April 26, 2007

BY E-MAIL TO: rule-comments@sec.gov

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Re: SR-NYSE-2007-09, Release No. 34-55555: Comment on Proposed Rule Change Relating to NYSE Rules 18 and 134 (Compensation in Relation to Exchange System Failure)

Dear Ms. Morris:

The Trading Committee ("Committee") of the Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the above-referenced rule filing submitted to the Securities and Exchange Commission ("Commission") by the New York Stock Exchange LLC ("NYSE" or "Exchange"). The NYSE is proposing to adopt Rule 18, "Compensation in Relation to Exchange System Failure," to provide a form of compensation to member organizations when a loss is sustained in relation to an Exchange system failure. The NYSE is further proposing to amend Rule 134 ("Differences and Omissions-Cleared Transactions ("QTs")") "…to require that profits equal to or greater than $5,000 gained in relation to an Exchange system failure be remitted to the Exchange to be included in funds available for distribution pursuant to proposed Rule 18."

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

I. Introduction

The Committee is very concerned with the limitation of liability in general for self-regulatory organizations ("SROs") – exchanges and ADF participants – in this new for-profit and Regulation NMS world. As you are aware, broker-dealers are now required to access these venues – venues that are competitors. With the changes in the business models of the SROs, the general liability issue should be revisited by the SEC, SROs, and the industry.[2] Such a review is especially necessary in light of the systems problems that we have experienced recently, such as those on February 27, 2007 that resulted in losses to both member organizations and their customers.

II. Member Organization Concerns Regarding the NYSE Proposal

Currently, pursuant to NYSE's Rule 17, the NYSE generally disclaims all liability for damages incurred by member organizations while using its facilities. The NYSE's proposed rule change suggests that the NYSE is conforming its rules to reflect current industry practice to provide some compensation to its member organizations for certain losses sustained in relation to the use of the Exchange's systems. The NYSE further claims that its proposal is based on NYSE Arca's Rule 13.2, which relates to NYSE Arca's own liability for systems failures. The NYSE's proposal, however, deviates from current industry practice in a number of respects that would cause member organizations concern.

A. Definition of Exchange System Failure and Exclusion of Queuing

The NYSE's characterization of what constitutes an "Exchange system failure" is more narrowly tailored than that of other exchanges.[3] In particular, proposed NYSE Rule 18(b) explicitly excludes from the definition "delays in order processing as a result of large volume, commonly known as 'queuing'." Such an exclusion would essentially absolve the NYSE of any liability for the queuing of orders that occurs in or between either NYSE's own systems or those of SIAC (a wholly owned subsidiary of the NYSE), including after having communicated its "acknowledgement" of an order. Currently, for orders to be received for display and execution on the Exchange, they must be routed by member organizations via the SIAC "customer gateway" infrastructure to access the NYSE's Display Book, its order management and execution facility. Member organizations receive an acknowledgement of the delivery and receipt of their orders by the customer gateway prior to actual order receipt by the Display Book. It is therefore possible for member organizations to receive acknowledgements of their orders that are later "stuck" in queue between the customer gateway and actual receipt by the Display Book.

In accordance with common industry practice, as reflected in NYSE Arca Rule 13.2 and NASDAQ Rule 4626, liability for an exchange with respect to systems failures should begin

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[2] We note that these liability issues raise important access concerns that also may need to be reviewed.

[3] See NYSE Arca Rule 13.2 and NASDAQ Rule 4626 for comparison.

upon the acknowledged receipt of an order. Under NYSE's proposed definition of an Exchange system failure, however, the NYSE would not incur any liability for orders acknowledged by the customer gateway, but then thereafter stuck in queue prior to reaching the NYSE's Display Book for handling. As evidenced by systems issues experienced by the NYSE on February 27 and March 28, 2007, the possibility of orders being queued internally in NYSE (or NYSE subsidiary) systems between acknowledgement of the order and receipt by the NYSE's Display Book is a reality that the broker community must operate under today. It is common industry understanding that this occurrence is due in large part to a technical implementation decision made by the NYSE to acknowledge the order upon receipt by the customer gateway as opposed to by the Display Book. Most other exchanges provide for the acknowledgement and receipt of an order by their respective matching engines.

The queuing of orders in this manner has the potential to impair price discovery both during the trading day in the continuous market, as well as at the closing auction where price discovery in NYSE-listed securities occurs solely on the NYSE. The NYSE's proposed exclusion of liability for internal queuing of orders after acknowledgement of the orders by the customer gateway differs significantly from the liability that would currently be incurred by NYSE Arca and NASDAQ under their respective rules. The NYSE's proposal should therefore be amended to include queuing in its proposed definition of an Exchange system failure to provide uniformity and consistency across exchanges with respect to their liability for such failures.

B. Remittance of Net Gains to the Exchange

Member organizations are currently required to report certain profits to the Exchange that result from any error transactions in relation to an Exchange system failure, but are not required to remit them to the Exchange. Proposed NYSE Rule 18(d) and related amendments to NYSE Rule 134.40 would now obligate member organizations, in certain cases, to remit all net profits in excess of $5,000 gained in relation to an Exchange system failure to the NYSE, which would then use those funds to provide additional reimbursement to member organizations. This is a novel proposal and would impose new obligations on member organizations to remit profits that did not result from any act or omission on their part, but because of an act or omission on the part of the Exchange. Such a requirement is not imposed by NYSE Arca or NASDAQ under their current limitation of liability rules.

In addition, it is also not clear from the description of the rule proposal how the NYSE intends to reconcile this new requirement under proposed Rule 18 and amended Rule 134.40 with it current Rule 411 regarding the handling of erroneous reports by NYSE member organizations. Under Rule 411, among other things, member organizations are required to offer, for trades that are executed but for which reports were not generated or delivered, to a non-member customer any errors whether favorable or unfavorable to the customer. The customer may choose which, if any, of the execution reports to accept, but will most likely accept only those that are favorable and decline those that are unfavorable. Member organizations should not be subject to double liability under the current and proposed rules in that they must offer favorable erroneous reports to their customers and then may also have to count these as "profits"

relating to an Exchange system failure for disgorgement purposes. The determination of whether there is a net profit should therefore be made after all erroneous reports are offered to customers; otherwise, member organizations with non-member customers would be significantly disadvantaged under the proposal.

Furthermore, it is unclear how proposed Rule 18 and amended Rule 134.40 would be applied in the case of orders received by NYSE's Display Book that remain unexecuted because of an Exchange system failure. Currently, for unexecuted orders for which no reports are generated, neither the Exchange nor the member organizations would be obligated to provide an execution. Under this proposal, however, it is not easily ascertainable as to whether and when the Exchange would incur liability for unexecuted orders and how member organizations would determine whether they have a net loss to claim.[4] The NYSE needs to provide clarity and guidance on the practical application of proposed Rule 18 and amended Rule 134.40 in order for the public to provide meaningful comment on this proposal.

C. Member Organization Contribution

Proposed NYSE Rule 18(e) provides that an Exchange-designated panel consisting of three Floor Governors and three Exchange employees will review all claims made by member organizations and could potentially reduce the amount claimed based on the "actions or inactions of the claiming member" with respect to the Exchange's system failure, including whether the member organization made appropriate efforts to mitigate its loss. The proposal, however, does not provide any clarity as to what types of actions or inactions would lead to a reduction in the amount claimed. While it is understandable that the NYSE would want to provide such a panel with flexibility to consider a wide array of possible contributing factors, such unbridled discretion could potentially lead to abuse. The NYSE should therefore amend its proposal to either provide objective criteria for its panel to make determinations and/or provide examples of actions and inactions that would constitute grounds for the reduction of any possible reimbursement.

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[4] The following example illustrates our concern: Non-member customer Client A sends a market-on-close order to Member Organization to buy 100,000 shares of ABC stock with a limit price of $30.10. Non-member customer Client B sends a market-on-close order to Member Organization to sell long 50,000 shares of XYZ stock with a limit price of $39.90. Both orders are sent by Member Organization to the NYSE, are acknowledged by the NYSE and are received by the Display Book. However, due to an Exchange system failure around the market close, both orders remain unexecuted. ABC stock closes at $30.00 and XYZ stock closes at $40.00. Therefore, both orders were marketable and should have been executed in the closing auction. Assume that the next morning, ABC stock opens at $31.00 and XYZ stock opens at $42.00. Client A wants to claim a loss for $100,000.00 – the $1.00 price difference based on the current market price times 100,000 shares. Client B would not want to claim anything and would want to instead sell its shares long at $42.00 the next morning. Under the proposal, could Member Organization claim a loss for Client A? Or, would Member Organization have had to commit capital and execute Client A's order at risk in order to have standing to file a claim with the NYSE? If capital commitment is not required, then would Member Organization have to claim a "profit" for Client B for $100,000 simultaneous with the claim for liability for Client A? These are important questions that need to be addressed to understand the true impact of this proposal on member organizations.

D. Deadlock Decisions Made by the Chief Executive Officer or President

Proposed NYSE Rule 18(f) provides that in the event of a deadlock on the panel determining claims filed by member organizations for losses, the Chief Executive Officer or the President of the Exchange or his or her designee[5] will make the final determination. Decisions impacting the regulation of and compensation to NYSE member organizations should not be made by an officer of the for-profit NYSE entity, and should instead be made by the Chief Regulatory Officer of the Exchange or some other senior officer within the Exchange's regulatory arm.

E. Recent NYSE Information Memos Relating to Systems Failures

The NYSE recently issued two information memos regarding the use of floor error accounts for the handling of unexecuted orders and executed trades after the systems failures that it experienced on February 27 and March 28, 2007.[6] Both information memos illustrate the Exchange's recognition of necessary recourse for its systems failures, including for "delays in order processing" and "delays in delivering execution reports," and the acceptance of limited liability in these cases. Through these information memos, however, the NYSE solely provided limited relief to its floor broker members and did not provide similar relief to upstairs member firms, thereby unfairly discriminating between different classes of members.

Pursuant to the information memos, floor brokers were advised that they could use their floor error account to execute any customer orders that remained unexecuted or to unwind any trades for which order cancellations were received but not appropriately processed by the NYSE relating to the systems failures. In addition, floor brokers that received "double executions" (*i.e.*, they manually executed a customer order still pending with the specialist or a NYSE system, which later executed the order) could trade out of the subsequent automatic execution and apply for reimbursement of any losses.[7]

While the Exchange via these information memos took steps towards accepting some liability for its systems failures, it did so in a manner that discriminated against non-floor broker member organizations and those parts of member organizations that transmit orders electronically with little ability to leverage their floor brokers. Upstairs firms were left without any recourse following the February 27 and March 28, 2007, incidents. **Furthermore, as evidenced by these recent systems issues at the NYSE, the bulk of any Exchange systems problem impact is likely to be on upstairs firms that send large volumes of orders**

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[5] Please note that the description of the NYSE's proposal states that the Chief Executive Officer or the President or his or her designee will make the final decision, while the actual proposed rule text states that the President and his or her designee will make such decision.

[6] See NYSE Information Memos 07-20 and 07-29, respectively. It is arguable whether these information memos constitute "rules" that would require them to have been filed with the SEC pursuant to Section 19 of the Securities Exchange Act of 1934, as amended.

[7] In NYSE Information Memo 07-29, the NYSE instructed floor brokers to check the status of their electronically transmitted orders with the specialist and to trade manually. This is something that upstairs firms would not have had the ability to do in case of a systems failure. Given the multiple thousands of orders entered electronically by upstairs firms, even checking the status of the electronically transmitted orders would be impracticable.

electronically to the Exchange. A practical application of proposed Rule 18, as currently drafted, would result in a benefit to floor broker members in the case of an Exchange system failure to the detriment of upstairs firms.

III. Conclusion

With the changes in today's market structure, it is critical that the Commission reevaluate the rules governing exchanges and market center liability. In addition, we believe that this NYSE proposal should be reevaluated for clarity, uniformity with respect to the NYSE Arca and NASDAQ rules, and the discriminatory impact on different classes of member organizations. We appreciate your consideration of our views. If you have any questions or require further information, please feel free to contact me at 610-617-2624 or Ann Vlcek, SIFMA Vice President and Associate General Counsel, at (202) 434-8400.

Respectfully submitted,

Jerry O'Connell, Chair
SIFMA Trading Committee

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Roel C. Campos, Commissioner
The Hon. Annette L. Nazareth, Commissioner
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