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VIA E-MAIL

Kevin M. O'Neill
Deputy Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C., 20549-1090

Re: Response to Comment Letters, Securities Exchange Act Release No. 72548 (July 7, 2014), 79 FR 40183 (July 11, 2014) (SR-NYSE-2014-32) ("Proposal")

Dear Mr. O'Neill:

The New York Stock Exchange LLC ("NYSE" or "Exchange")[1] appreciates the opportunity to respond to the comment letters submitted in connection with the Proposal.[2] For the reasons set forth in the Proposal and in this response, the Exchange believes that its proposed rule change to make the Add Liquidity Only ("ALO") modifier available for limit orders and make the day time-in-force condition available for Intermarket Sweep Orders ("ISO") is consistent with the Section 6(b)(5) of the Securities Exchange Act of 1934 ("Act").[3] The Exchange therefore respectfully requests that the Securities and Exchange Commission ("Commission") approve the Proposal.

Background

The Exchange proposes to amend Rule 13, which governs orders and modifiers, to make the existing ALO modifier available for limit orders. The ALO modifier is currently available for mid-point passive liquidity ("MPL") orders. In addition, the Exchange proposes to make a time-in-force

1 Both the NYSE and its affiliated exchange NYSE MKT LLC ("NYSE MKT"), which operates on the same trading platform as the NYSE, submitted virtually identical rule proposals. See Securities Exchange Act Release No. 72547 (July 7, 2014), 79 FR 40169 (July 11, 2014) (SR-NYSEMKT-2014-56). The Commission extended its time to act on the Proposal and the related NYSE MKT proposal to October 9, 2014. See Securities Exchange Act Release Nos. 72893 (Aug. 21, 2014), 79 FR 51208 (Aug. 27, 2014) (SR-NYSE-2014-32) and 72894 (Aug. 21, 2014), 79 FR 51208 (Aug. 27, 2014) (SR-NYSE-2014-56) (Notice of Designation of Longer Period for Commission Action on Proposed Rule Change). The comment letters only address the NYSE proposal, however, this response is intended to support both the NYSE and NYSE MKT proposals.

2 See Letter from Haim Bodek, Managing Principal, Decimus Capital Markets, LLC to U.S. Securities and Exchange Commission, dated September 15, 2014 ("DCM Comment Letter") and Letter from Raymond M. Tierney III, President and Chief Executive Officer, and Gary Stone, Chief Strategy Officer, Bloomberg Tradebook LLC, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission, dated September 22, 2014 ("Tradebook Comment Letter").

3 15 U.S.C. 78f(b)(5).

condition of "day" available for ISOs ("Day ISO"). Currently, the Exchange only accepts an immediate-or-cancel ("IOC") time-in-force condition for ISOs. The Proposal sets forth in detail the full characteristics of the proposed changes, including:

- Limit orders designated ALO would not route and would not remove liquidity from the Exchange's book and upon entry, must have a minimum of one round lot displayed (see proposed paragraph (a) governing ALO Modifier);
- If marketable upon arrival, limit orders designated ALO would re-price and re-display so as not to trade through or lock or cross protected quotations, and any such re-pricing and re-display will receive a new time stamp (see proposed paragraph (b) governing AL Modifier);
- Specifying which order types may not be combined with an ALO Modifier (see proposed paragraph (c) governing ALO Modifier);
- Specifying that a limit order designated ALO would not trigger a contra-side MPL order to trade (see proposed paragraph (d) governing ALO Modifier);
- Specifying how a Day ISO would execute if marketable upon arrival and how the unexecuted portion of a Day ISO would post to the Exchange's book (see proposed paragraph (c) governing ISOs);
- Specifying that a Day ISO could only lock or cross a protected quotation that was displayed at the time of arrival, and if after posting, a Day ISO would lock or cross a protected quotation, the Exchange would re-display and re-price so that it would not lock or cross a protected quotation (see proposed paragraphs (c) and (c)(i) governing ISOs);
- Specifying how a Day ISO designated ALO would be handled if marketable upon arrival (see proposed paragraph (c)(ii) governing ISOs);
- Specifying which order types may not be combined with a Day ISO or an IOC ISO (see proposed paragraph (e) governing ISOs);
- Specifying how pegging interest would be handled if designated ALO (see proposed paragraph (c)(6) governing Pegging Interest); and
- Defining a new term to specify against which interest a limit order designated ALO would be re-priced (see proposed Supplementary Material .10 to Rule 13).

In addition to the above-described proposed rule text, the Proposal includes nine detailed examples regarding how the expanded ALO modifier and Day ISO would operate in different trading scenarios.

Summary of Comment Letters

The Commission received two comment letters on the Proposal, both requesting that the Proposal be disapproved. Both comment letters raise general questions regarding current equity market structure. The Exchange welcomes discussion regarding current equity market structure in the appropriate forum. However, we believe that these issues can only be addressed at a national level so that if any changes result, they would be applied uniformly across all trading venues. Because all other securities exchanges offer the order types the Exchange proposes, Commission disapproval of the Exchange's proposal would be ineffective in addressing commenters' concerns because the order types would continue to be available on all securities exchanges, except the Exchange. Further, the Commission has found the same order types when proposed by other exchanges to be consistent with the Act. Disapproval of the Exchange's proposal, therefore, would impose a different standard to the Exchange's Proposal than to its competitors, which would impose a burden on competition that is not necessary or appropriate in furtherance of the Act.

Because the Exchange does not believe that the equity market structure issues raised in the comment letters are dispositive to whether the Proposal is consistent with the Act, the Exchange is focusing its response to the comment letters on the points raised that are specific to the Proposal. Specifically, the DCM Comment Letter objects to expansion of ALO modifiers because they would (i) have "queue-priority" over "traditional orders" (the letter does define a "traditional order"); (ii) encourage the use of "non-bona fide" orders; and (iii) allow a sophisticated trader to detect hidden orders by analyzing price-sliding confirmation messages. Both the DCM and Tradebook Comment Letters object to the proposed Day ISO functionality because they believe that the proposed functionality is inconsistent with Rule 610(d) of Regulation NMS ("Rule 610(d)").[4]

The Proposed Expansion of the ALO Modifier Promotes the Display of Liquidity on Public Exchanges

As noted in the Proposal, the Exchange believes that the proposed expansion of the ALO modifier for limit orders would help perfect the mechanism of a free and open market by encouraging additional displayed liquidity on a public registered exchange and therefore promote price discovery. In addition, the proposed re-pricing and re-display feature of the proposed ALO modifier would improve the best protected bid or offer ("PBBO") as the PBBO moves, thereby improving the public prices available to marketable contra-side interest. Orders executed off-exchange would also benefit from the improved PBBO that results from the re-pricing and re-display feature of the ALO because the order protection rule would require such off-exchange orders to be executed at prices no worse than the PBBO that was improved by orders with an ALO modifier.

In today's fragmented market, the Exchange believes that encouraging the display of liquidity on a public exchange provides incentives for additional retail order flow to be routed to lit markets.[5] Use of the ALO modifier would assure that such liquidity would continue to be available for investors seeking an immediate execution. Any market participant interested in providing such liquidity

4 17 CFR 242.610(d).

5 In 2010, the Commission noted that approximately 63.8% of share volume in NMS stocks was executed on registered exchanges, with 17.5% of share volume in NMS stocks internalized at broker-dealers, which likely represents a very large percentage of order flow of individual investors. See Concept Release on Equity Market Structure, Securities Exchange Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594 (Jan. 21, 2010) (File No. S7-02-10) ("Equity Market Concept Release"). The intended purpose of an order designated ALO is to provide an incentive for member organizations to post displayed liquidity on a public exchange, which would promote price discovery and encourage member organizations to route retail orders to the public exchanges for an execution.

could use the proposed ALO functionality, including Exchange designated market makers, Floor brokers, off-Floor market participants, and market participants representing customer interest.[6]

Only the DCM Comment Letter raises issues with the proposed expansion of the ALO modifier for limit orders. The DCM Comment Letter alleges that use of an ALO modifier on limit orders would harm interest that may be on the same side of the market as the limit order designated ALO. For example, the letter claims that users of this order type gain a "superior queue position when a more aggressive price is permissible," which DCM claims is not available for "traditional orders." However, the ALO modifier would be available to all member organizations, including those that represent agency trading interest.[7] In addition, the DCM Comment Letter argues that the availability of the expanded ALO functionality would promote the use of aggressively priced, "non-bona fide" orders. As the Commission knows, "aggressively" priced orders improve the public quote and provide better prices to contra-side interest. This is precisely the type of priced orders the Exchange is trying to encourage and agrees with the commenter that the ALO modifier would promote such orders. In addition, the Exchange disagrees with the commenter's assertion that orders with an ALO modifier are not bona fide orders. A member organization would price a limit order designated ALO at the price it is willing to pay (or sell) and bears the risk of its order being re-priced to that limit and executed at that price. Accordingly, orders designated as ALO are bona fide.

The comment letter does not provide any examples of how limit orders designated ALO could obtain a superior queue position. However, a review of potential trading scenarios demonstrates that an order designated ALO could not receive any advantage over same-side interest. For example, assume the PBBO is 10.00 x 10.01. If the Exchange receives two buy limit orders priced at 10.01 and one of those limit orders is designated ALO, the order designated ALO would not receive an execution. Rather, the order that is sent as a straight limit order to the Exchange is likely seeking an immediate execution opportunity and in such scenario, would receive the execution (or route).

If instead, the Exchange receives a straight buy limit order priced at 10.00 and a buy limit order designated ALO priced at 10.01, both would be displayed by the Exchange at 10.00 (the order designated ALO would be re-priced and re-displayed one MPV below the 10.01 PBO). If the Exchange receives marketable sell interest, those two resting displayed buy orders would be allocated on parity consistent with Rule 72(c), which governs the allocation of executions at the

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6 As the comment letters note, limit orders designated ALO would be eligible for a rebate under the Exchange's current fee structure. The goal of this fee structure is to provide an incentive for market participants to display liquidity on a public exchange, rather than engage in off-exchange trading in the dark. The Exchange believes that the current fee structure together with the use of ALO modifier is consistent with the Act. <u>See</u> Equity Market Concept Release at 3598-99 (noting that the maker-taker pricing model is an effort to attract liquidity providers).

7 On June 5, 2014, in a speech entitled "Enhancing our Market Equity Structure," Mary Jo White, Chair of the Commission, noted that while the focus of the public debate has been on high-frequency trading firms, it is "important to remember that many brokers use the same tools on behalf of their customers" and that we should "not roll back the technology clock or prohibit algorithmic trading." <u>See</u> Speech at the Sandler, O'Neill & Partners, L.P. Global Exchange and Brokerage Conference (June 5, 2014) (available at http://www.sec.gov/News/Speech/Detail/Speech/1370542004312#.VCV5LPIdXIZ.)

Exchange.[8] There is nothing inherent in the order that has been designated ALO that would provide it priority over other displayed interest at the same price. Instead, if Exchange systems received the straight buy limit order priced at 10.00 before it received the buy limit order designated 10.01, the straight buy limit order would have an earlier time stamp; the ALO order re-priced to 10.00 would not have any priority over the earlier-arriving interest.

If the PBO moves to 10.02, the order designated ALO, which is willing to pay 10.01, would be re-priced to be a 10.01 displayed bid on the Exchange and receive a new time stamp at that new price. The order that has a limit price of 10.00 would not be disadvantaged by this re-pricing because it was not willing to pay 10.01. The Exchange notes that if it were to have received a buy order priced at 10.01 before the PBO had moved to 10.02, such order would have been either executed, routed, or cancelled, depending on the terms of the order, and would not have been disadvantaged by the resting ALO order to buy, which would not yet have been re-displayed at 10.01. If the Exchange receives a buy order priced at 10.01 virtually simultaneous with the updated PBO to 10.02, it would depend on time of receipt of that order as to whether it or the re-priced order designated ALO would have an earlier time stamp. However, as noted above, the Exchange allocates executions on parity based on participant, and whether the order designated ALO receives priority would depend on (i) it being re-priced before another same-side order at the same price is received and therefore has time priority; and (ii) the order designated ALO is in the same participant bucket as the arriving same-side interest. Again, there is nothing inherent in the functionality associated with limit orders designated ALO that would give it priority.

What these examples demonstrate instead is the benefit of a limit order ALO to the market, which is to provide displayed liquidity on a registered exchange available to provide price improvement for incoming opposite-side marketable interest. In the above scenario, if the PBO moves to 10.02, the Exchange would re-price and re-display the limit order to buy designated ALO at 10.01, thereby improving the PBB. If the Exchange were to receive marketable sell interest, such interest would receive an execution at 10.01, which is a penny better than the prior displayed bid on the Exchange. The Exchange believes that this is a benefit for investors and the public as those market participants that are seeking immediate executions would receive price improvement if such interest were routed to the Exchange.

Likewise, the Exchange notes that the DCM Comment Letter expresses concern that market participants would use limit orders designated as ALO to detect hidden orders at the Exchange. The Exchange believes that, because of the minimum display quantity requirement for limit orders designated ALO, and the related risk of a round-lot execution, it would be cost-prohibitive to use this functionality to probe for hidden interest. The Exchange further believes that the benefit associated with the proposed functionality, i.e., displayed liquidity at the Exchange that is available to provide price improvement, outweighs the potential cost that a market participant could determine the existence of hidden interest at a price – though not the depth of such hidden interest.

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8 Rule 72(c) sets forth how the Exchange allocates shares in an execution among individual participants. If the two limit orders are part of the Book Participant, the Exchange allocates shares among such orders by means of time priority with respect to entry. As noted in the Proposal, if a limit order designated ALO is re-priced and re-displayed, it receives a new time stamp associated with the timing of such re-pricing. Accordingly, interest that has arrived earlier at such price would have time priority over the re-priced ALO order.

Finally, the Exchange notes that the DCM Comment Letter states that the Exchange should "bear the burden of documenting all material properties" of it proposed order type changes. As discussed in detail in the Proposal and summarized above, the proposed rule text provides detailed information regarding the operation of the ALO modifier, including order types with which it will not interact and order types with which it may not be combined. The Exchange has thus provided full transparency regarding the operation of the proposed functionality in its proposed rules.

As such, the Exchange believes that the proposed expansion of the ALO modifier for limit orders, as described in more detail above and in the Proposal, promotes just and equitable principles of trade, removes impediments to and perfects the mechanism of a free and open market and a national market system, and in general, protects investors and the public interest, because it would promote the display of liquidity on registered exchanges that would be available to provide price-improvement opportunities to incoming opposite-side interest. Moreover, as the examples above demonstrate, the proposed expansion of the ALO modifier for limit orders on the Exchange would not harm investors because (i) the functionality would be available to all member organizations, including those that represent customer interest, and (ii) an order designated ALO would not have any priority vis-à-vis same-side interest that is at the same price.

<u>The Proposed DAY ISO and DAY ISO ALO Are Consistent with Rule 610(d)</u>

The Exchange's proposed Day ISO and use of the ALO modifier with Day ISO are designed to remove impediments to and perfect the mechanism of a free and open market and national market system by providing functionality to support a member organization's ability to comply with Regulation NMS through use of ISOs. The proposed functionality is consistent with approved rules on other exchanges[9] as well as Rule 610(d) and the Commission's Division of Trading and Markets' ("Staff") guidance concerning both Rule 610(d) and use of ISOs.[10]

As the commenters correctly note, Rule 610(d) requires exchanges to establish, maintain, and enforce written rules that require its members to *reasonably avoid* displaying quotations that would lock or cross any protected quotations. In the adopting release for Regulation NMS, the Commission noted that "it would be reasonable for the SROs to include in their rules implemented pursuant to Rule 610(d) exceptions equivalent to those included in the Order Protection Rule."[11] Staff guidance regarding this requirement specified that "the SRO lock/cross rules include several

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9 <u>See</u> Securities Exchange Act Release No. 54549 (Sept. 29, 2006), 71 FR 59179 (Oct. 6, 2006) (SR-NYSEArca-2006-59) (approval of NYSE Arca Equities, Inc. proposal that provides that "[i]f an ISO is not marked as 'immediate or cancel,' any remaining balance would be displayed by the Exchange without regard to whether that display would lock or cross another market center, only if the participant routing the order has already sent an order to satisfy the quotations of other markets so that the display of the order would not lock or cross those markets.")

10 <u>See</u> Commission Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS, April 4, 2008 Update, available at: http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm ("Reg NMS FAQ").

11 <u>See</u> Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 at 37547 (June 20, 2005) (File No. S7-10-04).

exceptions that are analogous to those included in Rule 611(b), such as the ISO exception."[12] In connection with this requirement, the Exchange adopted Rule 19, which includes the ISO exception.[13] Accordingly, there is not an absolute prohibition on exchanges displaying quotations that lock or cross the market, provided that such locked or crossed market is consistent with an approved exception to Rule 610(d).[14]

Inherent in the ISO exception to Rule 610(d) is that an ISO would be displayed, and thus could lock or cross a protected quotation. An ISO exception in Rule 610(d) would not be necessary if all ISO orders were required to be IOC. To the contrary, Staff have given express guidance that an ISO is not required to be cancelled if not executed.[15] Therefore, Regulation NMS does not prohibit an ISO from having a day time-in-force condition. Moreover, provided that exchange rules provide for the subsequent handling of the unexecuted portion of a Day ISO in a manner consistent with Regulation NMS, an exchange can accept a Day ISO.

The ISO exception to Rule 610(d) requires member organization compliance with the obligation to simultaneously route ISOs to execute against all protected quotations with a price that is equal to or better than the displayed price.[16] If a member organization meets this obligation, it could route an ISO with a day time-in-force designation to an exchange and the exchange that receives that order instruction could post any portion of the order not executed at the original locking or crossing price consistent with the ISO exception to Rule 610(d).

The Exchange already has an effective rule providing for the ISO exception to Rule 610(d). The Proposal would allow member organizations to comply with this existing exception by sending ISOs designated with a day time-in-force modifier, similar to how all other equity exchanges currently operate and could, consistent with Rule 610(d) and Exchange rules, result in a Day ISO locking or crossing a Protected Quotation. Specifically, a Day ISO could lock or cross a protected quotation only if a Day ISO is marketable upon arrival and trades against interest on the Exchange up to the full size of the Day ISO. Any unexecuted portion of a Day ISO would be posted to the

12 See Reg NMS FAQ 5.01

13 See NYSE Rule 19(d)(3) (specifying an exception when the "locking or crossing quotation was an automated quotation, and the member of the Exchange displaying such automated quotation simultaneously routed an intermarket sweep order to execute against the full displayed size of any locked or crossed protected quotation.") The Exchange notes that until it implements Day ISOs, it has not had the functionality to support this exception to Rule 610(d).

14 Staff have provided the following guidance with respect to the ISO exception to Rule 610(d): "The ISO exception to the SRO lock/cross rules, in contrast, requires that ISOs be routed to execute against all protected quotations with a price that is equal to the display price (i.e., those protected quotations that would be locked by the displayed quotation), as well as all protected quotations with prices that are better than the display price (i.e., those protected quotations that would be crossed by the displayed quotation)." See Reg NMS FAQ 5.02.

15 See Reg NMS FAQ 3.01 ("Regulation NMS neither requires a trading center to cancel immediately the unexecuted portion of an ISO nor prohibits it from doing so.")

16 The Tradebook Comment Letter claims that only an exchange can display quotations, Rule 610 compliance is solely an SRO obligation. However, exchange receipt of an ISO signals that such order is subject to an exception to Rule 611 or 610(d).

Exchange's book at its limit price and would lock or cross a protected quotation *that was displayed at the time of the arrival of the Day ISO.*[17]

For example, assume the PBBO is 10.00 x 10.01. The 10.01 PBO is displayed on an away market with 100 shares displayed, and the Exchange's best offer is 100 shares priced at 10.02. A member organization that sends a Day ISO to buy 200 shares to the Exchange with a limit price of 10.02 would be required, both under Exchange Rules and Regulation NMS, to have simultaneously routed ISOs to trade with all protected offers, including the 100 share PBO priced at 10.01. Upon the Exchange's receipt of the Day ISO priced at 10.02, the Exchange would be permitted to trade through the 10.01 PBO and execute 100 shares of the Day ISO with the Exchange's best offer at 10.02. This execution would occur regardless of whether the order had a day or IOC time-in-force condition. However, with the day time-in-force condition, the unexecuted portion of the Day ISO would be posted to the Exchange's book at 10.02. If the 10.01 offer on the away market were still the PBO, the 10.02 bid on the Exchange would cross the 10.01 offer. The Exchange's posting of the unexecuted portion of the Day ISO would be consistent with the ISO exception to Rule 610(d) because the member organization sending the Day ISO had an obligation to route an ISO to trade with that 10.01 PBO. Under the ISO exception to Rule 610(d) and Exchange rules, the Exchange may post any unexecuted portion of the Day ISO. However, after this initial posting, any re-pricing or re-displaying of a Day ISO would not be subject to the ISO exception to Rule 610(d) and, thus, would only display at prices that do not lock or cross a protected quotation.[18] Accordingly, the Proposal is consistent with Rule 610(d) of Regulation NMS because the re-display of a Day ISO (or limit order designated ALO) would be at a price that would not lock or cross a protected quotation.

The proposed functionality to add an ALO modifier to Day ISOs would serve the need of those member organizations that have met their obligation pursuant to Regulation NMS to simultaneously route ISOs to execute with protected quotations and are seeking to also display liquidity on the Exchange. For example, if the PBBO is 10.00 x 10.01, and the Exchange's best offer is 10.02, a member organization that sends a buy Day ISO with an ALO modifier priced at 10.02 would be required to simultaneously route an ISO to execute with the 10.01 PBO. Upon arrival, because of the order's ALO designation, the buy order would not execute against the 10.02 Exchange best offer. Instead, it would re-price and re-display to 10.01. That 10.01 bid would lock the 10.01 offer that was displayed at the time of the arrival of the Day ISO. That locked quotation would be consistent with the ISO exception to Rule 610(d) because the member organization had simultaneously routed an ISO to execute against the 10.01 PBO that was displayed at the time of the arrival of the Day ISO.

The Exchange believes that the proposed Day ISO and Day ISO with ALO modifier functionality are not only consistent with Rule 610(d), but also consistent with the Act. In particular, the Proposal removes impediments to and perfects the mechanism of a free and open market and a national market system because it provides member organizations with a means to comply with the ISO exception to Rule 610(d). The Exchange believes that it would be a significant burden on competition if the Proposal were not approved because it would preclude the Exchange from

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17 See proposed paragraph (c) governing ISOs in Rule 13.

18 See proposed paragraph (c)(i) governing ISOs in Rule 13.

offering order type functionality that is consistent with Regulation NMS and used on all other equity exchanges.

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For the foregoing reasons, the Exchange respectfully requests the Commission approve the Proposal. To the extent the comment letters raise issues regarding equity market structure issues in general, the Exchange looks forward to ongoing review of these issues in the appropriate forum. In the interim, the Exchange does not believe that it promotes fair and orderly markets to deny the Exchange the ability to operate in a manner that is consistent with the Act and Regulation NMS. Moreover, because all other securities exchanges have order types like those proposed by the Exchange, disapproval of the Exchange's proposal would constitute a burden on competition not consistent with the Act.

Sincerely,