the NYSE would "blind" the specialist to information about stop orders, and therefore eliminate the requirement that specialists guarantee elected stop orders the "electing" sale price if their purchasing or selling elects the stop orders. I pointed out the problem here in terms of the way the "hybrid" market actually works: the elected stop orders become market orders,and the specialist's algorithm has the exclusive first crack at trading against market orders, and can do so at prices away from the "electing" price, to the detriment of the stop orders.

Removing the specialist's guarantee hardly address the real problem here: the inherent advantages the specialist's algorithm has, and the fact that, regardless of the specialist's knowledge or lack thereof, the specialist, with an anti-competitive advantage to begin with, will be executing elected stop orders in many instances at prices inferior to that which they would receive today (in cases where the "guarantee" is operative). Good for the specialist, bad for the public. And I am not being "anti-specialist" here (or in any of my other comment letters, for that matter), just anti-specialist unfair competitive advantage.

The NYSE had no real answer here, other than meaningless marketing babble (the letter reads as though it came from the NYSE's marketing department) about how "customers" are "lauding" the NYSE's execution options and that I (a firm advocate of electronic trading conducted on a "level" competitive playing field, as is obvious from my comment letters) am somehow arguing for the NYSE to become a "museum exhibiting the quaint trading practices of previous centuries." If that's the "interpretation" the NYSE would put on my comments, the NYSE staff are clearly in need of a course in remedial reading comprehension!

To the extent that the NYSE condescends to deal with what I actually wrote, the NYSE makes the following observation: "Nothing in the filing [2006-65] even remotely suggests that the specialist, or indeed any NYSE market participant, has an exclusive right to interact with stop orders." In addition, the NYSE suggests that I have "completely ignored" the "trading competition" provided by floor broker "d quotes" (hidden limit orders).

Thus, the NYSE concludes that its proposal "neither exacerbates nor causes specialists to have any additional trading privileges than they currently have...."

The NYSE's representations are entirely false. In the current auction, an "elected" stop order (regardless of whether "elected" by a specialist's trade)becomes a market order which the specialist must expose to all other market interest in the trading crowd. Only if no one else will trade with the order may the specialist then trade with it (even if the specialist was otherwise required to "guarantee" the electing price, the specialist cannot trade if another market participant would trade at that price). The NYSE's order exposure rules, and the negative obligation, mandate that the specialist may function only as the trader of last resort so as not to displace public trading interest.

The NYSE is correct in the narrowest technical sense that nothing in 2006-65 suggests that specialists have the exclusive right to trade with elected stop orders.
But this is true only because 2006-65 contained no discussion whatsoever of how the NYSE "hybrid" trading process really works, and the limitations on "d quote"
competition with specialists.

The NYSE's "d quote" rules provide that "d quotes"
trade against "published" NYSE interest. But under the "hybrid" rules, market orders (which are what elected stop orders become) are never "published", but rather receive an immediate electronic execution. A fair reading of the "d quote" rules indicates that "d quotes" trade against limit orders, not market orders.
The specialist's algorithm, however, gets exclusive first crack at market orders. Thus, under the NYSE's proposal, another universe of orders (elected stop
orders) would become the exclusive preserve of the specialist. This is blatantly anti-competitive per se.

The point I am making here is not new. I discussed it at length in my comments on 2006-35, and the NYSE never rebutted my analysis.

It is simply disgraceful for the NYSE to keep repeating its erroneous positions as though they were the gospel truth.

The SEC staff cannot possibly accept the NYSE's representations at face value after their falsity has been amply demonstrated.

Hidden Order Trading and the Sweep Methodology

The NYSE continues to offer meaningless truisms about how hidden order trading is permitted in other markets, without even attempting to deal with my specific, substantive criticisms.

The issue, as the NYSE well knows, is not whether hidden order trading/reserve interest should be permitted, but whether it should be permitted on as "level" a competitive playing field as possible.

I need not repeat here the specific points I made in my September 10, 2006 comment letter, but they clearly demonstrate the inherent competitive unfairness of the NYSE model, from its anti-competitive restraints on order entry (only floor brokers, who do not execute the order, can perform the administrative order entry function) to the truly egregious "splitting rules", which harm the public limit order book to such an extent that, as I have noted in other comment letters, the media are quoting the professional trading community as concluding that the NYSE "hybrid" market is not a venue for posting limit orders.

While the NYSE pays "lip service" to meeting the needs of its customers, the professional trading community has easily concluded that the "hybrid" market was designed first and foremost to serve the interests of the NYSE's trading floor constituency.

The SEC staff need to seriously focus on the "burden on competition" issue. Facile analogies to other markets, with fairer rules, will not do, as no other market's hidden order methodology is as egregiously anti-competitive as the NYSE's.

To date, the SEC staff have refused to deal with these matters analytically. The SEC staff must confront the anti-competitive issue here head-on. As the NYSE is presenting for SEC approval a revised sweep methodology, any prior "approval orders" are inoperative here.

The SEC must act to ensure that the Congressional mandate as to "fair competition" is fully effectuated here, and that primacy be given to public limit orders, which the Commission has indentified as the critical element in the national market system's price discovery process.

Conclusion

Unique trading privileges for trading floor intermediairies are an aspect of the "quaint trading practices" of the physical trading era.

It is unconscionable for the NYSE to be installing these "museum pieces" into an electronic market.

Sincerely yours,

George Rutherfurd
Consultant (to two institutional trading organisations)
Chicago, IL