

September 5, 2013

VIA E-MAIL AND FEDERAL EXPRESS

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

Re: Securities Exchange Act Release No. 34-70047 (SR-NYSE-2013-21; SR-NYSEMKT-2013-25); Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Changes Amending NYSE Rule 104 and NYSE MKT Rule 104-Equities, as Modified by Amendment Nos. 1, to Codify Certain Traditional Trading Floor Functions that may be Performed by Designated Market Makers (“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 (“Second Order Instituting Proceedings” or “Second Order”)

Dear Ms. Murphy:

NYSE Euronext, on behalf of New York Stock Exchange LLC (“NYSE”) and NYSE MKT, LLC (“NYSE MKT,” collectively with NYSE, the “Exchanges”), submits this letter in response to the grounds for disapproval provided by the Securities and Exchange Commission (the “SEC” or the “Commission”) in the above-referenced Second Order Instituting Proceedings.¹ The proceeding will determine whether the

¹ On October 31, 2011, the Exchanges each filed with the Commission proposed rule changes to amend Rule 104. See Securities Exchange Act Release Nos. 65735 (Nov. 10, 2011), 76 FR 71405 (SR-NYSEAmex-2011-86) and 65736 (November 10, 2011), 76 FR 71399 (SR-NYSE-2011-56). The Commission received no comment letters on the proposals. On December 22, 2011, the Commission extended the time period to February 15, 2012 to approve, disapprove, or institute proceedings to determine whether to disapprove the proposals. The Commission again received no comment letters on the proposals during the extension. On February 15, 2012, the Commission issued an order instituting proceedings. See Securities Exchange Act Release No. 66397, 77 FR 10586 (February 22, 2012) (“First Order Instituting Proceedings”). At that time, the Commission received six comment letters supporting the proposals. The Commission disapproved the proposed rule changes on July 13, 2012. See Securities Exchange Act Release No. 67437, 77 FR 42525 (July 13, 2012) (“Disapproval Order”). After the Disapproval Order, the Exchanges submitted revised proposals to address the concerns raised by the Commission in the Disapproval Order. See Securities Exchange Act Release Nos. 69427 (April 23, 2013), 78 FR 25118 (SR-NYSE-2013-21) and 69428 (April 23, 2013), 78 FR 25102 (SR-NYSEMKT-2013-25). The Commission issued the Second Order Instituting Proceedings on July 26, 2013. See Securities Exchange Act Release No. 70047 (July 26, 2013), 78 FR 46661 (Aug. 1, 2013). The Commission received three comment letters supporting the proposals. See Letter from James Angel, Visiting Associate Professor, University of Pennsylvania, to Securities Exchange Commission, dated May 14, 2013 (“Angel Letter”); Letter from Daniel Beunza, London School of Economics and Political Science, to Elizabeth M. Murphy, Secretary, Securities and

Commission disapproves the above-referenced proposed rule changes, which propose 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, including disaggregated order information,² and to amend the Exchanges' Rules governing the ability of DMMs to provide market information to Floor brokers.

As recognized in the Second Order, the Exchanges proposed largely identical changes to those at issue in this proceeding almost two years ago.³ In disapproving the prior proposals, the Commission identified the following as inconsistent with the Securities Exchange Act of 1934 (the "Act"):

- Failure to explain how disaggregated information proposed to be provided to DMMs would further legitimate Floor functions;
- Failure to justify allowing Floor brokers to pass on to their customers the identity of the responsible Floor broker for e-Quotes or any disaggregated order information with respect to orders on the Exchange books that originate off the Exchange floors;
- Failure to explain why the disaggregated order information would afford only a slight benefit to Floor members; and
- Failure to articulate a rationale for providing disaggregated order information exclusively to DMMs and Floor brokers and not to all Exchange members and customers.

The Exchanges responded in the instant proposals with detailed factual scenarios and additional support addressing each of the previously identified grounds for disapproval. The scenarios and support specifically illustrated how the availability of disaggregated order information would serve the interests of the investing public and issuers by facilitating size interactions and reducing transaction costs. In particular, the Exchanges provided numerous and concrete examples where the provision of such information would have been a critical causal link in the creation of a market impact-reducing block trade.⁴ The Second Order does not raise any of the above-identified issues, which leads the Exchanges

Exchange Commission, dated May 20, 2013 ("LSE Letter 1"); Letter from Daniel Beunza, London School of Economics and Political Science, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated August 22, 2013 ("LSE Letter 2").

² Order information can be arranged in aggregated or disaggregated form. Aggregated order information would, for example, consolidate order quantity at a particular price level. Disaggregated order information, on the other hand, would show the quantity of each component order making up the aggregated order information. In addition, disaggregated order information would include the identity of the entering and clearing firms for the component orders.

³ See footnote 1 *supra* for the procedural history of the prior proposal, including the absence of any comments in opposition to the prior proposal, and six comments in support.

⁴ For instance, consider the following scenario included in the proposal demonstrating how the provision of disaggregated order information allows a Designated Market Maker ("DMM") to facilitate a block trade between a Floor broker and an upstairs seller. Assume a pension fund customer gives Floor broker a 20,000 share order to buy ABC, a mid-cap stock, at up to \$10.08 at 11:00 AM when the PBBO for the stock is \$10.03 by \$10.06 with 500 shares on displayed on each side. There is no crowd at the ABC post at the time the order is received, but Floor broker can see from the tape that the stock is trading electronically on the Exchange. On

to believe that the instant proposals have addressed the concerns identified in the Disapproval Order. Instead, the Division of Trading and Markets (“the Division”), acting pursuant to delegated authority, has shifted its focus to two entirely new concerns—concerns that rest in significant part on an apparent misinterpretation of a comment letter supporting the proposals and that were not identified in the Disapproval Order.

The new concerns raised by the Division focus on two questions: (1) why the dangers of making disaggregated order information generally available to off-Floor participants are not present when such information is made available only to Floor broker customers; and (2) whether the proposal incorporates a mechanism to prevent the misuse of disaggregated order information. As previously stated, the Exchanges believe that the proposals’ limited, narrowly tailored mechanism for the manual provision of certain limited market information does not provide a meaningful potential for abuse. The mechanism is specifically designed to facilitate block transactions while limiting possible misuse of such information. To the extent the Exchanges are concerned with broad dissemination of the market information in question, the concern stems from the electronic transmission of such information through real-time, high speed data feeds and the potential for such transmission to be used for automated, opportunistic trading. Any such potential, however, is neutralized by the strictly manual, stock-by-stock provision of the information in question.⁵ Further, the dramatic increase in competition between market venues and the ease with which market participants can divert their order flow, along with the affirmative obligations of DMMs and Floor brokers, provide a self-correcting mechanism to ensure the proper functioning of the proposals.

Manually Providing Disaggregated Order Information Prevents its Abuse by Automated, Opportunistic Traders

The Exchanges believe that they have proposed a mechanism that appropriately controls the provision of disaggregated order information. The potential dangers referenced by the Division are either not present or sufficiently mitigated where, as here, the disaggregated order information would be provided manually, one stock at a time, by the DMM to the Floor broker and the Floor broker to their customer. The manual nature of the provision of disaggregated order information, in other words, renders it

the book a penny away from the inside offer at \$10.07, there is a sell order for 10,000 that has been entered by Member Organization. There is no Floor broker representing the sell order, and there are no Floor broker e-Quotes on the book. Floor broker tells DMM for ABC that he or she represents a buyer of size beyond the displayed market. Currently, the DMM is permitted to inform the Floor broker of the aggregate selling interest at different price points on the book, but may not access or provide the identity of the Member Organization—an off-floor participant—that entered such selling interest. Under the proposed rule, the DMM could inform Floor broker that the off-Floor Member Organization is an entering firm for an order to sell 10,000 shares at \$10.07. Floor broker could then contact the upstairs desk of Member Organization or Member Organization’s on-floor representative, if any, who could then contact his or her upstairs desk, to explore a possible transaction.

⁵ See *id.* at 25128 (“[I]f disaggregated information were provided *electronically* to all participants, there would be no mechanism or informational barrier ensuring that the disaggregated information could only be used for the benefit of investors.”) (emphasis added).

practically useless to those employing high speed, automated trading strategies. The proposal thereby provides a mechanism designed to facilitate the highly beneficial order interactions illustrated in the scenarios, while at the same time neutralizing the possible risk of opportunistic or otherwise abusive trading.

Two market microstructure specialists at the London School of Economics (“LSE”) submitted two comment letters supportive of the proposal, one prior to and one subsequent to the Second Order. The first LSE letter notes the “positive impact on price discovery” resulting from the communication of partially disaggregated order information between DMMs and Floor brokers. The letter noted a concern with respect to the provision of disaggregated order information to “electronic market participants.” In particular, the letter stated:

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.⁶

Apparently based on the language immediately above, the Division took the position that the commenter “stated that disaggregated order information should not be made available to market participants outside the floor of the NYSE” and stated that the commenter had expressed “qualified support” for the proposal. In fact, as the second LSE letter made clear, the commenter’s concern was with “direct electronic dissemination,” not with “information dissemination through Floor brokers” and their support for the proposals was “unqualified.”⁷ Specifically, the commenter went on to say in the second LSE letter:

In making our argument, we rely on a structural analysis of the information dissemination networks generated by the two configurations mentioned by the Commission. In the case of direct disaggregated order information to off-Floor market participants, the information network would have a radial configuration, with information reaching numerous off-Floor participants instantaneously and systematically. By contrast, in the case of manual information dissemination through Floor brokers, information would reach a selected number of off-Floor participants, would do so through Floor brokers rather than directly, and it would arrive to them through a manual process.

There are important differences between these two configurations. One difference is the number of off-Floor recipients. While electronic dissemination would reach a

⁶ LSE Letter 1 at 2 (emphasis added).

⁷ LSE Letter 2 at 1.

sizeable portion of participants, broker dissemination would be more limited. There is thus a difference in information reach. Second, while a direct electronic dissemination of disaggregated order information would be fast, a broker-mediated configuration would be manual and therefore slower. There is thus a difference in speed. By themselves, these differences imply that a Floor broker-based configuration would produce a more limited dissemination than a direct one, and it would also release information that is less timely and thus less sensitive, though still vital to those seeking to find natural counterparties in the pursuit of block size liquidity.⁸

The Exchanges echoed similar concerns, stating in the instant proposals that “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 for the benefit of investors.” But because of the Exchanges’ decision not to integrate disaggregated order information into an electronic feed to be made available to all market participants, the Exchanges have created a mechanism beneficial to market participants looking to source large amounts of liquidity consistent with the protection of investors and public interest. The proposals’ value is the integration of human judgment into the price discovery process at a single, physical point of sale for each security.

The scenarios included in the Exchanges’ proposals, which were intended to illustrate how disaggregated order information serves the goals of facilitating block trades and expediting error resolution, also demonstrate the appropriateness of the proposal with respect to the concerns expressed by the Division. In the first scenario, for example, the information that would be manually provided under the proposal would add no meaningful incremental information that could be misused. Specifically, the scenario posits that a member organization placed a 10,000 share sell order a penny away from the inside offer. Under the proposals, the DMM would be permitted to inform an inquiring Floor broker of the identity of the off-Floor member organization representing the 10,000 share sell order—information, the scenario illustrates, that has the potential to produce a large, beneficial transaction. Importantly, however, the core of the actionable information is already generally available in this situation—the off-Floor market participant, because of proprietary data feeds, would already be aware of the liquidity a penny away from the inside offer. The only new information would be the identity of the individual representing the liquidity.⁹ There would be no new information under the proposal, in other words, for a predatory trading strategy¹⁰ to exploit because the significant fact—the existence of 10,000 shares of liquidity a penny away from the inside—is already generally available.¹¹

⁸ LSE Letter 2 at 2.

⁹ The off-Floor market participant also could have been aware that a single order represented all of the trading interest a penny away from the inside offer. NYSE OpenBook Ultra provides the number of orders at each price point. See NYSE OpenBook Ultra Client Specification, available at <http://www.nyxdata.com/openbook>.

¹⁰ See Securities Exchange Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594, 3609 (Jan. 21, 2010) (“Equity Market Structure Concept Release”) (“One example of an order anticipation strategy is when a proprietary firm seeks to ascertain the existence of one or more large buyers (sellers) in the market and to buy (sell) ahead of the large orders with the goal of capturing a price movement in the direction of the large trading interest (a price rise for buyers and a price decline for sellers). After a profitable price movement, the proprietary firm

The second scenario posits that a member organization has no current interest entered in Exchange systems, but was a seller on the Exchange earlier in the day, and that a Floor broker is seeking liquidity for an off-Floor market participant. The DMM tells the Floor broker that there is no interest to accommodate on the book, but that the member organization was a seller throughout the day. Here, the information that is being provided—the identity of the member that had been selling—may not be generally available, but the manual and limited manner in which it is provided would prevent any automated exploitation of the information.

Any potential negative implications associated with providing disaggregated order information to off-Floor market participants would not be a result of the manual process described above, but would stem from the incorporation of the information for the universe of securities in real-time, high-speed market data feeds. The integration of disaggregated order information via electronic dissemination could allow market participants to quickly integrate the information into their computer systems, allowing them to analyze the quoting and trading of individual member organizations throughout the trading day. This disaggregated look at the market could allow off-Floor market participants to discover the trading strategies and goals of individual member organizations, and use that information to their own advantage.

On the other hand, the proposed manual process for accessing disaggregated order information prevents its haphazard dissemination by interjecting human judgment, on the part of DMMs, as to the information that should be provided to Floor brokers. A Floor broker, and its off-Floor customer, would be futile in trying to replicate the information provided by an electronic feed. At best, a Floor broker would become aware at a single point in time that a member organization was representing a large order. But if no interest was available, the Floor broker would only be made aware that a member organization had previously been representing a certain amount of interest. And a Floor broker constantly inquiring about the interest available, attempting to gain a fuller picture of the market, would not be making an inquiry in the “normal course of business.”¹²

then may attempt to sell to (buy from) the large buyer (seller) or be the counterparty to the large buyer’s (seller’s) trading.”).

¹¹ If the off-Floor member organization wanted to protect itself from the harm of order anticipation strategies, they could enter the order as “dark” interest. As a result, the order would not be visible in any data feed as well as not seen in the disaggregated order information made available to DMMs.

¹² Proposed Rule 104(j)(iii) would permit a DMM to provide disaggregated order information only when responding to an inquiry from a Floor broker in the normal course of business. As made clear in the proposals, “normal course of business” includes seeking market probes into the depth of the market as well as seeking out willing contra-side buyers and sellers in a particular security.

Competition between Market Venues Forces the Exchanges to Constantly Survey for Opportunistic and Abusive Trading

While the manual provision neutralizes the potentially exploitative value of disaggregated order information, a stronger mechanism will ensure the protection of investors and the public interest: competition. The days of NYSE-dominated market share have passed, and marketplace fragmentation provides market participants with abundant execution venues. Those market participants choosing to trade on the Exchanges do so freely and, just as freely, may divert their order flow to another execution venue.

The Exchanges designed the proposals to aid those member organizations looking to source large amounts of liquidity, and those same members would be harmed if off-Floor market participants misused disaggregated order information. But ultimately, the member organizations dictate whether the disaggregated order information is available for DMMs and possibly relayed to Floor brokers. If member organizations find their execution quality hampered by the proposed changes, they have two avenues of action: (1) designate their interest as “dark” or (2) stop sending order flow to the Exchanges. In this way, it will not be a decrease in market quality that signifies a failure of the proposal but instead an exodus of order flow from the Exchanges to alternate market centers. The guiding hand of competition will protect the marketplace, following the objectives of the 1975 Amendments of the Act: “The objective [of the amendments] would be to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services.”¹³ As one commenter stated, institutional investors monitor execution quality very closely, with 97% of long-only managers surveyed performing some form of transaction cost analysis, and with 68% performing it daily.¹⁴ Any changes in execution quality will result in harm to the Exchanges’ market shares, not market quality, leading the Exchanges to reevaluate the proposals and, if necessary, rescind them.

Moreover, it is important to remember that the incentives and obligations that underlie the operation of the Floor would provide a structural check to ensure the proper functioning of the proposals. DMMs naturally have an interest in encouraging Floor brokers and their customers to make disaggregated order information available—that is, an interest in encouraging them not to enter their interest dark. In doing so, DMMs enhance the ability of the Floor to produce size interactions and increase the value they add in facilitating such transactions. Floor brokers whose customers make such interest available to DMMs have an interest in that availability producing beneficial interactions. To this end, the proposals seek to restore a function that was an approved rule of the NYSE prior to 2005: Rule 115 previously permitted the specialist to disclose to Floor brokers information about buying and selling interest in the market, which is precisely the issue that has been identified in the Second Order as potentially inconsistent with the Act.

¹³ S. Rept. 94-75 (1975), at 8.

¹⁴ Angel Letter at 4.

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And as the Exchanges have stressed in the instant proposals, neither DMMs nor Floor brokers are permitted to use disaggregated order information for their own benefit.¹⁵ Where a DMM observed opportunistic or abusive trading following the provision of disaggregated order information, it would have a powerful incentive to notify Exchange officials and, where appropriate, restrict the provision of such information to offending participants. Similarly, a Floor broker whose customer had chosen to make disaggregated order information available to the DMM would be inclined to notify the Exchanges of such misuse or to encourage customers to enter interest dark. Institutional customers, as commenters have noted, are increasingly attentive to transaction costs and able to see real-time indications of opportunistic or predatory trading. Where indications of such misconduct are present, they can either insist that their interest be entered dark, or exercise the ultimate leverage—choose another execution venue.

Conclusion

While the Exchanges appreciate the concerns expressed in the Second Order, the Exchanges believe that they have struck the right balance between facilitating order interaction and reducing the potential risks of the misuse of the disaggregated order information, which is consistent with the manner by which NYSE operated pursuant to approved rules prior to 2005. The Exchanges' prior experience with the provision of this sort of information confirms that the provision of disaggregated order information will enhance interactions without observed incidences of misuse. The Exchanges believe the proposal will reduce impediments to and perfect the mechanism of a free and open market and a national market system and will not impose an undue burden on competition. By facilitating the execution of block trades, the proposals will reduce market impact and associated transaction costs for Exchange members. The proposal will also not unfairly discriminate since all Exchange members will be able to take advantage of the benefits offered by the proposals by contacting a Floor broker to help facilitate large trades. Additionally, the Exchanges believe that the proposal will protect investors and the public interest since the existing trading restrictions and affirmative obligations required by the Exchanges will provide appropriate controls over the dissemination of disaggregated order information. Moreover, the Exchanges intend to monitor the provision of disaggregated order information for potential opportunistic or abusive trading or other misuses and remain prepared to propose amendments to the process in the event that unexpected problems develop. The Exchanges therefore respectfully request that the Commission approve the proposals.

Very truly yours,



¹⁵ See NYSE Rules 98, 104; NYSE MKT Rules 98 - Equities, 104 - Equities. Additionally, the Exchange notes that Floor brokers are not permitted to trade for their own accounts based on the disaggregated order information. See 15 U.S.C. § 78k(a).

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Cc: *via FedEx to:*
Mary Jo White, Chair
Luis A. Aguilar, Commissioner
Daniel M. Gallagher, Commissioner
Kara M. Stein, Commissioner
Michael S. Piwowar, Commissioner

via e-mail to:
John Ramsay, Acting Director, Division of Trading and Markets
James Burns, Deputy Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets