

January 14, 2014

**VIA EMAIL AND OVERNIGHT COURIER**

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

Re: File Nos. SR-NYSE-2013-72 and  
SR-NYSEMKT-2013-91 – Response to Comment Letters (“Response”)

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 comment letters received by the Securities and Exchange Commission (the “SEC” or the “Commission”) in connection with the above-referenced filings, which propose to establish an Institutional Liquidity Program (the “Program” or “Proposal”) on a pilot basis to attract additional institutional order flow to the Exchanges.

**I. Summary of the Institutional Liquidity Program**

The Program is a targeted size discovery mechanism designed to attract Institutional Interest through a balanced set of requirements and incentives. As discussed more fully in the above-referenced filings, the Program at its core would depend on the interaction between two new proposed order types, the “Institutional Liquidity Order” (“ILO”) and the “Oversize Liquidity Order” (“OLO”). In summary terms, ILOs would express non-displayed Institutional Interest (5,000 or more shares with \$50,000 or more market value), and OLOs would express liquidity of at least 500 shares<sup>1</sup> seeking to interact with an ILO. The presence of OLOs and ILOs in Exchange systems would be reflected in a new liquidity indicator, the Liquidity Identifier (“LI”), to be disseminated through the Consolidated Quotation System (“CQS”). The Exchanges believe that the size requirements will stimulate the expression of Institutional Interest in Exchange systems, and will ensure that liquidity suppliers seeking to interact with such interest commit meaningful size to the effort, thereby reducing the incidence of “pinging” or probing orders. The dissemination of LIs, in effect, requires oversize liquidity suppliers and Institutional Interest to communicate the fact, but not the details, of their trading interest and is designed to stimulate further the expression of both types of interest. The Program’s minimum size requirements on OLOs and optional use of Minimum Triggering Volume (“MTV”) restrictions with ILOs will reduce the incentives of pinging and order anticipation strategies. The Exchanges believe that the incentives offered by the Program, in particular the balanced and limited segmentation of Institutional Interest and the Program’s incorporation of price-size-time priority, have the potential to enhance the discovery of size on the

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<sup>1</sup> OLOs may have a minimum size of 300 shares for securities with an Average Daily Volume of less than one million shares.

Exchanges, to thereby reduce the transaction costs of investors, and more broadly, to offer a competitive response to serious market structure concerns held by both the Exchanges and the Commission.

## **II. Summary of Comments and the Exchanges' Response**

At the time of the filing of this Response, the Commission has received 3 comment letters relating to the Program.<sup>2</sup> Some of these comments address the mechanics and implementation of the Program, while others focus on issues unrelated to the Program. This Response first will review the competitive and regulatory context in which the Program would operate, and then briefly address several unrelated comments to the Program, respectively, on an issue-by-issue basis.

### **A. The Competitive and Regulatory Context**

The Exchanges appreciate the thoughtful comments analyzing the Program. Before addressing the specific issues raised in the comment letters, it is worth underscoring that our equity markets, and the Exchanges in particular, have undergone more than a decade of continual structural changes driven by increased competition and evolving technology facilitated by regulation. This transformative period has presented the Commission with a virtual thicket of structural challenges that remain humbling in their complexity and significance. A number of commenters have suggested that the Proposal significantly implicates the Commission's approach to several interrelated structural issues: segmentation of order flow; fair access and access fees; order protection and order handling; and best execution. Many of these issues date to the mid-1990s<sup>3</sup> and have since undergone extensive and sustained consideration by the Commission and staff. Each was addressed in the Commission's comprehensive effort to modernize

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<sup>2</sup> See Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA to Elizabeth M. Murphy, Secretary, Commission dated December 20, 2013 ("SIFMA Letter"); Letter from Clive Williams, Andrew Brooks and Christopher Hayes, T. Rowe Price, to Elizabeth M. Murphy, Secretary, Commission, dated December 18, 2013 ("T. Rowe Price Letter"); Letter from James Allen and Rhodri Preece, CFA Institute, to Elizabeth M. Murphy, Secretary, Commission, dated December 18, 2013 ("CFA Letter").

<sup>3</sup> See Exchange Act Release No. 34-38180 (Jan. 16, 1997); Exchange Act Release No. 34-37619A (Sept. 6, 1996), 61 Fed. Reg. 48290 (Sept. 12, 1996) ("Order Execution Obligations Adopting Release"); Exchange Act Release No. 34-40760, 63 Fed. Reg. 70844 (Dec. 22, 1998) ("Reg. ATS Adopting Release"). For discussions relating to access fees and fair access, see Reg. ATS Adopting Release at 70870-75. For discussions relating to order protection and order handling, see generally Order Execution Obligations Adopting Release and Reg. ATS Adopting Release at 70903-04. For discussions relating to private markets/two-tiered markets, see Reg. ATS Adopting Release at 70866-69, 70903 and Order Execution Obligations Adopting Release at 48308, 48312, 48326. For discussions relating to best execution as related to evolving execution venues, see Reg. ATS Adopting Release at 70869-71, 70885, 70902 and Order Execution Obligations Adopting Release at 48292-93, 48297-98, 48308-09.

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and strengthen the national market system in Regulation NMS in 2005.<sup>4</sup> Equity market structure remains the subject of a current, comprehensive Commission review.<sup>5</sup>

The Exchanges fully recognize that many market structure challenges, by their very nature, do not lend themselves to definitive, final resolution, particularly where change continues to sweep our markets. We remain committed to engaging with the Commission, our members, and other market participants with respect to the core structural challenges of today and tomorrow, and to revisiting compromises of yesterday where appropriate. Our efforts to maintain and enhance the quality of order interaction on the Exchanges, to deliver to our members the tools to optimize that interaction, and to reduce the transaction costs of the investing public should not, of course, be put on hold while the myriad of fundamental market structure challenges are addressed.

We regard the Program as an important but structurally modest effort by the Exchanges to attract institutional order flow. Several commenters, however, urge the Commission to closely scrutinize and reject the Program notwithstanding the fact that the participants, structure, and economics of the Program would parallel practices that operate on non-exchange venues on a relatively non-reviewed basis. These commenters fail to recognize, however, that the Securities Exchange Act of 1934 (the "Act") dictates:

It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure...fair competition among brokers and dealers, among exchange markets, *and between exchange markets and markets other than exchange markets.*<sup>6</sup>

It also bears emphasis that before the Exchanges can innovate and compete as contemplated by the National Market System, we typically must file proposed rules and expose them to public comment as we have done here. The Commission has noted more than once the asymmetry of the competition exchanges face:

National securities exchanges registered under 6(a) of the Exchange Act face increased competitive pressures from entities that trade the same or similar financial instruments, such as foreign exchanges, future exchanges, electronic communications networks ("ECNs"), and alternative trading systems ("ATs"). These competitors, however, can

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<sup>4</sup> Exchange Act Release No. 34-51808, 70 Fed. Reg. 37496, 37497 (Jun. 29, 2005) ("Reg. NMS Adopting Release").

<sup>5</sup> Exchange Act Release No. 34-61358 (Jan. 13, 2010), 75 Fed. Reg. 3594, 3596 (Jan. 21, 2010) ("Concept Release on Equity Market Structure") ("[T]he Commission is conducting a comprehensive review of equity market structure.").

<sup>6</sup> See 15 U.S.C. § 78k-1(a)(1)(C)(ii) (emphasis added).

change their trading rules or trade new products with greater ease and without the required Commission review.<sup>7</sup>

The Exchanges do not point this out to object in any way to their obligations to submit an initiative such as the Program to the comment process and the Commission's review and approval. However, it is important to note the fundamental tension between comments offered by those representing competing execution venues, on the one hand, and the intent of the Act to foster fair competition between markets and to deliver to the public the choice and innovation produced by that competition, on the other. Through the public comment process, non-exchange venues urge the Commission to examine closely the finest details of the Proposal to enhance size discovery on the Exchanges, while they meanwhile develop services that would divert size interactions away from exchanges and launch them without Commission review or any public transparency. Any appropriate consideration of such comments must take into account this commercial context and the incongruity of the scrutiny urged by some commenters with the Act's goal of fair and balanced competition among market centers.

The Commission has recognized specifically the link between fair and balanced competition among exchange and non-exchange markets and the interests of the investing public:

Enhancing the SROs ability to implement and to respond quickly to changes in the marketplace should encourage innovation and better services to investors, such as further automating the execution of trades. Investors should also benefit from a competitive environment in which SROs may easily adapt their trading rules to respond to market opportunities.<sup>8</sup>

Here, allowing the Exchanges to compete effectively with dark pools would serve the investing public by providing a more transparent and price competitive environment for the interaction of larger orders, and thereby reduce transaction costs, as discussed in more detail below.

## **B. Comments Related to Market Structure**

### **1. Market Segmentation.**

Two commenters raised concerns that the Program unfairly discriminates among market participants.<sup>9</sup> The Exchanges find the characterization based on incorrect assumptions. The Act prohibits *unfair* discrimination. As was the case for the Exchanges' Retail Liquidity Program, all market participants that offer orders meeting the requirements of the Program are permitted to participate in the Program.

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<sup>7</sup> Exchange Act Release No. 34-58092 (November 5, 2008) (footnotes omitted); *see also* Exchange Act Release No. 43860 (Jan. 19, 2001), 66 Fed. Reg. 8912, 8913-14 (Feb. 5, 2001) ("Rule 19b-6 Proposing Release").

<sup>8</sup> *See* Rule 19b-6 Proposing Release at 8912.

<sup>9</sup> *See* SIFMA Letter at 2-3; T. Rowe Price Letter at 1-2.

More specifically, one commenter questioned the “additional segmentation” that the Program would entail, arguing that the justifications for the segmentation identified by the Commission in approving the Retail Liquidity Program are not applicable to the Program, and stating that the Exchanges have not offered “specific evidence” of how the Program would serve “a broader policy goal.”<sup>10</sup> As the Exchanges made clear in the notice of the Proposal, the purpose of the Program is size discovery, which is appropriately distinct from the goal of the Retail Liquidity Program. That the proposed Program and the Retail Liquidity Program are distinct in their objectives and mechanisms obviously does nothing to undermine the support for the segmentation contemplated by the Program. With regard to such support, the Exchanges need not provide “specific evidence” for a pilot program that has not yet been implemented, but rather only demonstrate its consistency with the Act, which they have done. In particular, the filings make clear the Program’s potential to address three serious market structure concerns expressed by the Commission and shared by the Exchanges: (1) the migration of orders entered by investors less informed as to short-term price movements toward dark venues and away from the public markets; (2) the related isolation of such orders from displayed liquidity; and (3) the selective pre-trade transparency and inadequate post-trade transparency, as noted by the Commission, of broker internalization venues and dark pools.<sup>11</sup>

It is important to note that where the orders are priced inside the PBBO, therefore resulting in a full increment of price improvement, ILOs must first interact with orders resting on the Exchanges display book before executing against an ILO or OLO. As a result, the Exchanges believe that the Program offers

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<sup>10</sup> SIFMA Letter at 3.

<sup>11</sup> See Exchange Act Release No. 34-70909 (Nov. 21, 2013), 78 Fed. Reg. 71002 (Nov. 27, 2013); *see also* Concept Release on Equity Market Structure at 3613 (“It appears that a significant percentage of the orders of long-term investors are executed either in dark pools or at OTC market makers, while a large percentage of the trading volume in displayed trading centers is attributable to proprietary firms executing short-term trading strategies.”); Exchange Act Release No. 34-42450 (Feb. 23, 2000), 65 Fed. Reg. 10577, 10578 (Feb. 28, 2000) (“Fragmentation Concept Release”) (“These order flow arrangements may discourage quote competition by isolating investor order flow from investor limit orders and dealer quotes displayed in other market centers. Even when wholesale and internalizing broker-dealers execute trades at prices better than the national best bid and offer (“NBBO”), these superior transaction prices are often in part determined by formulas dependent on the NBBO.”); Exchange Act Release No. 34-60997 (Nov. 13, 2009), 74 Fed. Reg. 61208, 61219 (Nov. 23, 2009) (“Dark Pool Proposal”) (“The public, however, does not have access to this valuable information concerning the best prices and sizes for NMS stocks. Rather, dark pools transmit this information only to selected market participants. In this regard, actionable IOIs can create a two-tiered level of access to information about the best prices and sizes for NMS stocks that undermines the Exchange Act objectives of a national market system. The consolidated quotation data is intended to provide a single source of information on the best prices for a listed security across all markets, rather than force the public to obtain data from many different exchanges and other markets to learn the best prices. This objective is not met when dark pools or other trading venues disseminate information that is functionally quite similar to quotations, yet is not included in the consolidated quotation data . . . . The lack of information concerning the ATS on which trades are executed makes it difficult, if not impossible, for the public to assess ATS trading in real-time, and to reliably identify the volume of executions in particular stocks on individual ATSs. The Commission preliminarily believes that the current level of post-trade transparency for ATSs is inadequate.”).

balanced and limited segmentation to enhance the discovery of size on the Exchanges and potentially increases the incentives for public price discovery. As the Commission has previously stated:

Increasing the volume of order flow routed to public quoting markets could reward market participants for displaying their trading interest, thus leading to an increase in the display of trading interest. Such a result would be consistent with the Commission's emphasis on the need to encourage displayed liquidity – a critical reference point for investors. Moreover, increasing the volume of order flow directed to public quotations could increase the incentives for markets to compete by displaying the quotations that would attract such order flow.<sup>12</sup>

Consequently the Exchanges believe that the Program increases the incentive for market participants to submit displayed orders due to the increased potential to execute against institutional orders.

## **2. Liquidity Identifiers**

Two commenters also raised concerns about the use of the Liquidity Identifier and stated that the use of LIs are similar to Indications of Interest (“IOIs”) used by dark pools to attract order flow.<sup>13</sup> One commenter referenced the Commission's 2009 proposal regarding non-public trading interest (“Dark Pool Proposal”) which questioned whether the use of IOIs could undermine the incentives to display limit orders and quote competitively and proposed a narrowing of the IOI exclusion from the definition of “quotation.”<sup>14</sup>

The Dark Pool Proposal, however, specifically focused on “actionable IOIs,” that is, messages that effectively alert the recipient of trading interest in a particular symbol, side, size, and price.<sup>15</sup> The Commission worried that when actionable IOIs are disseminated to only a select group of market participants, the incentives to publicly display trading interest and quote competition among markets may be undermined. The LI as proposed clearly does not raise the same concerns that actionable IOIs may raise, as explained below.

First, as proposed in Rule 107D(b), the LI reflects the symbol for the particular security but does not include the price, side, or size of the OLO or ILO interest that the LI represents, distinguishing it almost entirely from actionable IOIs, which reflect symbol, side, size, and price. Moreover, underlying the Commission's concern regarding the treatment of non-public trading interest was the creation of a private or two-tiered market.<sup>16</sup> The LI raises no such concern: the LI will not be limited to select

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<sup>12</sup> See Dark Pool Proposal at 61233.

<sup>13</sup> See SIFMA Letter at 4; T. Rowe Price Letter at 2.

<sup>14</sup> See SIFMA Letter at 4.

<sup>15</sup> See Dark Pool Proposal at 61211.

<sup>16</sup> See *id.* (“The public, however, does not have access to this valuable information concerning the best prices and sizes for NMS stocks. Rather, dark pools transmit this information only to selected market participants. In this regard, actionable IOIs can create a two-tiered level of access to information about

participants, but rather disseminated through both the CQS and proprietary data feeds whenever an OLO or ILO resides in Exchange systems.

Second, the Commission was concerned that “actionable IOIs at NBBO matching prices potentially deprive those who publicly display their interest at the best price from receiving a speedy execution at that price.”<sup>17</sup> Here, the Program explicitly defers to the displayed book prior to allowing ILOs to execute against one another or against OLOs when priced at the NBBO and therefore has the potential to enhance rather than undermine the incentive to display. The knowledge that OLO interest rests in the Program, in other words, could attract not only ILOs to interact with OLOs, but also displayed liquidity to compete with OLO interest because under priority rules of the Program, OLOs will yield execution priority to displayed liquidity at the same price on the Exchange. The Program’s support of the incentive to display therefore serves to address rather than heighten the concerns of the Dark Pool Proposal and contrasts starkly with the execution priority of dark pools, which do not yield to displayed orders at the same price.

In any event, the Dark Pool Proposal’s treatment of certain IOIs as quotes was the subject of considerable opposition by commenters<sup>18</sup> and was not approved by the Commission. A hypothetical application of a proposed definition that was never adopted provides no basis for rejecting the current proposal even if the definition encompassed the LI, which it does not.

Third, the same commenter raised concerns about the use of the CQS to distribute the LI, questioning whether adding an identifier is appropriate in light of recent technology problems at a different Security Information Processor (SIP). While the Exchanges share the commenter’s concern for maintaining a robust SIP, we would note that the SIP in question has not experienced similar technology problems and has sufficient capacity to absorb the addition of the LI. We would also note that in their comment letter to the Exchanges’ Retail Liquidity Program, the commenter raised concerns that the Retail Liquidity Identifier would not be disseminated through CQS and potentially limited only to subscribers of individual exchange proprietary data feeds.<sup>19</sup>

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the best prices and sizes for NMS stocks that undermines the Exchange Act objectives for a national market system.”).

<sup>17</sup> *See id.*

<sup>18</sup> *See, e.g.*, Letter from Leonard J. Amoruso, General Counsel, Knight Capital Group, Inc. to Elizabeth M. Murphy, Secretary, Commission, dated February 24, 2010; Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth M. Murphy, Secretary, Commission, dated February 18, 2010.

<sup>19</sup> *See* Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth M. Murphy, Secretary, Commission, dated December 7, 2011.

### 3. Clarifying the Roles of Market Participants

One commenter raised concerns that the current market structure is flawed by the lack of bright lines defining the roles certain market participants are intended to fill.<sup>20</sup> This criticism raises structural issues beyond the scope of the Commission's consideration of this Proposal. The Commission, from its earliest days, has declined to force all trading onto exchanges or to mandate that trading be centralized on any particular venue. Indeed, Congress has, in effect, embedded competition between exchanges and broker-operated execution venues into the National Market System and thereby rejected the bright lines and clear categories that the commenter references. The Exchanges would welcome a careful reconsideration of the roles of exchanges and other execution venues play. The present Proposal, however, has the potential to enhance the transparency and price competition associated with the execution of larger orders and should be considered in the current competitive and regulatory context rather than deferred until the fundamental structural issues referenced are addressed.

The commenter also suggests that the Exchanges should lower access fees and dark pools should be required to provide size and/or significant price improvement. The Exchanges largely agree with the commenter and have been advocating similar changes for several years.<sup>21</sup> During these discussions, Exchange representatives have sought out consensus with industry groups and remain engaged in discussions with industry participants and regulators to address the fractures we believe to be growing in the U.S. equity market structure. Included in those discussions is the lowering of exchange access fees if appropriately offset with rules that give deference and protection to displayed orders.

### 4. SRO Immunity

One commenter devotes substantial attention to the position that the Program raises fundamental issues related to distinguishing between the commercial offerings of an exchange and its SRO functions, and goes on to offer its view that the Program "would clearly be a commercial offering that should not enjoy immunity from liability that is not available to broker-dealers providing identical services."<sup>22</sup> The commenter notes the Exchanges' comparison between the Program and services offered by broker-dealers and requests that the Commission "explicitly recognize the distinction between regulatory and commercial functions of an exchange."<sup>23</sup>

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<sup>20</sup> See T. Rowe Price Letter at 1.

<sup>21</sup> See, e.g., Testimony of Joseph Mecane, EVP & Head of U.S. Equities, NYSE Euronext before the Subcommittee on Securities, Insurance and Investment of the Senate Committee on Banking, Housing and Urban Affairs (December 18, 2012).

<sup>22</sup> SIFMA Letter at 3-4.

<sup>23</sup> As a threshold matter, the Exchanges do not see the connection between SRO immunity and the Proposal. Not every Exchange proposal implicates every difference between the regulation of exchanges and broker-sponsored execution venues. It is neither productive nor instructive, for example, to dwell in the instant Proposal on the all-encompassing record retention obligation of exchanges (as distinguished from strictly delineated broker-dealer obligations) or the obligations of exchange facilities (which have no parallel in broker-dealer regulation).

The commenter misconstrues the Exchanges' roles with respect to the Program, and the Commission's role with respect to the judicially created and judicially applied<sup>24</sup> doctrine of SRO immunity. Briefly, courts recognize that SROs are protected by absolute immunity when they perform their statutorily delegated adjudicatory, regulatory, and prosecutorial functions.<sup>25</sup> The scope of that immunity is determined not simply by labeling conduct as commercial or for-profit, but rather based on a fact-specific analysis of the conduct in question and the particular context of the specific acts in question and their incidence to the exercise of regulatory power.<sup>26</sup> By way of example, the Proposal would enable the Exchanges to prohibit a member organization from accessing the Program if the member submitted size ineligible orders, or if it failed to maintain policies and procedures reasonably designed to ensure that the Program's size requirements are met. In enforcing such prohibitions, the Exchanges would be affecting the rights of a member pursuant to a rule approved by the Commission, pursuant to statutory authority. SRO immunity would appear to be available to protect the Exchanges in the event that such a prohibition was challenged by a member in court. Whether or not the doctrine of SRO immunity would serve to protect the Exchanges against such a claim or any other claim related to the design, testing, or operation of the Program would depend necessarily on the details of the claim and the specific actions of the Exchanges related to the claim. In other words, incanting that "the ILP would clearly be a commercial offering" does not settle the more complicated and fact-bound judicial question of the scope of SRO immunity that may or may not be available, and the Exchanges are under no obligation to "assert[] regulatory immunity" in the Proposal in order to seek the appropriate protection in the future. Nor is it the Commission's role to predetermine the availability or scope of SRO immunity that may or may not attach to the Program. Accordingly, the Commission should decline the commenter's invitation to play a role created by and uniquely suited for the courts.

### **III. Conclusion**

The Exchanges have proposed to adopt the Program in an effort to attract Institutional Interest to an exchange environment with increased order competition. The pilot Program would offer an enhanced but structurally similar complement to existing OTC internalization arrangements. Because the Program would operate as a pilot, the Commission would be positioned to review its operation and impact during its initial implementation and modify the rule as may be warranted. As part of that review, the Exchanges will produce data throughout the pilot, which will include statistics about participation and any effects on the broader market structure. At the end of the pilot, the Exchanges will determine the appropriateness of extending the pilot or seeking to make the Program permanent. Because the Program is an important component of the Exchanges' effort to innovate and compete with exchange

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<sup>24</sup> See *In re NYSE Specialists Sec. Litig.*, 503 F.3d 89 (2d Cir. 2007); *Standard Inv. Chartered, Inc. v. Nat'l Ass'n of Sec. Dealers, Inc.*, 637 F.3d 112 (2d Cir. 2001); *D'Alessio v. NYSE, Inc.*, 258 F.3d 93 (2d Cir. 2001); *Barbara v. NYSE*, 99 F.3d 49 (2d Cir. 1996).

<sup>25</sup> See *Weissman v. Nat'l Ass'n of Sec. Dealers*, 500 F.3d 1293, 1296 (11th Cir. 2007) (en banc).

<sup>26</sup> See *In re Facebook, Inc., IPO Securities and Derivative Litigation*, MDL No. 12-2389 (S.D.N.Y. 2013) (quoting *Opulent Fund v. Nasdaq Stock Market, Inc.*, 2007 WL 3010573, at \*5 (N.D. Cal 2007)) ("[T]he immunity inquiry turns on the nature of the challenged conduct, not its profitability.").

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and non-exchange markets for Institutional Interest and because it would present no meaningful operational, capacity, regulatory, or other concerns, the Exchanges respectfully request that the Commission approve the Proposal.

Very truly yours,

A handwritten signature in blue ink, reading "Janet McInnes". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.