



JEFFREY S. DAVIS
VICE PRESIDENT & DEPUTY GENERAL COUNSEL
9600 BLACKWELL ROAD
ROCKVILLE, MD 20850

P: (301) 978-8484
F: (301) 978-8472
E: jeffrey.davis@nasdaqomx.com

November 25, 2008

Florence Harmon
Acting Secretary
US Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: SR-NYSE-2008-108
SR-NYSE-2008-110

Dear Ms. Harmon:

The NASDAQ Stock Market LLC urges the Commission to abrogate and publish for regular notice and comment the above-listed proposed rule changes filed by the New York Stock Exchange (“NYSE”). The first, SR-NYSE-2008-108, creates Supplemental Liquidity Providers or SLPs, an entirely new class of market participants on the NYSE, including a new evaluation committee, a new set of initial qualifications, a new allocation process, and a new set of penalties applicable to member firms. The second, SR-NYSE-2008-110, layers on a new incentive structure that advantage this new class of market participants at the expense of other members. The fee proposal rewards liquidity provision and aggressive quoting by SLPs, but does not reward the same conduct when engaged in by non-SLPs. The SLP Creation Proposal and the SLP Fee Proposal – collectively the “SLP Proposals” - were permitted to take effect immediately; in fact, the Division of Trading and Markets waived the 30-day preoperative period set forth in SEC Rule 19b-4(f)(6) for the SLP Creation Proposal.¹

NASDAQ owns and operates a broker-dealer, NASDAQ Execution Services (“NES”), that is an NYSE member and that provides significant liquidity to the floor of

¹ NYSE stated no compelling justification for a waiver of the 30-day pre-operative period. The fact that the waiver was improvidently granted or that the SLP Proposals have taken effect should not prevent the Commission from taking the appropriate step of abrogating the SLP Proposals now.

the NYSE. NASDAQ established this structure to comply with its obligations under Regulation NMS under the Exchange Act, particularly Rules 610 and 611, the Fair Access and Order Protection provisions of Regulation NMS, which require exchanges to route orders to better priced quotations on other exchanges and enable them to do so via wholly-owned broker-dealers. Since the implementation of Regulation NMS, NASDAQ, through its NASDAQ Execution Services broker-dealer², has at various times been both the largest member of the NYSE measured by shares traded³ and also the largest execution venue for NYSE-listed securities.⁴

NASDAQ believes that the SLP Proposals grant the NYSE substantially unchecked authority to discriminate among NYSE members. The SLP Proposals lack codified standards and other vital elements of due process, and fail to explain how the NYSE will ensure that all members will be treated fairly and equally as required under Section 6 of the Exchange Act. For example:

- The NYSE proposes to create an SLP Liaison Committee consisting of NYSE employees, but it fails to explain whether and how that committee will represent the interest of members, when and how it will deliberate, how it will decide which firms become SLPs, how the NYSE will oversee the Committee to ensure the fair and equal treatment of members, or whether and how it will be governed by the board of The NYSE Group, the NYSE, or FINRA.
- The NYSE proposes to establish a quota for SLP firms, but it fails to explain what that quota is, how it is established, why it exists, or whether it will vary by security. The proposal also fails to explain how SLP slots will be allocated among equally-qualified members before the quota is reached, what happens to equally-qualified firms once the quota is reached, or how SLP slots will be reallocated if an approved SLP fails to meet its continuing obligations. In contrast to NASDAQ's market maker standards which permit an unlimited number of equally-qualified members, the SLP Proposals create a scarce status and then fail to explain how it will be distributed.
- The NYSE proposes that the Liaison Committee will assign specific securities to qualified SLPs, but it fails to explain which securities will be assigned to an SLP, how the Committee will decide to assign SLPs to each security, or how the Committee will balance the number and types of securities assigned to each SLP. The proposals also fail to explain how the interests of members will weigh in that analysis, how the Committee will ensure the equal treatment

² The NYSE Arca Exchange, a sister-exchange to the NYSE, is identically structured to route orders to other exchanges via its wholly-owned broker dealer

³ The last NYSE Broker Volume report measuring shares executed solely on the NYSE SRO shows that NASDAQ Execution Services was the largest NYSE member in November 2007. The NYSE Broker Volume report has since comingled volume on the NYSE SRO with the NYSE ARCA SRO and by that measure NASDAQ Execution Services was the largest member of the combined SROs through July 2008.

⁴ On numerous trading days NASDAQ matches more share volume in NYSE listed securities than the NYSE. For example, in September 2008 NASDAQ matched more NYSE-listed volume than the NYSE on 12 of the 21 trading days.

of members, how that allocation process will interact with the SLP quota, or how the NYSE management or board will oversee the allocation process to ensure the fair and equal treatment of members.

Taken together, the SLP Proposals provide NYSE with the unparalleled ability to burden competition for order flow and executions without explaining why such ability is necessary or even prudent. For example, the SLP Creation Proposal limits SLPs to firms that engage in proprietary trading, excluding NES and others that operate on an agency basis either to comply with Regulation NMS (in the case of NES) or by choice. NYSE fails to explain why this limitation is necessary or prudent. As stated earlier, NASDAQ has often been the largest liquidity provider to the NYSE and yet would be disqualified from serving as an SLP under the SLP Proposals. NYSE fails to explain why proprietary liquidity is more valuable than agency liquidity, or why proprietary liquidity should be favored over agency liquidity. NYSE claims that the proposal is designed to prompt liquidity provision but it simultaneously disqualifies large liquidity providers.

NYSE also claims that it is encouraging aggressive quotations, but it simultaneously disqualifies an entire category of members with predominantly agency order flow that have historically been among its most aggressive quoters. NYSE fails to explain why agency quoting is not aggressive, why proprietary liquidity is more aggressive, or to ensure that among all members the most aggressive quotations will receive the added rewards of SLP rebates. The NYSE fails to explain why it chose this limitation from among other options available for accomplishing its stated goals. For example, the NYSE could accomplish the same goal by simply offering a rebate to the most aggressively quoting members, similar to the incentives the Commission established via the “Quote Credit” element of the revenue allocation formula of Regulation NMS.

In NASDAQ’s view, these irregularities reveal that NYSE’s true motivation for the SLP Proposals is to discriminate among its members and to burden some members’ ability to compete with NYSE. NYSE’s failure to explain adequately either the operation or the rationale for its proposed rule is evidence that NYSE’s stated basis for the proposal is a pretext. NYSE’s proposals are a naked attempt to disadvantage one group of members – those that compete with NYSE – to benefit another class of members – those that do not compete with NYSE.

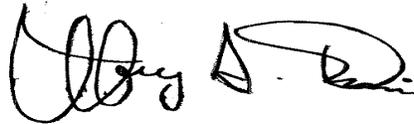
Perhaps most surprising is the NYSE’s aggressive attempt to implement these proposals on an immediately-effective basis. In doing so, the NYSE prompted the Commission to act inconsistently with past practice, inconsistently with its Rule Streamlining Guidance issued in July of 2008⁵, and inconsistently with its obligation to ensure that self-regulatory organizations comply with their obligations under Section 6 of the Securities and Exchange Act of 1934. NASDAQ, as an active proponent of the Rule Streamlining Guidance, is concerned that the NYSE will undermine that streamlining effort by attempting to leverage the Guidance in an inappropriate manner.

⁵ See Securities Exchange Commission Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008) (“Commission Guidance and Amendment to the Rule Relating to Organization and Program Management Concerning Proposed Rule Changes by Self-Regulatory Organizations”).

To support immediate effectiveness, the NYSE SLP Creation Proposal cleverly collects numerous past rule proposals that touch tangentially upon the topic of market makers and fees. None of the cited proposals is directly appurtenant to NYSE's SLP Proposals. For example, the Commission has not previously approved the creation of a new class of market participants on an immediately effective basis, and none of the cited proposals stands for that proposition. The Commission has not approved a new process for discriminating between members without requiring member representation or other governance protection for members. The NYSE attempted to overwhelm this weakness through sheer numbers of citations.

If the Commission is inclined ultimately to approve the SLP Proposals, it should first analyze the proposals carefully and explain how they are consistent with the statute. If the Commission permits the profound changes set forth in the SLP Proposals to become immediately effective, NASDAQ and perhaps other SROs will look forward to an equally expansive application of that relaxed standard to their own upcoming rule proposals. For example, NASDAQ would consider immediately effective filings to identify a class of proprietary-only trading firms that would be eligible for beneficial treatment to encourage greater participation in NASDAQ. NASDAQ would also consider aggressive pricing strategies and selection methods for its Select Market Makers program, or for its agency broker members. NASDAQ has considered such approaches in the past but concluded that the Commission would not permit such discriminatory practices.

Sincerely,

A handwritten signature in black ink, appearing to read 'Jeffrey S. Davis', written in a cursive style.

Jeffrey S. Davis

cc: The Honorable Chairman Christopher Cox
Commissioner Luis A. Aguilar
Commissioner Kathleen L. Casey
Commissioner Troy A. Paredes
Commissioner Elisse B. Walter
Dr. Erik Sirri, Director, Division of Trading and Markets