THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Houghton Street
London, WC2A 2AE

T: +44 (0)20 7106 1146
F: +44 (0)20 7955 7424
d.beunza@lse.ac.uk

Daniel Beunza
Lecturer
Department of Management

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Elizabeth M. Murphy
Secretary, Securities and Exchange Commission
100 F Street NE Washington, DC 20549
United States

Dear Ms. Murphy,

We would like to submit a comment regarding the New York Stock Exchange notice of proposed changes to Rule 104 [SEC Release No. 34–69427; File No. SR–NYSE– 2013–21]. We are two academic sociologists, specialized in the study of finance and market microstructure, and contributors to the emerging field of the Social Studies of Finance. We have been studying the trading floor of the NYSE in various forms over the years 2003-2011, conducting more than 60 research visits to the floor of the NYSE, both before and after Regulation NMS (Beunza and Millo [2013], available upon request).

Our findings indicate that the communication of partially disaggregated orders between designated market makers and floor brokers has a positive impact on price discovery, as it facilitates a more widely shared understanding of the market. This results in greater willingness to transact. Based on these findings, explained below, we believe that allowing designated market makers to be involved in detailed, fine grained communication with floor brokers as the changes to Rule 104 put forward by NYSE propose, is likely to have a positive effect on market liquidity and stability.

We witnessed firsthand the importance of communicating disaggregated information about order prize and size in 2003. At the time, we observed how floor brokers intending to sell stock asked specialists at their posts about the state of the book. A typical answer from the specialist was, “I think it is a little heavy,” suggesting that the floor broker should try to conduct the sale later. Critically, the specialists did not provide all the details they had—only the necessary ones—so as not to compromise the interests of others. We observed this again as we followed floor brokers as they walked from one post to another, asking about a stock. One of the typical answers we overheard was “stock’s hanging in there, lots of machine buying, Morgan’s a seller, Merrill has an interest.”

We now understand the significance of this practice, known on the NYSE's floor as "giving looks." By partly revealing the identity and position of the contraside, brokers and specialists can help the counterparty overcome the problem of adverse selection. Investors are typically wary of buying from a better-informed seller. Knowing something about the identity of that seller addresses this fear because the seller's motives can often be inferred from his or her identity, helping the buyer rule out the possibility of a better-informed seller. In this manner, giving looks incentivizes transactions, contributing to greater liquidity. Giving looks can also help brokers and DMMs find counterparties for a certain trade. Such detailed communication is particularly important for the matching of large blocks of shares. As microstructure specialist Wayne Wagner argued in connection with this, "the market maker cannot accelerate liquidity arrival without revealing trading interest" (Wagner, 2004: 5).

Importantly, the practice of giving looks needs to take place in a context that is safe. It entails exercising judgment as to how much information to provide: if too much information is given about a given order, it can be detrimental to the investor who sent it. Our research at the NYSE indicates that disclosure is kept safe by making it partial. Furthermore, the NYSE maintains a highly developed system of formal rules and sanctions, combined with an informal mechanism of shared reputation and ostracism to opportunists. In our fieldwork, we observed these two mechanisms first-hand. We saw how floor governors walked around a crowd of brokers and enforced rules of timely disclosure of size and price during a market close. We also noted the existence of tight social networks among Floor participants, leading to reputation building. Other academic studies have also documented these aspects of trading floors. For instance, Abolafia (1996) showed that the floor of the NYSE was characterized by a culture of restraint and "rule veneration." Similarly, Baker (1984) showed that the social dynamics on trading floors play a decisive role in helping prevent opportunism. In the context of a different floor, Pitluck (2011) showed that giving looks is a central component of how intermediaries create liquidity. More recently, the articles by Wunsch (2011) point in the same direction.

Given the empirical evidence we collected, we do not believe that disaggregated information should be available to market participants outside the floor of the NYSE. To stress, while the Floor has the formal and informal mechanisms to prevent abuse of disclosure, electronic market participants outside the Floor are not subject to such mechanisms, and thus are unsuitable for safe disclosure. If disaggregated information were made available to off-Floor participants, there would be no means to control the use that this information is put to.

Finally, we do not believe the NYSE should increase the restrictions it already imposes on DMMs as part of its proposed rule change. We argue that giving views is an activity that would not only benefit the NYSE, but all market participants, as it would lead to better prices. Put differently, if the NYSE were not allowed to let its DMMs give views, all investors would be worse off.

For all the reasons above, we support the proposed changes to Rule 104. If you have any questions, feel free to contact us at the addresses below.

Sincerely,

Daniel Beunza, Lecturer in Management, London School of Economics, Houghton Street. London, United Kingdom WC2A 2AE.

Yuval Millo, Professor of Social Studies of Finance. School of Management Ken Edwards Building. University of Leicester. University Road, Leicester United Kingdom, LE1 7RH.

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