

March 28, 2012

VIA E-MAIL AND FEDERAL EXPRESS

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE.
Washington, DC 20549-1090

Re: Securities Exchange Act Release No. 34-66397 (File Nos. SR-NYSE-2011-56 and SR-NYSEAmex-2011-86); Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Changes to Codify Certain Traditional Trading Floor Functions That May Be Performed by Designated Market Makers and to Permit Designated Market Makers and Floor Brokers Access to Disaggregated Order Information—Rebuttal Comment Letter

Dear Ms. Murphy:

NYSE Euronext, on behalf of New York Stock Exchange LLC (“NYSE”) and NYSE Amex LLC (“NYSE Amex,” collectively with NYSE, the “Exchanges”), submits this letter in response to the grounds for disapproval identified by the Securities and Exchange Commission (the “SEC” or the “Commission”) in the above-referenced proceeding. The proceeding will determine whether the Commission disapproves the above-referenced proposed rule changes, which propose to codify certain traditional trading floor functions that may be performed by Designated Market Makers (“DMMs”) and to permit DMMs and Floor brokers access to disaggregated order information where market participants who placed the orders have not opted out of such access.

I. Background and Summary of the Proposals

On October 31, 2011, the Exchanges filed with the Commission proposed rule changes (“Proposals”) to amend certain of their rules relating to DMMs and Floor brokers. The Proposals were published for comment in the Federal Register on November 17, 2011.¹ The Commission received no comment letters on the Proposals. On December 22, 2011, the Commission extended the time period to February 15, 2012 in which either to approve the

¹ Securities Exchange Act Release Nos. 65735 (November 10, 2011), 76 Fed. Reg. 71405 (SR-NYSEAmex-2011-86) and 65736 (November 10, 2011), 76 Fed. Reg. 71399 (SR-NYSE-2011-56).



Proposals, disapprove the Proposals, or to institute proceedings to determine whether to disapprove the Proposals.² The Commission received no comment letters on the Proposals during the extension. On February 15, 2012, the Commission issued an order instituting proceedings to determine whether to disapprove the Proposals (“the February 15th Order”).³ In response to the February 15th Order, the Commission received five comment letters, all of which support the Proposals.

As discussed more fully in the Proposals, the Exchanges have proposed to amend NYSE Rule 104 to codify certain traditional Trading Floor functions that may be performed by DMMs, to make Exchange systems available to DMMs that would provide DMMs with certain market information, to amend the Exchanges’ rules governing the ability of DMMs to provide market information to Floor brokers, and to make conforming amendments to other rules.

The functions in the Proposals have traditionally been performed by specialists, now DMMs, at the point of sale, as described with more specificity in the NYSE’s *Floor Official Manual*.⁴ They fall into four categories: (1) maintaining order among Floor brokers manually trading at the DMM’s assigned panel; (2) bringing Floor brokers together to facilitate trading; (3) assisting Floor brokers with respect to their orders; and (4) researching the status of orders or questioned trades. To assist with certain of these functions, the Exchanges propose to amend their rules to specify that they would make systems available to DMMs at the post that display specified information. As noted in the February 15th Order, this would include access to disaggregated information about the price and size of any individual order or e-Quote, unless the entering firm has designated such interest as fully dark. The Exchanges further propose to restore their “market look” rule to provide that the DMMs may provide market information available to the DMMs at the post, including such disaggregated order information, to respond to inquiries from a Floor broker in the normal course of business.

The Commission stated in the February 15th Order that “while the Commission has recognized that exchanges may legitimately confer special benefits on market participants willing to accept substantial responsibilities to contribute to market quality, such benefits must not be disproportionate to the services provided.” As reasons for instituting the proceeding, the Commission stated (1) the Proposals do not “require of DMMs or Floor brokers any additional obligations to the market that might correspond to the proposed informational benefits” and (2) the Exchanges have not “explained how the Proposals might materially improve the quality of the [Exchanges’] markets, particularly given the increasing amount of automated transactions on the [Exchanges] and the reduced role of the Exchange floors.” As discussed more fully in Section II below, the Exchanges respectfully submit that the Proposals

² Securities Exchange Act Release No. 66036, 76 Fed. Reg. 82011 (December 29, 2011).

³ Securities Exchange Act Release No. 66397 (February 15, 2012), 77 Fed. Reg. 10586 (“February 15th Order”).

⁴ The *Floor Official Manual* was last published in 2004 and provides guidance on the manual market aspect of the NYSE’s trading Floor.



do not raise material market structure concerns that warrant this level of Commission scrutiny. And, as discussed more fully in Section III below, the Proposals do not confer special advantages or benefits that are disproportionate to the services provided in any way.

In particular, the limited nature of the proposed changes, yet how they promote the public interest, is demonstrated by the following:

- the disaggregated order information at issue in the Proposals relates only to the individual size components, including the identity of the entering and clearing firms (but not the identity of the ultimate customer), of the aggregate trading interest to which the DMMs already have access;
- the disaggregated order information would be available to DMMs and Floor brokers only when the participant entering the order decided to make such information available—that is, where the participant had chosen not to enter the interest as dark;
- the proposed availability of disaggregated order information would restore a longstanding and proven mechanism for bringing together buyers and sellers, not break new ground regarding market structure;
- the proposed availability of disaggregated order information will potentially make the Floor more hospitable to large orders, reduce transaction costs and produce savings for long-term investors;
- the concern about an informational advantage on the Floors is not a new premise, has already been addressed by existing restrictions on how Floor-based market participants trade, and has been, in effect, swept away by the profound competitive dynamics that has unfolded since 2005—dramatic declines in exchange market share and trade size and increases in speed have produced corresponding reductions in informational content on the Floor; and
- the absence of *any* opposition to the Proposals by institutional investors or any other market participant strongly indicates that the users of the Floor value rather than fear the informational flow contemplated by the Proposals and are confident that competitive forces will serve as an effective arbiter of the Proposals' merits.

II. Regulatory and Competitive Context of the Proposals

Before turning to the grounds for disapproval under consideration by the Commission, the Exchanges believe it would be useful to place the Proposals in the context of the fundamental structural reforms the Exchanges have undertaken since 2006. Notably, these reforms have their roots in significant part in the Commission's effort to modernize and strengthen the national market system for equity securities, Regulation NMS, adopted in 2005.⁵ In March 2006, the Commission approved the beginning of NYSE's historic shift "from a floor-based auction market with limited automated order interaction to a more automated market with

⁵ Securities Exchange Act Release No. 51808, 70 Fed. Reg. 37496 (June 29, 2005) ("NMS Adopting Release").



limited floor-based auction market availability.”⁶ With the approval of the “Hybrid Market,” the NYSE began the substantial expansion of automatic execution and the ability of its Floor members to participate in its automated market electronically.⁷ At the time of approval, automatic executions on the NYSE represented approximately 11% of its market share volume, and the bulk of executions occurred manually in its floor-based auction.⁸ The average speed of execution was over ten seconds.⁹ NYSE’s share of consolidated volume in NYSE-listed names for the year preceding the approval of the Hybrid Market was 79.1%.¹⁰

Roughly two years later, the NYSE proposed further and substantial structural reforms with its New Market Model.¹¹ Foremost in significance were: (1) the phasing out of the specialist system and the concurrent creation of the DMM; (2) the alteration of the NYSE’s longstanding priority and parity rules to allow DMMs to freely trade on equal footing with other market participants where the specialist previously had been obligated to yield to public customer orders in the book; and (3) the elimination of the advance electronic “look” at incoming orders that had been a historical feature of the specialist system.¹² In 2009, the year following the adoption of the New Market Model, NYSE’s share of consolidated volume in NYSE-listed names was 25.1%.¹³ By 2009, the average speed of execution was less than a second. Between 2005 and 2009, the average trade size in NYSE-listed securities fell from 724 to 268 shares.¹⁴ These structural reforms and the highly competitive market conditions under which they occurred were, needless to say, transformative.

In contrast, the current Proposals represent limited and non-controversial enhancements of several isolated components of the Exchanges’ product offering. The Proposals are not in any meaningful sense structural or impactful in any fundamental sense on the public interest. In proposing to codify certain trading floor functions and to provide Floor participants with effectively consensual access to certain order information, the Exchanges seek to provide improved conditions for buyers and sellers to interact at potentially more favorable prices, or

⁶ Securities Exchange Act Release No. 53539, 71 Fed. Reg. 16353 (March 31, 2006).

⁷ *Id.*

⁸ *Id.*

⁹ Securities Exchange Act Release No. 61358, 75 Fed. Reg. 3594, 3595 (January 21, 2010) (“Equity Market Structure Release”).

¹⁰ Equity Market Structure Release at 3595.

¹¹ Securities Exchange Act Release No. 58845, 73 Fed. Reg. 64379 (October 29, 2008) (“New Market Model Release”).

¹² *Id.* at 64380, 63387-88.

¹³ Equity Market Structure Release at 3595.

¹⁴ *Id.*



in larger-sized executions, on the Floors of the Exchanges. Notably, the change in access to order information is rooted in the historical function of the specialist in facilitating interactions between buyers and sellers, and the change in effect restores that function.¹⁵ Where much of the effect of the regulatory and competitive dynamics since 2005 has been focused on improving the speed of executions for traders, these Proposals represent a modest effort to enhance the Floor's ability to facilitate larger-sized executions, particularly for buy-side market participants.

Underlying the level of Commission scrutiny of the Proposals that the February 15th Order contemplates is an apparent skepticism with respect to the continued utility of the Exchanges' Floors, and a related concern that the restoration of access to disaggregated order information would somehow unfairly favor DMMs and Floor brokers at the expense of investors.¹⁶ To understand why the Exchanges believe that this apparent skepticism and concern do not warrant the level of scrutiny contemplated by the February 15th Order, it is useful to focus on what Floor brokers in particular offer investors. In a 2010 article investigating the determinants of volume in dark pools that cater to institutional investors, former SEC Chief Economist and Professor Mark Ready summarized what is perhaps the core function of Floor brokers:

Buy-side traders look for ways to reveal their orders only to potential counterparties, and keep them hidden from other market participants. Exchange floor brokers are perhaps the oldest example of this type of trading mechanism—they represent large institutional orders and look for other floor brokers who may be representing an order in the same stock but the opposite direction.¹⁷

It is important to keep the challenges and motivations of institutional traders firmly in mind in considering the role of Floor brokers. As another former SEC Chief Economist Larry Harris stated, institutional traders determine how much information to share about their trading interest by:

¹⁵ Rule 115 previously allowed NYSE Exchange specialists to provide disaggregated order information to Floor brokers prior to the adoption of the Hybrid Market. *See* NYSE Regulation Information Memo 05-5. The NYSE amended Rule 115 in connection with the Hybrid Market because at that time Floor brokers had no way to enter fully dark electronic interest. Now that Floor brokers, as well as off-Floor participants, have that ability, the purpose of the change to Rule 115 has been obviated and the Rule can return to its prior form.

¹⁶ *See* February 15th Order (stating that the Exchanges have not explained how the Proposals materially improve the market, “particularly given the increasing amount of automated transactions on the SROs and the reduced role of the Exchange Floors” and that the Commission is concerned that the Proposals may “unfairly discriminate in favor of DMMs and Floor brokers”).

¹⁷ Mark J. Ready, *Determinants of Volume in Dark Pools* (2010).



[W]eighing the benefits of display against the costs of display. The benefits are obvious. Buyers and sellers can find each other more easily when they both know that they want to trade For large traders, however, exposure can be quite costly.¹⁸

Because of this delicate balance, “[d]isplay decisions are the most important trading decisions that large buy-side traders make.” Professor Harris frames the stakes clearly: “Traders who optimize their trading strategies will have lower transaction costs and higher portfolio returns than those who do not carefully consider their trading problems.”¹⁹ Lower transaction costs and higher returns attributable to the careful management of display decisions, of course, directly benefit mutual fund shareholders, pension beneficiaries, and other long-term investors.

The Exchanges understand well that the increase in automation and the reduced role of the Floor have constrained the contribution that Floor brokers can make in helping navigate difficult trading decisions. That said, knowing first hand that the combined dynamics of markets and technology are humbling things, we continue to believe that the unique blend of human judgment and human interaction that distinguishes the Floor will continue to offer value to investors faced with difficult or complex orders and challenging market conditions.

The wake of decimalization illustrates the merits of restraint in prognosticating here. Predictions were common at that time that decimalization would drive market structure relentlessly and quickly toward a floorless future. Reality, as described in a 2005 GAO report, turned out to be more complicated:

Despite advances in electronic trading technologies that give institutional investors increased access to markets, some institutional investors continue to use full-service brokers to locate natural sources of liquidity as they did before decimal pricing began. According to institutional investor officials we interviewed, with fewer shares displayed as available for trading and reductions in average trade size, they are more patient about the time required to completely execute (fill) large orders using brokers in this way. *In addition, some noted they increasingly use NYSE floor brokers to facilitate the trading of large orders in less-liquid stocks, explaining that floor brokers have information advantages in the current market structure that help to minimize adverse price changes.*²⁰

Market structure dynamics and changing technology, in other words, presented investors with new challenges, and created new opportunities for agents to add value in meeting those

¹⁸ Larry Harris, *Trading & Exchanges: Market Microstructure for Practitioners*, at 383 (2003).

¹⁹ *Id.* at 380.

²⁰ *Securities Markets: Decimal Pricing Has Contributed to Lower Trading Costs and a More Challenging Trading Environment*, United States Government Accountability Office, Report to Congressional Requesters, May 2005, at 43 (emphasis supplied).



challenges. Professor James Angel, another veteran analyst of market structure and a member of the board of one of our all-electronic competitors, offered the following more current observation in this proceeding:

I personally witnessed the following example several years ago. I was visiting the NYSE floor and hanging out with a specialist and just watching the trading. A floor broker approached the specialist and indicated that he was working a large buy order. The specialist stated that there weren't many sell orders in the book, but he then pointed to another broker and said "He's brought in a 50,000 share sell order every day this week. Maybe he knows a big seller." The first floor broker walked over to the second, who then walked back to his booth, presumably to call his customer. A few minutes later, they printed a 500,000 share trade. In this way, the specialist helped a natural buyer meet a natural seller by disclosing just a little bit of what he knew about who was doing what. This reduced the leakage of information and thus the market impact for both parties.²¹

Once again, "leakage" and "market impact" are more than faculty lounge concepts—they are concrete trading phenomena that increase transaction costs and reduce portfolio returns. Providing a mechanism that allows agents to avoid them not only materially improves the quality of the Exchanges' markets, but also puts real money in the hands of investors.

Institutions representing those investors, often directly connected to every exchange and alternative market and fully armed with technology that allows them to optimize that access, continue to use the services of Floor brokers to meet the challenges presented by difficult and complex orders and unusual market conditions.²² Brokers, similarly enabled and duty bound to serve the interests of their customers, continue to find value in the services of Floor brokers. The Exchanges continue to see Floor brokers as an important component of the value proposition we offer to the investing public and our membership. The Exchanges respectfully suggest that the intense and transformative competitive dynamic referenced above displaces any theoretical concern that the Proposals would unfairly favor the Floor to the disadvantage of investors.

Moreover, the Exchanges believe that a close reading of the precedent cited by the February 15th Order indicates that the level of scrutiny contemplated by the Order is not required. In articulating the balance of benefits and responsibilities of Floor participants and the grounds

²¹ See Letter from James Angel, Ph.D., CFA, Associate Professor of Finance, Georgetown University, to the Securities and Exchange Commission, dated March 15, 2012 ("Angel Letter"), at 1-2.

²² More detailed descriptions of the services that Floor brokers provide institutional customers are set forth in the comment letters submitted by representatives from the Floor trading community. See Letter from Jonathan Corpina and Jennifer Lee, Organization of Independent Floor Brokers, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 13, 2012 ("Organization of Independent Floor Brokers"); Letter from Patrick Armstrong and Daniel Tandy, Alliance of Floor Brokers, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 13, 2012 ("Alliance of Floor Brokers").



for disapproval under consideration, the Order cites the New Market Model Order²³ and guidance issued by the Commission in 2008 with respect to proposed rule changes filed by SROs²⁴:

*As the Commission has previously recognized, the participation of market makers in exchange markets may benefit public customers by promoting more liquid and efficient trading, and an exchange may legitimately confer benefits on market participants willing to accept substantial responsibilities to contribute to market quality. While the rules of an exchange may confer special or unique benefits upon certain types of participants, however, such rules still must ensure, among other things, that investors and the public interest are protected. Accordingly, the Commission carefully reviews trading rule proposals that seek to offer special advantages to market makers and others. Although an exchange may reward such participants for the benefits they provide to the exchange's market, such rewards must not be disproportionate to the services provided.*²⁵

The Order goes on to apply a particularized balance to the Proposals by focusing on the absence of obligations specifically tied to the proposed change in DMM and Floor broker access to disaggregated order information:

In this case, the SROs have not proposed to require of DMMs or Floor brokers any additional obligations to the market that might correspond to the proposed informational benefits. Nor have the SROs clearly explained how the proposals might materially improve the quality of the SROs' markets, particularly given the increasing amount of automated transactions on the SROs and the reduced role of the Exchange floors. As a result, the Commission is concerned that that the SROs' proposals, among other things, may unfairly discriminate in favor of DMMs and Floor brokers, may not be designed to protect the broad group of investors that trade on the SROs, and otherwise may be inequitable.²⁶

Before turning to the argument set forth in Section III below that no "special advantages" or disproportionate benefits are being conferred by the Proposals, it is worth reviewing in some detail this standard as proposed by the February 15th Order. In particular, the source of the "substantial responsibilities" language from the Order, italicized above, is the New Market Model Order.²⁷ As noted above, the New Market Model proposal involved fundamental

²³ See New Market Model Release.

²⁴ Securities Exchange Act Release No. 58092 (July 3, 2008), 73 Fed. Reg. 40144, 40148 (July 11, 2008).

²⁵ February 15th Order (footnotes omitted and emphasis supplied).

²⁶ *Id.*

²⁷ New Market Model Release at 64388.



structural changes to the NYSE, including the phasing out of the specialist system and a wholesale alteration of the NYSE's historic priority and parity rules, a change that enabled DMMs for the first time to trade on parity with orders in the Display Book. Similarly, the second italicized excerpt above stating that the Commission "carefully reviews trading rule proposals that seek to offer special advantages to market makers and others" also comes from the New Market Model Order. Its reference to "special advantages" must similarly be understood as arising from a proposal constituting a fundamental structural reform of the NYSE.²⁸ What was proposed in the New Market Model, in other words, called for a qualitatively more intense review by the Commission than the modest changes proposed here. Accordingly, the language framing that standard of review and its underlying logic do not support the level of scrutiny contemplated by the February 15th Order.

Moreover, the source cited by the New Market Model Order for the "carefully reviews" language is the 2008 Commission guidance regarding proposed rule changes filed by SROs. The context from which it comes is the Commission providing "a partial list of the types of trading rules that the Commission believes are *appropriate for filing as immediately effective* rule changes"²⁹ That the Commission would want to telegraph that it scrutinizes trading rule proposals relating to market maker advantages that would go effective on filing makes perfect sense given the immediacy of the potential impact. The reference, however, does not justify an intensive and detailed review of limited adjustments to floor participant incentives that have been exposed to the notice and comment process.

Relatedly, in an apparent illustration of what it regards as "special advantages" and "rewards that are not disproportionate to the services provided[,]" the Commission cites in the 2008 guidance a series of orders approving proposals that generally involve the creation or registration of a new class of market maker or participation of an existing class in a new market.³⁰ The proposals cited were therefore structural in nature and in stark contrast to the limited nature of the Proposals in this proceeding. The Exchanges respectfully suggest that the level of scrutiny associated with them is not required here and that the standard applied in those proceedings should not be imported into the current proceeding. More fundamentally,

²⁸ *Id.*

²⁹ 73 Fed. Reg. 40144, 40147 (emphasis supplied).

³⁰ See Securities Exchange Act Release Nos. 54580 (October 6, 2006), 71 Fed. Reg. 60781, 60782 (October 16, 2006) (SR-ISE-2006-40) (providing that all members approved to operate ISE market maker memberships would be eligible to be Competitive Market Makers in the Second Market); 54238 (July 28, 2006), 71 Fed. Reg. 44758, 44761 (August 7, 2006) (SR-NYSE Arca-2006-13) (creating two types of Market Makers on OX trading platform: LMMs and Market Makers); 53652 (April 13, 2006), 71 Fed. Reg. 20422 (April 20, 2006) (SR-Amex-2005-100) (order approving the establishment of a new class of registered options trader called a Remote Registered Options Trader); 52094 (July 21, 2005), 70 Fed. Reg. 43913, 43915 (July 29, 2005) (SR-CHX-2004-11) (proposing to permit CHX participants to seek registration as market makers in one or more of the securities traded in electronic book); and 51366 (March 14, 2005), 70 Fed. Reg. 13217, 13221 (March 18, 2005) (order approving the introduction of Remote Market Makers).



the principal market participant impacted by the present proceeding, Floor brokers, is not a market maker at all, but an agent, rendering much of the referenced precedent factually distinct.

It is important to note that virtually all proposed rule changes—fundamental and structural, like the Hybrid or the New Market Model, or limited and modest, like the current Proposals—follow extensive consideration, and often, a balancing of diverse interests by the Exchanges. Building, maintaining, and reforming a market that serves the interests, for instance, of all investors and that remains conducive to the provision of liquidity in varying market conditions represents a formidable challenge. The Exchanges continue to listen carefully to the demands of investors and members and remain convinced that the Floors are a distinct and important part of the services the Exchanges should offer. It is this “interplay of competitive forces,”³¹ within the boundaries of the public interest, that continues to drive the shape of the product we offer.

III. Response to Grounds for Disapproval under Consideration Identified by the Commission’s Order Instituting Proceedings

1. The Proposals do not reward DMMs and Floor brokers with substantial benefits.

In contrast to the New Market Model, where DMMs were permitted for the first time to trade on parity with public customer orders, the rewards offered by the Proposals are insubstantial. DMMs already have access to aggregated order information; current Rules 13, 70, and 115 allow a DMM to have access to and disclose market information, including aggregated buying or selling interest contained in Floor broker agency interest files, aggregated interest of Minimum Display Reserve Orders, and interest included in DMM interest files. Currently, the aggregated buying and selling interest of Minimum Display Reserve Orders and reserve Floor broker agency interest files is not available to off-Floor market participants, unless a request is made on a specific security to a Floor broker. Moreover, market participants who enter such interest do so with full knowledge that a DMM will be able to access aggregated information about these types of interest and potentially relay such information to a Floor broker. In return for providing DMMs with access to this information, market participants entering such interest are assured that such interest will participate in manual transactions.

No “special advantages,” in other words, are conferred by the Proposals. The proposed increase in informational access is in reality a restoration of information previously available on the Floor, and not substantial in the context of information already available. The difference between the current and proposed information is that DMMs and Floor brokers will be able to see the disaggregated form of such aggregated interest, which means simply that the components of the aggregated interest and the entering and clearing firms that are associated

³¹ NMS Adopting Release at 37633; *see* H.R. Rep. No. 94-229, 94th Cong., 1st Sess. (1975) (“Conference Report”), at 92.



with those components (but not the ultimate customers) will be visible. Any informational advantage conveyed is extremely slight, as all market participants who choose to access the Floor through Floor brokers can receive the benefit of that information. Any Floor broker, that is, will be able to share manually (by phone or via the hand-held device³²) the components underlying the aggregated interest with any customer off the Floor. The reason for making this information available to Floor brokers is both simple and plainly aligned with the interests of the Floor broker's customer—it makes it easier for the kind of exchange illustrated by the Angel comment letter to occur, for size trades to be arranged, and for leakage and market impact to be avoided. Finally, any market participant who does not want information about their interest shown is entitled to instruct that their interest not be displayed, which makes the access to the disaggregated information entirely consensual and not “special” in any meaningful sense of the term.

From a trading perspective, DMMs receive no additional benefit from the disaggregation of trading information: the information is not available to a DMM's trading algorithm.³³ A DMM unit's use of an algorithm must be consistent with NYSE and SEC regulations.³⁴ As was the case following the adoption of the New Market Model, a DMM Unit's trading algorithms only have access to information with respect to orders entered on the Exchanges, Floor broker agency interest files, or reserve interest to the extent the information is made publicly available.³⁵ Any information usable in the DMM Unit's algorithm would be “the same information that is disseminated to the public by the Exchange[s], at the same time that it is available to other market participants, with respect to orders entered on the Exchange[s], Floor broker agency interest files, or reserve interest.”³⁶

Exchange rules already recognize that DMMs on the Floor have access to non-public order information. DMMs have been subject to the restrictions found in NYSE Rule 98, which governs access to non-public order information, since before the adoption of the New Market Model. Specifically, while on the Floor, DMMs and individuals assigned to the DMM unit cannot communicate with individuals or systems responsible for making trading decisions for the integrated proprietary aggregation unit. Also, an individual assigned to a DMM unit who moves to a location off the Floor cannot (1) make available any non-public order information or DMM confidential information to individuals or systems responsible for making trading

³² See NYSE Rules 36.21 (permitting Floor brokers to use authorized portable phones from the point of sale) and 36.70 (permitting Floor brokers to use wireless hand-held devices to transmit, among other things, information about buying and selling interest in the market).

³³ Providing DMMs with access to disaggregated order information increases their obligation as a Floor participant in that they must fairly and impartially provide the information to Floor brokers and serve a role to assist Floor brokers with their orders. DMMs receive no benefit from performing these functions.

³⁴ NYSE Rule 104(b)(i).

³⁵ NYSE Rule 104(b)(iii).

³⁶ New Market Model Release at 64379.



decisions for the integrated proprietary aggregation unit, or (2) use any non-public order information or DMM confidential information in connection with making trading decisions for the integrated proprietary aggregation unit. NYSE Rule 98 therefore erects a barrier between a DMM Unit's Floor participants and off-Floor trading operations, and contemplates the DMM having access to disaggregated information while on the Floor of the Exchanges.

As noted in the Proposals, the disaggregated information provided to DMMs as a result of these Proposals is only available to a DMM while on the trading Floor at the trading post, and the information is only available to the DMM in a static form. In a practical sense, to receive disaggregated information, a DMM must go stock by stock to determine what interest is available at each price point. A DMM must query the specific information about a particular security, a process which limits the number of securities for which information can be obtained at any given time. Any actual informational advantage resulting from viewing disaggregated information would be eliminated by the staleness of the information.

Further, DMMs' manual s-Quotes have to yield to all public interest. Under the provisions of Rule 72, DMM interest added intraday to participate in a verbal transaction with a Floor broker will be allocated shares only after all other interest eligible for execution at the price point are executed in full. Only s-Quotes representing DMM interest present at the price point prior to the verbal transaction with a Floor broker will receive an allocation on parity pursuant to Rule 72(c)(v).³⁷

For Floor Brokers, any benefit conferred by the Proposals is a benefit inherent in the function of a Floor broker acting as an agent. As discussed in more detail below, existing restrictions recognize the inherent informational advantage of operating on a trading floor and provide appropriate controls to prevent any potential abuse of non-public order information available on the Floor for a Floor broker's own benefit. Floor brokers act as agents for both large and small investors, and since they are prohibited from trading on a principal basis, any potential benefit accrues to the investor, not the Floor broker. In today's fast-moving electronic markets, Floor brokers need to rely on DMMs more than ever to source liquidity. As made clear in the New Market Model release, "the increase in electronic executions on the Exchanges as well as the increase in the use of smart routing engines by market participants of all types has reduced the advantages once enjoyed by Floor brokers and specialists."³⁸ Because Floor brokers must now compete with electronic markets, while still being regulated under pre-Regulation NMS Floor-based regulations, the benefit of the Proposals to Floor brokers is increased execution quality for their customers, which certainly promotes the public interest.

It is worth noting that less-regulated competing execution venues make disaggregated order information available to market participants under circumstances that raise more significant

³⁷ NYSE Rule 72(c)(xi).

³⁸ New Market Model Release at 64379.



concerns than the Proposals. For instance, dark pools already offer specialized size discovery mechanisms in order to bring large buyers and sellers in the same NMS stock together and facilitate a trade between them.³⁹ Also, broker-dealers maintaining both customer-facing and proprietary desks sometimes have access to disaggregated information within the same information barrier.⁴⁰

2. Existing Obligations and Restrictions match any benefits conferred on DMMs and Floor brokers as a result of the Proposals.

As the restoration of disaggregated information provided by the Proposals does not convey any truly exclusive or significant benefit to DMMs and Floor brokers, new, additional obligations are not necessary. Rather, existing trading restrictions and the additional affirmative obligations required by the New Market Model provide appropriate controls so that the Proposals meet the requirements of Section 6(b)(5) of the Securities Exchange Act of 1934 (the “Act”). While, for DMMs, benefits have changed in connection with the adoption of the New Market Model, trading obligations have changed as well.⁴¹ DMMs are subject to a number of restrictions governing access to non-public order information that remain unchanged since before the adoption of the New Market Model, and which were put in place when DMMs still had an agency role. Even though they no longer act as agents, DMMs are subject still to those trading restrictions. The rules of the Exchanges are designed such that any additional access by DMMs and Floor brokers to information not available generally to off-Floor traders carries with it restrictive obligations regarding the permissive uses of such information.

DMMs are subject to affirmative obligations regarding the quality of markets for its assigned securities. Specifically, NYSE Rule 104 provides that a function of a DMM is:

[T]he maintenance, in so far as reasonably practicable, of a fair and orderly market on the Exchange in the stocks in which he or she is so acting. The maintenance of a fair and orderly market implies the maintenance of price continuity with reasonable depth, to the extent possible consistent with the ability of participants to use reserve orders, and the minimizing of the effects of temporary disparity between supply and demand. In connection with the maintenance of a fair and orderly market, it is commonly desirable that a member acting as DMM engage to a reasonable degree under existing circumstances in dealings for the DMM’s own account when lack of price

³⁹ Equity Market Structure Release at 3599.

⁴⁰ *Id.*; see also FINRA, *OATS for all NMS Stocks Frequently Asked Questions*, <http://www.finra.org/Industry/Compliance/MarketTransparency/OATS/NMS/P122893> (last visited Mar. 27, 2012), (referencing a customer-facing desk and a proprietary desk “within the same information barrier.”).

⁴¹ See New Market Model Release.



continuity, lack of depth, or disparity between supply and demand exists or is reasonably to be anticipated.⁴²

Additionally, any transaction by a DMM for the DMM's account must "be effected in a reasonable and orderly manner in relation to the condition of the general market and the market in the particular stock."⁴³ A DMM Unit is still subject to the requirement that its algorithms receive only the same information with respect to orders entered on the Exchanges, Floor broker agency interest files, or reserve interest as is disseminated to the public.

In addition to trading obligations, DMMs also perform a number of administrative functions, which are inherent to the smooth operation of an auction market on the Floor. As stated in the original Proposals, DMMs perform four categories of Trading Floor functions. First, DMMs maintain order among Floor brokers manually trading at the DMM's assigned panel. Second, DMMs bring Floor brokers together to facilitate trading, which may include the DMM acting as a buyer or seller. Third, DMMs assist Floor brokers with respect to their orders by providing information regarding the status of a Floor broker's orders, helping to resolve errors or questioned trades, adjusting errors, and cancelling or inputting Floor broker agency interest on behalf of a Floor broker. And fourth, DMMs research the status of orders or questioned trades. The restoration of access to disaggregated information promotes enhanced facilitation of these important functions. DMMs perform these functions for the benefit of a fair and orderly market, and do not receive any benefit to their own trading in performing these functions.

As for the obligations of Floor brokers, Section 11(a) of the Act provides appropriate controls that Floor brokers will not "effect any transaction on [the] exchange for its own account"⁴⁴ This trading restriction has been in place since 1978, when Floor brokers regularly had access to disaggregated order information on the Floor. As noted in the Proposals, the Exchange amended Rule 115 regarding what information could be provided in connection with a market look because, at the time, the Exchange did not have technology to replicate the ability of Floor brokers to maintain certain interest as "dark." Although the Exchange whittled back the access to information made available to Floor brokers – which is always via the specialist, and now, DMM – the trading restrictions were not lessened. Now that the Exchange has enabled market participants to replicate electronically the type of dark interest formerly performed manually by Floor brokers, the Exchange can restore the access to disaggregated order information without any need to adjust the applicable trading restrictions. The Exchange further notes, and as noted by the comment letters,⁴⁵ Floor brokers have an obligation to provide any additional information they receive as a result of the Proposals in a non-discriminatory fashion to investors. This obligation is inherent in their role as an agent.

⁴² See NYSE Rule 104(a)(1).

⁴³ NYSE Rule 104(g).

⁴⁴ 15 U.S.C. § 78k(a) (2011).

⁴⁵ See Organization of Independent Floor Brokers at 1; Alliance of Floor Brokers at 3.



While the inherent nature of the Floor results in some differing levels of access to information, the controls of the Floor are designed to protect investors. On-the-floor access to disaggregated information is a manual function. While the DMM has access to this information in an Exchange system, access is through a manual process that can only be done while at the point of sale, and only on a stock-by-stock basis. Floor brokers must orally request this information at the point of sale; it is not provided electronically to them and therefore cannot be replicated for off-Floor participants. Moreover, as discussed above, there are significant negative obligations or Floor-specific trading restrictions related to Floor trading by DMMs and Floor brokers. As a result, the rules governing Floor trading, which were designed for this very purpose, provide effective controls such that the disaggregated information will directly benefit investors, will not provide any significant personal advantage on the Floor to DMMs and Floor brokers, and will not provide any off-Floor advantage whatsoever to DMMs and Floor brokers.

Unlike the restrictions, summarized above, placed on DMMs and Floor brokers, other market participants do not have similar obligations regarding the use of disaggregated information. NYSE Rules 98 and 104(b) are not applicable to other proprietary traders. Accordingly, if disaggregated information were provided electronically to all market participants, there would be no mechanism or informational barrier ensuring that the disaggregated information could only be used to the benefit of investors. Therefore, the Proposals' success in protecting investors and the public interest is directly tied to its limited access of information to DMMs and Floor brokers, who are subject to extensive regulation by the Exchanges.

3. The Proposals improve the quality of the Exchanges' markets.

In the Order, the Commission states that the Exchanges have not "clearly explained how the Proposals might materially improve the quality of the [Exchanges'] markets, particularly given the increasing amount of automated transaction on the [Exchanges] and the reduced role of the Exchange floors."⁴⁶ The Exchanges note that the Act does not require that an exchange proposal must "materially" improve the quality of a market. In today's competitive market among registered exchanges and alternate trading systems, exchanges often submit rule change proposals in an effort to attract order flow. Inherent with an ever-fragmented market, not all are always successful, and predicting whether a proposal would "materially" improve a market should not be the basis for whether a proposal should be approved.

Nonetheless, in the context of the Proposals, as one commenter stated,⁴⁷ the Trading Floor provides a mechanism that allows Floor brokers to match large buyers and sellers while minimizing informational leakage. The purpose of the Proposals is to help DMMs facilitate large orders on the Trading Floor if an investor wishes to utilize the resources of a Floor

⁴⁶ Exchange Act Release No. 34-66397 (February 15, 2012).

⁴⁷ See Angel Letter at 3.



broker. The Exchanges, and all of the commenters, believe that restoring the type of historic information endemic to a Floor would improve the market quality of the Exchanges.⁴⁸

The majority of the benefit provided by the Proposals is not conferred on DMMs or Floor brokers, but on the market overall. Floor brokers, acting as agents, provide a number of services: order execution, order routing, and information gathering. Floor brokers offer advantages over electronic orders that directly benefit investors. Their position on the Floor is invaluable for those seeking to liquidate large positions, “work” the order, and minimize any market impact the order may have. As the Commission has already noted, “the participation of market makers in exchange markets may benefit public customers by promoting more liquid and efficient trading”⁴⁹

If an investor is concerned about the exposure of their order information from DMMs to Floor brokers, the investor has two courses of action: (1) choose to have the order not display on a disaggregated basis or (2) place the order with an NYSE competitor. There is nothing novel about specialists providing disaggregated order information to Floor brokers.⁵⁰ As noted above, Rule 115 was changed in 2006 because at that time, there was no way to enter such truly dark interest. Now that market participants are capable of sending fully dark electronic interest, which is not available to DMMs even in an aggregated form, allowing access to disaggregated order information for interest that DMMs or Floor brokers already have access to on an aggregated basis is not a huge leap, particularly given that the utility of such information to DMMs is insubstantial and the benefit to Floor brokers flows to the ultimate customer.

The ability of traders to find suitable counterparties directly affects the transaction costs of those traders, and studies have shown that the use of Floor brokers results in reduced

⁴⁸ See Alliance of Floor Brokers at 3 (“[B]enefits would accrue to all market participants and specifically to all customers directly or indirectly in the form of additional liquidity opportunities and the potential for associated market quality.”); Organization of Independent Floor Brokers at 1 (“[The amendments] would help the accessing of liquidity and thereby facilitate the consummation of ‘block trades’ in a single market place. The accessing of this liquidity would bring block trading out of the ‘dark’, add more transparency and promote the inclusion of more market participants in a ‘fair and orderly market’ with fewer price aberrations and less volatility.”); Letter from John Petschauer, CEO, EZX, Inc. to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 14, 2012 (“[The filings] will result in a more open and transparent market structure that encourages illuminated market centers and in turn will foster the interaction of natural buyers and natural sellers.”); Letter from Kenneth Polcari to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 12, 2012, at 2 (“The ability to source liquidity within one single market center will contribute to strengthening and rebuilding the institutional block trading business rather than allowing its continuing decline as an increasing amount of orders are sent to ‘dark’ venues in a frustrating attempt to find meaningful liquidity.”).

⁴⁹ New Market Model Release at 64388.

⁵⁰ See *supra* footnote 15.



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execution costs.⁵¹ Providing disaggregated information to DMMs and Floor brokers would only help to further reduce the executions costs for investors. As many of the commenters made clear, the Proposals would improve price discovery, create a more open auction process, and foster interaction between buyers and sellers. “Restoring the ability for Floor Brokers to access disaggregated order information in an effort to source liquidity and provide price discovery for block transactions could only result in improving the current environment where so many seek aggregated liquidity solutions.”⁵²

For the reasons set forth above, the Exchanges believe that the Proposals are consistent with the public interest, the protection of investors, and the requirements of Section 6(b)(5) of the Act and respectfully request that the Commission approve the Proposals.

Very truly yours,

cc: The Hon. Mary Schapiro, Chairman (via FedEx)
The Hon. Luis Aguilar, Commissioner (via FedEx)
The Hon. Daniel M. Gallagher, Commissioner (via FedEx)
The Hon. Troy Paredes, Commissioner (via FedEx)
The Hon. Elisse Walter, Commissioner (via FedEx)
Mr. Robert W. Cook, Director of Trading and Markets (via email)
Mr. David S. Shillman, Associate Director of Trading and Markets (via email)

⁵¹ See Puneet Handa, Robert Schwartz, & Ashish Tiwari, *The Economic Value of a Trading Floor: Evidence from the American Stock Exchange*, 77 CHI. J. BUS. 331 (April 2004).

⁵² See Alliance of Floor Brokers at 3.